Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Methods

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Introduction

In recent years, federal administrative agencies have played an increasingly significant role in the substantive regulation of business. Despite much sentiment calling for a change in this trend,1 direct regulation of rates and charges, coupled with the broader authority of "umbrella" agencies, continues to have significant impact on industry in general. One federal agency involved in this trend is the Securities and Exchange Commission (SEC), which is armed with a wide range of licensing and general enforcement powers under the federal securities laws.2 Both in terms of size and breadth of authority the SEC is a super-agency, second only to the Federal Trade Commission3 (FTC).

Increased regulatory activity and growing concern over regulation in general have created a climate in which reconsideration of existing regulatory agencies is in order. Recently Congress revamped many of

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2. See notes 31-36 & accompanying text infra.
the FTC's procedures, reflecting its awareness that the passage of nearly sixty years and the increased use of the agency called for a reexamination. More recently, after ten years of preparation, the American Law Institute approved the final draft of the proposed Federal Securities Code, which would have substantial impact on SEC operations. The code most likely will be introduced in Congress this year, but if it is to be adopted, the legislative hearings which no doubt will ensue put passage years away.

SEC enforcement mechanisms have been attacked by commentators. This attack, together with the timeliness of the proposed code, calls for an examination of the current SEC enforcement scheme. After a brief overview of the administrative process in general, this Article explores the SEC's exercise of enforcement authority both in terms of efficiency and the legal standards applying to that authority. Consideration is given to possible improvements under the present statutory base and to alternative methods of operation. Specific attention is accorded to the need for increased administrative enforcement sanctions, particularly with respect to an expansion of the Commission's investigatory and adjudicatory power at the administrative level.

The Theory of the Administrative Process

Despite the existence of administrative agencies in this country for 190 years, the mere definition of administrative law remains unclear. In light of the rapid increase in agency regulation in the twentieth cen-

8. Because many of the SEC's problems are endemic to administrative enforcement in general, much of the discussion which follows applies with equal force to the various federal agencies and their operation.
tury,\textsuperscript{10} defining the field and its salient characteristics becomes essential to any evaluation of administrative jurisprudence.\textsuperscript{11}

The distinction between the procedure and the substance of the regulatory process has been urged as one method of defining administrative law.\textsuperscript{12} This dichotomy may be illusory, however, for practically speaking both are intertwined in the operation of administrative bodies.\textsuperscript{13} A functional analysis of agency activity would appear to be a more helpful basis for examining the administrative process. Justice Holmes suggested the following functional distinction between judicial and legislative law making:

\begin{quote}
A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power.\textsuperscript{14}
\end{quote}

An examination of various types of administrative activity suggests that an administrative agency is an attempt to combine these functions, and in some instances a third, prosecutorial function, by vesting a single entity with the power to carry them out. Accordingly, agency functions may be divided into three major subdivisions: (1) legislative, including the interpretation of legislation through rulemaking and other interpretive pronouncements; (2) judicial, including the adjudication of private disputes as well as the imposition of remedial or penal sanctions in resolving them; and (3) prosecutorial, including the

\begin{footnotes}
\begin{enumerate}
\item Approximately two thirds of the federal peace time agencies have been created since 1900. \textit{1 Davis Treatise, supra} note 9, §§ 1:7-1:9.
\item "Thus, when we deal with the questions of the propriety of granting certain powers to an agency or the fairness of its rule making, adjudicative, or investigative processes, we are in the realm of administrative law; but where an agency such as the National Labor Relations Board issues an order finding a certain practice of an employer to be an unfair labor practice, the law which that order makes really belongs in the field of labor law." M. Carrow, \textit{The Background of Administrative Law} 16 (1948).
\item The procedural aspects are of course significant and have been subjected to careful scrutiny and analysis. \textit{See generally 1 Davis Treatise, supra} note 9.
\item Prentis v. Atlantic Coast Line Co., 211 U.S. 210, 226 (1908).
\end{enumerate}
\end{footnotes}
investigation and enforcement of violations of the governing statutory scheme. Each of these functions may be fulfilled through the use of a number of powers; each function serves a different end and not all agencies are empowered to enter each of these areas.  

The legislative function can take two forms. An agency may have express statutory authority to set the limits of permissible conduct or may have power merely to establish interpretive guidelines to statutes. These interpretations occur by way of rulemaking, private letter rulings, no action letters, advisory opinions, and interpretive releases. Empowering administrative agencies to perform legislative activities can be justified on the basis that the delegation of a complex area of regulation from congressional generalists to administrative experts will enable the agency to better administer legislation. Additionally, legislative power in agency hands permits more fluid regulation and, because of the nature of the political process, increases the ease of review and amendment of legislative decisions. Theoretically then, the combination of these factors will result in a more legitimate regulatory process, adaptable to the changing demands of the subject matter of the regulation.

The second administrative power—to adjudicate disputes—can operate as another way to inject expertise into the governmental process, by substituting the agency for the generalist judge. Other rationales for administrative adjudicatory authority include expediting the resolution of disputes and unburdening court dockets. Use of this adjudicatory power has occurred in four different types of disputes: disputes solely between private parties; disputes between a private party and the government; use of licensing or disciplinary power;  

17. This function has been characterized as administrative expressions of policy. The Judicial Function, supra note 11, at 58.
18. A great deal of scholarly energy has been devoted to administrative jurisprudence and thus repetition here is not warranted. See generally F. Blachy & M. Oatman, Administrative Legislation and Adjudication (1934); The Judicial Function, supra note 11, at 58; 1 Davis Treatise, supra note 9.
20. Examples include disputes before workers' compensation boards, the Department of Agriculture, and the Interstate Commerce Commission. See id. at 3. A greater informality than court proceedings and the increase in expediency resulting therefrom are two of the justifications advanced in favor of agencies exercising this type of judicial function. Id. at 7.
21. Id. at 4. This frequently is the basis for the broadest type of regulation. Examples include the Federal Trade Commission's ability to discipline for unfair trade practices, 15 U.S.C.A. § 45(b) (West Supp. 1979), and the jurisdiction of the National Labor Relations
and, finally, disputes over the grant of government benefits such as veterans' compensation claims.23

The third basic administrative function is that of investigator and enforcer. An agency may handle a complete prosecution or may refer it to a prosecutorial body once the investigation is finished.24 To the extent that an agency such as the FTC or the SEC has power to impose sanctions, it may operate as both a prosecutor and a judge, i.e., in both investigatory and adjudicatory capacities. Generally this dual function is handled by a division of authority within the agency.25

In addition to enforcement power that can result in administratively imposed sanctions, some agencies have authority to seek compliance orders by securing injunctive relief in the courts.26 Although less efficient than administrative adjudication, the primary advantage of an injunction over other forms of judicial enforcement is "the ease and speed with which it may be obtained."27 This contrasts with criminal sanctions, which require higher standards of proof as well as more stringent procedural and constitutional guarantees. As discussed more fully below,28 the injunction does have some significant inherent limitations, including the lack of any deterrent or compensatory byproducts and its minimal utility in dealing with one time violations.

The use of these three modes of regulation by any particular agency can be assessed accurately only in light of the substantive regulation involved. Furthermore, these powers presently vary widely throughout the various federal agencies. Of the fifty-five federal agen-
cies, nineteen have prosecutorial power, twenty-seven have adjudica-
tory power, and forty-six have legislative power. Only fourteen
agencies have all three powers. Although general principles will
emerge from the examination of any particular regulatory scheme,
overgeneralization should be avoided both because of the varied pow-
ners available to different agencies and because of the inability to fully
separate administrative procedure from the substance of the activity so
regulated. This is not, however, to minimize the more general lessons
that can be learned from the examination of the SEC which follows.

The Work of the SEC

The Securities and Exchange Commission is entrusted with several
multi-faceted functions under the Securities Act of 1933, the Securi-
ties Exchange Act of 1934, the Public Utility Holding Company Act
of 1935, the Trust Indenture Act of 1939, the Investment Company
Act of 1940, and the Investment Advisers Act of 1940. In adminis-
tering these acts the Commission is vested with each of the three basic
agency powers.

The legislative power of the SEC is reflected in its capacity as
rulemaker, both in an advisory capacity and as an implementation tool

29. These figures are based on the number of "agencies" listed in the 1977/1978 United
States Government Manual and do not include departments or other governmental units
with similar powers. See 1977/78 UNITED STATES GOVERNMENT MANUAL (1978). How-
ever, this distinction between "agencies" and "departments" is subject to dispute; hence, the
figures given should be considered as guides only.
31. Ch. 38, Title I, 48 Stat. 74 (1933) (current version at 15 U.S.C.A. §§ 77a-77aa (West
cited as Loss]; Johnson & Jackson, The Securities and Exchange Commission: Its Organiza-
tion and Functions Under the Securities Act of 1933, 4 LAW AND CONTEMP. PROB. 1 (1937).
& Supp. 1979)). See generally 2 Loss, supra note 31, at 1165-528; Redmond, The Securities
33. Ch. 687, 49 Stat. 1149 (1939) (current version at 15 U.S.C.A. §§ 79 to 79z-6 (West
1971 & Supp. 1979)).
(West 1971 & Supp. 1979)).
(West 1971 & Supp. 1979)). See generally North, A Brief History of Federal Investment Com-
pany Legislation, 44 NOTRE DAME LAW. 677 (1969); Rosenblatt & Lybecker, Some Thoughts
on the Federal Securities Laws Regulating External Investment Management Arrangements
36. Ch. 686, Title II, 54 Stat. 847 (1940) (current version at 15 U.S.C. §§ 80b-1 to 80b-
21 (1976)).
for federal statutes. Certain sections of the acts specifically empower the Commission to promulgate rules having the force of statutory provisions. For example, section 3(b) of the 1933 Act gives the Commission power, within statutory limits, to promulgate additional exemptions from the registration provisions of the Act. Similarly, section 10(b) of the 1934 Exchange Act provides that the Commission shall promulgate rules to determine the scope of antifraud liability. In contrast to this type of rulemaking, the Commission also has promulgated interpretive rules to aid corporate and financial planners and to supplement statutes.

In addition to its dual rulemaking activities, the SEC gives unsolicited advisory opinions in the form of releases, which may include guidelines or suggest interpretations of statutory provisions or rules. One step below the interpretive releases as an expression of policy are the so-called "no action" letters. In these letters the Commission responds to requests from private parties for rulings that, based on the facts supplied by the inquirers, the Commission will take no action. This ad hoc method of advising not only is cumbersome and time consuming but also fails to provide the practitioner with any significant precedential or predictive aid.

Beyond these administrative functions, the Commission has regulatory oversight and quasi-judicial power over brokers, dealers, and the


40. Section 23(a) of the 1934 Act expressly vests the Commission with this type of interpretive rulemaking authority. Examples of such rules include the recent "safe harbor" guides to exemption from the 1933 Act's registration provisions. 17 C.F.R. §§ 230.144, 230.146, 230.147 (1978).

Correlative to this power is the agency's ability to impose administrative disciplinary sanctions upon those subject to its licensing authority. Moreover, with regard to all of the legislation it administers, the Commission performs a prosecutorial function. This function is served by conducting initial investigations, by forwarding recommendations to the Department of Justice or the Attorney General, and by bringing civil suits for injunctive relief against private parties who are in violation of the various acts.

As this brief overview suggests, the SEC has a well stocked arsenal of enforcement weapons. The sections that follow focus on the prosecutorial and adjudicatory functions of the SEC, the current uses of the various enforcement techniques and their success rate in terms of the goals of the SEC and the legal constraints of the agency's organic acts. The Article next examines various alternatives to present SEC enforcement practices, including those suggested by the proposed new code. This examination reveals that an expansion of the range of enforcement weapons is in order, and that such an expansion will enable the Commission to perform its burdensome task more efficiently.

SEC Enforcement Powers

As noted in the preceding section, the Commission's enforcement powers allow it to sit as an adjudicatory body with sanctioning power, investigate potential criminal violations, and seek injunctive relief in civil cases. These latter two powers derive from the Commission's responsibility to investigate and police violations of all the statutes it administers. Nonetheless, the effectiveness of both criminal actions and civil injunctive relief are limited.
Because a reasonable level of efficiency is difficult to establish in terms of success rate, time spent, and economic cost, criminal prosecutions are rarely pursued. The constitutional and procedural safeguards that accompany criminal trials are more extensive than in the civil context. Elements of proof—specifically the scienter and mens rea requirements—are more difficult to establish than in civil proceedings. Furthermore, criminal proceedings utilize far more governmental resources. After the SEC makes its initial investigation, if the facts developed so warrant, the matter is turned over to the Attorney General. The Justice Department then works with the SEC preparing for the grand jury and for trial. These two arms of government may in turn avail themselves of the additional investigatory resources of the Federal Bureau of Investigation.

Consequently, the bulk of SEC investigations resulting in any enforcement action are on the civil side of the docket. This is not to say that the civil side is significantly more efficient. Even at the investigatory stage, the procedure can be quite cumbersome and expensive as the Commission often must go to court even to enforce its subpoena power.

In addition to the foregoing enforcement and prosecutorial functions, a large portion and perhaps the most efficient aspect of the Commission’s enforcement activities arises under its adjudicatory function from its licensing powers. Although these powers are found in all of the statutes that the SEC administers, the following discussion is limited to the two primary statutes, the Securities Act of 1933 and the Securities Exchange Act of 1934.

Under these two acts, the SEC exercises broad disciplinary powers over those persons and entities subject to its licensing powers. Under the 1933 Act, the sanctions available to the Commission without judicial proceedings revolve around the Act’s registration requirements.


47. See notes 106-08 & accompanying text infra.


49. The Commission’s adjudicatory powers extend beyond the 1933 and 1934 Acts. See notes 31-36 & accompanying text supra.
Specifically, the SEC, after notice and opportunity for a hearing, either can delay, suspend, or deny the effectiveness of the registration statement. A concomitant power is the Commission’s ability to prevent or suspend the use of a prospectus. Both of these responsibilities fall within the licensing category because they merely prevent or inhibit the use of a registered offering. In contrast, the sanctions available under the 1934 Act are more varied.

Pursuant to section 6 of the 1934 Act the Commission is charged with overseeing national securities exchanges. Although the power has been exercised only once, the SEC may suspend or revoke registration of an exchange. The SEC also has the power to expel individual broker-dealers from a national exchange. The 1934 Act additionally charges the SEC with overseeing registered securities associations and other broker-dealer self-regulatory organizations. It can suspend or revoke an association’s registration, as well as suspend or expel a member of the association. Also, by virtue of its registration...
tion of broker-dealers.\textsuperscript{60} the Commission has the power to suspend or revoke such registration.\textsuperscript{61} Finally, the Commission can bar any person from associating with a broker-dealer,\textsuperscript{62} a member of a registered securities association,\textsuperscript{63} or an investment adviser,\textsuperscript{64} or bar that person from serving in various capacities with a registered investment company.\textsuperscript{65} However, with respect to all of the powers discussed above, the Commission can impose the less drastic sanction of censure.\textsuperscript{66}

In addition to the foregoing sanctions against broker-dealers, associations, and individuals, the Commission has broad powers with respect to securities registered under the 1934 Act and their issuers. Section 12(a)(1) requires registration of all securities traded on a national exchange,\textsuperscript{67} while section 12(g)(1) provides for the registration of equity securities by issuers with more than five hundred shareholders and over one million dollars in assets.\textsuperscript{68} Violations of these registration requirements, including misleading or fraudulent acts and filings, can lead to various SEC imposed sanctions. The Commission can of course deny, suspend, or revoke the registration of a security on a national exchange.\textsuperscript{69} The Commission also has the power to order a summary suspension of securities trading in either securities exchanges or over-


the-counter trading. Unlike its power with respect to broker-dealers and members of registered securities associations, the Commission does not have the express power to bar persons from associating with issuers subject to either 1933 or 1934 Act registration.

The 1934 Act gives the SEC broad discretion in fashioning sanctions, with the sole limitation that any measure "be necessary or appropriate in the public interest." In applying its own standards, however, the Commission imposes the more severe sanctions reluctantly. Furthermore, the Commission is held to a high standard of proof in establishing violations. Although a significantly less stringent standard than that required in a suit for injunctive relief, there must be "substantial" or "clear and convincing" evidence supporting findings of a violation. Additionally, when acting upon the findings of an administrative law judge, the Commission can affirm only after a full review of the record. These requirements suggest that there are adequate procedural safeguards to imposing severe sanctions, an especially significant concern in considering the effect of agency adjudication on subsequent private damage actions.

In terms of the four instances of administrative adjudicatory power discussed earlier, the SEC's sanctioning authority is limited to its licensing power. Any disciplinary authority is couched expressly in terms of those persons and entities subject to registration requirements; those directly related to regulation of the marketplace, not to the regulation of the internal affairs of issuers whose securities are subject to registration requirements. This distinction is important in considering any changes in SEC regulation. A primary reason is the need to avoid undue incursions upon internal corporate affairs, an area properly reserved to the corporate chartering authority. On the other hand, regulation of the securities markets inevitably affects chartering matters to

72. A classic example of the SEC taking a light-handed approach to a clear violation is found in In re Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959).
74. See, e.g., Berkley Land & Inv. Corp. v. SEC, 575 F.2d 77 (4th Cir. 1978); 17 C.F.R. § 201.17(e) (1978).
75. See notes 188-205 & accompanying text infra.
76. See text accompanying notes 19-22 supra.
some extent. The Commission's greater powers over broker-dealers, registered securities associations, and exchange members, in contrast to its powers over issuers, may well be an attempt to maintain a proper balance between market regulation and corporate chartering.

Despite the need to maintain this balance, to the extent that the integrity of the market place warrants SEC intervention, use of administrative sanctions against issuers and affiliated persons should not be disregarded. The value of administrative adjudicatory power in this area is worth examining because of its efficiency, the potential for expansion of this adjudication under the current scheme, and because of possible legislative reform. Moreover, as discussed below, expansion of administrative adjudicatory power to cover issuers and affiliates need not extend the reach of SEC regulation, but rather can be achieved by an expansion of the range of existing remedies. Accordingly, the issue becomes whether this expansion will result in increased efficiency and flexibility without undue incursion upon corporate chartering matters.

Suspension of the Right to Practice Before the Commission

SEC Rule of Practice 2(e) provides that the Commission may suspend, limit, or bar "any person" from practicing before it "in any way." This broad language would appear to give great leeway in applying sanctions against both individuals and corporations who would not otherwise be subject to SEC administrative disciplinary proceedings. Although the Commission has the express power to impose sanctions against broker-dealers and persons associated therewith,

78. See notes 79-103 & accompanying text infra.

79. 17 C.F.R. § 201.2(e)(1) (1978) (emphasis added). The regulation provides that the Commission "may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of an opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws . . . or the rules and regulations thereunder." Id. Although the SEC's power under this rule has been challenged in Touche Ross & Co. v. SEC, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,742 (S.D.N.Y. 1976), aff'd, [1979] FED. SEC. L. REP. (CCH) ¶ 96,854 (2d Cir. 1979), there has been no judicial indication that the rule is invalid. See notes 223-24 & accompanying text infra.

there is no comparable power with respect to issuers. Imaginative application of Rule 2(e)'s suspension power could aid in filling this gap.

Notwithstanding the broad language of Rule 2(e), its application to date has been limited to disciplining professionals, specifically attorneys and accountants. Even this use of the 2(e) sanction has been questioned. The validity of the disciplinary sanction is especially vulnerable in light of the absence of express statutory authority for its promulgation. In *Touche Ross Co. v. SEC*, however, the Second Circuit upheld the rule as consistent with the Commission's overall statutory mandate:

We reject appellants' argument for several reasons. First, it is clear that the SEC is not attempting to usurp the jurisdiction of the federal courts to deal with "violations" of the securities laws. The Commission, through its Rule 2(e) proceeding, is merely attempting to preserve the integrity of its own procedures, by assuring the fitness of those professionals who represent others before the Commission. Indeed, the Commission has made it clear that its intent in promulgating Rule 2(e) was not to utilize the rule as an additional weapon in its enforcement arsenal, but rather to determine whether a person's professional qualifications, including his character and integrity, are such that he is fit to appear and practice before the Commission.

Moreover, an examination of the policies underlying the securities laws indicates that, contrary to appellants' assertions, the Rule is not inconsistent with the Commission's statutory authority.

The court's reasoning emphasizes that Rule 2(e) has a valid role, not as a remedy for violations of the securities acts, but as a tool to maintain the integrity of practice before the Commission.

81. See text accompanying notes 68-70 supra.
88. At least one member of the Commission's enforcement arm has stated that Rule 2(e) sanctions may be imposed for misconduct that does not rise to the level of substantive securities law violations. Landau, *Legal Opinions Rendered in Securities Transactions*, in
By their own terms, the Rules of Practice are applicable to "proceedings" before the Commission, "particularly those which involve a hearing or opportunity for a hearing," but not to investigations. The provisions of the 1934 Act governing the registration of unlisted securities provide that no application shall be granted without notice and opportunity for a hearing and thus the Rules of Practice expressly apply. Similarly, there is a protracted certification process for registration of securities to be listed on a national exchange. Although there is no express opportunity for hearing, the Rules of Practice would still apply if this certification process were designated as a proceeding. Also, because the Commission has oversight responsibilities with respect to national exchanges, the hearing at the exchange level may suffice to call the suspension authority of Rule 2(e) into play. Finally, sections 15 and 19 of the 1934 Act give the Commission registration powers and oversight responsibilities with respect to brokers and dealers both directly and through their self-regulatory organizations, such as the National Association of Securities Dealers (NASD). Once again, the suspension power of Rule 2(e) could be applied in these proceedings.

All of the foregoing registration provisions include periodic reporting requirements. The 1933 Act registration requirements entail SEC filings, as do the proxy rules and the provisions regulating corporate takeovers. To the extent that any or all of these filings and registration applications legitimately can be denominated as Commission proceedings, the suspension power found in Rule 2(e) can have dramatic impact. For example, officers and directors who violate reporting provisions conceivably could be suspended from practice before the Commission. Depending upon the scope of the officers' duties this might mean that they must resign their positions, at least pending the duration of the suspension. Otherwise their companies would be running

PLI, NINTH ANNUAL INSTITUTE ON SECURITIES REGULATION 3, 37 (1977) (remarks of Theodore Sonde, Associate Director, Division of Enforcement).

89. 17 C.F.R. § 201.1 (1978) (Rule of Practice 1).
95. E.g., 15 U.S.C. §§ 78m(a), 78p(a) (1976).
afoul of the provisions of the same reporting requirements.\textsuperscript{99} This prejudice, or even disability, to issuers is not without precedent, as the SEC has exercised similar powers over past violators,\textsuperscript{100} brokers, and dealers.\textsuperscript{101} Consequently, the current regulatory scheme may well contain a wealth of untapped SEC sanctioning power.

Such use of Rule 2(e) or any other administrative sanction against issuers and their affiliates, officers, directors, and major shareholders must be tempered. The regulatory role of the SEC derives from its responsibility for the maintenance of an orderly marketplace. As has been discussed, however, once this regulation is extended to the issuers themselves, there is immediate tension between ownership rights and investor protection and the risk of undue incursions upon the province of state corporate chartering statutes.\textsuperscript{102} This tension must be considered before expanding the scope of Rule 2(e).

On balance, the Commission could use the power under Rule 2(e) as a means of more efficiently achieving current enforcement goals. Insofar as the Commission currently institutes civil enforcement proceedings against officers and directors in federal district courts,\textsuperscript{103} use of this one-step sanctioning power would increase efficiency and benefit respondents by providing a speedier resolution of the controversy. The Rule 2(e) remedy is not currently employed by the Commission as a means of policing the marketplace. However, such use of Rule 2(e) would not require legislative reform. Furthermore, to the extent that such suspensions are applied to participation in SEC filings on the same basis as in other proceedings, expanded use of Rule 2(e) would merely extend currently available powers without expanding the scope of SEC regulation.

The Need for Increased Efficiency

Granting the SEC a multitude of powers, including an expanded application of Rule 2(e), is of little value if the Commission is unable to

\textsuperscript{99} In a somewhat analogous situation, the SEC, in settlement, recently has suspended an accountant from practice before the Commission based on reporting violations occurring when he was the chief financial officer of the offending issuer. \textit{In re} Martin E. Davis, Accounting Services Release No. 267, \textit{reprinted in} 6 \textit{FED. SEC. L. REP.} (CCH) ¶ 72,289 (July 2, 1979); \textit{see also} SEC v. Hamilton, 511 SEC. REG. & L. REP. (BNA) A-28 (D.D.C. 1979).

\textsuperscript{100} For example, ancillary relief granted pursuant to a court-ordered injunction resulted in prejudice to past violators. \textit{E.g.}, SEC v. Cosmopolitan Inv. Funding Co., 42 SEC ANN. REP. 119 (1976).

\textsuperscript{101} \textit{See} notes 46-78 & accompanying text \textit{supra}.


\textsuperscript{103} \textit{See} notes 115-22 & accompanying text \textit{infra}.
exploit such powers effectively. Examination of the Commission's past enforcement activities can aid in evaluating the ability of the SEC to use available sanctions and remedies. One significant comparison is the breakdown of the number of investigations resulting in criminal actions, civil injunctive suits, and SEC administrative proceedings. The SEC now handles many times the number of docked investigations handled at its inception.104 Through 1976 the Commission had instituted more than 11,700 docked investigations.105 Of these investigations, 1,621 criminal cases were referred to the Justice Department,106 resulting in 1,228 indictments—approximately a 75% success rate. Of the 5,276 defendants indicted, 2,846 were convicted, resulting in a conviction rate of nearly 55%.108 Despite this success, criminal cases represent a small part of the Commission’s overall activities.

In contrast to the criminal side of the SEC enforcement program, the Commission had instituted 2,770 civil injunctive suits through 1976.109 During this time both the use of the SEC injunction and the number of SEC suits disposed of by settlement increased significantly.110 Settlement is an attractive alternative to litigation for all involved. The opportunity to merely consent to not repeat an infraction lessens much of the sting to any defendant while saving courts and the Commission from expending time, effort, and expense.111

The SEC’s record reveals that, notwithstanding vigilant Commission activity, the number of violations continues to rise. Staffing limitations have, or soon will, prevent the SEC from being able to keep up with violators. One solution might be to increase the enforcement staff of an already highly staffed agency. In a time of concern over governmental spending and expansion, however, this does not appear to be the optimal solution. Another approach might be to shift much of the enforcement power to the private sector by expanding the scope of private remedies. This too is unlikely to be an available solution as the

110. One estimate suggests that the Commission settles about 90% of its cases. Interview with SEC Commissioner Irving Pollack, 484 SEC. REG. & L. REP. (BNA) AA-4 (Jan. 3, 1979). See also 41 SEC ANN. REP. 98 (1975).
Supreme Court seems to be moving in the opposite direction, and limiting private remedies in the securities area.\textsuperscript{112} A viable variation might be to increase the efficacy of private enforcement with the use of SEC ancillary relief\textsuperscript{113} or by increasing the collateral estoppel effect of SEC injunctive actions.\textsuperscript{114} A final alternative, advocated here, is to expand the scope of SEC administrative sanctions, thereby increasing effective enforcement while reducing costs. Before the case for expanded administrative sanctions can be made, however, one must examine the ability of current practice, \textit{i.e.}, use of injunctions in the courts, to achieve the Commission's goals.

The SEC as Enforcer in the Courts

The SEC Injunction Action

Despite express statutory authorization for SEC injunctive relief,\textsuperscript{115} this is the mode of regulation in which effectiveness and efficiency issues become most acute. This is true not only because of the low success rate in these suits,\textsuperscript{116} but also because of the questionable effect of the injunctions issued. More specifically, the bare prohibitory injunction results merely in an order prohibiting the defendants from repeating certain conduct in the future. If the prohibited conduct is repeated, the eventual remedy depends upon still further judicial action in which the SEC, through the Justice Department, seeks to have the defendant held in contempt of court. Also, because many frauds or

\textsuperscript{112} E.g., International Brotherhood of Teamsters v. Daniel, 99 S. Ct. 790 (1979) (restricting the definition of "security"); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (requiring a showing of deception in a suit under Rule 10b-5); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977) (denying a private right of action under the Williams Act to a competing tender offeror); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (requiring scienter in a private damage action under Rule 10b-5); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (plaintiff in a Rule 10b-5 suit must be a purchaser or seller of the securities in question).

\textsuperscript{113} See notes 123-45 & accompanying text infra.

\textsuperscript{114} See notes 148-87 & accompanying text infra.


\textsuperscript{116} See text accompanying notes 109-11 supra.
other violations are one time occurrences, the simple injunction has little deterrent effect. Furthermore, insofar as it is issued after the fact, the decree has neither a remedial nor prophylactic effect. Despite these difficulties the Commission continues to expend time and energy seeking injunctive relief.117

An analysis of three factors—the standards of proof the Commission must meet, the potential for expanded use of ancillary relief, and the trend toward settlement of SEC actions—shows that despite some potential for improving the effectiveness of SEC injunctive actions, severe limitations remain. Before examining the impact of ancillary relief and the effect that injunctive suits can have on private litigation, it is necessary at least to note the standards for securing judicially awarded injunctions.

Under each of the acts it administers, the SEC has the authority to seek either temporary or permanent injunctive relief in the courts "[w]henever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation."118 The statutes speak in terms of continuing and future violations, thus making the remedy seemingly inappropriate for past violations. As the Second Circuit recently announced, "[i]t is well settled that the Commission cannot obtain relief without positive proof of a reasonable likelihood that past wrongdoing will recur and that there is "something 'more than the mere possibility which serves to keep the case alive.'"119 Accordingly, the SEC frequently must prove the reasonable likelihood of future substantive violations, despite proven past violations, or no relief will be granted.120 This is a much more stringent standard than the Commission's adjudicatory sanctioning power,121 which merely requires that the public interest

117. See notes 104-14 & accompanying text supra.
warrant the relief. On the other hand, the test for an injunction is not so stringent as to require the Commission to prove the threat of irreparable harm.122

SEC injunctive relief in the courts thus is a limited remedy. It is most useful when used to prevent violations before they occur. Unfortunately, absent a preliminary injunction or a temporary restraining order, delay and crowded dockets may eliminate the SEC's ability to prevent injury to investors. Although the two mechanisms discussed below may increase the effectiveness of SEC injunctive relief, an injunctive action nonetheless may remain ineffective because of the inability to use this remedy against prior non-recurring violations.

Ancillary Relief

Notwithstanding that the enabling provisions of the securities acts speak solely in terms of the SEC's power to enjoin violations,123 the SEC and the courts have fashioned remedies ancillary to the traditional injunctive decree, relying on "the general equitable powers of the federal courts."124 Such ancillary relief has taken many forms, ranging from disgorgement of ill-gotten profits125 to more imaginative corrective action. Among such imaginative remedies are the appointment of an independent majority on the board of directors,126 the appointment

of a receiver,127 prohibitions against exercising voting control in a proxy battle,128 the appointment of “special professionals” to assure compliance with securities laws,129 additional reporting requirements,130 orders designed to protect remaining assets,131 and prohibitions of continued participation as an officer or director of any public company.132 Most recently, the Commission secured the judicial appointment of a “special independent officer” to assure compliance.133

Although the appointment of a receiver, restitution, and protection


This power is expressly given to the Commission by § 42(e) of the Investment Company Act for violators of the Act’s registration requirements. 15 U.S.C. § 80a-41(e) (1976). However, the remedy has been applied as a matter of the courts’ general equity power. See generally Farrand, supra note 124, at 1784-89.


130. See generally Farrand, supra note 124, at 1792-93.


133. SEC v. Western Geothermal & Power Corp., [1979] FED. SEC. L. REP. (CCH) ¶ 96,920 (D. Ariz. 1979). One commentator has broken down ancillary remedies into thirteen categories: “(1) appointment of a receiver; (2) appointment of a special trustee or a special fiscal agent; (3) restitution or ‘disgorgement’ of profits; (4) appointment of independent members of boards of directors and special committees of the board including audit committees, executive committees, and litigation and claims committees; (5) appointment of ‘special counsel’ to conduct a court supervised investigation to file a report of the investigation with the SEC and the court, and to recommend and pursue claims against prior management and others on behalf of the corporation and its shareholders; (6) orders requiring recission offers; (7) ‘freeze’ orders or a temporary trust; (8) orders requiring an accounting; (9) orders requiring filing of additional reports concerning financial condition or securities transactions; (10) orders requiring attorneys or accountants to disclose to future clients past violations of law or inability to practice before the SEC, requiring attorneys to furnish the SEC with all opinion letters issued, or requiring reports of all securities transactions to the SEC; (11) orders restricting or precluding purchase or sale of shares, voting of shares or proxies, or otherwise influencing or participating in management of an issuer or its subsidiaries and affiliates; (12) orders requiring establishment of new supervisory and compliance procedures; and (13) orders requiring ‘guarantee of losses’ or ‘hold harmless’ protection for an issuer.” Mathews, supra note 115, at 538-41 (footnotes omitted).
of assets can be viewed as supplemental investor protection, the less drastic remedies are more directly related to assuring future compliance. These less drastic forms of relief would appear to fit more closely within the preventive focus of the acts' injunctive provisions than the more remedial forms of relief, which tend to place the Commission in a position of consumer—or investor—advocate.

One caveat must be recognized with respect to ancillary relief. An overzealous approach to the SEC's pursuit of ancillary remedies would lead to an undue incursion upon corporate governance issues that are more properly left to corporate chartering statutes.134 While there is no question that reform is needed in this area, it should not be accomplished by the SEC under the guise of investor protection. Rather, the task of considering corporate governance should be undertaken on its own merits.135 An example found in one area of SEC enforcement activity which intrudes upon the corporate chartering function with respect to internal governance should serve to illustrate the danger.136

Since 1976, the Commission has favored requiring independent audit committees. In fact, such a rule was adopted in 1977 for issuers whose securities are listed on the New York Stock Exchange.137 In 1978, the SEC's general counsel stated that the Commission had the

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134. Lengthy debate over the direction of the modern corporation recently has accelerated. See generally Symposium-Corporate Social Responsibility, 30 HASTINGS L.J. 1247 (1979); Symposium-Reweaving The Corporate Veil, 41 LAW & CONTEMP. PROB. 1 (Summer 1977).


136. A potentially greater incursion into the realm of corporate autonomy may result from the passage of the Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, §§ 202, 203, 91 Stat. 1494, 1498-99 (1977). The Act amended the Securities Exchange Act to require increased disclosure of acquisition and ownership information to the SEC, securities exchanges, and to the company itself. More troublesome is the requirement in § 103 of the Act that reporting issuers institute a system of internal accounting controls to assure that management policies are being followed. 15 U.S.C. § 78m(b)(2)(B) (Supp. 1 1977). This section requires that a company "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences."

power to promulgate its own rules requiring independent audit committees for all issuers subject to the reporting requirements of the 1934 Exchange Act and the registration provisions of the 1933 Securities Act.\textsuperscript{138} Even though no such rule has been adopted to date, the SEC has been able to accomplish this goal indirectly by entering into consent decrees in settlement of enforcement actions that have incorporated the independent audit committee requirement.\textsuperscript{139} Such a requirement forces changes in operating procedures that undoubtedly will alter the substance of corporate transactions and governance. The potential for direct impact of ancillary relief upon corporate governance in similar instances should not be underestimated. Accordingly, in fashioning ancillary remedies the Commission and the courts should be mindful of overstepping the appropriate boundaries of disclosure and other forms of investor protection.

The Commission has been increasingly vigorous in seeking ancillary remedies,\textsuperscript{140} but its stated reasons for doing so have focused on deterrence rather than the compensatory or remedial effects served.\textsuperscript{141} While to do otherwise might appear to depart from the securities acts' injunctive design,\textsuperscript{142} increased emphasis on remedial effects by the Commission is justifiable insofar as it would comport with the spirit of both acts and the courts' equity powers. Accordingly, the current restrictive focus may be unnecessary. The Commission, in assuring investor protection, especially in disgorgement actions, should recognize its remedial role. This change in emphasis both would deter future violations and compensate injured parties.\textsuperscript{143} One commentator has sug-

\textsuperscript{138} Memorandum of General Counsel Harvey L. Pit to Chairman Williams (June 10, 1977), reprinted in [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,535 (1978).


\textsuperscript{140} See Ellsworth, supra note 124, at 642 n.4.

\textsuperscript{141} "The Commission's primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals. Thus, a request that disgorgement be required is predicated on the need to deprive defendants of profits derived from their unlawful conduct and to protect the public by deterring such conduct by others." 42 SEC ANN. REP. 108 (1976). This language has appeared in the SEC annual reports since 1972. See Ellsworth, supra note 124, at 649 n.54. The emphasis on deterrence dates back at least to 1968. See Dolgow v. Anderson, 43 F.R.D. 472, 483 (E.D.N.Y. 1968), rev'd on other grounds, 438 F.2d 825 (2d Cir. 1970).

\textsuperscript{142} See note 115 & accompanying text supra.

\textsuperscript{143} One obvious problem with such a shift in objective from deterrence to compensation is the necessity that the Commission look beyond disgorgement of ill-gotten gains, as
gested, however, that costs and other indicia of efficiency make the SEC ill-suited for the task of acting as an investor advocate. In light of the newly increased potential for the offensive use of collateral estoppel in private damage actions following SEC injunctive suits, however, compensation issues have gained renewed importance. After a brief discussion of the impact of the current trend toward SEC settlements, the next sections of the Article analyze the potential for increasing the aid to private litigants resulting from SEC proceedings. Statutory changes needed to increase SEC efficiency while recognizing the need for a compensatory remedy in securities regulation are then discussed.

Settlement

In light of the time and effort involved in fully litigating an injunctive suit, the SEC has become increasingly willing to accept out of court settlements. Consent to an injunction has minimal impact because the defendant, without admitting past violations, merely agrees not to engage in the charged violations in the future. This impact is further lessened because the collateral estoppel effect that might apply to a fully litigated injunction order does not attach to a consent decree. On the other hand, a consent injunction does have some deterrent effect, at least with respect to the defendants in a particular case; breach of a settlement agreement or consent decree can result in criminal contempt proceedings. The usefulness of this remedy should not be overestimated, however, as it requires a second SEC investigation and prosecution, doubtlessly duplicating previous efforts.

The effectiveness of the injunction consent decree as an enforce-


144. Ellsworth, supra note 124, at 651.
145. See text accompanying notes 148-87 infra.
ment device is increased to the extent that the Commission is willing to insist upon the type of ancillary relief that would increase investor protection. As previously noted, there has been some movement in this direction by the SEC and by the courts and a continuation of this trend, both in the number of cases and types of remedies, is clearly warranted. Consequently, the party under SEC investigation may fear both the collateral estoppel effect of a judicially secured injunction and as the imposition of ancillary relief by a court. This incentive to settle should improve the SEC's position in negotiating a meaningful consent decree. Indeed, unless the Commission strikes a hard bargain, an increase in settlements portends nothing more than an easy way out for those under threat of SEC suit.

The Role of the SEC in Private Suits

The Collateral Estoppel Effect of SEC Injunctions

A significant factor in favor of the vigorous pursuit of SEC injunctions is the extent to which such suits can foster the compensatory and deterrent goals of private rights of action. By stimulating private actions the SEC can achieve results that are largely absent in the typical injunction decree.\(^{148}\) The primary method by which SEC enforcement actions can stimulate private suits is the offensive application of the doctrine of collateral estoppel.

An early impediment to private plaintiffs' offensive use of issues previously litigated was the requirement of mutuality.\(^{149}\) Later federal decisions eliminated this requirement.\(^{150}\) Also, until recently the courts

\(^{148}\) But see text accompanying notes 46-78 supra, discussing the availability of ancillary relief in actions instituted by the Commission.

\(^{149}\) Under this doctrine the plaintiff would be entitled to collaterally estop the defendant in a situation where the defendant could assert the collateral estoppel defense against the plaintiff. However, because private plaintiffs are not parties to the prior SEC litigation, any facts found contrary to their interests would have to be relitigated in the second suit lest they be denied their day in court. See generally Hansberry v. Lee, 311 U.S. 32, 40 (1941); F. James & G. Hazard, Civil Procedure § 11.26 (1965); IB J. Moore & T. Currier, Federal Practice ¶ 0,411(1) (2d ed. 1974); Moore & Currier, Mutual and Conclusiveness of Judgments, 35 Tul. L. Rev. 301 (1961); Semmel, Collateral Estoppel, Mutual and Joiner of Parties, 68 Colum. L. Rev. 1457 (1968). Cf. Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation, 402 U.S. 313, 320-30 (1970) (reviewing mutuality of estoppel doctrine but concluding estoppel could be pleaded when patentee seeks recovery for infringement after patent declared invalid in separate action).

had held uniformly that application of the doctrine could result in denial of the defendant’s constitutional right to a jury trial.\textsuperscript{151} The Supreme Court, however, recently has explained in \textit{Parklane Hosiery Co. v. Shore}\textsuperscript{152} that the application of many procedural developments since 1791, including collateral estoppel, has diminished the scope of the right to a jury trial without violating any seventh amendment right.\textsuperscript{153} The lifting of this barrier, however, does not pave a clear road for easy application of collateral estoppel principles.\textsuperscript{154}

In the first instance, because of the potential unfairness involved in the offensive use of collateral estoppel, the Court merely declared that it would “grant trial courts broad discretion in determining when it should be applied.”\textsuperscript{155} Accordingly, in exercising this discretion courts must balance the advantages gained by application of the doctrine against possible prejudice to the defendant. The \textit{Parklane Hosiery} decision, although holding that no seventh amendment issue is involved, necessarily leaves the jury issue open to consideration in evaluating unfairness to the defendant.

Perhaps the major potential unfairness is the risk that in defending the SEC action the defendant did not litigate as vigorously as it would have in a private action. In most SEC cases this should not be a major obstacle, as even minor SEC injunctions can result in disability under

\begin{thebibliography}{99}
\item 152. 439 U.S. 322 (1979).
\item 153. \textit{Id.} at 333-35.
\item 155. 439 U.S. at 331. The Court cautioned that the potential for such unfairness should not be underestimated. \textit{Id.} at 330-31. \textit{See also} Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation, 402 U.S. 313 (1971); \textit{Bowen v. United States}, 570 F.2d 1311, 1322 (7th Cir. 1978); \textit{Restatement (Second) of Judgments} § 68.1 (Tent. Draft No. 4, 1977).
\end{thebibliography}
the securities acts. Furthermore, the publicity factor involved in SEC injunctive actions may force the defendant to defend vigorously. Notwithstanding the general proposition that such unfairness will not ordinarily result, the trial judge must consider each case on an ad hoc basis in exercising this broad discretion. As such, the extent to which the vigor of the defense of a prior SEC suit stands as a barrier to the offensive use of collateral estoppel can only be ascertained after sufficient cases have been decided to present an identifiable pattern.

A second barrier to expansive application of collateral estoppel that remains after the Supreme Court's decision in Parklane Hosiery is the extent to which the elements of an SEC claim differ from that of a private party. It is black letter law that collateral estoppel will preclude relitigation only of those issues that not only are determined adversely to the defendant in the first action, but also were necessary to support the judgment. With respect to the elements of any claimed violation, the utility of collateral estoppel thus must vary with the substantive violation at issue. Accordingly, the remainder of this section examines the claims arising under those sections of the 1933 and 1934 Acts that provide a private remedy.

The major area of litigation in the antifraud realm derives from the implied private remedies under Rule 10b-5's general proscriptions, section 14(a)'s regulation of the proxy machinery, section 156. For example, Regulation A's qualified small issue exemption from 1933 Act registration is expressly unavailable where the issuer, underwriter, any affiliate, or any individual connected thereto has been subject to sanctions imposed under the securities acts. 17 C.F.R. § 230.252(d)(3) (1978) (Rule 252(d)(3)). The rule also covers sanctions imposed by the Commission in its adjudicatory function, such as stop orders. Id. Professor Kenneth Culp Davis has identified adverse publicity as one of the "sanctions" imposed by the SEC. K. Davis, ADMINISTRATIVE LAW 446 (3d ed. 1972).

"Since one of the major functions of injunctive actions brought by the Commission is the alerting of potential private plaintiffs to actionable violations of the securities laws, the defendants should be well aware of the possibility of multiple private suits at a later date. Thus, it is unlikely that the defendants would regard the injunction as unimportant and therefore fail either to defend the first suit vigorously or to appeal an adverse judgment." Comment, The Effect of SEC Injunctions in Subsequent Private Damage Actions—Rachal v. Hill, 71 COLUM. L. REV. 1329, 1338-39 (1971) (footnotes omitted). See Shore v. Parklane Hosiery Co., 565 F.2d 815, 822 n.7 (2d Cir. 1977), aff'd, 439 U.S. 322 (1979). See note 228 & accompanying text infra. Significantly, both the publicity factor and the potential for disabling penalties apply to administrative adjudications as well. See notes 206-10 & accompanying text infra.


14(e)'s regulation of tender offers, and the 1933 Act's general misrepresentation provision embodied in section 17(a). Despite its particular importance in private suits under Rule 10b-5, section 17(a), and section 14(e), the standing issue is not affected by prior SEC action. In contrast, one question which pervades each of these sections is the necessity of proving that the defendant acted with scienter. By virtue of the holding in *Ernst & Ernst v. Hochfelder* scienter is an element of a Rule 10b-5 private damage claim. There is some authority to the effect that scienter may not be required in actions brought under the proxy rules or under section 17(a), but these issues have not yet been definitively resolved. Similarly, the Supreme Court in *Hochfelder* expressly left open the issue of whether scienter is an element to be proved by the SEC when seeking injunctive relief under any of the foregoing sections. There has been much literature evaluating this question, but the majority of cases strongly favor not requiring scien-

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164. *E.g.*, Piper v. Chris-Craft Indus. Inc., 430 U.S. 1 (1977) (competing tender offeror lacks standing in a private damage suit under § 14(e)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (10b-5 damage suits can be brought only by one who purchased or sold the securities in question); Reid v. Madison, 438 F. Supp. 332 (E.D. Va. 1977) (the Blue Chip requirement does not apply in suits brought under § 17(a) of the 1933 Act).


168. 425 U.S. at 193 n.12.

ter in SEC injunctive actions. Assuming this trend continues, and the SEC is not required to establish scienter while private parties must, the collateral estoppel effect of at least Rule 10b-5 enforcement actions will be severely curtailed. Of course, questions of whether there was a material misstatement or omission would be the same in both the SEC and private actions, but the elements of reliance, causation, and damages would not be, as the SEC is concerned with the general investing public rather than specific injuries. On the other hand, the availability of ancillary relief in the SEC action may depend upon showing a specific injury to identifiable investors and may require a showing of scienter. Thus, absent a request for ancillary relief, the antifraud provisions of the 1933 and 1934 Acts do not appear to present opportunities for extensive use of offensive collateral estoppel.

The effect of prior SEC action may be much more significant in private actions brought under the express liability provisions of both the 1933 and 1934 Acts. Section 11 of the 1933 Act provides a private remedy for any purchaser of a registered security when the registration statement contains material misstatements or omissions. Although the issuer is “absolutely” liable, the defenses of “due diligence” and “reasonable investigation” are available to all other defendants, effectively creating a negligence standard as to them. To the extent that an SEC action results in a finding of misleading infor-

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171. The proposed Federal Securities Code would impose no more than a negligence standard in SEC enforcement actions. ALI FED. SEC. CODE § 1602(a), Comment (3) (Proposed Official Draft, 1978).

172. See text accompanying notes 123-45 supra.


175. Id. Liability under this section extends to the issuer, directors, partners, signers of the registration statement, and persons who have helped prepare the statement, as well as all underwriters.

mation in a registration statement, collateral estoppel would enable the plaintiff to prevail against issuers merely by proving that he or she purchased the securities. As for the liability of other defendants, private litigants suing under section 11 would face the same problems as those suing under Rule 10b-5, with the exception that the plaintiff need not prove reliance or a causal connection to the damages suffered.\footnote{177} 

Even less difficult to establish than the section 11 claim is a private suit under section 12(1),\footnote{178} which provides that any person who sells a security in violation of the 1933 Act's registration or prospectus requirements\footnote{179} shall be liable for rescission and damages. A section 12(1) suit requires no showing of causation or actual damage and is used to redress even mere technical violations.\footnote{180} Here the only fact a private plaintiff must prove after a successful SEC enforcement action is the purchase of the security. Consequently, the collateral estoppel effect in section 12(1) claims would be substantially greater than in Rule 10b-5 suits.

The third express liability provision of the 1933 Act, section 12(2),\footnote{181} provides an antifraud remedy to any purchaser in privity with the violator, who is held to a negligence standard.\footnote{182} The differences between section 12(2)'s privity requirement and negligence standard and rule 10b-5's requirement of reliance, causation, and actual damages are so substantial as effectively to provide the defendant in an SEC suit with the opportunity for a second complete defense in any subsequent private litigation.

In contrast to some of the 1933 Act provisions, the express liability provisions of the 1934 Act do not provide an effective basis for the use of collateral estoppel. Section 9(e) prohibits market manipulation and provides a private remedy for "willful" violations—a standard which would appear on its face to embody more of an actual intent requirement than does mere scienter.\footnote{183} Section 16(b) provides for disgorgement of insider short-swing profits, but the SEC does not exercise

\footnotesize{\textsuperscript{177} Section 11(e) spells out the measure of damages. 15 U.S.C. § 77k(e) (1976).
\textsuperscript{183} 15 U.S.C. § 78i(e) (1976).}
enforcement power in such situations.\textsuperscript{184} Finally, section 18(a) affords relief for an investor who relies on misleading documents filed with the SEC when the defendant has acted knowingly or in bad faith.\textsuperscript{185} In addition to its express fault requirement, however, section 18(a) has an express reliance requirement, rendering an SEC initiated adjudication of a misleading filing of limited effect.

In light of the limited utility of sections 9(e) and 18(a),\textsuperscript{186} pursuit of SEC actions under the 1934 Act seems of little use to private plaintiffs. Similarly, even with respect to the more heavily litigated antifraud actions under Rule 10b-5 and section 14(a), the primary aid of a successful SEC injunction would be to establish a misstatement or omission and materiality. However, these are issues which frequently may be appropriate for partial summary judgment in the private suit.\textsuperscript{187} Under the 1933 Act, the successful SEC injunction may be somewhat more helpful in private suits under sections 11 and 12(2), but its real utility lies in section 12(1) rescission actions.

The foregoing demonstrates that, even in the most favorable light the efficacy of SEC injunctive suits as an aid to private parties is minimal, particularly when the costs to the SEC are considered. This inability to aid private parties, when coupled with the limitations as a public enforcement tool discussed previously, cast considerable doubt upon the desirability of pursuing injunctive relief. In addition, these actions drain the resources of the SEC and add to the overflow of busy court dockets. One way to preserve this function of the SEC and improve its efficiency would be to remove these cases from the courts and put them before the SEC sitting in its adjudicatory capacity.

The Collateral Estoppel Effect of SEC Agency Adjudications

As previously noted, the current statutory scheme empowers the SEC, sitting in its adjudicatory capacity, to impose a broad range of sanctions against issuers subject to the registration and reporting re-

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\begin{enumerate}
\item \textsuperscript{186} It has been observed that "section 9(e) has been swallowed by Rule 10b-5 and Section 18(a) has been completely supplanted by the implied actions under Section 14 and other sections." R. JENNINGS & H. MARSH, \textit{SEcurities Regulation: Cases and Materials} 872 (4th ed. 1977) (footnote omitted).
\item \textsuperscript{187} The absence of a scienter requirement in private suits under § 17(a) of the 1933 Act and § 14 of the 1934 Act, of course, would make the prior SEC determination more significant. However, this aspect of the scienter issue has not yet been resolved. See text accompanying notes 165-73 \textit{supra}.
\end{enumerate}
\end{footnotesize}
quirements, broker-dealers, members of self-regulatory organizations, and national exchanges.\textsuperscript{188} In addition, the Commission has similar power with respect to investment companies\textsuperscript{189} and investment advisors.\textsuperscript{190} Commonly, many of these administrative adjudicatory proceedings involve violations of substantive sections that also give rise to private remedies. The effect of an adverse agency determination in a subsequent court action for private relief thus warrants some investigation.

The Supreme Court's approach in its recent \textit{Parklane Hosiery} decision, when read in conjunction with agency adjudication decisions, offers a great opportunity for the offensive use of collateral estoppel by a private party. As noted earlier, the benchmark of the \textit{Parklane Hosiery} opinion was to give the trial court a broad range of discretion, remaining mindful of the potential unfairness of offensive estoppel.\textsuperscript{191} In a recent pre-\textit{Parklane Hosiery} decision, the Seventh Circuit in \textit{Bowen v. United States}\textsuperscript{192} examined the effect of a prior administrative adjudication. The court held that facts found in an administrative license suspension proceeding before the National Transportation Safety Board against a pilot were to be given collateral estoppel effect in a subsequent civil damage action brought by him. Although in \textit{Bowen} collateral estoppel was used against the pilot to bar his claim,\textsuperscript{193} the principles announced therein bear on the offensive use of prior SEC agency proceedings.

The chief objection to applying collateral estoppel in \textit{Bowen} was the difference between an agency adjudication and a complete judicial determination. The Seventh Circuit, however, pointed to the well-established rule that agency adjudication will operate as res judicata in subsequent judicial proceedings.\textsuperscript{194} It relied on the reasoning of Pro-
fessor Davis, who twenty years earlier suggested that, where appropriate, the doctrine should be applied in the administrative context because the underlying policies of res judicata can apply with equal force to a prior agency determination. After noting the acceptance of Professor Davis' reasoning amongst the judiciary, the Seventh Circuit recommended that "the courts have not hesitated in recent years to expand the application of collateral estoppel . . . to better serve the underlying policy on which the doctrine is based, viz., that one opportunity to litigate an issue fully and fairly is enough." Recognizing that agency adjudication procedures are less formal and the rules of evidence are relaxed, the court nevertheless concluded that this test had been met. Additionally, the court placed a heavy emphasis upon the fact that the administrative sanction—suspension of a license—was a significant one, and that there had been a vigorous defense including the presence of counsel at the agency level.

All of the foregoing factors are equally present in SEC administrative hearings. Because suspension or license revocation of broker-dealers, exchanges, investment companies, and investment advisors, stop orders on 1933 Act registration statements, and suspension of trading or delisting under the 1934 Act are possible sanctions, a defendant is likely to pursue a case vigorously. Even the less severe SEC sanctions can have significant adverse results on the defendant.

Taking the Bowen rationale, the approach of the Supreme Court in Parklane Hosiery would appear to foreshadow expansion of the offensive use of collateral estoppel based on a prior administrative adjudication. A significant difference here, in contrast to the judicially imposed SEC injunction, is that the potential for unfairness is increased by the differences in agency and court procedures. This in turn may render trial judges less likely to exercise the discretion identified in Parklane Hosiery. In light of the standard of proof and procedural safeguards afforded the defendant in SEC proceedings, however, the...

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195. 570 F.2d at 1321 (quoting 2 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 18.02 (1st ed. 1958)). Cf. RESTATEMENT OF JUDGMENTS § 1 (1942) (underlying principles of finality).

196. 570 F.2d at 1322.
197. Id.
198. Id. at 1323.
199. See notes 46-78 & accompanying text supra.
200. See notes 46-78 & accompanying text supra and note 156 supra.
201. See text accompanying notes 73-74 supra.
claim of unfairness may not succeed. As in a prior SEC injunction suit, the standard of proof may differ when compared with a private damage action; however, this issue is yet to be resolved. In fact, the suggestion has been made that scienter may be a necessary element before the Commission can impose sanctions.202

Whatever the future may hold in this regard, collateral estoppel in private damage suits based on prior SEC adjudication may become a significant factor. To the extent that the Commission continues to require a showing of willfulness for the more severe sanctions, collateral estoppel may be more of a real threat in administrative adjudication than in an SEC injunction suit. As the potential for the offensive use of collateral estoppel becomes more apparent, a shift toward the increased use of administrative rather than judicial adjudication would be warranted. By decreasing the caseload in the more time-consuming injunction suits, the Commission would be able to productively redirect those efforts without denying important benefits to private plaintiffs.

The discussion so far has been directed toward collateral estoppel and SEC sanctions as they currently are enforced. To the extent that administrative adjudicatory power is expanded to consider many of the violations now reserved for judicial proceedings,203 the utility of collateral estoppel necessarily will increase. Thus, from the standpoint of SEC efficiency, it would seem preferable to severely limit the judicial injunction remedy204 while retaining the possible collateral estoppel effect of administrative adjudications.205

Other Roles for the SEC in Private Litigation

Collateral estoppel is far from the only means by which the commission can aid private litigants. An obvious additional means would be SEC intervention into private suits. Short of direct intervention the SEC may submit amicus briefs. Although the Commission currently submits such briefs, it does not do so primarily to aid particular private

203. See notes 256-68 & accompanying text infra.
204. See notes 256-68 & accompanying text infra.
205. If, however, the SEC is given cease and desist powers rather than increased sanctioning power, collateral estoppel would be less significant, as the guidelines of Bowen and Parklane Hosiery would not allow summary proceedings to be the basis for applying the doctrine. See text accompanying notes 256-58 infra.
plaintiffs, but rather to establish beneficial precedent from the perspective of investor protection. This motivation behind allocation of limited agency resources certainly is consistent with the SEC's current focus on deterrence as opposed to compensation. Moreover, although this emphasis necessarily restricts the number and type of private suits in which the Commission will appear, such limitations seem reasonable in view of the limited resources currently available to the Commission.

Another possible role for the Commission having a broad impact on the resolution of private disputes would be for the SEC to act as the adjudicating authority. This type of adjudicatory power, although beyond the current statutory scope of SEC authority, is a legitimate use of an administrative body and can be supported in principle on various grounds. The primary justification would be the high degree of expertise that SEC adjudication would bring to the resolution of private disputes. In addition to being expensive and protracted, private securities litigation can be exceedingly complex. Lengthy opinions and findings of fact are common to such cases. Courts have even gone so far as to refuse a party's jury demand because of the complexity of the issues involved. Furthermore, the costs of judicial litigation often preclude prosecution of small claims. SEC adjudication of private disputes would be of particular significance to such plaintiffs.

Use of SEC expertise in fact finding and arbitration of disputes certainly would expedite the resolution of private securities litigation, but also would call for a significant increase in administrative personnel. As noted previously, current budgetary restraints might not be conducive to an expansion resulting in increased bureaucracy. Moreover, the magnitude of most securities claims belies reference to administrative rather than judicial adjudication. For this reason, and in view of the already expansive role of the SEC, this alternative for reform does not appear to be viable.

206. By the close of the 1971 fiscal year the Commission had participated as amicus curiae or intervenor in approximately 350 cases. 37 SEC ANN. REP. 227 (1971). From fiscal year 1972 through 1976 the Commission participated in approximately 62 additional cases. 38 SEC ANN. REP. 170 (1972); 39 SEC ANN. REP. 170 (1973); 40 SEC ANN. REP. 90-93 (1974); 41 SEC ANN. REP. 209 (1975); 42 SEC ANN. REP. 206 (1976). The Commission participates when it considers it important to present its views on the proper interpretation of the provisions involved. Such participation is usually at the appellate level. 40 SEC ANN. REP. 90 (1974).

207. See text accompanying note 21 supra.


Perhaps the most effective, as well as the least expensive, SEC activity is its publicity function.\textsuperscript{210} This may be one of the most underestimated tools available to the Commission. The potential of adverse publicity flowing from an SEC investigation has a significant deterrent effect. Public awareness of such investigations cannot avoid injuring the reputation and goodwill of broker-dealers. Also, because they instill a lack of investor confidence, SEC investigations can have adverse effects on the price of publicly traded securities. A second aspect of the publicity function is that it alerts investors to the existence of possible private remedies. A disgruntled investor who hears of an SEC investigation may be spurred to consult an attorney, which in turn may well result in a successful suit for damages.

To the extent that desired deterrent effects and remedial results derive from SEC publicity, further administrative proceedings should be closely scrutinized. If much of the desired effect of an SEC injunctive suit may be accomplished prior to the filing of a complaint by publicity, full litigation is a waste of administrative resources. Just as the Commission currently issues litigation releases, it could expand the publicity function by issuing investigation releases which would disclose information discovered during the course of its investigation, subject to the boundaries of confidential information. Although there could be no adjudication of guilt, the charges could be aired publicly.

Section 21(a) of the 1934 Act expressly authorizes such public reports.\textsuperscript{211} To date, however, this power to issue public reports has not been utilized to its optimal extent.\textsuperscript{212} In fact, section 21(a) has formed the basis of much recent controversy. In \textit{In re Spartek, Inc.},\textsuperscript{213} the Commission issued a section 21(a) report of a staff investigation including the acceptance of the registrant’s offer of settlement. Commissioner Karmel vigorously dissented, considering the report to be in excess of the SEC’s jurisdiction.\textsuperscript{214} She reasoned that the publicity function could not properly be used as an alternative to SEC enforcement actions.\textsuperscript{215} Nonetheless, the SEC has since used the publicity function in

\textsuperscript{210} See I Davis Treatise, supra note 9, ch. 5.
\textsuperscript{213} 491 SEC. REG. & L. REP. (BNA) E-1 (February 21, 1979).
\textsuperscript{214} Id. at E-4.
\textsuperscript{215} “I object to the use of Section 21(a) as an alternative administrative remedy against persons who allegedly violate the securities laws. In particular, it should not be used to take administrative action against persons not subject to the Commission’s jurisdiction under Section 15 of the Exchange Act. I object even more strenuously to the use of Section 21(a) as
this manner. Additionally, the SEC has issued a statement of practice supporting the use of section 21(a) reports and asserting that "where it appears to be in the public interest" settlement statements given to the Commission should be submitted "with the expectation that the Commission may make the statements public." Once again Commissioner Karmel voiced her objection, pointing, inter alia, to possible due process objections:

The Commission also has authority under Section 21(a) to publish information concerning violations of the Act, as long as the requirements of procedural due process are satisfied. Publication may be utilized to support rulemaking, to form a basis for legislative proposals, or to aid in enforcement of provisions of the Act.

The practice announced today relates solely to enforcement matters. However, in the absence of Commission authorization of a proceeding specified in the Act, I believe that publication of the type of statement involved here would be appropriate only if the Commission reasonably believes the admitted conduct may violate the securities laws and if the publication would serve to avoid undue harm to investors or the trading markets, or to achieve some other similar articulated public purpose. Because the majority has not so limited the basis for publication of this type of statement, it has, in my opinion, carved out not only a new practice but also a new administrative

an enforcement vehicle to publicize facts which do not constitute violations of the securities laws. The Commission has express statutory provisions under which it must proceed to determine whether violations have occurred and what sanctions should be imposed. Once those findings are made, the Commission then may publish information about these violations under Section 21(a) for the purposes enumerated therein. Using Section 21(a) instead of invoking express statutory procedures I believe is improper.

"The Commission could have instituted an injunctive action based on the facts set forth in the opinion of the majority. If the public interest were not sufficient to warrant such action, the matter could have been resolved informally by the filing of adequate definitive proxy materials by Spartek. Spartek's preliminary proxy materials were never disseminated. The Commission's failure to have the necessary authority to correct the perceived problems with respect to the preliminary proxy materials and Cable's statements to exchange officials involved here in an administrative proceeding may be due to the accidents of legislative drafting. I recognize there is a strong public policy which favors both the settlement of cases and the utilization of creative procedures by a regulatory agency to fulfill a statutory mandate. Nevertheless, I do not believe that prosecutorial discretion should be exercised by choosing an administrative course not set forth by statute.

"If the Commission does not have adequate remedies for handling cases like this under the present law, it should request further authority from the Congress. The implication of new remedies by a government agency is not an appropriate way to vindicate or develop the law." Id. at E-5 (footnotes omitted).


In response, the majority of the Commission pointed out that this was not a new administrative sanction, because a section 21(a) report is independent of and could not preclude an enforcement action.

If section 21(a) reports are to be adopted on a more frequent basis, fairness would dictate that those subject to such reports be given an equal opportunity to publicly refute the charges. It is not suggested that this type of publicity be a complete substitute for injunctive suits, or for administrative sanctions. Rather, the injunction remedy and administrative sanction should still be available to further interests other than publicity and thus still be viable remedies in many instances.

Significantly, the effect of SEC activity upon injured investors is but one factor to consider in evaluating the proper scope of Commission activity. Although significant, especially in light of the impact of private remedies, it is but one aspect of the overall regulatory picture. As valuable as the private remedy may be, it should not detract from the importance of the various roles of the SEC, including enforcement and deterrence.

Alternatives for the Future


In February, 1979, after more than ten years of work and six tentative drafts, the seventh and final draft of Professor Louis Loss' Proposed Federal Securities Code was adopted by the American Law Institute. The changes to SEC administration and enforcement which would be effectuated through enactment of the code have been described as “substantial,” yet the proposed reforms are essentially procedural in nature. These provisions would improve the current scheme, but they do not reach many of the problems discussed herein. More specifically, the proposed code would retain the SEC's basic method of operation while expanding the Commission's express statutory authority to work within that framework.

The code would give the SEC comprehensive rulemaking authority. This is similar to the present approach insofar as the code allows

218. Id. at 81,558 (footnote omitted).
219. Id. at 81,558 n.6.
220. For a more comprehensive discussion of an earlier draft of those provisions see Mathews, supra note 115.
for both general interpretive rules and rules expressly delegated by the
code's substantive provisions.

Earlier drafts of the proposed code contained an express statutory
grant of power to discipline and suspend attorneys and other "professionals" from practicing before the Commission. As noted previously, although the SEC currently exercises this power under Rule of Practice 2(e), there is no explicit statutory authority for the practice. Although a solid statutory basis for the SEC's disciplinary power would be advantageous, the proposal was more limited than the expansive wording of the current rule. These earlier drafts would not have allowed for the disciplining of officers, directors, and others who would not qualify as "professionals" under the proposed code. The final draft adopted by the Institute, however, has deleted this section, thereby "neither enlarging nor diminishing whatever implicit authority the Commission has." Accordingly, the code would not preclude expanding the current scope of SEC activity in this area.

In the administrative portion of the proposed code, there are provisions specifically identifying and spelling out the SEC's investigatory powers. A significant change from the present statute is that the new code would distinguish between private, enforcement oriented investigations and those involving public, quasi-legislative inquiries. While not expanding the scope of investigations relating to issuers and broker-dealers, the code identifies the manner in which investigations can be conducted. As is the case under the present statutory framework, enforcement oriented investigations could result in administrative proceedings before the Commission, SEC initiated injunction suits, or criminal prosecution. The proposed code also details the Commission's investigatory authority and the available methods of information gathering.

A significant limitation under the proposed code is that it contains

224. See notes 79-103 & accompanying text supra.
225. 17 C.F.R. § 201.2(e) (1978).
228. Id. §§ 1808-1809.
229. Id. § 1819(a).
230. Id. § 1821.
231. The Commission would have the power to require answers to interrogatories in the course of enforcement investigations, id. § 1806(a); subpoena power, id. § 1806(c); and visitori authority, id. § 1806(g). See generally Matthews, supra note 115, at 482-90.
a more narrow publicity power than currently exists under section 21(a) of the 1934 Act.\footnote{232} Except in the quasi-legislative investigations, the Commission would not be given publicity power.\footnote{233} Although this would place limits on the publicity function, it also would protect against undue public probing. On the other hand, the proposed code's restriction on publicity in enforcement investigations may only apply to ongoing investigations. Thus, it might not preclude the public announcement of results of investigations, as was suggested earlier, as one way of improving SEC efficiency and efficacy.\footnote{234}  

Following the pattern of the current statutory scheme, under the proposed code the Commission would be given administrative quasi-adjudicatory authority over both issuers\footnote{235} and securities professionals.\footnote{236} The code would require registration of all issuers with at least one million dollars in total assets and five hundred holders of non-exempt securities.\footnote{237} Section 1808 of the proposed code would give the Commission a wide range of sanctioning powers over such issuers, including the issuance of compliance orders,\footnote{238} stop orders,\footnote{239} suspensions of the privilege of using the summary prospectus,\footnote{240} and suspension or termination of listing privileges.\footnote{241}  

Again following the current pattern, the SEC would have sanctioning power against securities professionals who are subject to the code's registration provisions.\footnote{242} Section 1809 would provide a broad range of sanctions including the denial, suspension, or revocation of

\footnote{232}{15 U.S.C. § 78u(a) (1976). See text accompanying notes 211-12 supra.}
\footnote{233}{\textit{ALI FED. SEC. CODE} § 1806(b), (d) (Proposed Official Draft, 1978). The code expressly provides for a right of reply by any person or entity subject to adverse publicity. \textit{Id.} § 1806(d)(3).}
\footnote{234}{See notes 210-19 & accompanying text \textit{supra}.}
\footnote{235}{\textit{ALI FED. SEC. CODE} § 1808 (Proposed Official Draft, 1978).}
\footnote{236}{\textit{Id.} § 1809.}
\footnote{238}{\textit{ALI FED. SEC. CODE} § 1808(c) (Proposed Official Draft, 1978).}
\footnote{239}{\textit{Id.} § 1808(d).}
\footnote{240}{\textit{Id.} § 1808(f).}
\footnote{241}{\textit{Id.} § 1808(g).}
\footnote{242}{Part VII of the code deals with the registration of brokers, dealers and advisers. \textit{Id.} §§ 701-706.}
registration, and the barring of association with individuals who violate the code. The same pattern would apply to adjudication of violations by members of self-regulatory organizations.

The new code deals with the SEC's administrative rulemaking and adjudicatory power procedurally, leaving the substance of the present arrangement basically unchanged. Most striking is that the Commission would have broad powers to disqualify or suspend individuals from association with brokers, dealers, underwriters, investment advisors, investment companies, banks, or insurance companies. Like the present regulatory scheme, however, there would be no comparable power over issuers and persons associated with them.

The third area of SEC authority—as enforcer in the courts—would not be dramatically altered by the code. The Commission's ability to seek injunctive relief in the courts would not differ significantly from current practice. Section 1819 tracks the provisions of the current statutes. The only exception is that the code would give express statutory authority for ancillary relief:

In an action created by or based on a violation of this Code, whether or not brought by the Commission, the court has the authority of a court of equity to grant appropriate ancillary or other relief, including an injunction, an accounting, a receivership of the defendant or the defendant's assets, disgorgement of profits, and restitution.

243. *Id.* § 1809.
244. *Id.*
245. *Id.* § 1809(b)-(c).
246. *Id.* § 1810. Part VIII of the code is concerned with SEC oversight of such organizations. *Id.* §§ 801-810.
247. See note 12 & accompanying text *supra* for a discussion of the dichotomy between agency procedure and the subject matter of the regulation.
249. Such sanctions, however, may be judicially imposed by way of ancillary relief in a civil injunction action. See text accompanying notes 123-45 *supra*. See ALI FED. SEC. CODE § 1819(l) (Proposed Official Draft, 1978) (quoted at text accompanying note 251 *infra*).
250. "The Commission may bring an action to enjoin a violation of, or to enforce compliance with, this Code or the rules of a national securities exchange or registered securities association of which the defendant is a member or an associate of a member or a registered clearing agency in which the defendant is a participant.

"On a showing that the defendant has engaged, is engaged, or is about to engage in acts or practices constituting such a violation, and that there is a reasonable likelihood that he will engage, or will continue to engage, in such acts or practices unless enjoined, the court shall grant appropriate relief in the form of temporary or permanent restraining orders and injunctions and orders enforcing compliance." *Id.* §§ 1819(a)(1),(3). See generally Matthews, *supra* note 115, at 534-49.
The statute would defer to current case law and practice to determine the nature of such ancillary relief as this power is based on the same inherent equity authority that the SEC and the courts look to presently.\textsuperscript{252} One difference would be extension of the availability of ancillary relief to private litigants and to the SEC in criminal proceedings. Seemingly, insofar as the SEC is charged with enforcement, its ability to secure far reaching remedies would exceed that of private litigants whose interests are tied to the particular issues of the private controversy before the court.\textsuperscript{253} The availability of ancillary remedies in criminal proceedings, however, would further the same ends as in SEC injunction suits.

With respect to the proposed code's provisions for criminal prosecution,\textsuperscript{254} the changes are directed primarily to the requisite standards of knowledge and corresponding penalties. These are issues which have also been considered in connection with recent changes in the federal criminal code.\textsuperscript{255} Once more, the differences in the proposed statute are not particularly significant with respect to the ultimate question of the scope of enforcement activity under the securities acts.

In sum, the essence of the proposed code's changes in the SEC's administrative role is procedural. These changes are well taken and may be most helpful in eliminating some of the deficiencies of the current law. The common thread giving express authority for many of the practices now followed by the Commission would lend more certainty to the basis of SEC power. Yet these statutory provisions could have the effect of providing less flexibility in the use of enforcement techniques. Certainly this is a balance which must be struck. The code, however, seems to go too far in restricting flexibility. The chief deficiency of the proposed code in this area is its failure to clarify the role of the SEC injunction and other enforcement techniques based on efficiency and the potential long term effects on the investing public. Although many of the reforms suggested herein with respect to the

\textsuperscript{251} See \textit{ALI FED. SEC. CODE} § 1819(f) (Proposed Official Draft, 1978).

\textsuperscript{252} See notes 123-45 & accompanying text \textit{supra}.

\textsuperscript{253} As is the case with all of § 1819, to the extent that the private litigant's ability to secure ancillary relief is based on judicial equity power, this provision of the code would seem to add nothing to the present enforcement scheme.

\textsuperscript{254} See \textit{ALI FED. SEC. CODE} § 1821 (Proposed Official Draft, 1978).

current acts also would be applicable and consistent with the language of the proposed code, any amendment to the current law should include such changes expressly.

Other Alternatives and Summary of Recommendations

After seriously questioning the advisability of the proposed code, SEC Commissioner Irving Pollack suggested the possibility of vesting the Commission with cease and desist power. Giving the SEC such summary authority would be a significant expansion of its current adjudicatory authority. Cease and desist power would promote the more expeditious resolution of the compliance suits that are now left to SEC injunctive actions. The use of such summary power against issuers subject to the 1933 and 1934 Acts would increase the Commission's ability to prevent continuing violations. On the other hand, the SEC's power to issue stop orders and refusal orders under the 1933 Act and its summary suspension power under the 1934 Act, afford many of the benefits of cease and desist power. Also, the provisions governing exchanges, broker-dealers, and self-regulatory organizations give similar power over securities professionals. In essence, cease and desist power would be a significant weapon only to the extent that it covered persons other than those already subject to the 1934 Act's licensing provisions.

An alternative expansion of SEC enforcement authority would be to increase the Commission's role either as an adjudicator of private disputes or as an investor advocate in terms of parens patriae power. As with cease and desist power, this would increase the strain on SEC resources, yet it could provide an important benefit in certain situations. Many securities violations involve sufficiently large scale trans-

256. BNA Interview: Pollack Questions Advisability of Passing Federal Securities Code at this Time, 484 SEC. REG. & L. REP. (BNA) AA-1 (Jan. 3, 1979). The best example of cease and desist power is found in the FTC which effectively can issue its own prohibitory injunction or compliance order without having to go to court. 15 U.S.C.A. § 45(b) (West Supp. 1979). Commissioner Pollack noted that this would be an extreme measure for the SEC and indicated a preference for strengthening SEC injunctive relief in the courts. Commissioner Pollack, however, has gathered support for this proposed cease and desist power. See Mathews, The SEC and Civil Injunctions: It's Time to Give the Commission an Administrative Cease and Desist Remedy, 6 SEC. REG. L.J. 345 (1979). See also The SEC Speaks in 1979: Panelists Focus on Self-Regulation, the Courts, Future Trends, 493 SEC. REG. & L. REP. (BNA) A-17 (Mar. 7, 1979).
actions to provide incentives for injured investors to bring suit. But what about the small investor? Consider, for example, the broker who invests an individual’s ten thousand dollar life savings and because of churning and improper investment advice the account dwindles to nothing. Unsophisticated investors are easy prey for brokers, especially when there is little threat of private enforcement as a result of the expense of litigating a securities case. Of course NASD and SEC sanctions are available, but limitations on resources make investigation and prosecution of such small scale activity unlikely.

There are two alternatives for increasing the chances of restitution to the small investor. The first would be to establish the SEC as an adjudicator of small disputes. Setting a maximum jurisdictional dollar limit on such SEC adjudicatory authority would give the small investor a remedy and at the same time leave the larger cases to the courts where full litigation is economically feasible. This increased adjudicatory power would go beyond compensating injured investors as it would provide a deterrent against the proscribed activity. In essence, private claimants would provide the Commission with sufficient facts to institute administrative sanctions against the offender, thus adding to the SEC’s enforcement power. Needless to say, this type of reform would require congressional action. A slight variation of this proposal would be to delegate this small claim adjudicatory function to a self-regulatory organization such as the NASD or to the national exchanges. Although this delegation would cover most broker-dealers, it would not extend to a large number of issuers subject to SEC jurisdiction but not listed on a national exchange.

The second alternative for dealing with small claims would be to have the Commission bring suit on the investor’s behalf. This is the ideal avenue for the expansion of ancillary relief. Although not requiring statutory amendment, this approach has drawbacks. In the first instance, the violation in question would have to be of sufficient magnitude and concern to the general investing public to warrant SEC investigation and enforcement. It simply would not be economically feasible to siphon off the Commission’s resources by dealing with every small claim. Secondly, the injunctive provisions of the statutes limit such actions to cases where there is the serious threat of future violations.\textsuperscript{262}

Shifting the SEC injunction action to administrative adjudication

\textsuperscript{262} \textit{E.g.}, 15 U.S.C. § 77t(b) (1976). See note 118 \textit{supra}; see text accompanying notes 119-20 \textit{supra}.
would decrease the relative costs of such Commission enforcement activity but would still require an enormous expenditure of SEC resources to investigate and prosecute all cases where small investors have been injured. Either administrative or judicial enforcement would leave few SEC resources for investigation and prosecution of larger cases.

With respect to the securities acts violations occurring within the context of large scale transactions, private suits are more economical. Thus, the increased use of the Commission’s publicity power to alert potential private plaintiffs would be of significant benefit, as would the expansion of the collateral estoppel effect of SEC injunction suits. It would be in this area of enforcement that amplification of SEC adjudicatory and sanctioning power might be most helpful. Moreover, to the extent that the Commission relies on current administrative sanctions, leaving injunctive suits to more appropriate cases, statutory amendment is not necessary. This is especially true in dispensing sanctions under its licensing authority, as the Commission could expand its impact significantly by using ancillary relief. Additionally, the availability of ancillary remedies in the settlement process significantly increases the SEC’s potential effectiveness.

The final method of increasing SEC efficiency would be the expansion of the administrative sanctioning power. As noted earlier, although the SEC has licensing power over issuers under both the 1933 and 1934 Acts, it does not have express statutory authority over individuals associated with such issuers. Expansion to cover such individuals, whether by way of statutory revision or expansion of current practice, would be advisable as a positive step toward increasing SEC efficiency. This is particularly true as collateral estoppel principles may well aid the private plaintiff.

Conclusion

The essence of the changes in current SEC practice advocated herein is to maximize the role of the Commission’s investigatory and adjudicatory power at the administrative level. Consequently, there should be less emphasis on the SEC role in the courts, leaving judicial

263. See text accompanying notes 211-12 supra.
264. See notes 188-205 & accompanying text supra.
265. See text accompanying notes 123-45 supra.
266. See notes 46-78 & accompanying text supra.
267. See notes 79-103 & accompanying text supra.
268. See notes 188-205 & accompanying text supra.
remedies primarily for criminal prosecutions and private litigants. Insofar as many of the proposals advocated herein can be accomplished under the current statutory framework, there is no need to await legislative reform. Congressional action, however, should not be discarded as the best method of implementing these proposals.