Enforcement Remedies

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William Allen: Good afternoon ladies and gentlemen, to those of you in the room and those who are listening through our cybercasting of this event. My name is William Allen and I am the Professor of Law and Business here at New York University, and the director of the NYU Center for Law & Business. We are tremendously gratified and pleased to be hosting today an extraordinary session of the Securities and Exchange Commission Historical Society.

All of us who study corporate law and securities law understand that the U.S. system is really a leader across the world in the development of the regulation of capital markets. And, in no respect, is the U.S. system more special and more highly developed than in its enforcement capacity.

Today we have an extraordinary group of officials, past and present, from the SEC Enforcement Division to talk about enforcement of the Securities and Exchange Commission laws and regulations. Leading that discussion is a friend of mine and a friend of this school, Ted Levine. Ted is the former deputy chief of the Enforcement Division of the SEC, and, having done that, he then moved to the world of practice where he was a partner in Wilmer, Cutler & Pickering, moved to the world of securities industry where he was executive vice president of PaineWebber and most recently he is a counsel to the New York firm of Wachtell, Lipton, Rosen & Katz. A great securities lawyer and I will leave it to Ted to introduce the other outstanding members of the panel.

Ted Levine: Thank you Bill. It is also my pleasure to welcome all of you here to NYU and all of you who are listening in live on www.sechistorical.org to the Enforcement Remedies panel being presented by the Historical Society in partnership with NYU Center for Law & Business. For those who don't know it, the Securities and Exchange Commission Historical Society is a non-profit organization, separate from and independent of the SEC. The Society preserves and shares SEC and securities history through our virtual museum and archive which can be located at www.sechistorical.org. Today's program, which is being heard live, will be preserved in the museum so one can listen to the discussion or read the transcript later.

Much of the work of the Society is made possible through the time and talents of the many volunteer leaders who help grow the virtual museum and archive. I would like to commend especially Dan Hawke, who is on the SEC staff, who has developed and nurtured today's program. The Society receives no federal funding and we are grateful to the many individuals and institutions which join in support of the museum and the archive. The Society also appreciates the support of many SEC alumni who contribute to our work and those who actually help the Society grow, and that has led us to this program today which is the Enforcement Remedies program.

What I'd like to do first is introduce the panelists today. Joining me is an incredible group of talented, experienced SEC practitioners which we're very fortunate to have and very appreciative of their committing the time to do this. On my far right, is Ralph Ferrara of LeBoeuf Lamb Greene & MacRae. Ralph, who worked with me at the Commission and is a former General Counsel of the Commission, has been one of the leading practitioners in the field of securities laws and securities enforcement for the last 25 to 30 years. Bill McLucas, who is the other distinguished gentleman up here, is a partner of Wilmer Cutler Pickering Hale & Dorr. Bill is a former staff member of the Commission and former Director of the Division of Enforcement, also one of the leading securities practitioners in the United States. Between Bill and Ralph is Linda Thomsen, who is the current Director of Enforcement at the SEC and we are very appreciative of Linda being here. And also on the panel is Mary Schapiro, vice chairman of the NASD, a former SEC Commissioner and once again a very experienced practitioner in the field of enforcement.

I should give a caveat that the remarks today are solely those of the speakers and they are not representative of the Society or the Commission and obviously we are not giving legal or investment advice, but, you probably can figure that out by looking at the panel. We will not be taking questions during the program but there is a reception which follows and if someone has a question, we will be happy to talk to you about it.

So let me turn to the program and one of the things that prompted us to put together this program was the question of the remedies available to the SEC in an enforcement context and to the SROs and NASD, New York Stock Exchange and others. The past few years has been dominated by headlines of improper business conduct and conflicts both in the financial service industry and corporate America. And the response from the SEC, the SROs and criminal authorities has been a very aggressive response to these events.

In 2002, Congress passed Sarbanes-Oxley which bolstered the SEC's enforcement arsenal significantly. Today, the SEC has the broadest range of remedies from which to choose and the greatest flexibility in applying those remedies, than at any time in its 71-year history. What we hope to do today is explore some of those remedies to see how the courts and the Commission and the SROs have been interpreting them and see if we can shed a little light on where the programs are going.

So I'd like to turn first to Bill McLucas. One of the hallmarks of the Commission's staff is its civil injunctive powers as an enforcement remedy and also, more recently, a cease and desist remedy. Bill, if you could give us a little history of how those developed and some of the issues surrounding that and the use of those remedies.

Bill McLucas: Thanks Ted. It's interesting, Ted mentioned that in the 71 years of the SEC's existence, it is both a rich history, but one that as we look at the world today, I think, many of us might forget that for 51 of those 71 years, the SEC's basic remedy was civil injunctive relief, period. In 1964, the SEC, through amendments to the Exchange Act, got some administrative powers to deal with violations of the '34 Act. Those generally though were confined to "obey the law" administrative orders with some marginally more invasive and substantive statutory remedies for regulated entities, broker dealers and investment advisors and investment companies. But for most of the life of the SEC, the basic remedy that was available to the agency and that formed the core of the entire enforcement program was an "obey the law" injunction.

As we look at where we have been, particularly in the last 5 or 6 years in our marketplace and in the law enforcement climate and look at Enron and WorldCom and Adelphia and a whole host of other cases, and look at the criminal prosecutions and the size of the penalties that have been levied, I think we tend to forget that for the overwhelming majority of this agency's life, it had no authority to do anything other than ask a court to enter an order that required the offending corporation or individual to basically do what he or she or it should have done in the first place - obey the law.

Nevertheless, if you look at the '60s and into the '70s, generally speaking, the SEC was still quite remarkably effective in its enforcement program. Much has changed in the several decades since then but the concept of the agency's mission being one designed to get prophylactic relief only and then use the idea of public charges and airing the dirty laundry associated with violations of law or misconduct, was an extraordinarily effective vehicle in the marketplace for the SEC, to police market behavior.

The evolution of that very plain vanilla and basic remedy to where we are today has happened quite quickly. In 1984, the SEC for the first time in its history got the authority to level statutory penalties, only in insider trading cases. As we moved into the 1980s, from the Foreign Corrupt Practices Act and the foreign payments and off the book slush funds investigations of the '70s, the markets experienced a period of very substantial merger and acquisition change and control activity. Along with that activity came the prospect of individuals making a fair amount of money by trading in advance of change of control situations, in effect, insider trading in takeover situations.

Those cases, which involved at the time what today seems like a relatively small amount of money but extraordinary financial opportunities for individuals in public companies, law firms and investment banks, and financial advisors to capitalize on the information in advance of a takeover, led the Commission to seek and the Congress to pass what was called the Insider Trading Sanctions Act in 1984. The Act essentially said that if you were found to have engaged in insider trading, you are susceptible now not only to paying back the ill-gotten gain with interest, but to a penalty of 3 times the gain that you put in your pocket from the trading or the loss that you had avoided in the instance of a bad new selling.

That remedy, which was extraordinarily effective as the SEC moved through the Dennis Levine, Ivan Boesky, Marty Siegel and into the Michael Milken, Drexel Burnham kinds of investigations, really captured the attention of the marketplace and was viewed as a centerpiece of this agency's extraordinary powers to go after people who engaged in insider trading.

The next step in the evolution of expanding the agency's authority was, in 1998, passage of what was called the Insider Trading Securities Enforcement Act, which very slightly broadened the penalty powers to add vicarious liability and had a provision called the controlling person's provision, which said that anybody who employed or controlled a third party, who engaged in insider trading, could be held vicariously liable for the bad actor's conduct.

And the statute imposed some affirmative obligations on investment banks and broker dealers. But you saw, in the space of 4 or 5 years, an expansion of the penalty authority of the Commission but confined very narrowly to a species of behavior that had captured the attention of the Commission and was viewed as the worst conduct in the marketplace, and that was insider trading.

Now, by the time we move through the '80s and into the '90s, we had experienced a debacle in the savings and loan industry and a series of cases involving, in effect, looting of the industry. There were a substantial number of criminal prosecutions and investigations by the federal banking regulators. The individual who had been the head of the task force on financial institutions in the Reagan/Bush White House was a guy named Richard Breeden. He was nominated to be the Chairman of the SEC when President Bush took over, and came into the position with a view, colored largely by his experience of watching the S&L industry and what he viewed to be the relatively weak authority that the banking regulators had, that when you looked at the SEC's arsenal, the power the Commission had was frankly quite weak. And in relatively short order, he had put together a recommendation to expand the SEC's enforcement arsenal to include penalty authority across the board.

The statute that was passed in the October of 1990 was the Remedies Act, which very basically provided for financial penalties for virtually any violations of the federal securities laws.

If you look at the statute, there were tiers for the penalties that are key to the gravity of the violation, the level of scienter involved by the Act, and the level of damage to investors in the marketplace. But, in retrospect, it was a piece of legislation that passed without of lot of controversy or objection but fundamentally changed the landscape for the way the SEC was going to deal with violations of law and in some respects involved quite a bit of foresight because the markets had changed dramatically in the late '80s and certainly in the '90s. We quadrupled the number of individual investors who were participating in the marketplace and by every market metric, the SEC's regulatory charge expanded exponentially, but now we had an agency empowered to go out and literally collect its pound of flesh when there were violations of the law.

The penalty authority was used, it evolved, I guess, is the correct way to describe it and it evolved quite gradually and I might say responsibly during the '90s.

Ralph Ferrara: Is that when you were running the division?

Bill McLucas: Indeed, it was.

Ralph Ferrara: Okay.

Bill McLucas: Those were referred to as the golden years but that's very different.

Linda Thomsen: The record of responsibility continues to this day.

Bill McLucas: Well, I will leave that for the defense bar to judge but what you saw was basically an agency that now had an arsenal. I don't think people really anticipated what has happened in the marketplace in the 15 years since the passage of that Act, but it's been quite a stunning development in which we have seen that penalty power used in a way which I don't think anyone could have imagined 15 years ago.

Mary Schapiro: Bill, I'd like to ask you a question. I was at the Commission at the same time and perhaps I should know the answer but I don't. When the Remedies Act came into effect, was the Enforcement Division placed into the position of litigating a lot more cases than it had before or settling at about the same rate as historically?

Bill McLucas: There was a marginal up-tick in the litigation but I think that the approach to penalties was aggressive in some respects but nowhere near the exponential change in the landscape that I think we have seen since 1999 and 2000, if you divide the universe now, as I think you fairly can, into pre-Enron and post-Enron. Whatever we thought the rules or the standards were, when people like Ralph and Ted were at the Commission quite a few years ago, the world changed dramatically after Enron and those penalty powers, even in the minds of people who were accustomed to seeing some pretty serious cases, began to be wielded with numbers and with a ferocity that I don't think anyone had anticipated, certainly at the passage of the Act. And even as some of the scandals unfolded, the degree to which the Commission and the staff determined that seeking financial penalties was going to be the preferred vehicle of punishment, I think has surprised virtually everybody who had been at the Commission and who had seen the evolution of its enforcement program over the years.

Ted Levine: Can I just interrupt and ask Ralph and Linda? Bill has used the word punishment. My recollection is that historically, the agency viewed itself as essentially a remedial, administrative body in order to influence business conduct. It was not viewed as an organization with a mission to punish; that was really left to the criminal authorities. What is the impact of that change both in terms of the standard of proof that is imposed on the agency, and the willingness of people to settle?

Ralph Ferrara: Do you want the yes or the no, first?

Linda Thomsen: Great, you go.

Ralph Ferrara: It is not a fundamental change in the attitude of the agency. We are talking about a radical change to the genetic material from which this agency was growed. Clearly, unquestionably, when you look at Section 21 of the Exchange Act, the SEC was intended to be forward-looking, remedial and prophylactic in its enforcement program.

The notion was, I can recall, when we were all puppies at the SEC, which for me was a very long time ago, Stan Sporkin, who was our first deputy director of the Enforcement Division in those days, later to become director, said to us, look, you never deal with a crook. What they had in mind was Vesco who was "the crook" at the time.

But then he said, if any honest person comes in here, even one who recklessly or even knowingly bumps his or her head into a federal securities statute, you take the action that you have to take to protect the public going forward. But you allow that person to walk out with his head high when he walks or she walks out the door.

Now if there was to be punishment, something that was retrospective and punitive, then the statute provided a remedy for that. The SEC would meet, consider it and refer it over to the Department of Justice. And what the Department of Justice would do is bring in a criminal prosecution.

Well, that made for a very healthy agency and for an agency where the public, that is the registrars and their officers and directors and professional advisors, when they would stumble, they would come in, deal with the SEC, clean up their act, shoot straight going forward and know that they were going to be able to hold their heads up high and practice their trades going forward.

Today, what's happened is that some say you would level the playing field; I'd say we have leveled the basement. What's happened is every agency in town is out for the same thing and that's a scalp. Every agency in town, whether it be the Department of Justice, the State Attorney General, the SEC, the self regulatory organizations, they are not quite there yet, want one thing and that is a vindication of a public right, cast in terms of retrospective, punitive, criminal-like relief.

Now, what that means is that people like me say, what the hell, you may as well fight. If you are going to be out of business for the rest of your life, you might as well pay. So long as you can stay in business, before the Supreme Court throws you out, the better off you are.

Or, alternatively, it leaves other people to say, why go to the SEC to begin with? Now, if I go to the SEC, I am going to get whacked and I am going to get branded as a criminal. A civil penalty and a fine, I can tell you, are two sides to the same coin.

So it is not just going to change. The genetic material has been forever altered. The biggest mistake Congress ever made in my judgment is to give the SEC the ability to enter a civil penalty against a wrongdoer. When that happened, the entire fate and face of the agency changed.

Ted Levine: Well, I am glad you don't have a passion about this. So, Linda, having heard Ralph and we will come back once we talk about philosophy for a while, a little more than nuance, what's your sense of having been at the Commission for a while and inherited this power? How do you deal with this in terms of what we talked about, the remedial aspect of the Commission's work and the punitive aspect of the penalty, and how is that factored in? I am then going to ask Mary the same question from an SRO point of view.

Linda Thomsen: Well, with all due respect, Ralph, I do think all remedies have multiple purposes and always have and they fall into one of three categories, all of which overlap. There is a punishment element to almost every remedy, or almost any law enforcement reaction to illegal conduct. There is also a protective mechanism built into most law enforcement remedies for some of them, and there is finally the prevention element. Some of which are looking forward, some of which are deterrents.

And I think it is still the case and has always been the case, certainly for the SEC, fortunately because of where the law enforcement function was so well established, that we could be looking towards deterrents. And deterrents are measured both in term of general deterrents and specific deterrents.

And it is absolutely the case that to the extent of someone or some entity is penalized in a way, is sanctioned in a way that those who watch and see that conclude that they would rather avoid that sanction, rather engage in conduct so as to avoid that kind of remedy. It has served the function of general deterrence. We fortunately deal with a collection of potential respondents and defendants who are deterrable.

I'd like to think, if your choice is to steal or starve, regardless of the severity of the sanction and the certainty of the sanction, most people are going to steal because at that particular moment, starving is a far worse option.

For the populations that we see, they have choices other than engaging in illegal activity. If the sanctions for that illegal behavior are sufficiently unattractive, then they will change their conduct in such a way that they do not meet those sanctions. So to a certain extent, punishment, as you articulated, is part of prevention, is part of being forward-looking. I don't think anyone would argue that financial penalties have an element of punishment built into them, but part of that is also a deterrent function.

Ted Levine: Mary, from your vantage point both as a Commissioner in the past as well as your position with the NASD?

Mary Schapiro: When I got to the SEC in '88, I had, at an earlier time in my career, been at the Commodity Futures Trading Commission, which had always had the authority to assess civil penalties. And I was shocked to get to the SEC, the most vaunted, exalted, independent federal agency, and discover they didn't have nearly the powers that this little 300-person CFTC had to create an environment of honesty and fair dealing in the market.

So that was a surprise to me, but from my perspective at the NASD, I agree very much with what Linda has just said. I think the events that we have seen in the last 5 to 10 years have been sufficiently harmful to investors and harmful to the marketplace that an injunction to simply go forth and sin no more is not an adequate response. And that's whether you think that the remedies ought to be prophylactic or remedial or in fact be punishment.

In order to really change the behavior in certain components of the industry, on a going forward basis, the remedies just had to have more sting than an injunction.

Ted Levine: Bill, how much of what we have heard of this punishment aspect is a response to either the press or competition or Congress in terms of the Commission and the SROs reacting to those constituencies, rather than saying a $100 million fine as opposed to a $10 million fine is really going to make a difference to a multi-billion company in terms of punishment and deterrence? How much of it really is a reaction to those elements?

Bill McLucas: You have asked one of the key questions. If you take Ralph's point and much as it pains me to take my defense counsel hat off for a moment, when you think for a moment of Enron, WorldCom, Adelphia, BellSouth, Kozlowski, Ebbers, Sullivan, Fastow, if this agency today were in full enforcement regalia with civil injunctive power alone, it would be a failure of public policy. It would fail, I think, investors and tax payers. That's not a model that is appropriate to what's happened in the marketplace in the last 10 to 15 years. And I happen to think that the agency needs to have the power to do some of the things it is trying to do with penalties for both deterrence and to protect investors.

That's a different question, however, from the issue of how is the penalty authority being used and what are the barometers of magnitude of fairness of deterrents of a penal dimension to what the government is doing. When you look at the competition, you look at the press, when you look at the state regulators that are now in the game and when you look at what seems to drive some of the decisions of the regulators on the enforcement side, what it seems to be, fairly viewed, I think, is a competition, not only for who gets there, but who gets there first and who gets the largest chunk. You begin to worry that the factors going into the judgment about how much of a penalty and what should the consequence be and how should it be imposed are being influenced by things that are not really what we ought to seek or expect from law enforcement in terms of what the consequence ought to be.

I do believe there is a dimension to the competition. There is a reaction to the press that's disproportionately influencing the effort that basically gets measured in appropriate consequence from some of the conduct, which is inexcusable. You could not run a law enforcement program today without this authority, given what we have seen in the marketplace. I think the government fairly struggles with, is it a $10 million or is it a $100 million penalty with a multinational that has income of $2.8 billion.

I don't know what the right answer is there. Some, hopefully, consequence of public program and market damage to reputation still is a measure of the consequence. But I do worry that how one sets the number is sometimes affected by things other than the pure effort to say what should the right number be.

Ralph Ferrara: If I could comment, Ted, I will tell you that this question on public policy is an important one, and perhaps there is a reason why they put me at the far right end of this table. I will tell you.

Ted Levine: Because you were the last one here.

Ralph Ferrara: To me, to sit down and to talk about Enron, WorldCom, Adelphia, Tyco, maybe Refco, as being a kind of the goal post against which the public policy goals have to be kicked, is a huge mistake. What I see around the country, from board room to board room, is that they are honest executives. The other 10,000 publicly held companies with the maybe hundreds of thousands of executives who run them who now run in fear that if they crack a wing in their business plan it's going to be called fraud and they are going to be sanctioned for it.

The public policy decisions that are made to deal with a handful of high profile cases that have been stoked out of proportion, by the media is to me a public policy disaster. We can tinker with tax policy, fiscal policy, monetary policy. We can do anything we want to talk people up but until American enterprise and American managers once again get the guts to take risk and to keep us being a growth instead of a kind of utility driven economy, we are going to be in trouble. It is a public policy disaster.

We have grossly over-compensated legislatively. I was there when Sarbanes-Oxley was passed. I was among those who was petitioning for this or that provision, and I will tell you if you had gone before the Congress and said that executives who do x should be eviscerated and scrimshawed, they would have done it.

Ted Levine: Ralph, let me ask Linda and Mary this question. Does every violation of a securities law warrant a penalty? Or saying it differently, how do you determine in a given case whether you should have a penalty component? It looks like, with very few exceptions, that there is a penalty involved in every case. So what are the factors internally that you look at at the SEC and the NASD in determining whether a penalty should be put in? And secondly, do you really care about the other relief involved or is it really the penalty that is the most important thing?

Linda Thomsen: The penalties are not imposed in every case. I recently went back and took a look at financial fraud cases, for example, to see the number of cases where there were financial fraud or financial reporting cases, to see whether or not there were penalties, for example, imposed against the entity which is perhaps the most controversial issue out there. And we have had hundreds of cases going back two or three years involving financial fraud and financial reporting and I believe a number of cases, with penalties levied against issuers, which is frankly what everybody on this panel is talking about, although they are not saying it, is measured in about 20. It's really a rarity.

Ralph Ferrara: It's got to be more than 20. I mean, I can't be the only loser out here.

Linda Thompson: Apparently it sees to that.

Ralph Ferrara: I'll tell you, I would be much more calm and muzzled in these programs. Then, maybe the next five times I come in, you give me no penalty.

Ted Levine: Actually, let me just stop and focus this. Mary, I think up to the last five or six years ago, maybe more, there was never a civil penalty imposed against an issuer. Among other things, I think the theory is that the issuer has shareholders who are innocent and therefore, by imposing a penalty, you will be essentially harming innocent shareholders. That has obviously changed and I am thinking of the WorldCom's of the world for a minute. Is there any difference in thinking when you look to whether you are going to impose a civil penalty as a condition of settlement or in litigation? Or was that not part of the mix?

Mary Schapiro: For us with jurisdiction just over broker dealers, the question would be limited to broker dealers that are public companies. I don't think it is something that we have given a lot of thought to, but we do give a lot of thought to the size of the broker dealer when we are talking about the penalty.

There are 5,200 broker dealers in the United States and the vast majority of them are small operations. Well over 4,000 of them have just a handful of employees. A small firm that violates the securities laws and a large firm that violates the same laws are not going to have the same penalty even if the conduct was the same. If they did, it would put the small firm out of business and if that's what is the appropriate regulatory response, we should do it directly, but we shouldn't assess a penalty against them that is going to drive them into net capital violations and force them right out of business. We don't have so much the public and non-public line that we draw, but we absolutely look at the size of the broker dealer when we are evaluating the type of penalty.

We also look at the extent of investor harm. And the greater the investor harm, the more likely there will be a significant monetary penalty. We look at whether the firms are recidivists. You all read the newspapers and you know how many firms have shown up, month after month after month, in the monthly disciplinary actions from the NASD or the SEC or the New York Stock Exchange.

And so recidivism is a factor and also just the underlying egregiousness of the violation. But to go back to the question you asked Linda first, I want to respond, at the risk of having the SEC's Office of Compliance, Inspections and Examinations all over me, that every violation of a securities laws does not lead to either a case or a penalty. In the course of our investigating and examining brokerage firms, and we routinely examine about 2,500 of them a year, there are many occasions where they are not in full compliance with the law. That leads to a letter of caution or compliance conference with the firm where they are asked to fix the problem, and we will be back to check whether they did. But there is not a referral to the Enforcement department.

Ted Levine: Linda, I am sorry.

Linda Thompson: I was going to ask if we could complete the legislative history. We left out a chapter on penalties which is important to my mind just to where we are and that's 2002, with the enactment of Sarbanes-Oxley. Because in Sarbanes-Oxley, among other things, there was the fair funds provision which allows penalties that are collected to go back to shareholders as opposed to going to the United States Treasury. Until the enactment of Sarbanes-Oxley, penalties and securities law enforcement actions went to the United States Treasury. That keys into something that Ted referred to, which is when you are talking about penalties and public issuers, the need to consider, as Congress urged the SEC to do, the impact on shareholders. We need to consider whether the shareholders, who are the owners of the company at the time, were victimized by the conduct that's at issue, whether they benefited from the conduct at issue and whether or not there has been a sufficient passage of time to affect who the shareholders are at the time the penalty is imposed.

The devil is, of course in the details, because the issue is - what is a benefit to a shareholder and when you measure it? For example, is an inflated stock value, realized or unrealized, a benefit to a shareholder? It can be. Is the fact that a company can use inflated stock as currency a benefit to the company and to the shareholder? Is the fact that a company looks to outperform others in its market segment by virtue of the financial fraud it's engaged in and therefore beats its competition, by virtue of an ongoing yet undisclosed fraud, a benefit to the shareholders? And those are the kinds of things that can and should be considered in the context of penalties.

In the Foreign Corrupt Practices Act cases, for example, I think the issue of penalties has really never been disputed terribly much because the bribe was almost always for the benefit, if you will, of the company, even though when disclosed, it turns out to be hardly a benefit at all because of what has been imposed on the company.

I don't think that any penalty that has been levied against a corporation has ever led to, certainly in the securities context, the demise of the entity or serious damage to its bond rating or ability to borrow. So that sort of long term, larger issue of what you are doing to an entity I don't think has ever come to fruition.

Ted Levine: Let me just pick up on that because one of the changes, if we're looking at history, Linda has just identified and I'd like to get the reaction of the panel to it. Historically the SEC used its equitable powers to obtain disgorgement. Bill defined it as disgorgement of ill-gotten gain, which was an adjunct to an injunction in the court of equity. And one of the powers explicit in Sarbanes-Oxley is the ability to get disgorgement.

What Linda has just identified with the fair funds provision is essentially the ability to merge civil penalties and disgorgement. In order to get back funds to the injured, it used to be that the SEC took the position strongly. It was not involved in restitution. It was not a collection agency; it left it to the private bar and others in order to recover.

What has happened post-2002 is that now the SEC has become a collection agency. It is involved in that very act of essentially determining who should get money and how it should be given out, which is a different role than it played historically. I am wondering, Ralph and all of you, if you could react to that and how that impacts this whole question of civil penalty.

Ralph Ferrara: Perhaps I will begin with just the propriety of it all. To me there is a dramatic difference between the civil penalty and the disgorgement remedy. Disgorgement means giving back the gold watch, that is coughing up your ill-gotten gain, such as the old Diamond v. Oreamuno case, or the Brophy City Service Co. case, where the corporation could recapture insider trading profits to be held for the person who was injured before there was a direct action of the Exchange Act to do so. Those funds I think should be held by the agency for distribution to those who got hurt.

Conceptually to me, even though the dollars may be fungible, the concept of using the civil penalty to compensate investors gets on a different footing. I recall when this civil penalty provision was first enacted by the Senate, the legislative language said, "We expect that this civil penalty will never be used except in those circumstances where the current shareholders gained an improper benefit from the misconduct.

So it seems as though Congress had in mind that this was going to be used sparingly. Now I for one am not comfortable with the notion that you justify the imposition of these sometimes obscene civil penalties given the nature of the conduct that took place, merely by saying that what we are going to do is throw it into a disgorgement-like fund. Footnote to that, you can't do this through disgorgement indeed. This fair funds provision as I recall does not work for disgorgement, it only works for civil penalties. So there is a bias in the fair funds towards civil penalties as opposed to disgorgement.

Little footnote back to the text, so now that you are there, now that you are using this as a justification for civil penalties, should it go back to the shareholders? To be sure it should go back to the shareholders rather than to the United States Treasury. But be careful because, with all due respect, by administrative staff fiat, perhaps clothed with some Commission authority when you do this civil penalty and you return it to the shareholder class who claims they were damaged, the Commission says that you can't take credit for that. That is, the issuer can't use that as an offset to its liability. And you scratch your head and say what is smart about that? You can't take it as tax deduction because normally, if you pay damages in a class action, that is a tax deduction for the issuer.

So you put it all together and you say, well, of course you get some credit for having it included as part of the fund that goes to shareholders. But using it as a justification for doing these enormous civil penalties to begin with and not having it go through the disgorgement function which makes good equitable sense, worries me.

Ted Levine: Bill, when you negotiate with the SROs or the Commission, and Linda and Mary, when you decide based on Bill's advocacy, the contours of a settlement, how do you determine this mix because money is fungible? There is a dollar amount someone is paying. An issuer is paying $100 million; it can be $100 million disgorgement, or it can be $20 million in penalty and $80 million in disgorgement. As Linda said, there is a fair funds which merges it together. How do you arrive at what portion is the penalty and what portion is the disgorgement?

Ralph Ferrara: Yes, how do you do that?

Mary Schapiro: I will jump in first. For NASD, we have traditionally said that arbitration was really the means by which individual investors recoup their particular losses as a result of violations of the securities laws or NASD rules. And in the last several years, coincident I guess to some extent with the creation of Fair Funds, we have moved much more aggressively towards restitution as being the first thing we want to look to - before civil penalties. It's specifically contemplated in our sanctioning guidelines for enforcement staff. Whenever we can identify a person or a firm that suffered a quantifiable loss as a result of wrongdoing of the respondent, then restitution is appropriate to order by our hearing panels. And from our perspective, that ought to be the first place money goes, in restitution to investors and then secondarily to civil penalty.

Ted Levine: But Mary, when you give the terms of settlement to Bill and Ralph and their clients, there is always a penalty component of it. It's not simply the restitution component because in most of the cases you seek a penalty just like the SEC now. So the question I am really focusing on is, there is a mix here and how do you get to that mix? And obviously the same question to Linda.

Mary Schapiro: For Bill's clients there is always a penalty, but lots of other lawyers are successful in arguing just for restitution. It's not precise; obviously we need to quantify the harm that was caused by the respondent. Where we can identify the amount of restitution, that's easy and we can make that the first port of call in the settlement. And then we negotiate aggressively on both sides as to the amount of the civil penalty, if any, that ought to attach on top of that. We have had cases where we have only ordered restitution because the civil penalty on top of that would have been an excessive sanction from our perspective.

Ted Levine: Linda?

Linda Thomsen: You need to move from the very specific case to the more general, more difficult cases. Disgorgement at its simplest level is sometimes very easy to calculate. Perhaps the best example is an insider trading case where you calculate the gains obtained or the losses avoided. And even that can get complicated when you have got tippies, when it is a loss avoided case, when you have to do market studies. But at a certain level, you figure out what has been obtained from the illegal conduct. Fees, for example, that result from illegal behavior are an easy way to measure disgorgement, even moving into salary, for example. Certainly it is easy to say a bonus that is calculated based on share price or performance and that the performance or share price is a result of illegal behavior by the individual, is an easy disgorgement concept.

When you move into other cases, disgorgement being an equitable relief, you are going to look at all the facts and circumstances, so issues like what inflated currency may be used for what the result is. Sometimes it is quite easy to articulate but harder to measure, and then there is no circumstance where you may also start thinking about penalty in that context.

Built into the statute, baked into the statute, is the notion that penalty amounts may be calculated based on gain made or loss avoided. That is right in the statute within the tiers. We are talking about the penalty tiers, but an alternative and injunctive action is the gain that attends to the conduct. But calculating an appropriate range for penalties is difficult. That does not mean that it is random or willful or throwing darts at a board. It requires very serious analysis of the facts and a very serious analysis of the relative conduct. It requires looking at, for example, similarly situated entities or individuals. The goal for us is to treat the similarly situated similarly. And having said that once without tripping, the key is to figure out what's similar and what's different.

Ted Levine: 90% or more of SEC cases are settled, at least they were and I assume it is still the case, and the reasons for paying and settling have no relationship in a lot of those cases to what should be done if it was litigated, because there are reasons people pay and settle which have nothing to do with the merits of the matter. The Commission's articulated view is that settled cases are not precedent, and you shouldn't look to them for precedent. How do you look to settled cases as the barometer for arriving at what should be the penalty or disgorgement in matters which are not settled or even in other settled cases?

Linda Thomsen: The analysis that went into the settled cases is analysis that we can surely look to and replicate. And it is absolutely true that prior cases do not bind anyone with respect to the current situation and if you promise never to raise precedent or historical cases or penalties say from 1990 when you come in to negotiate, I'll sort of take it off the table.

Ted Levine: No one has a memory in the Commission going that back there except for us.

Ralph Ferrara: I'd say the only people up here who remember back that far are the three old guys.

Ted Levine: Let me ask, you bring a case against an issuer or registrant or an individual, and the individual listens to you and respectfully says I disagree and I am not going to settle on these terms. I would like to have a court hear my case. Isn't it true that the penalty amount goes up? If you litigate the case, the mere fact that you put up a good faith defense is an accelerator on the penalty number?

Linda Thomsen: You mean from a negotiating perspective?

Ted Levine: No, no, no, no.

Linda Thomsen: Our perspective?

Ted Levine: Yes, I come in to you; you say, do you want to settle it; I say, what's the deal, and the deal is a million dollar penalty. If I go to court and the only variable is I put up a good faith, honest defense, and I lose, the penalty is all of a sudden $10 million. Does that happen?

Linda Thomsen: No, no, no, it is not a tough question, it's actually a very straightforward question that comes up in law enforcement all the time. And another way to spin if you will, what you just said, is the notion that we do want to reward those who are willing to step up to the plate and resolve matters and figure out where they are and deal with it. And what underlies your question is the notion that the best deal for a cooperative good citizen is the only deal and the only resolution that's appropriate regardless of whether or not someone has engaged in obstructionist conduct, whether or not they are recalcitrant about getting to the facts, whether or not they self report. We do have a range and we ought to have a range of appropriate remedies for conduct that includes how people respond to the conduct, particularly in a corporate setting.

Ralph Ferrara: That's the problem. That is the problem. You shouldn't pay a penalty for wanting to defend yourself.

Linda Thomsen: Absolutely, it's a very important semantic difference. It is not so much a premium as a benefit for coming in early and resolving things.

Ted Levine: One would say $150 million penalty is not viewed as a benefit, when you say that. But then having said that, I think philosophically I agree with you.

Bill McLucas: The problem here is really the point from which you start and the notion that the staff has is that they are giving you a steep discount and if you're in Ralph's shoes the notion is, this is insane. If you are going to cut one of my arms off, where is the deal here, and their answer is, we are not killing you.

Linda Thomsen: Stop exaggerating. Nobody's arm has been cut off.

Bill McLucas: No arm has been cut off yet. It's early. Let me raise a point that Ralph has alluded to, which I think is not necessarily on the subject of injunctions but is critical to how lawyers practice in this environment today. Ralph said if you put up a defense, a good faith defense, and good faith is always in the eye of the beholder. I will tell you now the view from within the staff as we see it on this side of the table of defending oneself and mounting arguments and doing what lawyers are paid to do, which is be zealous advocates, has changed dramatically in the last five or six or seven years.

And there is a risk in this climate that the notion of defending your client gets turned around on your client to the client not getting it, the client not being a good corporate citizen, the client not in effect knuckling under. Some of the Wall Street Journal editorials about the Attorney General here in New York have raised that particular specter. And that criticism, that is a risk to all law enforcement programs and one that the SEC is neither immune from, nor should be insensitive to.

But there is a climate now against disagreeing with the Government and disagreeing aggressively. As Ted said a few minutes ago, people settle cases for a lot of reasons. It doesn't mean they believe they violated the law or they did anything wrong. Generally people are guilty of some things - they may be stupidity; they may be a combination of stupidity and bad timing; there may be a combination of stupidity, bad timing and bad press. It doesn't all translate sometimes into what the Government believes ought to go within the four corners of a complaint. And right now there is a risk in this system that advocacy, particularly zealous advocacy with the kind of flair that Ralph brings to the table for instance, can get turned back on your client, to be in effect a penalizing component of the way the Government will approach your client.

Now it's something I think that the defense bar is not imagining here. And it is a real issue that worries a lot of us out here about how you defend somebody. I want to turn to one other point, then I will keep quiet. We've been talking about this in the context of Sarbanes-Oxley. Ralph's correct, had they constructed gallows across the quad from the SEC during the Sarbanes-Oxley debate and built that into legislation, it would have sailed through.

Ralph Ferrara: There was no real consideration given to this bill at all in merits.

Bill McLucas: And one of the phenomena that now we hear from the staff, from individual Commissioners, and from the Commission itself is individuals. There's got to be individual culpability in these cases. And I am not talking about Andy Fastow and Enron. I am talking about every case where there is an accounting issue or disclosure issue or an FD problem of some nature. You ought to go after individuals because public companies are entities; individuals have to be responsible for violating the law. That is neither a maxim or principle that holds forth in any organization nor should it in a law enforcement organization.

There are many cases where people do dumb things as a collective. You may have a collective of dumb people but to say that they we're going to go down the hall and we are going to find that assistant controller and we are going to bring him to justice. Or we are going to bring the two people who didn't get the accounting issue. Much of that pervades the process when you are dealing with the enforcement staff right now in a lot of cases where you are talking about a corporate enterprise. There is search for individual accountability and in my opinion an institutional failure by the agency to accept the proposition, just as happens in the Government and certainly within the SEC in some instances, that failures do not result in individuals always being personally accountable. There was a budget problem with the SEC in the last year.

And the issue that the defense bar worries about is, is there an appetite for accountability in sanctions that doesn't give due account to the fact that people may not be perfect but they ought not to be personally and individually named in all these cases, and that is something that worries a lot of us.

Linda Thomsen: Listen carefully to what you have just heard by the two gentlemen on either side of me. If you put that in combination what you have just heard is an argument that individuals should not be tagged because it would be terrible.

Bill McLucas: That is absolutely not what I said.

Ralph Ferrara: You got it right.

Linda Thomsen: And then we're hearing that we ought not to tag entities because it is going cost some money, it is terrible for the shareholders. So at the end of the day, people and institutions that make an enormous amount of money off of individual investors, run by people who have benefits that most people would give several limbs for, talking about cutting off arms, should pass harmless for their illegal behavior, and that is unacceptable. That is entirely unacceptable.

Bill McLucas: You almost have it exactly right with a couple of footnotes, you almost got it exactly right. If there is ill-gotten gain, disgorge it; if there is damage, damage that could be incurred by restitution for it or if there is a forward looking restraint that should be placed on the edict to make sure that it doesn't violate the law again, do it. And if there is criminal conduct, refer it for prosecution. Other than that, you had it exactly right.

Linda Thomsen: Entirely not acceptable. That is completely ridiculous.

Ted Levine: Bill gave a great segue. One of the elements that follows from what Bill just said about individuals is the Commission's use of its power to bar individuals from being officers or directors of public companies. Under what circumstance should that be sought and how is the power being used by the agency?

Ralph Ferrara: Don't they regret they gave this one to me? So far we have only been talking about money, right? You recall that there was an old movie back in the 1970s where Charlton Heston was being hunted down by a group of simians, gorillas and chimpanzees and orangutans, I think it was called "The Planet of the Apes" and they piled these bodies up. When we are talking about officer and director bars, think about that scene, all right? If I can mix my metaphors, the SEC's ambition to procure officer and director bars against officials of public companies is a little bit like Ahab's relationship to the great white whale and its been going on, at least in theory, at least that long. You go back to the beginning of all this, it is fascinating. The Commission at least since the 1960s had the ability to bar, suspend or censure a market professional, which is usually a broker, dealer, investment advisor or the like. Indeed they could provide sanctions similar to professional organizations, SROs, not that they ever did.

So from there the SEC sought to impose those same types of sanctions - bar, suspension or place limitations - on people who were not market professionals. The SEC used all kinds of innovative ways to do this. I can recall I was a puppy at the SEC

There was a time when Levine and I, I think, were the only two branch chiefs in the Division of Enforcement. So I come up as a brand new branch chief of the Commission and Ted's got this raging case called executive securities going on forever and ever and ever. The small piece of this was, Ralph, try this case.

In this case, Levine has got Section 15 of the Exchange Act which is an administrative remedy against brokers and dealers which says under one of its provisions, Section 15(b)(6), as I recall it, that you can bring it an administrative proceeding against, quote, any person but in the section relating to broker dealers to censure or to bar them from practice as a broker dealer. Levine brings this case against the general counsel of the Florida Securities Commission and their chief investigator. And then he gives me the case to try. Well, to make a very long story, very short, I end up in the hearing. Who shows up on the other side of the bench? Louis Loss. That was my first trial.

Now for those of you who are too young to know, there wasn't a field called securities regulation until he invented it. He is the opposing counsel for this lawyer and this investigator. So he litigated the case for a little while, we go on and in the middle of the case, a break is called. Loss has to go out of town. It so happens that 75 active members were at a conference, while the securities statutes were going through Congress. We find out later, Loss goes in and tells the conference what's going on in this little proceeding down in Miami, Florida. He gets the conferees to change the statute to make sure that the SEC can no longer go after any person, administratively, to censure or bar from being a broker dealer, comes back down with the new statute, puts it on the table, case dismissed. I lost my first case that way. And that was the way the SEC tried to go after human beings who were not brokers or dealers. The statutes admitted to say, you can only go after brokers and dealers or people who are associated or seeking to be associated with them.

Linda Thomsen: Can we talk about where we are now?

Ralph Ferrara: So now the SEC goes on. The next crack they take at is going after lawyers that have Rule 102(e). In the good old days, the SEC would go after and bar the community of lawyers and then accountants. So now we've got broker dealers, market professionals, lawyers and accountants. All that's left are officers and directors of public companies.

In 1988, the Congress was asked to provide the Commission the authority to do it and they turn it down. In the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the court allows it and says that the SEC can go to court and seek to bar an officer or director from serving for a period of years in that capacity in any publicly held company, so long as they show that the officer or director was substantially unfit to do so. Not a bad standard if you're going to allow the SEC to go to court to do this, but, of course the SEC pushes it to the limit and the courts don't like that pushing it to the limit. They start defining substantial and fitness in a way that is not to the SEC's liking. Sarbanes-Oxley comes along and the government can get anything it wants in Sarbanes-Oxley. They strike the word substantial from this phrase, substantial unfitness. And so now the way the world turns, the SEC can bar a director or officer from serving as such in any public company for life, if the SEC persuades the court that they are unfit to do so. Now what the hell does that mean? Unfit to do so. We don't know.

The cases are evolving. Does it mean that you have to have engaged in something that is a violation with scienter? Does it mean that you have to have a history of violation? Does it mean that there has to be a reasonable prospect for a future violation? These are all things that are evolving in the courts. I can tell you though that in 2003, I stopped counting at 40 of these bars. And I can tell you the remedy du jour at the SEC is if you bump into a federal securities statute and you are a CEO, CFO of a public company, you are looking at a bar.

Ted Levine: I'll let Linda respond to that, maybe just not on the history part, just on the current.

Ralph Ferrara: You don't like "The Planet of the Apes" metaphor, I'm sorry.

Ted Levine: It is "The Return of the Planet of the Apes" that I'm worried about.

Linda Thomsen: I am almost left speechless because I am left with wondering whether what we are seeing here, whether the very simple proposition that an officer and director who engages in fraud -- and you can only get an officer and director bar in situations where there has been an allegation of a Section 10(b) violation. It is silly to suggest that such a person ought not be put in that same position again. And indeed I circle back to where Ted started. There is nothing more forward looking than taking a person who was engaged in serious misconduct and putting them in a situation where they can't do it again.

Ralph Ferrara: Excuse me, let me ask you a question. I am 27 years old. I am the assistant something or other officer in a public company and I make a mistake. I trade on inside information, I trade 100 shares. I make $1,500 and it's wrong and I am nailed. Why should I, at 27 years old, for having engaged in an admitted violation of the insider trading statutes, be barred forever from making a living in any public company in America? Why should that be?

Linda Thomsen: How many, Ralph? How many? How many permanent bars for insider trading by a 27-year-old?

Ted Levine: Usually there is only one, Ralph's client. But let me just stop because what we're hearing identified and Bill, I also like your view, is the critical question. As a matter of policy or law, that someone violated 10(b), should that be the basis for seeking an officer and director bar, or should there be more to it? The Commission has the power administratively to do it. But the real critical question is, how do you administer the power?

Bill McLucas: That's the key question. The issue is not, you can't name public companies, you can't name individuals. The issue is how is the power being wielded? The issue is, does the Government recognize that in the context of settlement it is doing things to people because people cannot fight? It's a question of how the authority is being used and how aggressive the agency is being and what is the balance of fairness in the process. That's the $64,000 question.

And the point that is being raised is not one to suggest that you ought not to enforce the law. The point is, how careful is the Government being in recognizing the issues of fairness and the issues of weight, evidence and balance that ought to be brought to bear in the administering of those powers? Regardless of what you hear from the Government, most people in these companies cannot fight. They can't get indemnified and if they can, it doesn't matter because they are ruined when the charges are brought.

Ted Levine: Linda, how much of a client problem do you have with your client, the Commission, in terms of their view of this power as opposed to your own view? In terms of cases that we have seen, there's been a lot of focus at the Commission of holding individuals accountable. And how much pressure do you get from your clients, the five Commissioners, in terms of imposing this in a case where an individual is involved in a public company?

Linda Thomsen: I think it is fair to say that, whatever other issue that may be out there among the five Commissioners, there is unanimity that individuals should be held accountable for the conduct that they engage in. And there is skepticism on the part of Commissioners when terrible things happen that individuals who were involved in were not aware and should not be held to pretty high standards.

So I think it is fair to say that the Commission will look to individuals, will look closely at their conduct and is serious about trying to get people who have been intimately involved in terrible conduct out of the business. We don't want to see them again. And I think that there may be all kinds of other issues out there but it is pretty clear that the Commission thinks individuals are and should be held accountable.

Ralph Ferrara: Linda, when you express it that way, it is very difficult to disagree with you.

Linda Thomsen: But you're about to.

Ralph Ferrara: No, no, no, what you just said one can't disagree but I must say we hear anecdotally and of course what you hear anecdotally may be apocryphal and not truly based. But we hear anecdotally that the sense at the Commission is that planes don't fall out of the sky without pilot error and if there is a registrant violation particularly in a restatement case then somebody has got to go down for the count. And that there is this kind of symbiotic relationship between the O&D bar and the action against the registrant. Now that's something different than what you just said.

Linda Thomsen: I think that is probably overstates where things are. I think it is fair to say that the more egregious -- using my least favorite word -- the violation, the more likely it is that everyone is going to be looking for the individuals who were responsible, for example, scienter based fraud, because at a certain level everyone is of the view that somebody had to be thinking something.

Once you move into areas that are more systems issues, I think there is certainly on the staff side and to a certain extent on the Commission side some recognition that certain kinds of conduct can occur that will result in violations of the securities laws which end up harming a lot of people or causing a great deal of damage and it may be difficult to find a particular person to identify as responsible for that.

Moreover in response to something that Bill just said, nobody is looking at the guy in the mailroom. The kinds of individuals that we are interested in holding accountable are the senior people who are responsible for setting the tone, for setting the culture, for establishing the policies, and for overseeing the enterprise as a whole.

Ralph Ferrara: Let me ask you a question, do you think that the SEC would consider, as it did quite constructively, I think in Seaboard and in the Thomsen memorandum, giving some content to the concept of unfitness by coming out with a release saying these are the factors we take into account in determining whether a D or an O who has bumped into a fraud provision should be a candidate for a full bar, a suspension for a period of time or other limitations on their business?

Linda Thomsen: I don't know whether it's necessary in part because of something you mentioned. You counted up the number of officer and director bars and put the number at 40.

Ralph Ferrara: As of 2003.

Linda Thomsen: As of 2003, the number of cases we brought that included the kind of conduct for which you could get an officer and director bar was considerably higher than 40 so it does suggest that just by the sheer numbers that thought and attention is being paid to the process of identifying the officers and directors whose conduct warrants keeping them out of the business for some period of time.

Ted Levine: Can I just shift the topic for a moment to one of the other remedies available both to the SEC and the NASD and SROs -- placing limitations on the activities, functions or operations of broker dealers and maybe companies. That language came in 1975 also, and was designed to give flexibility to the agencies so you didn't have to either suspend or bar someone in the regulated context. How is this power being used, is it being used to give you flexibility, or is it being used in addition to the other things we've already discussed?

Mary Schapiro: We view it as a very tailored response to a set of problems in our firms. We use it quite sparingly; it is specifically contemplated under our sanctioning guidelines. We use it in very egregious cases generally or again in cases where there's been recidivism and the idea is that if a firm has had repeated problems in a particular line of business or with respect to a particular activity, the issuance of research reports or in the case of a line of business, the sale of a particular type of product or mutual fund, that we will limit their ability to engage in that activity for a period of time.

We have used it about half a dozen times in the last year, I think pretty successfully. We had several firms that had failed as often as 70% of the time to update their broker's disclosure records in the Central Registration Depository, an important system for individual investors to see whether their broker has had problems. We've prohibited a couple of those firms from registering any new brokers for a period of time. It doesn't seem like the worst sanction in the world but if you are a broker dealer, imagine having to tell a new hire that actually they have to cool it for another week because they have been prohibited by their regulator from registering any new brokers. It has a very direct effect, very narrow in some ways, but a direct effect that responds directly to the kind of problematic conduct.

There was another case where a firm had engaged in really serious market timing problems with hedge funds, allowing them effectively to evade all of the mutual funds prohibitions on market timing by opening serial accounts for their hedge funds. We prohibited that broker dealer from opening any new mutual fund accounts for a 30 day period, a pretty serious sanction again when you think about the fact that they have to tell a new investor that they can't open an account for them. So we had found it to be very effective, very powerful remedy but want it to be used sparingly.

Bill McLucas: Mary, you were a Commissioner in the early '90s in a case when I was instructed to leave a particular defendant naked, homeless and without wheels.

Mary Schapiro: Those were not my words, however.

Bill McLucas: But you sat quietly by.

Ted Levine: Which part did you object to?

Bill McLucas: The naked part really troubled me, but actually it was the O'Hagen case and the terminology by the then-Chairman that got some widespread circulation after the fact.

Ted Levine: There is an interesting decision by Brenda Murray, Chief Administrative Law Judge of the SEC, involving Raymond James, a regulated entity. In a case in which the facts were pretty horrendous, there was theft essentially of multiple million dollars and the issue was really to supervise the people who were fired. The SEC Enforcement staff sought in that case to place limitations on the business of Raymond James among other sanctions. The Administrative Law Judge did not agree with that and she declined to order that. One of the things that struck me in that case is the question of how you police when you seek this kind of relief in cases and what kind of standards do you seek. That was a troubling case in the sense of a lot of the relief that you sought was rejected, and it is hard to figure out why.

Linda Thomsen: There was however a case that a) went to trial and b) if I am not mistaken, there were some relatively significant financial penalties imposed in that matter. And I also think, although I could be wrong, but I am pretty sure that is the same Administrative Law Judge who in another litigated matter imposed a limitation on business for another entity. So I think it is fair to say that all judges are fact finders and all adjudicators struggle with the issue of appropriate sanctions in appropriate packages of sanctions.

And when you are litigating, you very well may seek a pretty full range to give the adjudicator the full range of options. I don't think when Raymond James looks at the sanctions that were imposed on it that they have much to cheer about. And I do know that we also are trying to seek limitations on business activities sparingly. I do think when they are imposed they are effective and I am reasonably confident. I know that the six months time-out new business was one that was litigated and imposed by a judge, as opposed to, as people had suggested, everybody was just falling over and signing up for whatever we request.

Ralph Ferrara: Just so that you know that I can be consistent. Placing limitations on the activities of an entity I think is an appropriate and judicious use of enforcement resources because what you are doing is applying a prophylaxis, you are saying to the entity that until you can get your act together, your business has to be limited in the following respect.

Linda Thomsen: So why shouldn't we impose limitations on individuals?

Ralph Ferrara: You want to bar them.

Linda Thomsen: Yes.

Ted Levine: I pointed out when we were talking earlier that two courts of appeals, the 7th Circuit and the 11th Circuit, in litigated cases, have reacted to this sense of enhanced power in remedy. I'll make a statement and ask a question. Are the courts viewing this burden of proof and the standards that they apply to both the SEC and the NASD more harshly, once you shift from a prophylactic approach to a penalty?

And those two cases, one is the 7^{th} Circuit and one is the 11^{th} Circuit, Smyth and WHX, I believe both suggest that the courts are having trouble in the way that the agency applied the power in a particular case and concluded they weren't going to allow a cease and desist order to be entered in one case.

In another case, the courts said that the $200,000 penalty was inappropriate and the Commission later reduced it to $40,000 on remand. Are the courts reacting in part to this enhanced use of powers? Bill or Ralph, is this your experience, and your thoughts on whether that is a trend and whether you see that as a challenge for the Commission.

Ralph Ferrara: It is a dangerous trend for the SEC. The SEC should not be forced to litigate all of their cases and turn into just another litigant. If they take principled positions, 99% of those cases should be settled and the courts are getting tired of it. You've got the Smythe and WHX case that you've mentioned. There are two other cases that are out there now that are equally difficult, including that FD opinion where the courts are saying, look, you got too close in bed with the criminal prosecutors and you didn't let the other side know that you were setting him up for a criminal prosecution. We are not going to let you use the evidence.

In another case the courts are saying on this FD that you just went way too far, and that you said that it was a breach of an FD to do something that a normal human being would never say. And when the courts start saying that, what happens is it erodes the confidence of other courts, I think, and the integrity and legitimacy of the Commission's positions and it shouldn't happen. As someone who as everyone else here loves this agency, I do not relish when this agency loses a case in court. When it loses a case in court,I know that it is going to make its job and in the long run my job more difficult. We like to see them win. But we like to see them win where they should win.

Ted Levine: Other than your clients.

Bill McLucas: Ted, I think what Ralph said is, in a sense what I had been saying, the issue here is not, should they not be pursuing companies and individuals. The issue is discipline in measure. And until courts step in and try to set the equilibrium in a more balanced degree, I don't think that there is much of a governor in many of these cases. Whatever you hear from the staff, most people in most companies and most business enterprises can't litigate with the SEC. And because of the damage to the franchise and the business and with individuals these days and with the position that is being articulated by indemnification from criminal authorities, it is the rare individual that has the financial wherewithal to stand up to the Government even when they believe they are right.

Linda Thomsen: While we often hear that we can't afford to fight, et cetera, teams, squadrons of lawyers come in and fight with us everyday. People settle everyday in part because they decide it is in their best interest and more often than not it is because we've got the facts and the facts demonstrate the violation. And we get to the point where we are in fact settling virtually somewhere north of 90% of our matters. I am not surprised that there are cases that go against us, the litigated cases are the hardest, but we are winning a lot. And juries understand the facts. Juries are having no difficulty coming to terms with the facts and holding people accountable. So I am not surprised we are going to lose some but I think our focus on the facts is a record we can be proud of.

Ralph Ferrara: Ted, if I can say one thing, the only greater risk to the system from the defense lawyers drinking their own Kool-Aid is the government drinking its own Kool-Aid, which it has in vats.

Ted Levine: I don't know if we can top that. We didn't get to another subject which we don't have time for - which is the question of cooperation and the ability to get credit for cooperation both at the NASD and SEC. There has been a lot said on that. The question - will you have to waive attorney-client privilege as a condition of that and the whole subject of cooperation - is another aspect of the subject of remedies which is something that we'll have to leave for another day.

I think we're just about at the end of the session. What I would like to do is thank Ralph, Bill, Mary and Linda for a great discussion today. I would like to remind our audience both here and those listening online that the audiotape of this is now in the museum and archive at www.sechistorical.org and a transcript of the program will be ready soon.

I also was remiss in not mentioning at the beginning that in part this program was made possible through a grant from the Association of SEC Alumni, Inc. – ASECA - for which we are very thankful. And on behalf of my fellow trustees, I would like again to thank Professor Allen and the New York University Centre for Law and Business for joining in partnership with us to present the program today, and thank you all.