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**Seton Hall University School of Law Legislative Bureau  
Symposium on Securities Law Enforcement Priorities**

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**SETON HALL UNIVERSITY SCHOOL OF LAW  
LEGISLATIVE BUREAU SYMPOSIUM ON  
SECURITIES LAW ENFORCEMENT PRIORITIES  
APRIL 10, 1992**

***Introduction - Leonard M. Leiman - Moderator*<sup>1</sup>**

*This symposium, while specifically directed at securities law enforcement priorities, reflects a basic tension between two approaches: on the one hand, there is the view that strong enforcement is necessary to maintain public confidence in the securities markets; on the other hand, there is a concern that imposing harsh penalties on business people, who do not know the limits of imprecise securities laws, or even understand them, seems unfair. The need to accommodate this tension, which probably arose as soon as the securities laws were enacted in the 1930s, continues today, as is evident from the dialogues that make up this symposium.*

*The discussion takes place against a background of several recent sharply-contrasting enforcement situations. First is the **Coated Sales** case, which involved the criminal prosecution in New Jersey of members of management of a public company who falsified the company's books and stole its assets, a classic case for aggressive law enforcement. Second, the discussion also reflects a series of criminal prosecutions brought by the United States Attorney for the Southern District of New York which may have been over-ambitious on the facts or the law and in any event resulted in defendants being acquitted, having their convictions reversed, or the charges against them being dropped.*

*The participants bring together a fascinating breadth of experience.*

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<sup>1</sup> Mr. Leiman is a graduate of Wesleyan University and Harvard Law School. He is currently employed with the law firm of Fulbright & Jaworski and is the television host of *Wall Street Week in Review*. He was a representative to a 1974 Joint American—Japanese Conference on Securities Regulations, sponsored in Japan by the Tokyo Stock Exchange and the University of Pennsylvania, and presented a paper on comparative securities laws. Mr. Leiman is presently a member of the Association of the Bar of New York City and has served on committees involving Professional Responsibility and International Human Rights. He is also a member of the American Bar Association and the Committee on Federal Regulation of Securities. Mr. Leiman was formerly the Chairman of the Subcommittee on Regulation of Securities and Commodities Options and, is both a frequent lecturer at Practising Law Institute programs and author of several published works on corporate and securities law.

*Michael Chertoff, as the United States Attorney for New Jersey, and William McLucas, as the Director of the SEC's Division of Enforcement, are two of the most important figures in federal securities law enforcement. Roberta Karmel, an experienced practicing lawyer and law professor, spent more than two years as a Commissioner of the SEC; and Edward H. Fleischman, a distinguished securities lawyer who became an SEC Commissioner in 1986, participated in the symposium on the eve of his retirement. Alan R. Bromberg is the author of the best-known treatise on Rule 10b-5, one of the most-used enforcement tools. Theodore V. Wells and Lewis Lowenfels are leading practitioners on the defense side of securities law enforcement actions, civil and criminal.*

*In the pages that follow, you will find these participants debating the basic question of whether decisions to extend governmental jurisdiction by an expansive definition of the securities laws are appropriate. The enforcement officials, Mr. Chertoff and Mr. McLucas, as might be expected, see themselves as merely following their mandate to enforce the law, with the choice of cases determined largely by those who commit the violations. Ms. Karmel, a persistent critic of the SEC's enforcement policies, is the author of a book entitled **Regulation by Prosecution—The Securities and Exchange Commission versus Corporate America**.<sup>2</sup> It is no surprise to find her suggesting that fashion, rather than manifest destiny, determines enforcement choices. Mr. Fleischman takes a fresh look at an old problem: the propriety of the SEC, as a regulatory agency, acting as both prosecutor and judge in its enforcement cases. And the defense lawyers, Mr. Lowenfels and Mr. Wells, would like to see enforcement activity only in the clearest cases, where punishment is appropriate because a clear line has been consciously crossed by the defendant.*

*All the participants are, of course, right at least in part. The law cannot always be advanced in clearly defined legislative stages. Lawyers trained in the Anglo-American tradition are accustomed to the common law development of legal principles through case-by-case decision, and are not shocked by the retroactivity of this method. Manuel F. Cohen, a career SEC employee, SEC Commissioner and Chairman of the SEC from 1964 to 1969, believed that the fertile imaginations of those who prey on the investing public would inevitably find loopholes in rigid rules, and therefore advocated a common law approach to enforcement policy.<sup>3</sup> This is just what the*

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<sup>2</sup> Simon & Schuster (1982).

<sup>3</sup> See generally Manuel F. Cohen & Joel J. Rabin, *Broker-Dealer Selling Practice Standards: The Importance Of Administrative Adjudication In Their Development*, 29 LAW & CONTEMP. PROBS. 691 (1964).

*defense lawyers in this symposium do not want. They would sympathize with a critic of the common law, Jeremy Bentham, who is supposed to have complained that judges make law after the fact, "just as a man makes laws for his dog. When your dog does anything you want to break him of, you wait till he does it, and then beat him for it." This view would favor enforcement only in clear cases of after prospective law changes. The correct path is almost certainly somewhere between the extremes, and the test of good law enforcement is how well the enforcement officials define that path.*

*I used to think that, based on political outlook, there was another generality that could be applied to this subject. Democrats, who tend not to be afraid of big government, prefer to govern by regulation, but do not press for aggressive enforcement because they know that business needs time to adjust to new laws. Republicans resent over-regulation, but want everyone to play by the same rules, so they demand fewer laws, but more enforcement. I suspect that this generalization is not as valid as it once was, if indeed there ever was any truth in it. Perhaps, as the Administration turns over in 1993, we will find out.*

### **Part I**

#### **SEC Priorities in Enforcement**

**Leonard M. Leiman**

Our first speaker is William McLucas of the Division of Enforcement of the Securities & Exchange Commission (SEC). I would like to point out that the position of Director of the Division of Enforcement is not a position that has existed at the Commission through its entire life. For most of the life of the SEC, there was no Division of Enforcement. Anyone organizing an agency like the SEC would naturally think that as an enforcement agency there should be a division charged with an enforcement role. Nevertheless, for many years there was a firm belief that enforcement responsibility should not be separated from the divisions of the Commission that deal with substantive regulation. The belief was that as the regulators developed new principles of regulation, if enforcement became too separate from such development, it might reflect the uncertainties of the rules and the appropriate nature of regulation. It took a Republican Administration in 1972 to create the Division of Enforcement. At that time, all of the Commission's enforcement powers were taken away from the operating divisions and put into the enforce-

ment division. To the credit of those who have occupied the top position in that division, they have been terrific people, leading right up to the present director, William McLucas. Those who attempted to prevent the separation of enforcement have not proved to be justified and I think the reason is because the Division has been reasonably sensitive to the problems of regulation. Bill will talk about priorities in enforcement, a subject which emphasizes the relationship between the regulatory purposes of the Commission and the enforcement of the rules that the Commission has developed.

***William R. McLucas*<sup>4</sup>**

Since we have formed a separate division and have taken that power, I can tell you that we are not going to give it back. I have been the Director of the Division of Enforcement for two years and four months, and the most notable problem I have seen since I have been the Director is that I have gotten grey hair, gained weight and witnessed my salary increase but my hourly rate decrease.

When we talk about what the Division does and what the Commission is going to do in terms of priorities, it really is interesting. I came to the Commission in 1977. If we were to take a snapshot of the inventory of cases that the Commission was involved in fifteen years ago and compare it to what the Commission is doing today, you will probably find that approximately seventy percent of the inventory of cases is quite similar today to what we had fifteen years ago.<sup>5</sup> Policing, accounting, financial

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<sup>4</sup> Chief of the Division of Enforcement, Securities and Exchange Commission. B.S., Pennsylvania State University (1972). J.D., Temple University School of Law (1975). Past positions held by Mr. McLucas at the Securities and Exchange Commission include Assistant Director, Associate Director and Director of Publications. Mr. McLucas is also the author of several publications on securities law.

<sup>5</sup> See, e.g., *SEC v. Century Mortgage Co.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,777 (Jan. 17, 1979) (fraudulent sales of securities); *SEC v. Hart*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,454 (May 26, 1978) (false and misleading financial statements); *SEC v. Aminex Resources Corp.*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,352 (Mar. 9, 1978) (misappropriation of assets); *SEC v. SCA Services, Inc.*, No. CIV.A.77—, 1977 WL 21710 (D.C. Cir. Aug. 8, 1977) (anti-fraud, reporting and proxy solicitation violations); *SEC v. Forest Labs. Inc.*, No. CIV.A.77-2745-MEL, 1977 WL 21271 (S.D.N.Y. June 7, 1977) (inflating revenues).

disclosure and deterrence of fraud are probably the core mission of the Agency, the basic reason for our existence. That was true in 1934<sup>6</sup> and is true today. That core part of the enforcement program remains, probably, the single largest area where we devote manpower and resources. Currently, the inventory of those cases is up slightly. We probably instituted about fifteen to sixteen percent more cases in the accounting and financial disclosure area this year than we had last year. That is a function, to a great extent, of the current economic climate<sup>7</sup> we are in and the expectation that comes with a recession or during difficult economic times. Within a year or eighteen months we have been seeing an increase in accounting-disclosure problems "kick out" at the Commission in the filings and the disclosures that public companies make.<sup>8</sup> But the core program has essentially re-

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<sup>6</sup> The Securities Exchange Act of 1934 was designed to regulate post-distribution trading of securities in the secondary market by protecting ordinary investors and the general public by promoting disclosure of information, regulating securities markets and the amount of credit used in them, and imposing sanctions for abuse of the facilities for trading securities. See 15 U.S.C. § 78(b) (1988). The fundamental purpose of the 1934 Act was "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*." SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963).

<sup>7</sup> See generally David R. Altany, *Slow Slog Upward*, INDUSTRY WK., Sept. 21, 1992, at 51 (economic recovery figures); James C. Cooper & Kathleen Madigan, *Will the Fed Put America Back to Work?*, BUS. WK., Sept. 21, 1992, at 23 (Federal Reserve and its economic recovery initiatives); *Fearing the Worst*, ECONOMIST, July 25, 1992, at 73 (economic downturns in worldwide financial markets); Stephen Greenhouse, *It Didn't Only Seem Worse*, N.Y. TIMES, Aug. 2, 1992, § 4 at E2 (revised recession statistics); John Greenwald, *The Great American Layoffs*, TIME, July 20, 1992, at 64 (industry unemployment figures); S.C. Gwynne, *The Long Haul*, TIME, Sept. 28, 1992, at 34 (economic burdens facing America); Marc Levinson, *A Wimp of a Recovery*, NEWSWEEK, July 13, 1992, at 48 (sub-par recovery from the 1990-91 recession); Janet Novack, *Recession? What Recession?*, FORBES, Aug. 3, 1992, at 38 (state and local budget difficulties).

<sup>8</sup> See 15 U.S.C. § 78m (1988). The Securities Exchange Act of 1934, commonly referred to as the '34 Act, created a continuous mandatory public disclosure system regulating the secondary securities market. It applies to corporations and those who stand in a fiduciary capacity to the corporation: officers, directors, employees and shareholders are considered insiders. The current § 13(d) requires a person who acquires more than five percent of the shares of a publicly traded company to file a Schedule 13D disclosure statement with the exchanges, the SEC and the target corporation within ten days of the acquisition. *Id.*

Section 13 of the '34 Act requires corporations to register with the SEC and file periodic reports if: (1) the corporation lists its securities on a national securities exchange pursuant to § 12(b); (2) any class of its equity securities is held by at least 500 persons and the corporation has gross assets over a specified level (currently

mained the same whether one looks at market manipulation, policing activities of broker-dealers and their relationship to customers, the regulatory responsibilities in the industry, or policing activities of investment advisors. Some change in the overall allocation of resources to different program areas obviously takes place! It is a function as much of the marketplace as it is of the priorities of the Commission and the Chairman at any particular time.

The world today is a lot different than it was ten or fifteen years ago. We were in a market in 1980 where total trading on the exchanges was about \$476 billion.<sup>9</sup> By 1990, total trading had increased to \$1.8 trillion.<sup>10</sup> The international flavor of the market today is dramatically different than what it was ten years ago.<sup>11</sup> Reflected in enforcement cases of eight or ten years ago, the extent of our international issues in enforcement cases primarily involved the use of Panamanian corporations,<sup>12</sup> Bahamian

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\$5 million dollars in accordance with § 12(g)); or (3) the corporation files a Securities Act of 1933 registration statement that becomes effective pursuant to § 15(d).

The required § 13(a) periodic reports are (1) the annual report on Form 10-K, containing audited financial statements and a detailed description of the corporation, *see* 17 C.F.R. § 240.13a-1 (1992); (2) quarterly reports on Form 10-Q using unaudited financial statements, *see* 17 C.F.R. § 240.13a-13 (1992); and (3) current material developments reported on Form 8-K within ten days of the month in which the event occurred, *see* 17 C.F.R. § 240.13a-11 (1992). The '34 Act further requires, under § 16, that insiders and their tippees disclose all material information prior to trading. 15 U.S.C. § 78p (1988).

Section 14 of the '34 Act regulates proxy disclosures. 15 U.S.C. § 78n (1988). Schedule 14A outlines the material information which must be disclosed to shareholders concurrently with proxy solicitations. *See* RICHARD W. JENNINGS & HAROLD MARSH, JR., *FEDERAL SECURITIES LAWS* 643 (1991). The Williams Act of 1968, as amended, added to the disclosure requirements of the '34 Act in takeover and corporate control transactions. Williams Act of 1968, Pub. L. No. 90-439, 82 Stat. 454 (1968). The Williams Act also added § 14(d) which currently requires the filing of Schedule 14D-1 disclosing the particulars of any tender offers that result in the bidder owning five percent or more of a class of publicly traded stock.

<sup>9</sup> U.S. BUREAU OF THE CENSUS, *Statistical Abstract of the United States: 1991* (111th ed.), at 514, tbl. no. 841.

<sup>10</sup> *Id.*

<sup>11</sup> 1990 SEC ANN. REP. 4, 21. *See generally* Charles E. Engros, Jr. & Patricia K. Schlegel, *Integrating the U.S. Into Global Securities Markets*, 24 REV. OF SEC. & COMM. REG. 169 (1991); Linda C. Quinn et al., *Internationalization of the Securities Markets*, in SECURITIES REGULATION, at 7 (PLI Corp. Law & Practice Course Handbook Series No. 712, 1990).

<sup>12</sup> *E.g.*, SEC v. Rogers, 790 F.2d 1450 (9th Cir. 1986) (gold mining tax shelters in Panama and French Guiana); SEC v. Foundation Hai, 736 F. Supp. 465 (S.D.N.Y. 1990) (insider trading action against Panamanian and Lebanese corporations); SEC

banks,<sup>13</sup> Liechtenstein-based anstalts,<sup>14</sup> Swiss bank accounts<sup>15</sup> and trading in our markets during mergers and acquisitions developments in the 1980s.<sup>16</sup> Those issues continue to surface, but there are many other international issues that could come up just in the enforcement program. We have to deal with questions of getting the accounting work papers<sup>17</sup> when United States conglomerates, who have major operations abroad, are audited by an affiliated United States auditing firm. These issues raise many problems in dealing with foreign jurisdictions, foreign regulators, domestic issuers and their auditors. We recently brought

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*v. Hansen*, 726 F. Supp. 74 (S.D.N.Y. 1989) (illegal "day-trading" through a Panamanian corporation); *SEC v. Tome*, 638 F. Supp. 596 (S.D.N.Y. 1986) (insider trading case involving Panamanian entities), *aff'd*, 833 F.2d 1086 (2d Cir. 1987), *cert. denied*, 108 S. Ct. 1751 (1988); *SEC v. Ablan*, [1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,209 (July 23, 1985) (injunctive and monetary relief against a Panamanian business); *SEC v. Allison*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,545 (Nov. 1, 1983) (violators included five Panamanian corporations and a Panamanian religious society); *SEC v. Drucker*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,529 (Sept. 26, 1983) (defendant attempted to hide his personal violative activities behind the mask of a Panamanian entity); *SEC v. Everest Management Corp.*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,814 (July 30, 1982) (civil injunctive action against forty-four defendants regarding securities violations involving Panamanian and Liechtenstein-based entities and Swiss bank accounts).

<sup>13</sup> *SEC v. Levine*, [1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,761 (June 5, 1986) (secret purchases and sales of securities through a Bahamian bank).

<sup>14</sup> *E.g.*, *SEC v. Finacor Anstalt*, No. CIV.A.89-7667-JMC, 1989 WL 258401 (S.D.N.Y. Nov. 20, 1989) (Liechtenstein-based entity allegedly violated antifraud provisions in making \$2.8 million in illegal profits); *SEC v. International Tel. & Tel. Corp.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,586 (May 4, 1979) (action against defendant for improper and questionable payments to various foreign entities, including a company from Liechtenstein).

<sup>15</sup> *See, e.g.*, *Tome*, 833 F.2d at 1095; *SEC v. McGoff*, 647 F.2d 185 (D.C. Cir. 1981) (granted subpoena duces tecum requested by SEC, in part, for defendant's records with Swiss bank); *SEC v. Vaskevitch*, 657 F. Supp. 312 (S.D.N.Y. 1987) (preliminary injunction prohibiting defendant from transferring funds to Swiss bank); *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981) (action against a Swiss corporation); *SEC v. Certain Unknown Purchasers of the Common Stock of, & Call Options for the Common Stock of, Santa Fe Int'l Corp.*, [1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,424 (July 25, 1983) (enforcement action against defendants subject to Swiss banking secrecy laws).

<sup>16</sup> *E.g.*, *SEC v. Wang*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,727 (May 22, 1989), 944 F.2d 80 (2d Cir. 1991); *SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991); *SEC v. Unifund SAL*, 910 F.2d 1028 (2d Cir. 1990); *SEC v. Heider*, No. CIV.A.90-4636-CSH, 1991 WL 296464 (S.D.N.Y. Mar. 11, 1991); *SEC v. Foundation Hai*, 736 F. Supp. 465 (S.D.N.Y. 1990).

<sup>17</sup> Obtaining accounting workpapers is a common investigative step in any Commission inquiry into the adequacy of an issuer's financial disclosure.



our first case involving what is called "Reg S,"<sup>18</sup> a new regulation that permits the issuance of stock to foreign investors, which then is subsequently brought or sold back into the United States markets without the benefit of registration. That kind of development was probably unheard of or unthought of about ten years ago, and these kinds of international issues are going to continue to be a major component of our markets as we move into the 1990s.

Ten years ago we had nothing close to what exists today in the high-yield bond market.<sup>19</sup> Today, we have a high-yield bond market in excess of \$200 billion where there is no transparency.<sup>20</sup>

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<sup>18</sup> SEC v. Westdon Holding & Inv., Inc., No. CIV.A.91-7531-KTD, 1992 WL 136673 (S.D.N.Y. June 5, 1992). "Regulation S is not available for any transaction or chain of transactions that is part of a plan or scheme to evade . . . registration requirements." *Id.* at \*2. Regulation S, which was promulgated pursuant to 15 U.S.C. § 77e (1992), appears in 17 C.F.R. §§ 230.901-904 (1992). For a discussion of the significant provisions of Regulation S, see R. Brandon Asbill, *Securities Regulation—Great Expectations and the Reality of Rule 144A and Regulation S; The SEC's Approach to the Internationalization of the Financial Marketplace*, 21 GA J. INT'L & COMP. L. 145 (1991).

<sup>19</sup> See generally EDWARD I. ALTMAN, *DISTRESSED SECURITIES, ANALYZING AND EVALUATING MARKET POTENTIAL AND INVESTMENT RISK* (1991); EDWARD I. ALTMAN & SCOTT A. NAMMACHER, *INVESTING IN JUNK BONDS, INSIDE THE HIGH YIELD DEBT MARKET* (1987); Ralph H. Fletcher, Jr. & Stephen D. Gray, *Private Placements' Big-Screen Success*, CORP. CASHFLOW MAG., Mar. 1990, at 32 (volume of private placements now matches or surpasses the number of transactions in securities markets); R.S. Salomon, Jr., *Leverage in Reverse*, FORBES, June 8, 1992, at 161. "Today companies have every incentive to reduce, rather than build, debt levels." *Id.* See Simon M. Lorne, *Securities and Securities Law Issues in Troubled Debt Situations*, in *HIGH-YIELD BONDS 1991: RECENT TRENDS IN WORKOUTS, EXCHANGE OFFERS AND BANKRUPTCY*, at 111 (PLI Real Estate Law & Practice Course Handbook Series No. 376, 1991).

In the current environment, with the relatively recent advent, growth into substantial significance, and then collapse—with some fair question as to the next stage of the cycle—of the high-yield debt (or "junk bond") market, there has been a sea change in the nature of holders of debt. A very large number of debt transactions that would have involved bank or insurance company loans (or syndications) only a few years ago now involve a more disparate group of security holders. For the most part, while these new lenders are a less cohesive group than those they replaced, the securities they acquired, typically in an offering registered under the securities laws, or in a private placement with rights to such registration, had greater liquidity.

*Id.* at 114-15.

<sup>20</sup> The total dollar volume of outstanding registered high yield securities, as of September 30, 1989, was approximately \$204 billion. THE HIGH YIELD REVIEW (Oct. 1989), Drexel Burnham Lambert. See also DIV. OF MKT. REG., SEC, THE CORPORATE BOND MARKETS: STRUCTURE, PRICING AND TRADING 3 (1992) ("As of Febru-

This means there is no real time reporting of price, volume and interval of trading. When you look at that market, my sense is there are some problems there. There are some abuses, and I believe you may see some cases involving trading in that market over the next year or so. There is a movement involving prodding of the National Association of Securities Dealers (NASD) by the Commission to develop a market system for real time reporting of trades, pricing and volume in the junk bond market.<sup>21</sup>

A year ago I would not have predicted that the SEC would be involved in probably the most substantial investigation of the United States Treasury market that we have ever undertaken, but now we have probably six to fifteen professionals any day of the week devoted to our investigation of possible abuses in the sale of treasury securities.<sup>22</sup> I hope these investigations will yield some developments from the enforcement standpoint in the not too distant future. Within the last two months, the Commission, with the Federal Reserve Board and the Comptroller of the Currency, pursued ninety-nine administration proceedings against banks, broker dealers and government securities dealers in connection with false reporting of customer orders to the government sponsored enterprises—Fannie Mae, Freddie Mac, Sally Mae and a few others.<sup>23</sup> This was unanticipated a year ago, and certainly was not perceived to be an issue ten years ago.

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ary 1991, the total face value of the high yield market was estimated at \$226 billion.”).

<sup>21</sup> See Letter from Richard C. Breeden, Chairman, SEC, to Donald W. Riegle, Jr., Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate (Mar. 29, 1991), in *SECURITIES LITIGATION 1991*, at 25 (PLI Corp. Law & Practice Course Handbook Series No. 755, 1991). “[W]e are concerned about the lack of transparency of information in the high-yield debt and other securities markets and we are working to encourage the development of an appropriate trade and quotation system for this market.” *Id.* at 28.

<sup>22</sup> See *SEC v. Salomon, Inc.*, No. CIV.A.92-3691-RPP, 1992 WL 114584 (S.D.N.Y. May 20, 1992) (recent significant fraud case arising out of misconduct in the government securities market); Steve Rosenbush, *SEC Reveals Settlement With Ex-Salomon Officers*, *STAR-LEDGER* (Newark), Dec. 4, 1992, at 47-48 (sanctions imposed for failure to supervise bidding). Other investigations potentially involving abuses in the sale of treasury securities are currently ongoing and are therefore non-public. See also Martin Dickson, *Dog Days Unleash Merger & Scandal*, *FIN. POST*, Aug. 17, 1991, at 17 (discusses U.S. treasury paper scandal involving rigged bidding).

<sup>23</sup> *E.g.*, *In re Distribution of Sec. Issued by Certain Gov't Sponsored Enters.*, Admin. Proc. No. 3-7646, 1992 WL 13151 (Jan. 16, 1992) (distribution of unsecured debt securities of government sponsored enterprises).

Today, we are seeing both a marketplace and an enforcement program that are considerably different from that of a decade ago. We have an agency which, when everybody shows up, has about 2,500 people. This relatively small agency oversees the capital markets of the United States. We oversee and regulate about 12,000 public companies, 17,000 investment advisors, some 400,000 plus people in the securities industry and a substantial amount of trading on a daily basis.<sup>24</sup> The regulatory system is designed hopefully not only to make sure the market works and is liquid, but also to function with some sense of integrity. It is quite remarkable, when you consider that the government accomplishes this not simply with an agency of 2,500 people, but in reliance on lawyers, accountants, self-regulatory organizations, the New York Stock Exchange,<sup>25</sup> the American Stock Exchange<sup>26</sup> and the NASD.<sup>27</sup> This self-policing, self-regulatory system is designed to make the markets work, to make sure that people play by the rules, to ensure that the markets remain liquid and hopefully to provide that the system is not going to collapse of its own weight. That, I believe, in my role as an enforcement lawyer and prosecutor, is the most remarkable aspect of the way the capital-market system in this country works.

This self-regulatory philosophy also carries with it the assumption that the enforcement agency is going to be tough, rea-

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<sup>24</sup> See Directory of Companies Required to File Annual Reports With the SEC for the Year Ended Sept. 30, 1991; 56th Annual Report of the SEC 1990 at 47; U.S. Securities and Exchange Commission Budget Estimate, Fiscal 1992, III-2 (on file with the SEC).

<sup>25</sup> Under § 19(g) of the Exchange Act, a self-regulatory organization (SRO) must enforce its rules with respect to its members. 15 U.S.C. § 78s(g) (1988). Section 19(d) authorizes the Commission to review final disciplinary sanctions for violations of the SRO's rules. 15 U.S.C. § 78s(d) (1988). For a discussion of the enforcement role played by the New York Stock Exchange, see David P. Doherty et al., *The Enforcement Role of the New York Stock Exchange*, 85 Nw. U. L. REV. 637 (1991) (NYSE-Division of Enforcement is responsible for investigating and prosecuting violations within the member firm community); 2 NYSE Guide—Constitution & Rules (CCH) (1984 & Supp. 1992).

<sup>26</sup> The American Stock Exchange's Rules are set forth in 2 ASE Guide—Constitution & Rules (CCH) (1984 & Supp. 1992).

<sup>27</sup> NASD has a mandate for continual enforcement of the securities laws and its rules of fair practice. See John E. Pinto, Jr., *The NASD's Enforcement Agenda*, 85 Nw. U. L. REV. 739 (1991). "In 1989, the NASD brought 1,011 formal complaints, rendered 678 disciplinary decisions, and accepted 353 settlement offers. These actions led to the expulsion of 25 firms, the barring of 286 individuals, and the suspension of 43 firms and 279 individuals." *Id.* at 747.

sonable and fair, but somewhat aggressive. There is an assumption, I believe, within the free market system, that if you take down the speed limits and eliminate needless regulatory barriers, you also must have a fairly aggressive shotgun behind the door so that when there is abuse in the market, you make sure that the message to the market as a whole is that "if you don't play by the rules and if you get caught—and there ought to be some fair probability of getting caught—you're going to really get whacked."

I have mentioned that our inventory accounting,<sup>28</sup> financial disclosure<sup>29</sup> and financial fraud cases<sup>30</sup> have increased slightly. It is a cyclical development, and it is not unusual. We always have the core group of those cases in the program, and I would expect that will continue to be the case and that we will continue to see some increase in that area of the program during the next year or so until the economy rebounds. The market is already rebounding. We are seeing an increase in the volume of offerings.<sup>31</sup> We may see, over a period of time, since enforcement is

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<sup>28</sup> *E.g.*, SEC v. Q.T. Wiles, No. CIV.A. 91-1393, 1991 WL 286429 (D. Colo. Aug. 14, 1991) (concealment of a \$4 to \$4 1/2 million inventory shortfall); SEC v. Antar, No. CIV.A. 89-3773-NHP, 1989 WL 258995 (D.N.J. Sept. 6, 1989) (understatement of accounts payable and overstatement of inventory); *In re Crazy Eddie Sec. Litig.*, 714 F. Supp. 1285 (E.D.N.Y. 1989) (inflation of inventory and per store sales figures).

<sup>29</sup> *See, e.g.*, *In re Caterpillar, Inc.*, Admin. Proc. No. 3-7692, 1992 WL 71907 (Mar. 31, 1992) (failure to properly disclose a subsidiary's earnings); *In re Fleet/Norstar Fin. Group, Inc.*, Admin. Proc. No. 3-7545, 1991 WL 286391 (Aug. 14, 1991) (materially inaccurate financial statements due to improper accounting).

<sup>30</sup> *E.g.*, SEC v. Barette, No. CIV.A.92-1417-TH, 1992 WL 150842 (D.C. Cir. June 17, 1992) (misstatement of earnings in plot to conceal failure to meet budgetary targets); *In re Amre, Inc.*, Admin. Proc. No. 3-7672, 1992 WL 45884 (Mar. 2, 1992) (failure to provide adequate and accurate disclosure regarding accounting policies and practices); SEC v. Weinstein, No. CIV.A.90-4276-AJL, 1990 WL 321965 (D.N.J. Oct. 26, 1990) (creation of phony invoices and receivables overstated Coated Sales, Inc.'s earnings). *See also* Scholes v. Stone, McGuire & Benjamin, 786 F. Supp. 1385 (N.D. Ill. 1992) (misleading limited partners into investing in fraudulent schemes); SEC v. Singer, 786 F. Supp. 1158 (S.D.N.Y. 1992) (possessing confidential information coupled with use of such information for personal gain is sufficient to establish act of misappropriation); *United States v. Sprecher*, 783 F. Supp. 133 (S.D.N.Y. 1992) (making false statements to SEC in connection with two separate security transactions); SEC v. Great Lakes Equities Co., 775 F. Supp. 211 (E.D. Mich. 1991) (president was alter ego of corporation and used his dominion and control to commit fraud).

<sup>31</sup> *See* "Financing America's Growth," Richard C. Breeden, Chairman, SEC, Remarks at the National Press Club, Wash., D.C. (Feb. 18, 1992); *IPO Quality Slides*,

fundamentally reactive, an increase in the volume of cases that come out of those offerings. The increase will be either accounting disclosure cases or cases involving market abuses by people who might manipulate those offerings.

The SEC also has a new remedies bill. For fifty years the SEC ran an enforcement program which was fundamentally remedial in nature.<sup>32</sup> If you violated the law, the SEC's recourse was to file an action in federal court and say to the court, "So and so violated the law, here's the evidence, and we would ask the court to enter an order that says to him in essence, 'Go and sin no more.'"<sup>33</sup> That was the statutory relief that the SEC was empowered to obtain. The SEC coupled with that relief the concept of ancillary<sup>34</sup> or equitable relief.<sup>35</sup> You could ask a judge to order the defendant to give back the money that had been stolen or to

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*But Market Keeps Surging*, CORP. FIN. WK., Mar. 2, 1992, at 1; Anne Newman, *IPOs Continue to Explode But Fireworks Are Fading*, WALL ST. J., Mar. 19, 1992, at C1; Michael Siconolfi, *Sizzling New-Issues Market Likely to Continue*, WALL ST. J., Apr. 1, 1992, at C1.

<sup>32</sup> See, e.g., *Study of the Securities and Exchange Commission: Hearings Before the Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 82d Cong., 2d Sess. 3-7 (1952). The Study states:

Prior to the passage of the Securities Act of 1933 it had become clear that lax financial and ethical standards were undermining the integrity of the capital markets, destroying investor confidence, and were leading the business and financial enterprises to the brink of disaster . . . . [O]ne of the basic features of the Securities Act was the creation of an administrative agency with special responsibility for ferreting out securities frauds, . . . .

*Id.* See generally HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 24.02 (1990). Often, the SEC initiates an administrative proceeding to impose sanctions of a remedial nature for securities violations. *Id.*

<sup>33</sup> Cases in which the Commission has obtained injunctive relief include *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082 (2d Cir. 1972).

<sup>34</sup> Courts have held that the power to grant ancillary relief in Commission actions can encompass a variety of remedies including disgorgement, receiverships and asset freezing. See, e.g., *SEC v. American Bd. of Trade*, 830 F.2d 431, 438-39 (2d Cir. 1987) (receivership and fund impoundment), *cert. denied*, 485 U.S. 938 (1988); *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1103 (ancillary relief is usually granted in the form of a disgorgement of "all the proceeds, profits and income received in connection" with the violation); *SEC v. Vaskevitch*, 657 F. Supp. 312, 314-15 (S.D.N.Y. 1987) (asset freeze).

<sup>35</sup> Type of relief sought in a court possessing equitable powers as, for example, in the situation of one seeking specific performance or an injunction instead of money damages. BLACK'S LAW DICTIONARY 539 (6th ed. 1990) [hereinafter BLACK'S].

take certain steps that amounted to, in essence, a use of the court's equitable powers to right the wrong.<sup>36</sup> It was not necessarily analogous to restitution,<sup>37</sup> putting people back in the same place that they were before, but basically to attach some baggage to the court's order to make sure that the person did not violate the law in the future. That has all changed. The 1980s saw a perception in Congress, and probably out in the heartland, that there was a tremendous amount of excess in and abuse of the markets. The net result of that in terms of the securities laws was, in part, the passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990,<sup>38</sup> which changed the landscape to provide that there could be money penalties assessed for every violation of the federal securities laws.<sup>39</sup> For instance, if a

<sup>36</sup> See, e.g., *American Bd. of Trade*, 830 F.2d at 438 (freezing defendant's personal assets); *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1103 (ordering disgorgement of all proceeds, profits and income); *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307-08 (2d Cir.) (restitution of ill-gained profits did not constitute a penalty assessment), *cert. denied*, 404 U.S. 1005 (1971); *Commodity Futures Trading Comm'n v. United States Metals Depository*, 468 F. Supp. 1149, 1163 (S.D.N.Y. 1979) (ordering disgorgement of all profits because of pervasive illegality and unrepentant fraud on public); *SEC v. General Refractories Co.*, 400 F. Supp. 1248, 1260 (D.C. Cir. 1975) (freezing assets to assure compensation to victims of security fraud).

<sup>37</sup> Equitable remedy by which a person is reinstated to his or her position prior to the injury or loss. BLACK'S, *supra* note 35, at 1313. When a person is unjustly enriched at expense of another, he or she must make restitution to the other. *Id.* "Restitution . . . deprives a defendant of the gains from his wrongful conduct." *SEC v. R.J. Allen & Assoc.*, 386 F. Supp. 866, 880 (S.D. Fla. 1974) (citing *Schine Chain Theatres v. United States*, 334 U.S. 110, 128 (1948)). The use of these varied remedies reflects the basic concept that "effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable." *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1104.

<sup>38</sup> Pub. L. No. 101-429, 104 Stat. 931 (codified as amended in scattered sections of 15 U.S.C.) [hereinafter Remedies Act]. The Securities Exchange Act of 1934, § 3(a)(51)(A), 15 U.S.C. § 78c(a)(51)(A) (West Supp. 1991) defines "Penny Stock" to include "any equity security other than a security" that is:

- (a) listed on an exchange or traded through NASDAQ;
- (b) issued by an investment company registered under the Investment Company Act of 1940;
- (c) that is a put or call option issued by the Options Clearing Corporation;
- (d) that has a price of five dollars or more.

In addition, "a security that is registered on the American Stock Exchange, Inc. pursuant to the listing criteria of the Emerging Company Marketplace, that does not otherwise satisfy the requirements of paragraphs (b), (c) or (d) is specifically included in the definition of a 'penny stock' under the rule." 17 C.F.R. § 240.3a51-1(a) (1992).

<sup>39</sup> See, e.g., Securities Exchange Act of 1934, § 21B, 15 U.S.C. § 78u-2 (1990)

quarterly report is due on April 15th, and you file on the 16th, you have violated the law, and therefore can be exposed to a money penalty.

Next is insider trading.<sup>40</sup> In 1984, Congress had already passed a statute that authorized the Commission to seek money penalties up to three times the profit gained or the loss avoided for insider trading.<sup>41</sup> The Remedies Act of 1990 applies to all violations in the public securities division. You can now be exposed to the imposition of civil money penalties for any violation of law.<sup>42</sup> We are using the statute since it applies to conduct that post-dates October 15, 1990.<sup>43</sup> It will take some time before enforcement experience develops sufficiently to assess some level of predictability about what the cost of a particular violation will be. As we proceed into the 1990s, this will significantly change the face of public securities law enforcement.

During the 1980s, we saw what the defense bar and a number of the commentators liked to call the "criminalization of the process."<sup>44</sup> Here are all these little technical rules that if you

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(three tier structure assesses penalty amount based on facts and circumstances); Securities Exchange Act of 1934, § 21(d)(3), 15 U.S.C. § 78u(d)(3) (1990) (substantial penalties levied for any violation of "any provision of this title, the rules or regulations thereunder, or a cease-and-desist order entered by the Commission").

<sup>40</sup> "Insider trading" is a label applied to a species of securities fraud in which a person trades based upon possessing material non-public information about the security obtained in breach of a relationship of trust and confidence. See generally *Dirks v. SEC*, 463 U.S. 646 (1983); *Chiarella v. United States*, 445 U.S. 222 (1980). Liability for insider trading may also result when a person misappropriates information in breach of a fiduciary or similar relationship of trust and confidence. *United States v. Willis*, 737 F. Supp. 269, 273-74 (S.D.N.Y. 1990) (quoting *SEC v. Materia*, 745 F.2d 197, 203 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985)). When one trades corporate securities for his own account with "access, directly or indirectly," to facts intended only for a corporate purpose rather than a personal benefit, he or she may not use such information if it is known that it is not available to the investing public. *Texas Gulf Sulphur Co.*, 401 F.2d at 848 (citation omitted). In the case of persons who obtain information as company insiders, a "disclose or abstain" duty typically applies. *In re Cady Roberts & Co.*, 40 SEC 907, 911 (1961). See also Linda S. Eads, *From Capone to Boesky: Tax Evasion, Insider Trading, and Problems of Proof*, 79 CAL. L. REV. 1421, 1456-61 (1991) (examines the judicial response to insider trading cases).

<sup>41</sup> Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, (codified in 15 U.S.C. § 78u-1 (1988)).

<sup>42</sup> See *supra* note 39 and accompanying text.

<sup>43</sup> Remedies Act, *supra* note 38, § 1(c)(1).

<sup>44</sup> See Theodore A. Levine et al., *Outline of Current Developments Governing Enforcement of the Federal Securities Laws: 1988 Through 1990 Overview*, in ALI-ABA POSTGRAD-

violated them the worst that could happen is that you got an administrative proceeding order where the SEC said, "Go, and don't violate the law in the future." Suddenly, people were being indicted, tried and, in many cases, going to jail. That is a phenomenon, in part, that arose out of the kinds of cases and situations that were being pursued. Most of the cases involved abuses in the American acquisition markets.<sup>45</sup> Most of the cases involved conduct which gave the general perception to have gone quite a degree over the line. These were not people being criminally prosecuted for jaywalking. My personal opinion is that these people engaged in serious criminal involvement. Some of my colleagues share a different view. I can tell you from firsthand experience that there are vast arguments about it. As we go forward, that is a part of securities law enforcement which I think will remain a key part of the program that will possibly not have the kind of prominence and high profile that existed in the 1980s. That is a function to a degree, I would hope, of the success of the program over the past few years.

This is true, not only in the mergers and acquisitions cases<sup>46</sup> and the more sensational insider-trader cases out of the Southern District of New York,<sup>47</sup> but the criminal cases that were brought in the District of New Jersey by the United States Attorney's Office involving penny stock fraud, dealt with people who basi-

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UATE COURSE IN FEDERAL SECURITIES LAW 1569, 1574-75 (1990) (threat of RICO penalties, with asset seizure and forfeiture, is a substantial element in this criminalization trend); Jonathan R. Macey, *Agency Theory and the Criminal Liability of Organizations*, 71 B.U. L. Rev. 315, 330-31 (1991) (applies an agency cost perspective to the subject of corporate crime); Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law*, 101 YALE L.J. 1795 (1992) (argues for a tripartite concept of sanctioning laws that distinguish between criminal, punitive civil and remedial sanctions).

<sup>45</sup> See, e.g., SEC v. Drexel Burnham Lambert Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,474 (June 20, 1989) (entry of permanent injunction from violating the proxy, antifraud and reporting provisions of the Exchange Act and the antifraud provisions of the Securities Act); SEC v. Seigal, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,123 (Feb. 13, 1987) (disclosure of material nonpublic information concerning possible tender offer, acquisition or change in corporate control); SEC v. Boesky, No. CIV.A.86-8767-RO, 1986 WL 72240 (S.D.N.Y. Nov. 14, 1986) (purchase of securities for affiliated entities while in possession of material nonpublic information).

<sup>46</sup> See, e.g., SEC v. First City Fin. Corp., 890 F.2d 1215 (D.C. Cir. 1989).

<sup>47</sup> See SEC v. Solomon, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,648 (Nov. 27, 1990); SEC v. Milken, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,200 (Apr. 24, 1990).



cally feigned the results of operations<sup>48</sup> for publicly-held companies, sold their securities, moved to Florida or, in the worse case, perhaps went to Europe to avoid prosecution. In part, it was a function of the penny stock abuses out in Denver and Utah and, indeed, in New Jersey.<sup>49</sup> A lot of that conduct, I hope, has been dealt with and put to bed, but as we go forward, you are likely to see continued criminal prosecution of securities law violations. I would suspect that, for a period of time, we may not see the same kind of sensationalized cases—there is not likely to be another Ivan Boesky or Michael Milken case in the immediate future. That is, in part, a function of what has happened in the markets; it is a part of the whole function of what was accomplished by enforcement efforts, but, as we move into the 1990s, criminal prosecution of securities law is going to continue to be an important part of the program.

I will offer a final comment on the process from the Commission's perspective, and then I am sure we will have some reaction from the other people here. In our day-to-day investigative work and in looking at possible violations of the securities laws, there is an unacceptable amount of perjury, probably in the insider trading area more than any other area. For some reason, in insider trading cases there is a tendency for people to lie and to deny whatever the facts are that took place. Part of that, I think, is the nature of the violation. People do not equate insider trading perhaps with impropriety to the degree that one might often think they should. Another element of it is the sense that people can get away with it and people do not recognize that today there are telephone records, credit card receipts and a whole host of vehicles for linking people, conversations and events in time. We have become pretty good in the investigative process, and we are able to put that together. The good lawyers counsel their clients who get into situations where they have to account for their activities. Rather than have a client come in and lie, a good lawyer

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<sup>48</sup> *E.g.*, *United States v. Eisenberg*, 773 F. Supp. 662, 719-20 (D.N.J. 1991) (racketeering, scalping, bribery and securities fraud); *United States v. Zolp*, 659 F. Supp. 692 (D.N.J. 1987) (sufficiently plead allegations included fraudulent activities of corporation with no legitimate assets and fictitious executives).

<sup>49</sup> *United States v. Girdner*, No. CRIM.A.89-CR-0150-W, 1990 WL 309893 (D. Utah Feb. 1, 1990); *SEC v. Timothy*, No. CIV.A.89-C-53 5-J, 1989 WL 257477 (D. Utah June 29, 1989).

will tell the client to take the Fifth Amendment.<sup>50</sup> While I am always interested in getting the facts, I would advise everybody, "Don't worry about the Fifth Amendment, just tell me what happened." The government will help you. Whatever you do, when you or a client get into this situation, the worse thing you can do is not tell the truth, at least to your lawyer. Anybody on this panel who has been on either side of the fence would probably tell you the same thing.

Those are essentially my remarks. There is a lot more I could say. We are litigating a lot more cases now.<sup>51</sup> Securities fraud and insider trading remains a growth industry. The program is as complicated and as interesting as it has ever been, but there is a finite amount of time. I also saw Ted making notes in reaction to what I have said, so I will end here. Leonard, you may have some thoughts.

**Leonard M. Leiman**

I do indeed. But I would like to ask Roberta Karmel, a former Commissioner of the Securities and Exchange Commission, who has established a substantial reputation for being outspoken and having opinions of her own, whether she thinks that the priorities Bill McLucas outlined are appropriate priorities for 1992.

**Roberta S. Karmel**<sup>52</sup>

I think I continue to be outspoken even though it has been a

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<sup>50</sup> No defendant in a criminal case shall be compelled by a court of law to be a witness against himself. U.S. CONST. amend. V. See Lee S. Richards, III & Jonathan Kibbe, *Developing Issues in the Handling of SEC Investigations: The Implications of Defendant's Conduct in SEC Investigations for Related Private Civil Actions and Criminal Investigations*, in 1990 SEC ENFORCEMENT INSTITUTE, at 452 (PLI Corp. Law & Practice Course Handbook Series No. B692, 1990).

<sup>51</sup> See U.S. Securities and Exchange Commission Budget Estimate, Fiscal 1993, II-4 (on file with the SEC).

<sup>52</sup> Former Commissioner of the Securities and Exchange Commission (1977-80). B.A. cum laude, Radcliffe College (1959). LL.B. cum laude, New York University School of Law (1962). Ms. Karmel is a professor of law and Co-Director of the Center for the Study of International Business Law at Brooklyn Law School. She is also a partner in the law firm of Kelly, Drye & Warren and is currently a director of IMCERA Group, Inc. Professor Karmel served as a public director of the New York Stock Exchange, Inc. from 1983-89. Ms. Karmel is a Trustee of the Practising Law Institute and a member of the following associations: American Bar Association Federal Regulation of Securities Committee, the International Bar

while since I have been a commissioner. My main reaction to Mr. McLucas' remarks is to agree with his insight that the Remedies Act<sup>53</sup> is going to change the way in which the Commission's enforcement program operates. I would say, however, that this will only accelerate the trend toward criminalization of securities law violations. The new Remedies Act provides for a variety of sanctions and really does change the nature of enforcement from being remedial to being penal and that is in the direction of criminalizing securities law violations.

One of the conclusions that I have reached, watching securities law enforcement over the thirty years I have been involved in this area of the law, is that securities prosecutions are really very political. I think they are more political than is generally conceded by either the government or the private bar. When Director McLucas says, "Well, we're not likely to see the sensationalized cases that we had in the 1980s in the criminal law area," I think I would reply, "No, we're going to see some other type of prosecution become sensationalized."

Securities law enforcement is reactive, and it tends to be reactive in a way that is to some extent political. This is understandable since, after all, the SEC is a government agency. Therefore, what the SEC does is necessarily political to some extent. However, I think that the SEC should do two things that tend to be lost in this political criminalization of the securities law enforcement program. One is to maintain a very broad range of enforcement cases, particularly in the areas that are important to the functioning of the markets and the securities industry. However, if I may say so, these are boring cases involving garden-variety fraud, not headline-grabbing cases. It is very important to bring cases in a wide variety of areas to keep the markets fair and equitable and to keep the securities industry honest.

The other thing the SEC should remember is that the devel-

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Association, Financial Women's Association of New York, Association of the Bar of the City of New York Committee on Securities Regulation and the American Law Institute. She is a Fellow of the American Bar Foundation and is on the Boards of Advisors of the Review of Securities and Commodities Regulation, the Banking Law Journal, Business Accounting for Lawyers and the Center for National Policy. Ms. Karmel is an Advisor to the A.L.I. Corporate Governance Project and has authored numerous publications, including a bimonthly column for the *New York Law Journal*.

<sup>53</sup> See Remedies Act, *supra* note 38 and accompanying text.

opment of the substantive law can be impaired by bringing borderline cases. For better or worse, the securities laws, as a substantive matter, is the same in both civil, criminal and these quasi-criminal areas that are covered in the Remedies Act. When a case is brought as a criminal case and is lost, particularly when the case is lost because the trial court decision or the SEC administrative law decision is reversed by either a circuit court or the Supreme Court, this impairs or undermines a certain view of the substantive law that the Commission had in mind in bringing a case. That can have an important adverse effect on the SEC's enforcement program. I think one of the things that Mr. McClucas did not mention, and I can understand why, is that one of the reasons there may not be the same kind of criminal cases in the 1990s that we had in the 1980s is that a lot of the high-profile cases were lost by the government or reversed on appeal.<sup>54</sup> This is something that the Commission, as a whole, has to think about very carefully in making determinations as to whether cases should be prosecuted in a civil action, in a criminal action or under the Remedies Act.<sup>55</sup> My own judgment would be that extreme caution should be taken before securities law cases are brought as criminal cases or penal cases.

**Leonard M. Leiman**

I would like to turn to Professor Alan Bromberg who among all of us, given the nature of his work, must have read every case

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<sup>54</sup> United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc) (6-5 reversal of insider trading Rule 10b-5 and mail fraud convictions; 10-1 affirmance of insider trading Rule 14e-3 convictions), *cert. denied*, 112 S. Ct. 1759 (1992); United States v. Mulheren, 938 F.2d 364 (2d Cir. 1991) (reversal of manipulation, mail fraud and conspiracy convictions; dismissal of indictments); United States v. Regan, 937 F.2d 823 (2d Cir. 1991) (reversal of tax fraud and RICO convictions and remand of indictments; affirmance of securities fraud convictions); United States v. GAF Corp., 928 F.2d 1253 (2d Cir. 1991) (reversal of manipulation, mail fraud and conspiracy convictions; remand of indictments). The government decided not to retry the GAF case. Milo Geyelin & Arthur S. Hayes, *GAF Prosecutors*, WALL ST. J., Aug. 12, 1991, at B2. "In light of the three prior prosecutions in this matter, the government believes that the interests of justice will be best served by dismissing the indictment in this case at this time." *Id.* (statement of Roger Hayes, Deputy U.S. Attorney). Likewise, the remanded charges in *Regan* were not pursued. Wade Lambert & Milo Geyelin, *Princeton/Newport Defendants See Case Dropped by Prosecutors*, WALL ST. J., Jan. 9, 1992, at B4.

<sup>55</sup> See Remedies Act, *supra* note 38.

that ever was and will be in this area. Do you agree with Roberta Karmel that the Commission's case selection has not been particularly good from the standpoint of developing the law in constructive ways?

*Professor Alan R. Bromberg*<sup>56</sup>

De facto, that is true. For example, the four major cases from the Second Circuit are bound to show that for one reason or another the SEC did not choose the right cases or did not prepare them accurately.<sup>57</sup> But it seems to me that the Remedies Act covers important new opportunities. When you go at enforcement you have really three kinds of variables to consider: (1) the violations charge, (2) the kind of procedure you are going to bring and (3) the kind of sanctions for which you are going to ask. The Remedies Act affords new dimensions and new flexibility in all of those variables. So it seems to me that although I disagree somewhat with Roberta Karmel, I do not regard the Remedies Act's civil fines as quasi-criminal. I see them as much more civil. So I see this as an opportunity for the SEC to shy away from criminal work and to do civil or quasi-criminal work more effectively and more reasonably, and to avoid some of the gross injustices of criminal cases which may lead to a real setback in the development of the law.

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<sup>56</sup> Professor, Southern Methodist University School of Law. A.B., Harvard College (1949); J.D., Yale Law School (1952). Mr. Bromberg worked in private practice in Dallas, Texas between 1952-56 and then in 1976 became Counsel to Jenkins & Gilchrist. Professor Bromberg has been with the Southern Methodist University School of Law since 1955. He serves as a director to the Texas Business Law Foundation and has written substantial sections of the Texas securities, corporation and partnership statutes. Mr. Bromberg is the author of more than 100 articles on securities, corporate, partnership, commodities and tax law. He also serves as chair to the Legal Education Publications Advisory Board of Matthew Bender & Co. and is a member of the following organizations: American Law Institute, Advisory Board of the Review of Securities and Commodities Regulation, Advisory Board of the Securities Regulation Law Journal, Editorial Advisory Board of the Journal of Corporation Law, American Bar Association Committees on Federal Regulation of Securities, Partnerships, and Futures Regulation, and the Texas Bar Committee on Corporation, Securities, and Partnerships. Professor Bromberg is a former Chairman of the Section on Corporation, Banking and Business Law of the Texas Bar, former Chairman of its Securities Committee, Partnership Committee and Former Co-Chair of the Southwestern Legal Foundation Securities Institute.

<sup>57</sup> See *supra* note 54 for a historical account of Second Circuit reversals.

**Leonard M. Leiman**

Thank you Alan. Now, Ed, we will turn to you to ask your question.

**Edward H. Fleischman**<sup>58</sup>

My question, in general, will go to both what Roberta Karmel and what Alan Bromberg said. Roberta mentioned whether the Remedies Act has changed the securities law generally from remedial to penal. Alan glossed over it when he said that this is still squarely in the civil position. I understand that, as I hold that opinion myself. If you do accept the point Roberta makes, does that not hold quite a different perception in the courts to prosecutorial efforts, as well as private plans? If the statutes, in fact, have to be changed, as many people have suggested these last few years, from remedial to penal, will that argument not be advanced particularly in the appellate courts? Will there not be a real tidal wave effect back into the reception in the courts of the enforcement prosecution?

**Leonard M. Leiman**

Ted, you tried those cases, what do you think?

**Theodore V. Wells**<sup>59</sup>

I was lead counsel in the Princeton-Newport case involving

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<sup>58</sup> Former 66th Commissioner of the Securities and Exchange Commission (1986-92). Graduate of Harvard College; LL.B., Columbia Law School (1959). Mr. Fleischman served as an officer in the U.S. Army from 1952 to 1955. After obtaining a law degree, Mr. Fleischman practiced law for 26 years with Beckman & Bogue in New York City where he specialized in securities and corporate law. Since 1976, he has been an Adjunct Professor of Law in securities regulation at the New York University School of Law. In 1980, Mr. Fleischman was admitted to the bar of the U.S. Supreme Court and is President of the American College of Investment Counsel. He is also a member of the American Law Institute and the American Society of Corporate Secretaries. In the American Bar Association Section of Business Law, Mr. Fleischman chairs the Committee on Developments in Business Financing and serves as a member of the Committee on Counsel Responsibility, Committee on Federal Regulation on Securities, Committee on Futures Regulation, Committee on Developments in Investment Services and has been active in the Administrative Law Section.

<sup>59</sup> Graduate of the College of the Holy Cross (1972), Harvard Law School & Harvard Business School (1976). Since 1981, Mr. Wells has been a partner with the law firm of Lowenstein, Sandler, Kohl, Fisher & Boylan. From 1980-81, he was an

Mr. Regan,<sup>60</sup> and I successfully argued it in the Second Circuit and the convictions were reversed.<sup>61</sup> I have spent the last five years involved in these so-called high-profile securities cases.<sup>62</sup> I can say, without question, that the message that the Second Circuit sent was construed by the defense bar as being a rebuke of the positions taken by the United States Attorney's Office for the Southern District. But when Professor Bromberg said that the SEC Commission lost four cases, or suggested the Commission lost four cases, I think we have to keep in mind that all of those four cases were really U.S. Attorney Southern District of New York cases and not really the Commission's cases. The real concern I have as a practitioner is that nobody today knows what the rules are. What happened during the late 1980's, in my opinion, was that the Southern District, really Rudy Giuliani and others in that office, attempted to change the existing rules by the use of the criminal process.

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Adjunct Professor at the Seton Hall University School of Law teaching trade regulation. Mr. Wells has also taught trial practice courses for the Practicing Law Institute and the Harvard Law School Trial Workshop. Significant cases litigated by him include *Leon v. Shane*, where he was lead trial counsel and won a multi-million dollar jury verdict, and *United States v. Regan*, where Mr. Wells was lead defense counsel in a Wall Street RICO prosecution. Mr. Wells is a defense lawyer for the Essex County Urban League. He holds corporate directorships at the College of the Holy Cross and with the Association of Criminal Defense Lawyers. In 1989, Mr. Wells was selected by the *National Law Journal* as one of the top 50 lawyers in the United States under 50 years of age. In 1990, he was also selected by the *National Law Journal* as one of the top litigators in the United States.

<sup>60</sup> *United States v. Regan*, 699 F. Supp. 36 (S.D.N.Y. 1988), 706 F. Supp. 1102 (S.D.N.Y. 1989), 713 F. Supp. 629 (S.D.N.Y. 1989), 726 F. Supp. 447 (S.D.N.Y. 1989), 858 F.2d 115 (2d Cir. 1991), *rev'd*, 937 F.2d 823 (2d Cir. 1991), *modified*, 946 F.2d 188 (2d Cir. 1991), *cert. denied*, 112 S. Ct. 2273 (1992). Most of the *Regan* defendants were associated with Princeton-Newport Partners, a limited partnership investment firm, with offices in New Jersey and California. Defendant James Regan was a managing partner at the firm.

<sup>61</sup> *Id.*

<sup>62</sup> Mr. Wells was counsel for various directors, officers or controlling persons in the following securities cases: James Regan (Wall Street RICO prosecution); Leonard Tucker (prosecution of F.D. Roberts Securities for stock manipulations); co-counsel for Michael Milken in federal securities class actions in New York and California; counsel for Michael Steinhart in Salomon Brothers securities litigation involving possible collusion in the U.S. treasury securities market. His law firm appeared as counsel in *Rolo v. General Dev. Corp.*, 949 F.2d 695 (3d Cir. 1991) (class action based on fraudulent marketing scheme) & *Ford Motor Co. v. Summit Motor Products, Inc.*, 930 F.2d 277 (3d Cir. 1991) (counterclaim of violation of RICO Act).

As a result of that, none of us who title ourselves as criminal defenses lawyers are sure right now just what the rules are going to be in the future. I think it loops back and has a really detrimental effect in terms of civil enforcement because, ultimately, it is important on the civil side, that the Commission get the facts and get as much information as it can so that remedial remedies can be shaped. The real problem is that nobody wants to testify; everybody wants to assert the Fifth Amendment because you do not know if some over-zealous prosecutor in New York or someplace else is going to take something that has traditionally been viewed as a civil wrong and try and convert it into a criminal action. Therefore, all of us on the defense practitioner's side of the fence are being extremely conservative. Ultimately, I do not think that it really bodes well for the civil side of enforcement because what you really have now is the potential for criminal prosecutors and local United States Attorney's Offices to shape the direction of the securities law, and they can get out in front of the Commission and the enforcement division. The Commission has no real power to stop these local prosecutors.

I presently have a case in California where you have people in the local United States Attorney's Office trying to almost model themselves after Mr. Giuliani, because they think they have the next Milken case. I had the craziest case recently. I was representing a regional brokerage firm based in New Jersey that did some underwritings in South Carolina. The State prosecutor in South Carolina had read an article in the newspaper concerning some of Giuliani's prosecutions. The State prosecutor thought he could take some of the theories he had read about in the newspaper and (this prosecutor is a guy who practiced primarily in cases involving drugs) attempt to bring a securities case. This is a guy who knew no more about securities than the man in the moon. Yet he was going to attempt to try these cases. The difference between criminal and civil securities cases is often a pure policy decision, and there is a notion now that any local prosecutor can become a securities prosecutor. There is a higher standard of proof in the theoretical sense for criminal securities cases, but in almost all of these cases if you want to, if it is a civil wrong, you can say it is a criminal wrong. This is a real problem for the Commission and the Enforcement Division, which are los-



ing control of securities enforcement and fast becoming the tail, as opposed to the head, of the dog.

*Lewis D. Lowenfels*<sup>63</sup>

Picking up on what you said, Ted, it is interesting to me as a defense lawyer and a corporate securities lawyer. I feel sometimes as though I am sitting at the center of a maelstrom because you not only have the criminalization of the securities laws, and United States Attorneys like Mr. Chertoff coming after you, but also the powers of the SEC with Mr. McLucas. You also have a tremendous rise in the activity and aggressiveness of state enforcement.<sup>64</sup> In addition, you have a substantial increase in the intensity of the National Association of Securities Dealers (NASD), with their market surveillance group and their investigative forces coming at you.<sup>65</sup> So not only, as Ted says, do you

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<sup>63</sup> Adjunct Professor, Seton Hall University School of Law. Graduate of Harvard College and Harvard Law School. In the early 1970s, Mr. Lowenfels was special counsel to the American Stock Exchange in connection with the introduction of options trading to the American Stock Exchange floor. Since 1974, he has been a partner with Tolins & Lowenfels and represents investment banking firms and Wall Street individuals in all areas of business including public offerings, private placements, investigations, disciplinary proceedings and arbitrations. He is currently a member of the American Bar Association, New York Bar Association, New York County Lawyers Association, Committee on Securities and Exchanges, American Law Institute and the Southwestern Legal Foundation. Mr. Lowenfels is also the co-author of a seven volume treatise on securities law.

<sup>64</sup> *Armstrong v. State*, 811 P.2d 593 (Okla. Crim. App. 1991) (conspiracy to violate securities act); *State v. Johnson*, 823 P.2d 484 (Utah 1991) (felony security fraud violations); *State v. Newman*, 469 N.W.2d 394 (Wis. 1991) (conviction on theft and securities fraud).

<sup>65</sup> JAMES D. COX ET AL., *SECURITIES REGULATION* (1991). "The NASD's scope of responsibility is broad and includes overseeing the operation of the over-the-counter market and establishing and enforcing rules for its efficient and fair operation." *Id.* at 29.

Nearly all NASD disciplinary proceedings begin at the district level, where District Business Conduct Committees . . . hold such hearings as are necessary or appropriate to resolve a particular matter . . . . When a sanction is ordered at the district level in a formal proceeding, the matter is reviewed by the National Business Conduct Committee, a committee of the Board of Governors. The NBCC may order a hearing by a new hearing panel at the national level even if there is no appeal; such a hearing is automatically scheduled if the subject does appeal.

*Id.* at 1196. NASD also has a Market Surveillance Department with computer facilities that monitor all transactions reported through NASDAQ. Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. ILL. L. REV. 315, 346 (footnote omitted).

have a blurring of the rules, but you also have a tremendous aggregate of regulators coming from different angles and different sides with different interests that they are protecting, with different degrees of sophistication and with different degrees of sensitivity to the rights of defendants. It puts a tremendous burden on business. It is great for people like Ted and I, who make our living this way, but I really wonder whether this multi-tiered regulatory thrust is good for the country, particularly when you put it in the perspective of the small business initiatives, which the SEC is now trying to promote, and which the American Stock Exchange is promoting with their emerging market surveillance systems.<sup>66</sup> You have a number of regulators coming at you utilizing a number of different remedies based on a number of different laws, all with different interests to protect. I think it is a big problem today.

***Professor Alan R. Bromberg***

Let me add a footnote to what Lewis Lowenfels said that you may not be aware of. While Congress has successively raised fines for securities violations,<sup>67</sup> Texas, where I live, has gone at it the other way. Texas has successively raised the prison sentence.<sup>68</sup> Texas now has, for fraud, a minimum prison term of five

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<sup>66</sup> The NASD has computerized on-line and off-line surveillance of trading and quotations in NASDAQ securities. All quote changes and transaction reports are recorded and analyzed by NASDAQ computers, so that surveillance analysts can reconstruct activity in their investigations. Pinto, *supra* note 27, at 740.

<sup>67</sup> Maximum criminal penalties in Securities Exchange Act § 32 for willful violation of that Act were increased from 5 years and \$10,000 (\$500,000 for stock exchanges) in 1984 to 5 years and \$100,000 (\$500,000 for stock exchanges) and again in 1988 to 10 years and \$1,000,000 (\$2,500,000 for stock exchanges and anyone other than a natural person). See Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, 1265, 15 U.S.C. 78ff (1984); Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, 4680, 15 U.S.C. 78ff (1988).

<sup>68</sup> TEX. REV. CIV. STAT. ANN. art. 581-29 (West 1992). Maximum penal penalties under the Texas Securities Act for fraud were increased from 10 years and \$5,000 in 1983 to not less than 2 or more than 10 years and a fine of not more than \$10,000 (or if the offense involves more than \$10,000: not less than 2 or more than 20 years and a fine of not more than \$10,000) and again in 1991 to not less than 2 or more than 10 years and \$10,000 (or if the offense involves more than \$10,000 but less than \$100,000: not less than 2 or more than 20 years and a fine of not more than \$10,000). If the offense involves more than \$100,000: not less than 5 or more than 99 years of imprisonment and not more than a \$10,000 fine. See 1983 Tex. Sess. Law Serv. 2711 (Vernon); 1991 Tex. Sess. Law Serv. 2005-06 (Vernon). The

years and a maximum of ninety-nine years if the violation involves more than one hundred thousand dollars, with an aggregation provision.<sup>69</sup>

**Leonard M. Leiman**

Bill, you are certainly seeing more people resisting the easy settlements of past days. Lew Lowenfels was also suggesting that you are also out of synch with the regulatory practice. How would you respond to that?

**William R. McLucas**

Well, a couple of things. First of all, my view is absolutely consistent with reducing or eliminating barriers to capital raising, capital formation and tougher enforcement. When you lower the red tape and the rules, however, you also have someone standing by the road for those people who cannot play by the rules. The message has got to be: "If you cheat, if you commit fraud, you're going to get whacked, and you're going to get whacked severely."

Now, let me go back to a couple of things. You have heard here that there have been literally four reversals, that there is a tidal wave against the Commission, against the government, and against enforcement of the federal securities laws emerging primarily from some of the criminal decisions in the Southern District.<sup>70</sup> There are some problems with some of the decisions that came down inside the Southern District or from the Court of Appeals in terms of what they mean for the government enforcing federal securities laws.<sup>71</sup> I would submit to you: 1) there is no

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state has traditionally relied more heavily on criminal than on civil enforcement. Texas securities administrators believe that fines are not an effective discouragement and are rarely collectible, and that only "hard time" in prison is effectively deterrent.

<sup>69</sup> TEX. REV. CIV. STAT. ANN. art. 581-29 (West 1992) (amounts obtained under one scheme or continuing course of conduct are aggregated in determining the grade of the offense).

<sup>70</sup> See *supra* note 54.

<sup>71</sup> For example, the "familial relationship" analysis formulated by the Second Circuit in *Chestman* presents a difficult framework for determining when a sufficient "confidential" relationship exists between family members. *United States v. Chestman*, 947 F.2d 551, 567-68 (2d Cir. 1991). Other courts have handed down procedural opinions that make it more difficult to obtain meaningful remedies for

tidal wave; and 2) that is why there are courts and also why the difficult cases litigate. You do not get the equivalent in the securities law field of "slip & fall" cases going to the Second Circuit presenting complex, difficult legal policy judgments. These are the tough cases, and they are the tough cases because this is fraud, generally speaking, that is what we are talking about, and you prove it the hard way—through pieces of paper and circumstantial evidence. These are not people who walk through the door and say, "You caught me." The reversals are obviously troubling, but there is no tidal wave here. If the government only brings cases that it wins, or the government only brings cases that people consent to, then the government is not doing its job. No prosecutor ought to file a complaint or seek an indictment where he or she does not believe the evidence is there, that the conduct ran afoul of the law and it can be proven either to a court or to a jury. But if a prosecutor in this field, in particular, is only bringing cases that are so clear and so absolutely certain on the evidence and the law, that no one can disagree on the merits, then that prosecutor ought to go out and get another job.

*Leonard M. Leiman*

Let us hear a practitioner's response to that.

*Lewis D. Lowenfels*

I want to respond to the first thing you opened up with, Bill, which kind of made me shudder a little bit. If, and I have seen this in some of the Commission's briefing statements as well, you think that by streamlining the quote "red tape" that you, therefore, have to be tougher in enforcement to compensate for that, I respectfully suggest to you that is a very dangerous approach because when you streamline the red tape, the effect on the Richter Scale is maybe a one or a one-and-a-half. When you increase enforcement, particularly on smaller companies, the increase on the Richter Scale goes up to around six or seven. I submit to you

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securities law violations. See *SEC v. Steadman*, 967 F.2d 636, 641-43 (D.C. Cir. 1992) (vacating injunction entered for registration violation committed by person not acting with scienter); *SEC v. Unifund SAL*, 910 F.2d 1028, 1041-42 (2d Cir. 1990) (limiting circumstances under which Commission can freeze trading accounts of suspected insider traders).

that if the trade-off of "streamlining" is going to be more enforcement, particularly with respect to smaller companies, I think we are going down the wrong road.

**William R. McLucas**

I don't know how to respond to that. You cannot say, "Let's have the initiative to lessen the regulatory barriers, but let's not enforce the law."

**Lewis D. Lowenfels**

I am not saying that. I think it is a question of degree. I think the enforcement program of the Commission is strong enough as it is, and I think that when buttressed by the other regulatory agencies,<sup>72</sup> it is even stronger. I certainly do not think you need to compensate for any "streamlining." I think you just have to streamline and provide no offsetting compensation.

**William R. McLucas**

Now you are getting to the point. You are getting to where, over time, the use of the Remedies Act,<sup>73</sup> the use of penalties will occur . . . .<sup>74</sup> My view, contrary to Professor Karmel, is that indeed the Remedies Act may mean you see less criminal prosecution in certain kinds of cases because the deterring effect obtained in the civil context may eliminate the need for criminal prosecution. I would be interested in Michael Chertoff's reaction to that. But also, I guess, one thing I want to respond to, is Roberta's remark that all the securities law prosecutions were political. I assume that she means that with a small "p."

The agency is reactive obviously to the markets, what is going on in the economy, what is happening in the real world. We

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<sup>72</sup> In addition to the federal regulatory power of the SEC, state commissions enforce their own state securities law which are generally referred to as "blue sky" laws. Cox, *supra* note 65, at 28. The origin of the name reflects the states' initial objective of restricting and controlling promoters who would sell interests having no more substance than "so many feet of blue sky." *Id.* (quoting Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) (upholding the constitutionality of blue sky laws under the Fourteenth Amendment and finding no burden on interstate commerce)).

<sup>73</sup> Remedies Act, *supra* note 38.

<sup>74</sup> See *supra* note 39.

cannot have an agency with the responsibilities of the SEC that exists basically as a magnet. However, on the political issue, given my personal views, having been there for seventeen years, I differ, noting that both Roberta and Ed were my clients at various times during those periods. The issues of who is involved, who the company is, who the lawyers are, what political party, what religion, do not come into play in the Commission, probably less so than any other agency in the government. On that score, the political issue is with a small "p." It is what is going on in the market and the economy as opposed to, "Gee, who is this individual or who is this company and is this going to be a matter that would be a good thing or bad thing to pursue." Those judgments are made and called straight up on the facts and the law.

***Roberta S. Karmel***

There are two comments I would like to make. One is an elaboration by what I mean by "political." Yes, I mean political with a small "p." I do think the SEC has always properly functioned with independence in terms of party obligation and anything along those lines. Perhaps a word I could have used instead of "political" is "fashionable." That seems to almost trivialize what is going on, and yet there are times when that is appropriate. I can remember a time when what was politically appropriate or fashionable were criminal prosecutions for violations of Regulation T.<sup>75</sup> Today, many people hardly know what violations of Regulation T are, but, nevertheless, criminal cases were brought for those violations in the late 1960s. In the 1980s, insider trading was the politically exciting kind of case, and this had a lot to do with perceptions about whether the junk bond market<sup>76</sup> was good or bad for the economy of the country.

The other comment I really wanted to make was in response to Bill's statement that if a prosecutor is only bringing cases that

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<sup>75</sup> Credit by Brokers & Dealers, Reg. § 220 [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 47,501, at 47,141 (May 1990). "[Regulation T's] principal purpose was to regulate extensions of credit by and to brokers and dealers; it also covers related transactions within the [Federal Reserve System's] authority under the Act. It imposes, among other obligations, initial margin requirements and payment rules on securities transactions." *Id.*

<sup>76</sup> See generally ROBERT A. TAGGART, JR., *MERGERS & ACQUISITIONS* 5-24 (Alan J. Auerbach ed., 1988) (tracking the growth and volatility of the "junk" bond market).

are clear-cut and that can be won, there is something wrong. In terms of criminal prosecutions, I strongly disagree. I think that it happens and it is understandable that at times prosecutions, civil or criminal, are lost because of a failure of proof that is not anticipated. Certainly, in a situation where we have the kind of criminal justice system enjoyed in the United States, that is appropriate. On the other hand, it seems to me there is something wrong when a criminal prosecution is lost on the law. In other words, where the law was unclear but a criminal prosecution brought based on the prosecutor's interpretation succeeds in a district court, but the court of appeals or the Supreme Court reverses, I question the government's judgment in bringing the case. It does not seem to me in novel areas such as this, that criminal prosecutions are appropriate. I would say in civil actions, the story is different. Perhaps new law can be made in a civil case brought by the SEC. But I really do not feel it is appropriate in a criminal case.

### *Theodore V. Wells*

I would just like to add to what Roberta Karmel is saying in terms of bringing criminal actions where the law is unclear.<sup>77</sup> I see it really as a fair notice issue and, in many areas of the government, procedures have been set up to try and deal with this fair notice issue. For example, in the anti-trust area, the anti-trust division has enacted guidelines<sup>78</sup> to the effect that it will only proceed criminally in areas of the law that constitute a hard-core per se violation of the anti-trust laws, such that every one in the business community has been put on notice.<sup>79</sup> In the tax

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<sup>77</sup> *E.g.*, *United States v. Regan*, 699 F. Supp. 36 (S.D.N.Y. 1988), 706 F. Supp. 1102 (S.D.N.Y. 1989), 713 F. Supp. 629 (S.D.N.Y. 1989), 726 F. Supp. 447 (S.D.N.Y. 1989), 858 F.2d 115 (2d Cir. 1988), *rev'd*, 937 F.2d 823 (2d Cir. 1991), *modified*, 946 F.2d 188 (2d Cir. 1991), *cert. denied*, 112 S. Ct. 2273 (1992) (involved the controversial issue of whether stock "parking" is a criminal offense).

<sup>78</sup> See generally James M. Grippando, *Caught in the Non-Act: Expanding Criminal Antitrust Liability for Corporate Officials*, 34 ANTITRUST BULL. 713 (1989); Thomas E. Kauper, *The Justice Department and the Antitrust Laws: Law Enforcer or Regulator?*, 35 ANTITRUST BULL. 83 (1990); U.S. DEP'T OF JUSTICE, DEP'T OF JUST. MANUAL: ANTI-TRUST DIV., tit. 7, ch. 5 (P-H Supp. 1990-91).

<sup>79</sup> 15 U.S.C.A. § 1 (West 1973 & Supp. 1992).

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . [A violator] shall be

area, the Justice Department, in order to put a check on how local United States Attorney's Offices use their power to bring tax cases, requires that the main Justice Department in Washington, D.C. sign off on all criminal tax prosecutions.<sup>80</sup> Now why is that? That is because there is a recognition that you want some type of central control in terms of how the tax laws are developed. As it stands now if a criminal tax case is instituted and the court of appeals rejects the legal theory of the criminal case, the tax regulators, may in essence, be precluded from receiving a judicial decision that might have been received in a civil suit. Whereas in securities law, right now, there is no real check on local prosecutors.

There is some notion of comity, but the bottom line is if you get a powerful United States Attorney in a local office and that person wants to bring a securities case, that person has the power to bring it. And he may make bad law. Many of the cases that were reversed because they were criminal cases, might have been accepted by the court of appeals if the Commission had argued them as civil suits. Not only do I feel personally that the criminal laws have been misused because of the fair notice problem, but

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deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

*Id.*

<sup>80</sup> 26 C.F.R. § 301.7602-1(c)(2) (1992).

A Justice Department referral is in effect with respect to any person when:

- (i) The Secretary recommends . . . that the Attorney General either commence a grand jury investigation of or criminal prosecution of such person for any alleged offense connected with the administration or enforcement of the internal revenue laws, or
- (ii) The Attorney General . . . requests in writing that the Secretary disclose a return of, or return information relating to, such person. The request must set forth that the need for disclosure is for the purpose of a grand jury investigation of or potential or pending criminal prosecution of such person for any alleged offense connected with the administration or enforcement of the internal revenue laws.

The referral is effective at the time the document recommending criminal prosecution or grand jury investigation is signed by the Secretary . . . .

*Id.* See U.S. DEP'T OF JUSTICE, DEP'T OF JUST. MANUAL: TAX DIV., tit. 6, ch. 4 (P-H Supp. 1992-93).



we have also all been hurt because, as I stated before, certain positions of the Commission might have been adopted, but were rejected because the issues were presented to the court of appeals in the context of a criminal case, as opposed to a civil case.

**Roberta S. Karmel**

I agree 100% with what Ted said.

**Leonard M. Leiman**

An extremely well made point. Bill, perhaps you could close this part of the program by responding to that and along the way perhaps also comment on the manner in which those priority decisions are made within the Commission. We are all lawyers and we are at least as interested in process as we are in substance.

**William R. McLucas**

I think some of what Ted Wells said is true. Unfortunately, it is true if you look now at a couple of decisions that may indeed have come out the other way had the cases been presented as civil proceedings.<sup>81</sup> Which cases become criminal and how they are pursued clearly is determined in part, as a result of contact between the staff of the Commission and the United States Attorney's Office. For briefs and positions that are submitted on major legal issues, particularly at the appellate level, there is contact and communication. At the trial level, you can assume there is an effort by the Commission to basically work with the prosecutors as to how the law is going to be articulated by the government. It is very difficult for me to sort out in the major cases, *GAF*, *Regan*, *Mulheren*, and perhaps *Chestman*. I think *Chestman* is a decision that, on the insider trading holding of the court, it would have come out the same no matter how the case was presented.<sup>82</sup> I disagree with the way the court came out. *Chestman* was not, however, a reversal entirely.<sup>83</sup> But it is hard, sitting here today, to say

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<sup>81</sup> See *supra* note 54.

<sup>82</sup> *United States v. Chestman*, 947 F.2d 551, 571 (2d Cir. 1991) (absent fraud by the alleged misappropriator, defendant could not be derivatively liable as a tippee or an aider and abettor).

<sup>83</sup> *Id.* (Rule 14e-3(a) conviction prohibiting fraudulent trading in connection with a tender offer was affirmed, reversed Rule 10b-5 and mail fraud convictions).

whether the court would have viewed the law differently in a civil context than it did in the situation that was presented. It may well be the case, I do not know. The issues of fair notice, and how the decisions are made, clearly depend on who is in the United States Attorney's Office. The relationship generally has been a strong one between the Southern District of New York and the SEC where these cases came out of. However, we do have a fair and consistent dialogue with that office about how cases are going to be pursued and what cases are within the limits of that dialogue.

***Leonard M. Leiman***

How about at the level before criminal law? How are those priorities?

***William R. McLucas***

Well, do you mean, do we discuss with them whether it is a civil or criminal context that we are thinking about or . . .

***Leonard M. Leiman***

No, I'm really trying to get below that. You cannot possibly bring every case that pops into your mind or that appears on your desk, you take some and not others. You plainly are bringing loads and loads of insider trading cases. There is an implicit decision that insider trading is an important subject of the Commission to drive home. Is that a reasonable decision at the Division's level?

***William R. McLucas***

Roberta Karmel said that a few minutes ago. She said insider trading was fashionable in the 1980s. It was not fashionable. It was a fact of life. You had mergers and acquisitions, a market that was heated up to a degree that had never been seen, twenty-six year-old kids putting \$2,000 into money call options and making \$300,000 and \$400,000 using Swiss bank accounts. It was not a decision made by the SEC that, "Gee, wouldn't it be neat to try to bring some of these cases." It was a decision driven by the conduct in the markets.

There was fraud going on in the market in the 1980s, and it

was a reactive decision and a correct decision to go after it. What about insider trading cases today? The number of referrals from the self-regulatory organizations (SROs)<sup>84</sup> are down dramatically because of a decline in merger and acquisition activities. The kinds of cases though, are selling on bad news and tipping your friends and associates. We brought a case yesterday, which is in the *Wall Street Journal* today, against two former employees in the Comptroller of the Currency, who were alleged to have been tipping friends about developments between regulated banks and bank holding companies and, in one instance, about a scheduled examination of a financial institution.<sup>85</sup> So it is a decision that is driven by what the markets are showing and what the market surveillance group is kicking out in terms of how that fits into the overall program.<sup>86</sup>

My view is that we probably made a dent in insider trading. How much I cannot tell you. The decline may be more a function of the markets in the merger and acquisition activity than it is the result of people afraid of going to jail. But it will remain a reasonably consistent element of the program going forward because it is something we ought to be doing. That decision is made to a great extent at the staff level with the Commission basically reviewing the cases and the allocation of its resources as we assess those cases through the decision-making process.<sup>87</sup>

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<sup>84</sup> Cox, *supra* note 65, at 29.

The Securities Exchange Act is unique to the extent it prescribes a co-operative regulatory effort by the SEC and industry-sponsored groups, . . . [called SROs]. Currently, there are four types of SROs embraced by the Exchange Act: the national securities exchanges, the national securities association, registered clearing agencies, and the Municipal Securities Rulemaking Board.

*Id.*

<sup>85</sup> Kevin G. Salwen, *Former Comptroller of Currency Staffers Charged With Insider Trading by SEC*, WALL ST. J., Apr. 10, 1992, at A1.

<sup>86</sup> See John J. Gavin, *The Need for Market Intelligence*, in PROXY CONTESTS, INSTITUTIONAL INVESTOR INITIATIVES, MANAGEMENT RESPONSES 1990 (PLI Corp. Law & Practice Course Handbook Series No. 245, 1990), available in WESTLAW, Database JLR, 696 PLI/CORP 245 at \*1. Stockwatch "combines the latest in technology with sophisticated knowledge of the marketplace to detect and identify significant share accumulations. It provides market surveillance." *Id.* The resources to identify accumulations include 13F filings, depository lists, registered holders list, Non-Objecting Beneficial Owners (NOBO) lists, 13D filings and street contacts. *Id.*

<sup>87</sup> One of the factors in deciding whether to prosecute cases is to what degree its negative impact would have on short-term markets. Spencer Derek Klein, *Insider*

*Lewis D. Lowenfels*

One word Bill McLucas did not use was choice. Of course he makes choices. Of course his staff makes choices. Of course the Commission makes choices. And those choices are as to blocks of cases as well as to particular cases. Message cases are going to be brought. The choice of what is a message case, of what message is to be conveyed is, to use Roberta Karmel's term, a political choice, without a capital "p." It is a choice of where the emphasis in the enforcement program or, as Bill McLucas put it at the very end, where the allocation of resources is going to go. Insider trading was not a dictated decision. It was a political choice, with a small "p," to put emphasis into that particular part of the program. It goes on all the time. As Alan Bromberg said, each of the three major areas—what violations to charge, what type of proceeding to institute and what sanctions to recommend—all involve choices, little "p," political choices.

*Part II*  
*Criminal Securities Priorities*

*Leonard M. Leiman*

We will turn now to the criminal side, with Michael Chertoff leading off.

*Michael Chertoff*<sup>88</sup>

I thought we were doing the criminal side already! I am go-

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*Trading, SEC Decision-Making, And The Calculus Of Investor Confidence*, 16 HOFSTRA L. REV. 665, 681 (1988).

<sup>88</sup> U.S. Attorney, District of New Jersey. Graduate of Harvard College and Harvard Law School. Mr. Chertoff worked in private practice for three years after serving as a judicial clerk to Circuit Judge Murray I. Gurfein in New York and Associate Justice William J. Brennan, Jr. of the United States Supreme Court, respectively. In 1983, he was appointed as Assistant United States Attorney for the Southern District of New York. The "Mafia Commission" case was just one of the significant and successful actions which Mr. Chertoff prosecuted. In 1987, Mr. Chertoff was appointed First Assistant United States Attorney in the District of New Jersey. Within this position, he prosecuted and convicted former State Senator David Friedland for racketeering and mob figures for racketeering and murder. In June of 1990, Mr. Chertoff assumed the position of United States Attorney. His significant activities have included being lead trial counsel in the successful prosecution of Gerald McCann, former mayor of Jersey City, N.J.

ing to make Bill McLucas seem like a pussy cat. I am going to give everyone on the panel heartburn.

I am not a securities lawyer and the reason that is important is because I do not view these issues through what I consider to be the somewhat narrow prism of people who are securities lawyers by training and for whom the criminal process is just an adjunct to the securities law process. I am a prosecutor and I have been by profession for close to ten years. To me securities fraud is a species of fraud—like tax fraud, bank fraud, telemarketing fraud, consumer fraud.<sup>89</sup> Mainly, what securities fraud involves is lying about things that are material, lying in your books and records and lying in your disclosures. Insider trading is a form of lying or nondisclosure by people who have obligations to disclose.<sup>90</sup> I think that perspective is very important. I think it is probably shared by almost 100% of the prosecutors who serve as United States Attorneys or in positions of authority in the Department of Justice. That perspective is important, I think, in understanding the attitude that we take to securities enforcement. I do not reject a lot of what was said, but there are some fundamental premises with which I differ which I would like to talk about for a few minutes before I begin with the rest of what I have to say.

I think that the danger with much of what I have heard is the danger with any group of professionals or people who operate within a small club in which the rules are highly technical and complex. The professionals suppose the essence of their subject matter is unintelligible to mere mortals and that therefore they should be left alone to police themselves and take care of their own house in private. There are two places in the world that I am aware of in which this view of enforcement has been prevalent and I think they have been horror shows. I am not saying this is limited to two areas. One is England<sup>91</sup> and one is Japan.<sup>92</sup>

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<sup>89</sup> See, e.g., *Goldstein v. Equitable Life Assurance*, 289 N.Y.S. 1064, 1067 (N.Y. Civ. Ct. 1936) (traditionally, fraud is generally any kind of artifice employed by one person to deceive another). Generally, fraud involves the "intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing . . . or to surrender a legal right." BLACK'S, *supra* note 35, at 660.

<sup>90</sup> See *supra* note 40 and accompanying text.

<sup>91</sup> E.g., Nicolas Bray, *Securities Lending In U.K. Dealt Blow By Maxwell Affair*, WALL ST. J., Dec. 9, 1991, at A10. "The scandal over the late Robert Maxwell's alleged pillaging of his companies' pension funds has dealt a blow to securities lending [in

I had some personal experience some years back in private practice in dealing with regulators in England. The view for a very long time in the City of London was that the insiders policed their own securities, insurance and other financial crimes. When problems arose it was taken care of in the club room. They got a stern tongue lashing and perhaps there was some modest recompense to the victim and then matters were cleaned up. As a result, I think there was a pervasive distrust of financial institutions in England which ultimately, although I think it is now being corrected, could have damaged the ability of London to remain an international capital of finance.<sup>93</sup>

I think Japan is worse. In Japan there are now scandals so profound that they threaten the fabric of Japanese society.<sup>94</sup> Scandals in which it seems that everybody is involved in a kind of massive insider trading and government information swapping. Scandals in which law enforcement authorities have very deliberately shied away from attacking significant actors who were involved in violation of criminal laws and regulatory laws. I am not an expert in Japanese culture, but from what I read, I think that this is so pervasive that there are now serious questions about the ability of Japan to operate in a law-abiding fashion at the highest reaches where that country is governed.<sup>95</sup> Maybe it makes a dif-

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Britain].” *Id.* Since cases of fraud in the early 1980s, safeguards have been enacted to ensure that sufficient collateral is provided. “In Britain, lenders normally demand collateral equivalent to 105% of the value of the securities they are lending, but in the case of some borrowers this can rise to 110% or more, depending on creditworthiness.” *Id.* These safeguards, however, apparently were not observed in the Maxwell case.

<sup>92</sup> Maggie Farley, *How to Make a Killing in Japan: Teton Partners’ George Noble Shorts the Market and Wins Big*, BOSTON GLOBE, Aug. 4, 1992, at 37. The Japanese market, some claim, is rigged, marked by insider trading and almost impossible for foreign-based investors to understand.

<sup>93</sup> See *supra* note 91 for some of the ongoing lending reforms being shaped in the British markets.

<sup>94</sup> See, e.g., Clay Chandler, *Japan Penalizes Securities Firms in Stock Scandal*, WALL ST. J., July 9, 1991, at A3, A10 (Tokyo Stock Exchange scandal led to a government-imposed suspension of corporate business at four securities firms); Clay Chandler & Quentin Hardy, *Ministry Broadens Sanctions on Nomura*, WALL ST. J., Oct. 9, 1991, at C1, C16 (Japan’s Ministry of Finance ordered a securities firm to suspend various operations because of “excessive promotion” and illegally compensating favored clients for losses); Douglas R. Sease, *Japanese Securities Scandal Slams Stock Prices in U.S.*, WALL ST. J., June 25, 1991, at C1 (resignation of senior figures in the wake of charges that securities firms had compensated customers for investment losses).

<sup>95</sup> See *Japanese Major Proposes Coup to Clean Up Politics*, WALL ST. J., Oct. 16, 1992,

ference to Japanese society, maybe it does not. Maybe there are people who think that from the standpoint of increasing economic wealth it is more efficient to have an inside group at the top controlling everything. That view, however, is fundamentally inconsistent with the way *American* society works, and if there is a political dimension to what we do as prosecutors it stems from a vision of what society is about and what our obligation is in protecting society. To me that obligation is fostering fairness and equality—demonstrable fairness and equality that everybody can see. Enforcement of the law across the board, insiders and outsiders alike, is an example of that.

I also disagree with the idea that there has been a tremendous setback for securities law enforcement as a result of adverse rulings in a few of these high profile criminal cases.<sup>96</sup> I think it is too easy to buy into the myth which has been promulgated in some quarters, and notably in the *Wall Street Journal* editorial pages, that all these cases are bankrupt; that they were all rejected because of the judicial distaste for the criminalization of securities law;<sup>97</sup> that everything again should be returned to the inner sanctum of the board room of the New York Stock Exchange where insider trading or any other kind of misconduct, if it is misconduct, should be dealt with through "appropriate" administrative sanctions preferably under the veil of confidentiality.<sup>98</sup>

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at A11 (army personnel call for a coup in wake of illegal donations and bribes accepted by political figures); Jacob M. Schlesinger, *Kanemaru's Resignation from the Diet Portends Cleanup in Japan, Critics Hope*, WALL ST. J., Oct. 15, 1992, at A11 (Liberal Democratic Party vice chairman resigns over admittedly taking \$4 million in campaign contributions from a company with alleged ties to gangsters); Jacob M. Schlesinger, *Politics 'in Flux' in Japan as Scandal Ensnarers 2 Leaders*, WALL ST. J., Sept. 30, 1992, at A10 (written confession submitted by government official for accepting excessive contributions).

<sup>96</sup> See *supra* note 54.

<sup>97</sup> E.g., Wade Lambert, *Jefferies, Top Insider-Trading Witness, Draws Modest Fine, Is Put on Probation*, WALL ST. J., July 7, 1989, at 2 (\$250,000 fine and five year probationary period deemed mild in comparison with defendant's wealth); Sokolow's *Sentence in Insider Trading Case is Reduced*, WALL ST. J., May 5, 1987, at 17 (insider trading sentence of defendant reduced by one-third). But cf. Mark C. Hansen, *Public Sympathy for Milken and GAF Spurred on Salomon*, WALL ST. J., Aug. 29, 1991, at A12. "Looking back on the prosecutions of the 1980s, it becomes apparent that the government, for the most part, won its battles in the court but lost them in the public eye." *Id.*

<sup>98</sup> 17 C.F.R. § 201.2(e) (1992) provides that:

If you look at the sum total of the cases that were produced in the Southern District of New York in the 1980s, there were numerous cases in which people were convicted of outright fraud and insider trading in securities laws.<sup>99</sup> I confess that I was a member of that office. Although, I was not in the securities unit, I did organized crime work. So I have disclosed my personal interest.

Some people take the position that Michael Milken did not really commit crimes.<sup>100</sup> Some people believe that this half-billionaire, with legions of lawyers at leading law firms in the country, was brow beaten by two or three assistant United States Attorneys and a couple of postal inspectors. This is ridiculous. The reality is that the man pleaded guilty to multiple felonies. In the opinion, Judge Wood imposed a ten year sentence, and Judge Wood is not a maniac. Although relatively new to the bench, she had been a partner at a big Wall Street firm. The sentence imposed on Milken clearly reflects his serious and profound acts of misconduct.<sup>101</sup> Whether or not you think he did

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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 . . .

- (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.

Rule 2(e) applies to those professionals who have acted in a "dishonest, incompetent, unethical or unprofessional manner." Cox, *supra* note 65, at 1021-22. The promulgation of this rule was to ensure the preservation of the integrity of the Commission's own processes. *Touche Ross & Co. v. SEC*, 609 F.2d 570, 582 (2d Cir. 1979).

<sup>99</sup> See, e.g., *supra* notes 12, 15 & 45.

<sup>100</sup> JAMES B. STEWART, DEN OF THIEVES 45 (1991). "[T]he myth grew up and was cultivated by Drexel that Milken was a 'genius' who discovered the profit potential of [junk bonds]." *Id.*

<sup>101</sup> Kurt Eichenwald, *Milken Gets 10 Years for Wall St. Crimes*, N.Y. TIMES, Nov. 22, 1990, at A1. After Mr. Milken was to serve his term, he would have faced a three-year period of probation. Furthermore, Mr. Milken, in addition to the \$600 million in fines and restitution already paid when he pleaded guilty, would have also been required to perform a total of 5,400 hours of community service. *Id.* Subsequently, Mr. Milken's cooperation with prosecutors, restitution to victims in excess of \$1 billion and family illness reduced his prison sentence to only two years. Deborah Pines, *Milken Wins One Year Off Prison Term*, N.Y.L.J., Aug. 6, 1992, at 1; Ronald Sullivan, *Milken's Sentence Reduced by Judge; 7 Months Are Left*, N.Y. TIMES, Aug. 6, 1992, at A1.



other things that are good or bad is irrelevant. It is simply unmistakable that there was a pervasive attitude in the market in the 1980s that anything goes! As Tom Wolfe observed, there was the attitude, "We are masters of the universe and above the law."<sup>102</sup>

I disagree with the notion that an earlier panelist advanced that the SEC and the United States Attorneys' Offices pursue what is "fashionable."<sup>103</sup> I think it is very much the reverse. What tends to become fashionable is what we have pursued because in the making of the cases the press becomes interested. Next, they begin to look for the dramatic story. Then it rises to the public consciousness. When the initial prosecutions that led ultimately to *Boskey* and *Milken* were being pursued in the United States Attorney's Office in the Southern District of New York, securities law was not particularly a fashionable issue to be covered by the press. The press was spending most of their time with drugs, organized crime and some of the political corruption scandals. It was only after people started to plead guilty and the window opened up to this world that the press became interested and people started to look for the deeper thematic issues involved in those prosecutions.

Finally, on a somewhat narrower point, my last disagreement with earlier remarks relates to the suggestion that the new Securities Enforcement Remedies Act<sup>104</sup> for the SEC gives rise to a respectable argument that federal *criminal* law is preempted. There are legions of cases out there in which the courts have rejected arguments that the existence of narrow regulatory statutes, even narrow criminal statutes, are meant to preempt broader and more general criminal statutes.<sup>105</sup> Those preempt-

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<sup>102</sup> E.g., *Review & Outlook: Symbol of the 1990s*, WALL ST. J., Nov. 23, 1990. "Michael Milken has often been depicted as the symbol of the 1980s, the Master of the Universe presiding with Ronald Reagan over the decade of greed." *Id.*

<sup>103</sup> See *supra* views of Professor Roberta Karmel in text at 35.

<sup>104</sup> See *supra* note 38.

<sup>105</sup> "When an act violates more than one criminal statute, the [g]overnment may prosecute under either so long as it does not discriminate against any class of defendants." *United States v. Batchelder*, 442 U.S. 114, 123-24 (1979). See also *United States v. UNI Oil, Inc.*, 646 F.2d 946 (5th Cir. 1981) (Emergency Petroleum Allocation Act did not "preempt" application of general criminal statutes to conduct regulated by the Act); *United States v. Simon*, 510 F. Supp. 232 (E.D. Pa. 1981) (enactment of medicaid fraud statute did not preempt use of other federal

tion challenges are typically applied to the mail fraud laws and the fraud and false statement laws under § 1001; they are routinely rejected by the courts.<sup>106</sup> The only area in which I think this contention has ever been accepted is in the context of extortion, where there is a so-called labor exception to the extortion statute.<sup>107</sup> Other than that, I have never seen a body of case law that treats this sort of implicit preemption as an argument to be accepted.

Now, let me tell you what we do. I have given you my premises. We operate as an arm of the Department of Justice and someone said the tail of the United States Attorney's Office wags the tail of the SEC.<sup>108</sup> I think to us, we are the dog and the SEC is the tail. No offense of course! What I mean to say by that, seriously, is that our securities law cases do not come to us in neat packages which say "securities law." They come to us in all sorts of packages. A lot of our securities cases are also bank fraud cases.<sup>109</sup> There are cases that we have entered into by enforcing the bank fraud laws,<sup>110</sup> which we are obviously doing very aggressively now. For example, we discovered that apart from taking out a \$50,000,000 line of credit based on ten years of phony receivables, a company that is the target has also used the phony receivables to pump up their earnings on their SEC filings. So we get into the case as a traditional bank law enforcement case and not because it comes labeled as a "securities law" case.

We tend to look at the core violation, core criminality which really is, at bottom, lying about material things in a way that hurts

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criminal statutes). No firm rule exists "that the government must choose to prosecute under a specific rather than a general statute." *Id.* at 237 (footnote omitted).

<sup>106</sup> 18 U.S.C. § 1001 (1976) (knowingly and willfully falsifying, concealing, or making false, fictitious or fraudulent statements or representations punishable by fines or imprisonment or both).

<sup>107</sup> 18 U.S.C. §§ 871-877 (1955).

<sup>108</sup> See *supra* remarks of Theodore V. Wells in text at 29-30.

<sup>109</sup> See, e.g., *United States v. Davis*, 953 F.2d 1482 (10th Cir. 1992) (misapplying funds and making false entries in bank books and records; failing to disclose self-dealing in connection with bank's securities investment); *United States v. Stavroulakis*, 952 F.2d 686 (2d Cir. 1992) (conviction for money laundering conspiracy, bank fraud, and uttering and possessing forged securities affirmed).

<sup>110</sup> E.g., *United States v. Celesia*, 945 F.2d 756 (4th Cir. 1991) (check kiting can constitute "scheme or artifice to defraud" in violation of bank fraud statute); *United States v. Lemons*, 941 F.2d 309 (5th Cir. 1991) (bank need not suffer financial loss, only necessary to prove that fraudulent scheme or artifice placed bank at risk of loss).

people. When we find that kind of violation we look to see what the relevant criminal statutes are to address it depending on who the victims are. There are often multiple criminal statutes.<sup>111</sup> In other words, we do not get into it as an adjunct of the SEC. Often the SEC is working parallel to us. Occasionally they will refer matters to us or we will refer matters to them. We really are not driven by an administrative agency in general. We are driven by anti-crime and anti-fraud agendas. As a consequence of that, we don't rely exclusively on the SEC to do our investigating. However, the SEC is tremendously cooperative with us. We often do work together in pursuing particularly sophisticated cases. We also use the FBI, the postal inspectors, and the agencies in the state bureaus of securities.<sup>112</sup> All these agencies cooperate in giving us manpower.

We also do not confine ourselves to the kinds of techniques that are traditional in SEC enforcement cases. Subpoenas and depositions are typical ways to make paper cases, and we use those techniques too. But, we also use electronic surveillance, bugs and wires.<sup>113</sup> We have been successful in penny stock cases in intercepting calls in which people are openly discussing fraudulent conduct and market manipulation.<sup>114</sup> We use undercover operations and have been successful in using those operations with agents posing as investors or people who want to be involved in criminality in the stock market. That is how we penetrate a penny stock operation.<sup>115</sup> We also rely on international

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<sup>111</sup> In addition to federal securities laws, state racketeering and white collar law affords overlap in cases involving deception or fraud. *E.g.*, IND. CODE ANN. § 35-45-6-1 (West 1991) (state RICO); MISS. CODE ANN. § 7-5-59(2) (1988) (Attorney General authorized to conduct white-collar crime investigations to protect public rights or statewide interest).

<sup>112</sup> ARTHUR F. MATHEWS ET AL., *THE SEC'S 1988-89 ENFORCEMENT PROGRAM: THE RUDER-LYNCH YEARS* (P-H 1990). Since early 1989, the Department of Justice (DOJ) has taken an increased role in the prosecution of fraud. For instance, securities and commodities fraud task forces have been formed in U.S. Attorneys' offices in Los Angeles, San Francisco, Denver, Chicago, New York and Kansas City. DOJ personnel coordinate efforts with the SEC, CFTC, IRS, Postal Inspection Service and the FBI. These task forces focus on "boiler room" schemes, stock loan frauds, precious metal fraud, bank and brokerage fraud, tax evasion and obstruction of investigations. *Id.*

<sup>113</sup> 18 U.S.C. §§ 2511-2519 (1978).

<sup>114</sup> See *supra* notes 48-49 & 160-163 and accompanying text.

<sup>115</sup> *Id.*

treaties.<sup>116</sup> Increasingly we have taken advantage of protocols in treaties that have been entered into with Switzerland and the Cayman Islands to help us obtain information that was formerly considered outside of our jurisdiction.<sup>117</sup> Parenthetically, you could spend a whole program on what I think is the wave of the future, which is the internationalization of securities enforcement. I believe there will have to be an increase in cooperation efforts by international and national enforcement agencies to effectively enforce the laws, just as we have cooperation on the

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<sup>116</sup> See Richard M. Philips, et al., *The Internationalization of Securities Fraud Enforcement in the 1990s*, in 23RD ANNUAL INSTITUTE ON SECURITIES REGULATION, at 381, 390 (PLI Corp. Law & Practice Course Handbook Series No. 755, 1991) [hereinafter *Fraud Enforcement*].

In investigating international fraud, the SEC has sought to take advantage of several bilateral treaties which the U.S. has entered into for the provision of mutual assistance in criminal matters. Treaties are currently in effect with Italy, the Netherlands, Switzerland and Turkey. Treaties with the Commonwealth of the Bahamas, Belgium, Canada, the Cayman Islands, Columbia, Mexico, Morocco and Thailand have been entered into but are not yet ratified by both parties.

*Id.* at 435 (citing Michael D. Mann & Joseph G. Mari, *Developments in International Securities Law Enforcement*, in INTERNATIONAL SECURITIES MARKETS 1990, at 821, 877 (PLI Corp. Law & Practice Course Handbook Series No. 683, 1990) [hereinafter Mann & Mari]). "Since securities law violations are punishable by criminal sanctions, the treaties are available to assist the SEC in its enforcement investigations, but such assistance is generally available only where the conduct is punishable by criminal sanctions in both the requesting and executing countries." *Id.*

<sup>117</sup> *Fraud Enforcement*, *supra* note 116. "The Swiss treaty 'provides for broad assistance in . . . criminal matters . . . including assistance in locating witnesses, obtaining statements and testimony of witnesses, production and authentication of business records, and service of judicial or administrative documents.'" *Id.* at 436 (quoting Mann & Mari, *supra* note 116 at 877-78). The Swiss Treaty only applies to investigations of offenses which are criminal in nature under both the laws of Switzerland and the United States.

The treaty "is applicable to both court proceedings and ancillary civil proceedings. It is available to the SEC during investigations of criminal conduct under the securities laws. The Swiss Treaty also contains a provision which allows Switzerland or the United States to refuse to assist a request that is likely to 'prejudice its sovereignty, security or similar interests.'"

*Id.* (citation omitted).

The Cayman Islands Treaty provides for mutual legal assistance in criminal investigations and prosecutions that involve offenses punishable by more than one year's imprisonment under the laws of either the U.S. or the Cayman Islands. The Treaty also authorizes cooperation with respect to specific crimes, including insider trading and fraudulent securities practices.

*Id.* at 443 (citation omitted).

state and federal level to deal with law violators who are violating the laws of several states.

We use all kinds of statutes. We use the securities laws statutes and obviously there is an interest that the Commission has in the development of the securities laws, but very often we use even simpler statutes. We use mail fraud<sup>118</sup> and wire fraud statutes<sup>119</sup> which are garden variety fraud statutes used in a multiplicity of areas which do not require any particular sophistication. These statutes need not be addressed in terms of SEC policy, because what we are going after is traditional, hard-core criminality. Not marginal questions; not questions of negligence or honest misinterpretations of the law. We are looking for people who write things down on financial statements that are lies and that they know to be lies. That is what we are using those statutes for. We use money laundering statutes<sup>120</sup> for people who take the proceeds of their criminality and either attempt to hide it or apply it to some other use.

Something that Bill McLucas said, which I think deserves a great deal of emphasis, is our willingness to prosecute for obstruction of justice and perjury when it arises not only in criminal investigations, but also in civil investigations.<sup>121</sup> We will do that when people lie before the SEC. The idea that somehow truth does not count in an SEC action is a dangerous and wrong idea. Clients who are under that misimpression will lose it rapidly when they find themselves indicted. We take those cases very seriously.

The last issue I will deal with is the racketeering law issue.

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<sup>118</sup> 18 U.S.C. § 1341 (1982) (frauds and swindles punishable by monetary penalties and/or imprisonment).

<sup>119</sup> 18 U.S.C. § 1343 (1982) (fraud by wire, radio or television punishable by a monetary fine and/or incarceration).

<sup>120</sup> 18 U.S.C. § 1957 (Supp. IV. 1982) (imprisonment and/or fines). A court may alternatively impose a fine of not more than twice the amount of the ill-gained property. *Id.* § 1957(2).

<sup>121</sup> *E.g.*, *United States v. Brimberry*, 779 F.2d 1339, 1349-52 (8th Cir. 1985) (false statements by witness before grand jury were material to support perjury conviction); *United States v. Reed*, 601 F. Supp. 685, 722-23 (S.D.N.Y. 1985) (crime of perjury is deemed committed where the false statement is uttered); *United States v. Kline*, 366 F. Supp. 994, 998-99 (D.C. Cir. 1973) (defendants deemed to be adequately warned before questioning at SEC investigation, and therefore, answers given could provide a basis for perjury counts against defendants).

We have brought a significant number of racketeering influenced and corruption (RICO) cases against people involved in widespread and pervasive patterns of stock fraud.<sup>122</sup> These are cases of individuals selling stock on the basis of false promises or representations about the investments, like claiming to have invented beer cans that are supposedly self-chilling, or miracle health cures. People are spending thousands of dollars getting themselves enmeshed in these schemes. We have found over and over again that there is a small group of people who have been at the heart of many of these schemes. We have done RICO cases against these people because in our view they are engaged in persistent patterns of violations of mail fraud, wire fraud and securities laws. In the case of the F.D. Roberts brokerage firm, which culminated in RICO pleas by senior officers, I think we had twenty-five defendants who pleaded guilty.<sup>123</sup>

The second significant source of our racketeering cases are

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<sup>122</sup> See, e.g., *United States v. Ofchinick*, 883 F.2d 1172 (3d Cir. 1989); *United States v. Elliot*, 727 F. Supp. 1131 (N.D. Ill. 1989); *United States v. Santoro*, 647 F. Supp. 153 (E.D.N.Y. 1986).

<sup>123</sup> See Frances Ann Burns, *Former SEC Chief Examiner Pleads Guilty to Fraud*, WASH. POST, Sept. 28, 1989, at E3 (defendant guilty of funnelling cash to organized crime figures); John Crudele, *Mob's Muscle Cited as Force Behind F.D. Roberts Penny Stock Swindle*, L.A. TIMES, Feb. 4, 1990, at D6 (mob involvement in fraudulent securities dealings at F.D. Roberts Securities); *Ex-Official of Stock Firm is Guilty of Racketeering*, WALL ST. J., Sept. 5, 1990, at C8. The case pertained to high-level managers of F.D. Roberts Securities Inc. involved in racketeering and a stock-manipulation scheme that allegedly netted \$67 million dollars from 1986 to 1988. *Id.*; *Penny-Stock Guilty Plea*, N.Y. TIMES, Sept. 5, 1990, at D2 (former chairman and part-owner of F.D. Roberts Securities Leonard Tucker pleaded guilty to penny stock fraud); Steven A. Rosenbush, *3 More Settlements in Penny Stock Case*, STAR-LEDGER (Newark), Oct. 27, 1992, at 29-30 (New Jersey civil prosecution of F.D. Roberts defendants netted an additional \$2,354,378 in settlements).

The SEC found material omissions and misrepresentations of fact within the registration statement of Hughes Capital Corporation for which F.D. Roberts Securities was the underwriter and market maker. *Wiley v. Hughes Capital Corp.*, 746 F. Supp. 1264, 1268-69 (D.N.J. 1990). See *id.* at 1272 (indicating that the civil complaint alleged six omissions from the registration statement). One member of Hughes Capital implicated the Roberts firm in a host of illegal securities activity in his guilty plea. *Id.* at 1274. In his own guilty plea, the President/Director of F.D. Roberts admitted illegal activity relating to securities sales at F.D. Roberts, including concealment of material information from the investment community. *Id.* at 1275. The admissions of F.D. Roberts' treasurer confirmed these statements. *Id.* See also *In re F.D. Roberts Sec., Inc.*, 115 B.R. 485, 495 (Bankr. D.N.J. 1990) (granting in part and denying in part F.D. Roberts' petition for an order to enjoin the New Jersey Attorney General from proceeding with criminal actions against the firm while it underwent bankruptcy proceedings).

those which involve phony invoicing and inflated earnings on financial statements.<sup>124</sup> For example, Coated Sales, Inc. was once touted in the financial publications as a notable high-rising growth company.<sup>125</sup> Unfortunately, over a ten year period its earnings were inflated by millions of dollars of phony receivables, totally made up fiction. Ultimately there were RICO prosecutions out of that.<sup>126</sup>

We have also done some non-RICO cases. I do not have any difficulty in seeing these as criminal cases. I do not see anything marginal or questionable about it. If you have people printing up phony invoices or you are altering your books and records by adding zeros to your receivables, that is a crime! I do not think it needs to go to the SEC or anything of that sort and I do not think the judges have any trouble with those cases.

We have done some insider trading. Not very much here because the exchanges are located across the river in New York. One we did do, which was a little unusual, was a case against a member of the Board of the Federal Reserve Bank of New York who was trading on inside information—tipping based on

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<sup>124</sup> See, e.g., *United States v. Wallach*, 935 F.2d 445 (2d Cir. 1991).

<sup>125</sup> See *Homeless Jailbird*, *FORBES*, Aug. 17, 1992, at 19. A year before Coated Sales' bankruptcy, commentators praised the company for its strong earnings record and sales volume. *Id.*

<sup>126</sup> Though this case resulted in guilty pleas, the underlying facts may be ascertained from the civil litigation that it spawned. Coated Sales, Inc., a textile manufacturer, was incorporated in New Jersey in 1974 and became a publicly traded company in 1984. *Cammer v. Bloom*, 711 F. Supp. 1264, 1271 (D.N.J. 1989). The firm filed for bankruptcy on June 16, 1988 and engaged the public accounting firm of Peat Marwick Main & Co. as their auditors for that purpose. *Id.* at 1271. However, the auditors resigned after finding that Coated Sales' officers misrepresented a \$6,000,000 deposit with a machinery supplier. *Id.* at 1272. As a result, the company's Board of Directors removed the Chief Executive and other officers and made public disclosure of the \$6,000,000 overstatement in assets. *Shearson Lehman Hutton Holdings v. Coated Sales, Inc.*, 697 F. Supp. 639, 639-40 (S.D.N.Y. 1988). See also *Bridge Capital Investors & Terrego, S.A. v. Coated Sales, Inc.*, No. 88-2651, 1991 U.S. Dist. LEXIS 12908 (S.D.N.Y. Sept. 16, 1991) (granting defendant's motion to assert a third party complaint against insurer of an officer's Liability and Corporate Reimbursement Insurance Policy); *In re Coated Sales, Inc.*, No. 89-3704, 1990 U.S. Dist. LEXIS 16968 (S.D.N.Y. Dec. 13, 1990) (dismissing appeal to prevent the sale of the corporation while undergoing reorganization proceedings). See also *Coated Sales Inc.*, *WALL ST. J.*, July 1, 1992, at C19; *Former Coated Sales Executive is Fined \$55 Million*, *N.Y. TIMES*, July 16, 1992, at D4; Ann Hagedorn & Wade Lambert, *Former Officer of Defunct N.J. Firm Admits Role in Bank Fraud Scheme*, *WALL ST. J.*, Aug. 17, 1990, at B12; Dana Wechsler Linden, *Bogus Sales Inc.*, *FORBES*, Sept. 17, 1990, at 10 (Edward Giltenan, ed.).

changes in the discount rate.<sup>127</sup> Again I do not have any difficulty seeing those as crimes. Mr. Fleischman says there was a view in the Commission, among certain people at a certain point in time, that insider trading was insignificant. That may or may not be true. I do know that it violates the laws of the United States. It is not my job or the job of Commissioners to say we do not think Congress is right in making this illegal. We are not going to just ignore it and not enforce it. I think if there is a view to be pushed on that basis it ought to be presented to Congress or the Commission ought to make a ruling.

Let me deal with two last issues before I surrender my time. One is the prosecution of advisors such as attorneys and accountants.<sup>128</sup> We have prosecuted attorneys and accountants who have been involved in cases where there is knowing misinformation being presented to the public or knowing concealment of information from the public.<sup>129</sup> I have no difficulty prosecuting those cases. I think it would be a terrible thing if there was a view that lawyers live in a separate world in which they were immune to the kind of scrutiny that everyone else is subject to. Now, let me be clear about what I am saying. We are not talking about honest judgment. We are not talking about advocacy within the bounds of ethical avenues. We are talking about lawyers or accountants who have assumed responsibilities and obligations as part of their serving as advisors and fiduciaries of companies. If you are an attorney for a corporation, it seems to me, you are a fiduciary to the shareholders. If you knowingly operate together with the principals of the company in creating phony receivables, you should be prosecuted.

The last issue is on the problem of pre-trial restraining or-

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<sup>127</sup> See *Ex-Fed Director Sentenced To Jail For Leaking Data*, WALL ST. J., Sept. 14, 1989, at C19; Arthur S. Hayes, *N.Y. Fed Official Leaked Data To Friend, Didn't Make A Dime*, WALL ST. J., Sept. 1, 1989, at C1; Joseph F. Sullivan, *Ex-Fed Official Admits Disclosing Rate Data*, N.Y. TIMES, June 22, 1989, at D2.

<sup>128</sup> See *supra* note 98.

<sup>129</sup> The SEC rule permitting the Commission to determine whether professionals should be censured because of unethical or fraudulent conduct has been held valid as necessary to protect the public. *Touche Ross & Co. v. SEC*, 609 F.2d 570, 582 (2d Cir. 1979). *Accord* *Davy v. SEC*, 792 F.2d 1418 (9th Cir. 1986). See also Daniel L. Goelzer & Susan Ferris Wyderko, *Rule 2(e): Securities and Exchange Commission Discipline of Professionals*, 85 NW. U. L. REV. 652 (1991) (detailed analysis of the origin, implementation and enforcement of Rule 2(e)).



ders on assets. This is a very sensitive area and my own view is that it is very important not to overuse the device of restraining orders on assets,<sup>130</sup> particularly when you get into the issue of an attorney's fees. Principally, I think it is a side-show that sometimes threatens to envelop the core of the case so much that people lose sight of what it is we are trying to do in terms of the ultimate essence of the prosecution. By the way, under the law that allows a seizure or restraining orders of assets, the court does have an opportunity to play a reviewing role, and the laws generally provide for the posting of a bond in lieu of a freeze order.<sup>131</sup> The underlying concern in these pretrial seizure cases is what do you do when you are prosecuting people who can move money in the blink of an eye. People who have, according to the terms of the indictment, stolen money, should not be in a position to squirrel the money away or move it offshore when the government prosecutes. So the concern is, "what can we do in the least intrusive way to make sure that if in the end the government makes the case, the money will be there to be returned to the victims?"

I guess my final observation is this. There are no doubt cases about which people will disagree over whether they should have been brought and whether the criminal statute that was charged was too harsh. I think you have to take a balanced look at all of the cases to determine whether the program is generally on-course. I think it is. There may be excesses one way or the other from time to time and that is simply natural. I think the courts usually operate very effectively to prevent a problem with that.

I was talking to Ted Wells at the break, and I think I agreed with him as to one point and disagreed as to another concerning the philosophy of bringing cases. I believe, and I agree with Ted, that it is not appropriate to bring criminal cases to punish con-

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<sup>130</sup> 18 U.S.C.A. § 1963(d)(1) (West 1984 & Supp. 1992) provides that: "Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property . . . for forfeiture under this section."

<sup>131</sup> *Id.* § 1963(e). "Following the entry of an order declaring the property forfeited, the court may, . . . enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, . . . or take any other action to protect the interest of the United States in the property ordered forfeited." *Id.*

duct that was previously viewed as lawful conduct or as to which there was a reasonable question as to whether the conduct was lawful.<sup>132</sup> I fully agree with him as to that.

The harder question—I think where I disagree with him—is what do you do with conduct that was clearly unlawful, but as to which for a period of time, for whatever reason, the view was that it was not going to be punished very seriously? In my view if it is unlawful and people are acting with willful intent,<sup>133</sup> and it has been on the books as a violation of the criminal laws, the fact that the custom, and there is an element of “clubiness” to this, treated it with a slap on the wrist does not carry a lot of weight with me. I am not saying you execute somebody for the first offense, but there is going to be a first criminal case, and I do not think that you have to publish something in the *Federal Register* to bring that case.

**Leonard M. Leiman**

Michael, I agree with Bill McLucas, you have offended, undoubtedly, everybody on the platform. I would assume a defensive posture and try and figure out where we start. Why not start with your recommended policy of intimidating attorneys and tying up assets so that people cannot afford to defend themselves? Ed, you want to tackle that one?

**Edward H. Fleischman**

I hesitate because it is hard to have that type of discussion with Mike because in practice, this has not been his practice. His

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<sup>132</sup> See generally *Fowler v. State*, 676 S.W.2d 725, 726 (Ark. 1984) (affirmative defense to violation of statutes, afterwards determined to be invalid, exists if actor reasonably relies on it to guide his conduct); WILLIAM R. LAFAVE ET AL., CRIMINAL LAW § 5.1(e), at 416-20 (2d ed. 1986); Livingston Hall & Selig J. Seligman, *Mistake of Law and Mens Rea*, 8 CHI. L. REV. 641, 654-79 (1941).

<sup>133</sup> An act or omission is “willfully” done, if done voluntarily and intentionally and with the specific intent to do something the law forbids, or with the specific intent to fail to do something the law requires to be done; that is to say, with bad purpose either to disobey or to disregard the law. BLACK’S, *supra* note 35, at 1599. See also WILLIAM R. LAFAVE, MODERN CRIMINAL LAW 825 (2d ed. 1988) (citing MODEL PENAL CODE § 2.02(8) (1962)). “A requirement that an offense be committed willfully is satisfied if a person acts knowingly with respect to the material elements of the offense, unless a purpose to impose further requirements appears.” *Id.*

office has never taken any extreme position with respect to tying up attorneys' fees. In fact, it has been one of the more enlightened offices in terms of recognizing the constitutional problems that are created by putting any type of a condition on a person's ability to defend himself. I am not even sure he said anything about attorneys' fees. In terms of the forfeiture area, much of that is controlled out of the main Justice Department in Washington, D.C. by the Organized Crime Section,<sup>134</sup> as to all RICO problems.<sup>135</sup> One of the things that came out of the Princeton-Newport experience was that, prior to the Princeton-Newport indictment, there was a freeze put on the business of that brokerage firm.<sup>136</sup> It closed over a billion dollars worth of assets just by the government suggesting that it was going to put them out of business. They continued to freeze. Business ultimately was forced to liquidate pre-indictment.<sup>137</sup> As everybody knows, eventually the principals were exonerated.<sup>138</sup> The Justice Department, out of the Princeton-Newport episode, published new guidelines that made it far more difficult for prosecutors, both in local offices and in main Justice, to approve massive freezes of that kind.<sup>139</sup> The hot issue that exists today is not really so much freezes by the Department of Justice but really freezes now by the Office of Thrift Supervision, arising out of the savings and loan situation.<sup>140</sup>

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<sup>134</sup> See OFFICE FED. REG., THE UNITED STATES GOVERNMENT MANUAL 1991/92, 377-78 (1991) (contains an overview of the section's duties in areas of labor-management racketeering, loansharking, extortion and RICO). See also U.S. DEP'T OF JUSTICE, DEP'T OF JUST. MANUAL: CRIMINAL DIV., tit. 9, ch. 110 (P-H Supp. 1992) (establishes guidelines for criminal division's Organized Crime and Racketeering Section); U.S. DEP'T OF JUSTICE, DEP'T JUST. MANUAL: CRIMINAL DIV., tit. 9, ch. 3 (P-H Supp. 1992) (sets forth criminal division's statutory obligations).

<sup>135</sup> 18 U.S.C. §§ 1961-1962 (West 1984 & Supp. 1992).

<sup>136</sup> *United States v. Regan*, 726 F. Supp. 447, 450-51 (S.D.N.Y. 1989). The jury assessed over \$4.8 million in RICO forfeitures against the Princeton-Newport partners. *Id.* at 449-50.

<sup>137</sup> *United States v. Regan*, 706 F. Supp. 1102, 1104 n.1 (S.D.N.Y. 1989).

<sup>138</sup> *United States v. Regan*, 937 F.2d 823, 830 (2d Cir. 1991) (convictions of various appellants on all counts except conspiracy vacated). The conspiracy count was subsequently vacated. *United States v. Regan*, 946 F.2d 188, 188 (2d Cir. 1991).

<sup>139</sup> See JANET E. FERRIS, U.S. DEP'T. JUSTICE, STARTING FORFEITURE PROGRAMS: A PROSECUTOR'S GUIDE (1992). See generally GEORGE N. ALYESWORTH, U.S. DEP'T. OF JUSTICE, FORFEITURE OF REAL PROPERTY: AN OVERVIEW 19-26 (1991).

<sup>140</sup> *E.g.*, *Director of the Office of Thrift Supervision v. Lopez*, 960 F.2d 958 (11th Cir. 1992) (prima facie case of bank fraud justified freezing of assets); *Paul v. Office of Thrift Supervision*, 763 F. Supp. 568 (S.D. Fla. 1990) (temporary cease and de-

I think the most controversial thing that Mike would say to me is his notion that the United States Attorney's Office should be the head and the SEC Enforcement Division should be the tail.<sup>141</sup> The problem I have with that, and I do see this just the opposite, is that ultimately many of these questions come down to how you exercise prosecutorial discretion.<sup>142</sup> I believe it is very difficult for local United States Attorneys' Offices, who are not involved regularly in securities prosecution, to have sufficient experience and a feel for the industry as a whole as to what is going on and what types of messages have been sent by other regulatory bodies to exercise that prosecutorial discretion in the best fashion. Because of that, I would like to see some type of control by the SEC and the enforcement people in terms of how that prosecutorial discretion is exercised. Michael Chertoff referred to hard-core criminality. It just depends where you want to put it on the spectrum.

*Leonard M. Leiman*

Priorities, is it not Ed, what you are talking about?

*Edward H. Fleischman*

Well, it is more than priorities, it is really somebody with more experience in the industry sitting down and trying to figure out how a case should be fashioned. There are probably more

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sist order granted to prevent officer-shareholder from dissipating assets). See generally 15 U.S.C. § 1462 (West Supp. 1992) (establishes and proscribes powers of the Office of Thrift Supervision).

<sup>141</sup> See *supra* remarks of Michael Chertoff in text at 47.

<sup>142</sup> See JOAN E. JACOBY, U.S. DEP'T OF JUSTICE, *THE PROSECUTOR'S CHARGING DECISION: A POLICY PERSPECTIVE* (1977). External environmental factors that influence a prosecutor's discretionary activities include a community's characteristics, the workload, the judicial system and office resources. *Id.* at 1; JAMES I. K. KNAPP ET AL., *PROSECUTORIAL DISCRETION* (Cal. Crim. Law Practice Series (3d ed. 1979)). "Charging discretion takes three basic forms: (1) evidentiary sufficiency—a determination of whether the evidence warrants prosecution; (2) charge selection—a determination of the appropriate charge or charges; and (3) discretion not to prosecute—a determination of whether there is an alternative to formal criminal prosecution." *Id.* at 5; *THE INVISIBLE JUSTICE SYSTEM: DISCRETION AND THE LAW* 4-6 (Burton Atkins & Mark Pogrebin eds., 1978). Prosecutorial discretion extensively includes the selective prosecution of offenders, plea bargaining and giving strength to, or emasculating, law enforcement policies by not prosecuting violations of law. *Id.* at 4.

checks and balances within the enforcement division than in any other area of the law. I mean, to get a case out of the Commission, a lot of people touch it. It is really hard to get a case out of the office.<sup>143</sup> It just has always struck me funny that you have to go through all of these hurdles to get a case out of the SEC, but in the local United States Attorney's Office, you can get a case out very easily<sup>144</sup> and you are not always as fortunate to have a head prosecutor such as Michael Chertoff, who I think is really the exception rather than the rule. What Michael has done in the past is bring the hard-core cases in terms of *Coated Sales*<sup>145</sup> or *F.D. Roberts*,<sup>146</sup> but that has not existed in a lot of places.

**Leonard M. Leiman**

I think it is important to note that when Michael talks about bringing a *Coated Sales* type of case, when crude fraud is perpetrated over a long period of time and harms a great many people, nobody questions whether it should be brought as a criminal prosecution or not. It is back to those cases where the regulation may be a little bit soft or nobody quite knows what the regulations are. When conduct that occurs in that area is prosecuted criminally, that gets people upset. Roberta, you had something to say on this?

**Roberta S. Karmel**

Yes, it is really a follow-up comment that is related to what was just said. Michael started out by saying the choice here is

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<sup>143</sup> E.g., MARC I. STEINBERG, *SECURITIES LITIGATION: LIABILITIES AND REMEDIES* § 12.01 (1992). Under the Exchange Act of 1934, the Commission may issue reports of investigation, pursue disciplinary proceedings against professionals, issue stop orders, refer matters to the United States Attorney General in order for civil or criminal proceedings to be instituted, or initiate such proceedings itself. *Id.* To procure injunctive relief, the SEC must show a violation of the securities law and a "reasonable likelihood" that, "absent the ordering of an injunction, the defendant will engage in future violations." *Id.* § 12.02.

<sup>144</sup> See DAVID SCHWARTZ & SIDNEY B. JACOBY, *GOVERNMENT LITIGATION* 658 (1963) (Attorney General has broad power to institute suits on behalf of the United States so long as the action pursues and/or vindicates a legitimate national interest). See also 28 U.S.C. § 515 (1966) (Attorney General's authority for instituting legal proceedings); 28 U.S.C. § 516 (1966) (conduct of the litigation reserved to the Department of Justice).

<sup>145</sup> See *supra* notes 125-26 and accompanying text.

<sup>146</sup> See *supra* note 123 and accompanying text.

between criminal prosecution of hard-core criminality where there is lying and self-regulation. I would assert rather vigorously that the Securities and Exchange Commission is not self-regulating. It is an independent federal agency<sup>147</sup> that has always, I think correctly, been perceived as an agency with a lot of integrity, very tough, and hardly an agency in the control of the securities industry. So, I do not think we are talking about a situation that may exist in England<sup>148</sup> or Japan.<sup>149</sup> The issue here, really, Ed Fleischman said before, is which part of the government that may be responsible for policing the securities markets is going to make the choices about the kinds of cases that are going to be prosecuted and the kinds of cases that are going to shape future law and regulation. If all the United States Attorneys' Offices were just bringing mail fraud and wire fraud cases involving hard-core criminality where there is lying, I do not think we would be having the discussion that we are having here this morning.

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<sup>147</sup> Like the Phoenix, the Securities and Exchange Commission rose from the ashes of the Great Depression and the stock market crash of 1929. SUSAN M. PHILIPS & J. RICHARD ZECHER, *THE SEC AND THE PUBLIC INTEREST* 5 (2d ed. 1982). Established by the Securities Act of 1934, the Commission was a response to the Hoover Administration's failure to successfully install a self-governing compliance system. *Id.* at 8. Presently, the SEC works alongside state agencies and has jurisdiction over certain non-exempted securities involving the mails or interstate commerce. DAVID L. RATNER, *SECURITIES REGULATION: MATERIALS FOR A BASIC COURSE* 5 (3d ed. 1986). Toward insuring theoretical independence, the members of the Commission are appointed by the President of the United States, and with the advice and consent of the Senate. Only three of the five commissioners may be members of the same political party; terms are staggered. LARRY D. SODERQUIST, *SECURITIES REGULATION* 8-9 (2d ed. 1988). The SEC places primary reliance on the independent accounting profession to promulgate uniform standards for reporting companies. RATNER, *supra*, at 14-15.

<sup>148</sup> Unlike the American model, England's securities regulation system is complex and decentralized with much decision making conducted at non-governmental organizations. INTERNATIONAL SECURITIES REGULATION REPORT 23-24 (Buraff Publications, June 29, 1992). See also *UK: Confused Future for Local Authority Stock Lending*, REUTER TEXTLINE, (Feb. 10, 1992) (uncertain status of securities lending in England).

<sup>149</sup> The Japanese securities system is dominated by bureaucrats with large discretionary powers and a long history of political favoritism, including individuals who hold both regulatory positions with the government and with private securities firms. Robert Neff et al., *Hidden Japan: The Scandals Start to Reveal How the System Really Works*, BUS. WK., Aug. 26, 1991, at 37-38; *Can Tokyo Repent?*, ECONOMIST, Aug. 3-9, 1991, at 16; *Rigging the Rules*, ECONOMIST, Oct. 5-11, 1991, at 85; *Who Watches the Watch Dog?*, ECONOMIST, Sept. 21-27, 1991, at 94.

**Leonard M. Leiman**

I'd like to go back, if I may, to the attorney involvement in this and the concept that one of the areas of priority is making sure that participation by a member of the Bar in misleading the public will be punished criminally. Intimidation was my word, not Michael's, but plainly a lawyer who is engaged in dealing with regulatory authorities on behalf of a client who is always looking over his shoulder loses some effectiveness in conducting himself. I wonder whether it is having its effect. Lew, you are in this area a lot, what do you think?

**Lewis D. Lowenfels**

I think it is having an effect, and, Michael, what I would suggest very respectfully, as a defense-type of a person, is that the priorities here—I am divorcing myself from my occupation and looking at myself as an American citizen—would much prefer that the United States Attorneys focus on drug cases<sup>150</sup> and on organized crime cases.<sup>151</sup> That is where the resources, it seems to me, should be poured in. We have other agencies—we have

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<sup>150</sup> America's "War on Drugs" campaign has become a top priority throughout the federal court system. *See, e.g.*, *United States v. Kramer*, 955 F.2d 479 (7th Cir. 1992) (conviction for conspiracy to distribute marijuana affirmed); *United States v. Bailey*, 955 F.2d 28 (8th Cir. 1992) (conviction for possession and intent to distribute cocaine); *United States v. Andrews*, 953 F.2d 1312 (11th Cir. 1992) (crack cocaine commerce); *United States v. McKnight*, 953 F.2d 898 (5th Cir. 1992) (convicted felon found guilty of firearm and drug possession); *United States v. Johnson*, 952 F.2d 1407 (D.C. Cir. 1992) (drug trafficking conviction reversed; co-defendant's subsequent testimony may not be considered); *United States v. Christoffel*, 952 F.2d 1086 (9th Cir. 1991) (defendant convicted of possession with intent to distribute and import marijuana); *United States v. Morris*, 781 F. Supp. 428 (E.D. Va. 1991) (defendant convicted for aiding and abetting the distribution of marijuana and cocaine); *United States v. Ross*, 778 F. Supp. 393 (S.D. Ohio 1991) (defendants convicted of conspiracy to manufacture and possess with intent to distribute marijuana).

<sup>151</sup> *See, e.g.*, *Holmes v. Securities Investor Protection Corp.*, 112 S. Ct. 1311 (1992) (regulatory agency cannot invoke RICO treble damage provision to protect against stock fraud conspiracy); *United States v. Church*, 955 F.2d 688 (11th Cir. 1992) (RICO conviction upheld against defendant engaged in drug enterprise); *Harrell v. DCS Equipment Leasing Corp.*, 951 F.2d 1453 (5th Cir. 1992) (insufficient evidence for RICO claim); *Glessner v. Kenny*, 952 F.2d 702 (3d Cir. 1991) (RICO claim dismissed for failure to show corporation conducted pattern of racketeering activity); *Cadle Co. v. Schulz*, 779 F. Supp. 392 (N.D. Tex. 1991) (plaintiff successfully established cause of action for RICO violations against defendant); *United States v. District Council of N.Y.C. & Vicinity of the United Bhd. of*

the SEC, we have the NASD, we have the states, they can deal with, to pick up your language, "lying about something material." You are absolutely right that those statutes are on the books,<sup>152</sup> you are absolutely right that, if somebody lies about something material, it will fit in within the criminal statute, but I am not sure the resources should be allocated to that. A second point is, it disturbs me, and it disturbed me greatly when the insider-trading cases came out, to find the electronic surveillance, the telephone taps, all the paraphernalia that you would normally use in hard-core violent crimes applied to the securities area.<sup>153</sup> There is nothing attractive about securities fraud, and when you take the *Coated Sales* cases,<sup>154</sup> that is particularly unattractive, because that is hard-core. But there is a lot of "lying about something material" that is not the worst thing in the world. Not that I am trying to defend it, but it is a long way from masses of drugs being brought into the country and destroying the lives of masses of young people. So from my standpoint, I would say very respectfully, I think it would be better for the Republic if the United States Attorneys focused in other areas and let the SEC, the states and NASD freely deal in the securities areas.

### *Michael Chertoff*

I could not disagree with that more. I mean, one of the things, of course, which is true about drugs and even organized crime to some extent, is that traditionally state and county prosecutors have been very involved in that,<sup>155</sup> whereas the federal

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Carpenters & Joiners of Am., 778 F. Supp. 738 (S.D.N.Y. 1991) (violation of RICO statute upheld against a labor organization).

<sup>152</sup> See *supra* note 106. See also 18 U.S.C. § 1029 (1982) (fraud and related activity in connection with access devices); 18 U.S.C. § 1030 (1982) (fraud and related activity in connection with computers); 18 U.S.C. § 1341 (1982) (mail fraud).

<sup>153</sup> See *United States v. Santoro*, 647 F. Supp. 153 (E.D.N.Y. 1988). In prosecuting the Lucchese crime family under RICO, the government successfully minimized the use of electronic surveillance in charging the defendants with aiding and abetting in securities fraud. *Id.* at 162, 169-70.

<sup>154</sup> See *supra* notes 125-26 and accompanying text.

<sup>155</sup> See, e.g., *Moreland v. State*, 212 S.E.2d 866 (Ga. Ct. App. 1975) (insufficient evidence for drug possession conviction); *Jones v. State*, 324 N.E.2d 828 (Ind. Ct. App. 1975) (heroin possession conviction); *Commonwealth v. Harvard*, 281 N.E.2d 274 (Mass. 1972) (mere presence at place where marijuana is present is sufficient for conviction); *Commonwealth v. Harvard*, 253 N.E.2d 346 (Mass. 1969) (drug possession conviction upheld although contact with drug was merely fleeting and



prosecutors have a little bit more of an advantage in dealing with interstate fraud schemes. But I really think this requires us all to step out of our roles as lawyers and as securities people or whatever and just think about ordinary citizens. I would shudder to think of the public perception of a policy which said, "We are going to go after poor people who traffic in drugs and poor people who snatch purses but if it is a rich person who steals \$100,000,000, we are not going to do a criminal case." I think it was Woody Guthrie who said that "you can steal a lot more with a fountain pen than you can robbing a bank." He was right. We want to have public acceptance and support for our criminal justice system and for our securities law system and for our securities markets.

We better let the public know that we are going to police criminality, lying and stealing at whatever level. Now, we obviously balance, we do not necessarily give the same severity of sentence, although in some instances we do punish severely—for example, a person who defrauds people of their life savings deserves a stiffer sentence. I mean it is very easy to sit here and say, oh, you know, it is not much damage. If your mother loses her life savings to a stock swindle or a penny stock firm or because there was some kind of manipulation of her pension fund, I know that to your mother that is going to be a pretty serious life-destroying thing that requires a criminal response.

Just turning briefly to telephone taps, these are difficult cases to make. Often it is the best evidence we can get. Let me observe this—the initial use of electronic surveillance<sup>156</sup> and of RICO and a lot of these other tools in the securities area arose because traditional organized crime has always been a player in

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momentary); *State v. Tate*, 412 S.E.2d 368 (N.C. Ct. App. 1992) (defendant convicted of manufacturing marijuana); *State v. Ivey*, 439 P.2d 974 (Wash. 1968) (narcotic possession conviction affirmed). *See also* *State v. Pasante*, 542 A.2d 952 (N.J. Super. Ct. Law Div. 1987) (New Jersey RICO statute held constitutional); *State v. Benevito*, 350 A.2d 485 (N.J. Super. Ct. App. Div. 1975) (defendants convicted of conspiracy to violate gambling laws).

<sup>156</sup> The procedure for interception of wire, oral or electronic communications is set forth at 18 U.S.C. § 2518 (1982). *See also* *United States v. Donovan*, 429 U.S. 413 (1977) (wire-tap application must specifically name all individuals; "principal target" identification held insufficient); A.B.A. Standards Relating to Electronic Surveillance §§ 5.13-5.14 (1971) (authentication and procedural requirements pertaining to time, sealing, custody and destruction).

stock fraud. If you go back to cases like *United States v. Weismann* in New York, you had various mob figures who sat and plotted securities fraud in and around social clubs.<sup>157</sup> Among their loan-sharking and their gambling activities you also found significant swindles and penny stock frauds and other kinds of securities manipulations. No one disagrees that with respect—well maybe somebody does—few people would disagree, I think, that with respect to John Gotti or people who are traditional organized crime figures, you use electronic surveillance. Is the rule, that when you are Harvard graduates you are immune from electronic surveillance? I have a real problem from an equality of the law standpoint with that kind of principle.

*Lewis D. Lowenfels*

Mike, just to rebut for a second, I think you immediately turn my argument from a question of priorities in different areas of law enforcement into a class thing and rich guys and poor guys and so forth. I do not think that the people in the securities industry overall are any richer than perhaps the drug dealers or the people who engage in organized crime. I suggest to you by your analogies with Japan and England, you started out with a certain amount of a class orientation there.<sup>158</sup> Those societies are traditionally much more feudal societies,<sup>159</sup> much more rigid societies from a class standpoint, and I think in those countries perhaps there is a club or clique of people who have run things for a long time. Their fathers and grandfathers and so forth have run them and they think they are immune from prosecution. I would agree with you on something like that. What I am arguing for is that in the securities area, primarily, where you have other agencies set up with public monies allocated to deal with these types of problems, even though the United States Attorneys can deal with them, I think it is better left to these other people except in the

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<sup>157</sup> 624 F.2d 118 (2d Cir. 1980) (affirmed racketeering, securities fraud, bankruptcy fraud and conspiracy convictions).

<sup>158</sup> See, e.g., CARLTON HAYES, *BRITISH SOCIAL POLITICS* (1913); PATRICK VENTURINI, 1992: *THE EUROPEAN SOCIAL DIMENSIONS* (1989). See also Hideo Tanaka, *The Role of Law in Japanese Society: Comparisons with the West*, 19 U. BRIT. COLUM. L. REV. 375 (1985) (surveys Japanese legal attitudes and methods of dispute resolution).

<sup>159</sup> E.g., J.M.W. BEAN, *FROM LORD TO PATRON: LORDSHIP IN THE LATE MEDIEVAL ENGLAND* (1989) (discusses England's evolution of the feudal system).

exceptional cases like a *Coated Sales* situation or whatever. That is basically my point. I do not think it gets into money or who is rich or who is poor.

**William R. McLucas**

One thing that Lew noted that disturbed him was the technique. We now have wiretaps<sup>160</sup> and search warrants<sup>161</sup> in the securities areas. You can legitimately ask the questions that make sense. We do not do criminal investigations. We do not do wiretaps, we do not do search warrants—we rely on the Justice Department<sup>162</sup> to handle that and do it. Do not forget though, what we are talking about is fraud. I do not think that the analogy directly fits that it is a class thing—prosecute poor people criminally, white collar people civilly, but there is something there that you cannot miss. A kid who takes fifty bucks from a Seven-Eleven convenience store with a gun is going to jail. We ought not lose sight of the fact that we need to do something with people who use a phone or a pen and sell securities out of a boiler house or commit penny stock fraud; do not underestimate what it did to the average citizen in the 1980s.<sup>163</sup>

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<sup>160</sup> The federal securities laws confer jurisdiction on the Attorney General to prosecute offenses. 15 U.S.C. § 78u(d)(1) (1982). Since the Securities and Exchange Commission does not have criminal jurisdiction, it does not have the authority to seek or obtain wiretaps or search warrants. See 18 U.S.C. §§ 2510-2520 (Supp. 1992); FED. R. CRIM. P. 41. The Commission can, however, receive access from the Department of Justice to information obtained from both wiretaps and search warrants and has done so in the past. Most often, the fact that the Securities and Exchange Commission obtained evidence in this manner is not a matter of public record.

<sup>161</sup> See *supra* note 160. See, e.g., SEC v. American Bd. of Trade, 798 F.2d 45 (2d Cir. 1986) (search warrant allowed government to seize records of unregistered commercial paper); *In re Atritech, Inc.*, 1992 WL 40469 (Feb. 27, 1992) (trading suspension imposed with evidence obtained in a search by the United States Attorney's Office pursuant to a search warrant).

<sup>162</sup> See *supra* note 160.

<sup>163</sup> See, e.g., SEC v. Power Securities Corp., No. CIV.A.90-1579, 1990 WL 312149 (D. Colo. Sept. 6, 1990) (alleging scheme to defraud by, among other things, use of materially false or misleading statements or omissions, investment recommendations without a reasonable basis in fact, and high pressured, coercive sales practices); SEC v. Blinder, Robinson & Co., No. CIV.A.90-4534-RK, 1990 WL 312430 (E.D. Pa. July 20, 1990) (scheme involved the distribution and sale of shares in shell companies; fraudulent, high-pressured sales tactics; omissions of material fact and undisclosed markups of up to 140%); SEC v. Thomas James Assoc., No. CIV.A.90-0316-T, 1990 WL 310345 (W.D.N.Y. Mar. 29, 1990) (underwriting involving undis-

The penny stock abuse in this country was absolutely astounding, and some of those people ought to go to jail. You cannot make those cases unless you do it with criminal investigative techniques. I do not think that what the Department of Justice is talking about or what the SEC is talking about is policing this industry with criminal surveillance techniques methodology. We have got a whole industry that relies on self-regulation.<sup>164</sup> We have got 2500 professionals in the SEC to police the capital markets in the United States. If somebody thinks that we can do that effectively and use criminal investigative techniques, we are going to have to substantially increase the number of people in the budget.

I think what Michael is saying is that we ought to, on a selective basis, take some people and take some techniques that are needed to demonstrate that if you do this stuff you are going to go to jail. We ought to use it and not apologize about it, and we ought to put people in jail for it. That is what his office has done, and what some of the other offices have done. There was a criminal trial in Denver a month ago, a two-year undercover sting operation where the jury came back with an acquittal after two days.<sup>165</sup> I think it was an unfortunate development for the government, but I do not, for a minute, think that it means that you should not use those techniques. We are talking about fraud. These people do not walk in and say, "Oh, gee you got me, I confess, and I'll give the money back." These people stole money, and I think the development in the criminal area has been a healthy one. At least as long as I am in the Division of Enforcement, I will encourage it.

***Leonard M. Leiman***

Not to walk off this particular subject for a moment, but, Michael, back to what you were talking about. You mentioned

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closed domination and control of the market and fraudulent high pressure sales tactics).

<sup>164</sup> The federal securities laws contemplate use of a self-regulatory system both by allowing for the creation of a self-regulatory organization, *e.g.*, Securities Exchange Act of 1934, § 19, 15 U.S.C. § 78s (1982), and exposing regulated entities such as broker-dealers to sanctions if they fail reasonably to supervise employees. Securities Exchange Act of 1934, § 15(b)(4)(E), 15 U.S.C. § 78o(b)(4)(E) (1982).

<sup>165</sup> *United States v. Rimson*, CRIM.A.91-123-CR (D. Colo. filed Feb. 21, 1992).

the memoranda of understanding with foreign governments. Has the attitude of foreign governments towards enforcement of securities laws, as we know them here in the United States, changed significantly?

**Michael Chertoff**

Bill probably is much more involved with this than I am, I mean—we only have the limited experience of having had a case over in the Cayman Islands where we were, after lengthy legal battling, able to obtain documents and testimony.<sup>166</sup> I believe Switzerland and some other countries are now more accessible to us.<sup>167</sup> I do not know that it is so much a matter of their views of the securities laws as maybe an increasing sensitivity that it is not appropriate for a country to bill itself out as a safe haven for people who want to hide money from regulators or prosecutors. But Bill, I think, is probably much more involved in developing these things.

**William R. McLucas**

We have negotiated agreements with probably fifteen different foreign sovereigns to exchange information and participate in law enforcement. Ten years ago we made requests for assistance and information from every foreign government, where we had a case that we had to get assistance.<sup>168</sup> Today, we get more

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<sup>166</sup> *United States v. Cannistraro*, No. CRIM.A.89-218-L, 1992 WL 172680 (D.N.J. Feb. 11, 1992). In this RICO case, the United States Attorney's Office made a treaty request to enforcement officials of the Cayman Islands regarding the right to obtain testimony and evidence located there. *Id.* at \*1. In addition, the United States filed a motion for leave to take depositions in the Cayman Islands. *Id.* Both applications were granted.

<sup>167</sup> The SEC has entered into Memoranda of Understanding on information-sharing with authorities in Switzerland; the United Kingdom; Japan; the Canadian provinces of Ontario, Quebec and British Columbia; Brazil; France; Italy; Luxembourg; and the Netherlands. See 1990 SEC ANN. REP. 20-21. The SEC has entered into similar agreements with additional countries. *E.g.*, SEC Release No. IS-429, 1992 WL 188981 (July 8, 1992) (Spain); SEC Release No. IS-354, 1991 WL 288656 (Dec. 18, 1991) (Argentina); SEC Release No. IS-181, 1990 WL 322079 (Oct. 18, 1990) (Mexico).

<sup>168</sup> Typically requests for information made by either party to Memoranda of Understanding are non-public. In at least one administrative proceeding, the fact that the Commission had obtained information pursuant to Memoranda of Understanding was disclosed publicly. See *In re Dominick & Dominick, Inc.*, Admin. Proc. No. 3-7502, 1991 WL 294209 (May 29, 1991).

requests from those governments to us than we make. That is an indication that the trend, in terms of developments in international markets, is more conducive to our attitude about law enforcement in the markets than I think we would have anticipated. But the fact is we now can get a lot of information; we do have good cooperative arrangements. It takes time, it is cumbersome, but you can no longer open a Swiss bank account and assume that you are home free.

***Leonard M. Leiman***

Indeed, that could be the most significant development of all. I am going to stop this portion of the discussion. I now want to give Ed Fleischman a full chance to give his reflections of the Securities and Exchange Commission after five years. I will say, by way of introduction, that I have known Ed most of my professional life. I do not know of anyone who is a keener student and observer of the Commission, of the statutes, rules and the cases. He has an encyclopedic knowledge of the subject, and he brought to the Commission quite a rich body of experience as a practicing lawyer. I am as interested, as I am sure you will be, in hearing how he distills his five-year experience from the Commission side.

***Part III***  
***Reflections of a SEC Commissioner***

***Edward H. Fleischman***

The compliment from Len is very much appreciated. The last time we met was just a couple of weeks ago in a presentation I made in New York, and Len was one of my most insightful and decisive critics—a guy who both sides can give comments. I am not going to deal with the criminal aspects. My knowledge from a criminal prospective is minimal. I refer to Michael Chertoff on all those issues. Nor am I going to deal, I think it is equally important to say, because when you think of criminal, you think not only of the wiretaps and so on, but also the increased burden of proof, the “beyond a reasonable doubt” threshold. Furthermore, I am not going to deal with something that Lew Lowenfels mentioned in passing, and that is the NASD.

It is not wiretaps; however, it is the process within a self-

regulatory organization that nobody can exist without cooperative membership. It is a non-necessity for any burden of proof beyond a mere establishment of conduct that does not measure up to fair and equitable principles of trade; a deliberately moral rather than a legal standpoint. I do hope, however, having listened now with you for these past two hours, that by coincidence some of the things I am going to say are going to reflect themes that you have heard from all of the commentators, as well as from Len.

The presentation of civil and criminal enforcement priorities points out more of their similarities, it seems to me, than their differences. But Bill McLucas' and Mike Chertoff's presentations went to substance rather than process. My reflections, which again are limited to the civil side, will perhaps fill out your understanding by going solely to process. I am lucky by the construction of the program that you have to take these reflections without any elucidations that the panelists' responses may give; because there are no panel responses called for to these reflections that Len has already told you. There are several process themes arising out of the enforcement program of a civil agency that I would like to squeeze into these next few minutes. If I do these correctly, the themes will blend one into the other to end up with a kind of single overall pattern.

So let us start by remembering that a civil enforcement agency is no more than a conglomeration of human beings, of people, who take pride in what they do. Know that for the most part, they want their efforts to punish lawbreakers to succeed and, of course, they become convinced by the logic of their own cases, their own arguments. That is only human. The individual trees—the investigations and the particular prosecutions—tend to overwhelm the forest, which is the achievement of law compliance and which, even more than retribution or discouragement, is the true aim of the enforcement program. If you or I, have spent six months or thirty-six months on an investigation and my chief or even those Political, with a capital "P" appointees, the commissioners, who decide my case and who decide whether my case is strong enough to bring, determine it is not strong enough to bring, what happens to my self-esteem as a human being, not to speak of my year-end evaluation by my superiors?

Or, if you or I, as a commissioner, have spent months or

years rationalizing an enforcement program to buttress the confidence of investors in the markets, as a general matter, do you or I as that commissioner have time for, or sympathy, or understanding of a Wells submission,<sup>169</sup> that is either based on the generality of a Wall Street practice, on technical interpretation of the statutes, on rules even if they are correct interpretations, or on appeal to rethink interpretations that have already been rendered? Is it not, after all, right to argue that the function of an administrative agency is to interpret its statutory responsibilities broadly, or that the statutory adverbs and adjectives could not have been intended by Congress to limit the commissioners' or the stockpersons' discharge of legislatively-mandated remedial responsibilities? Think of what those adverbs and adjectives, particularly "willfull", mean in the Thirty-Four Act.

The courts have long been persuaded that the purposefulness suggested by "willfull" is satisfied by the mere doing of the deed consciously,<sup>170</sup> not being asleep when you do it, without the need of a conscious disregard for the law, not willfulness in any normal sense or recklessness.<sup>171</sup> The court derives a substitute for knowledge that is intended particularly to preclude the viability of any "see no evil, hear no evil" avoidance defense. But recklessness has been gradually pared down in cases where hindsight clearly demonstrates the quality of the conduct which was engaged in.<sup>172</sup> So that today, recklessly means little more than that

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<sup>169</sup> Cox, *supra* note 65, at 1010. A Wells submission is a written statement by subjects being investigated by the Commission which affords a possible defendant the opportunity to make a case against a probable SEC enforcement proceeding. *Id.* However, "[t]he attorney must prepare the submission without knowing the precise nature of the staff's case and without access to all the evidence available to the staff." *Id.*

<sup>170</sup> The courts have been forced to implement a working definition of "willfull" because the Exchange Act of 1934 is silent on setting forth such a legal standard. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Synonymous with willfulness is scienter—the "intent to defraud, reckless disregard for the truth, or knowing use of some practice to defraud." *Id.* at 193 n.12.

<sup>171</sup> *E.g.*, *McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979) (reckless conduct closely approaches conscious deception); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978), *cited in Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977) (reckless conduct is highly unreasonable and represents an extreme departure from ordinary care standards).

<sup>172</sup> *Broad v. Rockwell Intern Corp.*, 614 F.2d 418, 440 (5th Cir. 1980), *cited in Sanders*, 554 F.2d at 793 (reckless conduct should not be liberally construed so as to obliterate a distinction between negligence and scienter).



same court-approved willfully,<sup>173</sup> not recklessness in any usual sense. Aiding and abetting<sup>174</sup>—this ties back into issues raised by Michael.

Lawyers cannot avoid being prosecuted as principals. Likewise, lawyers cannot avoid being prosecuted as aiders and abettors. The courts have described this concept as being derived from the criminal law, but nowhere is it found in the securities statutes as requiring a general awareness of wrong-doing.<sup>175</sup> Which again usually is circumstantially derived, like recklessness, from the very fact of having engaged in the conduct at issue. Put all these together and any requirement of cognition, which is usually implicit in the law of violations, has been extracted from the securities laws. In the same category, add the requirement that non-disclosures<sup>176</sup> or mal-disclosures<sup>177</sup> relate to material facts.<sup>178</sup>

Despite Supreme Court admonitions, the notion of the substantial change in the total mix of disclosures is again, like recklessness, circumstantially established in hindsight from the very fact that the disclosure was incorrect.<sup>179</sup> What drives an adminis-

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<sup>173</sup> See *Sanders*, 554 F.2d at 793. Recklessness, under certain circumstances, "comes closer to being a lesser form of intent than merely a greater degree of ordinary negligence." *Id.*

<sup>174</sup> See *Hicks v. United States*, 150 U.S. 442, 450 (1893) (active participation by words or acts is included in criminal definition of aiding and abetting); *Bailey v. United States*, 416 F.2d 1110, 1113-14 (D.C. Cir. 1969) (participation in the venture must be such that by his action, a defendant intends the venture to succeed).

<sup>175</sup> See generally *Carpenter v. United States*, 484 U.S. 19 (1987) (one who acquires information via a fiduciary relationship may not use such for his own benefit). "[A] tippee assumes a fiduciary duty . . . not to trade on material nonpublic information only when the insider has breached his fiduciary duty . . . by disclosing the information to the tippee and the tippee knows or should know that there has been a breach." *Dirks v. SEC*, 463 U.S. 646, 660 (1983). See also *Chiarella v. United States*, 445 U.S. 222 (1980) (one may not profit from the use of inside information).

<sup>176</sup> E.g., *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (omitted fact may significantly alter the total mix of available information)). See generally *Ross v. A.H. Robins Co.*, 607 F.2d 545, 555-56 (2d Cir. 1979) (plaintiff must plead and prove that misstatement or omission was made with scienter).

<sup>177</sup> *Ross*, 607 F.2d at 555-56.

<sup>178</sup> *Basic Inc.*, 485 U.S. at 231 (quoting *TSC Indus., Inc.*, 426 U.S. at 449) (material fact is one that a reasonable investor would consider important when making a decision). Furthermore, a material fact is necessary for a shareholder to make an informed choice. *TSC Indus., Inc.*, 426 U.S. at 448 (citing *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381 (1970)).

<sup>179</sup> *TSC Indus., Inc.*, 426 U.S. at 449. "[T]here must be a substantial likelihood

trative agency to pare or attenuate the key concepts on which guilt or liability rests? Well, in part, it is the advocate inherent in all of us—pushing the law, always pushing the law—a little bit in favor of the agency. This methodology represents the advocate's mind. In part, it is the very proper desire to fulfill the remedial responsibilities assigned to the agency by Congress and the President.<sup>180</sup> In large part, it is the fear of judicial decision-making that some malefactor, whether a greater or lesser one, is exonerated because a purpose, state of mind or substantiality of facts has not been sufficiently established by conventional proofs.<sup>181</sup> It is far easier for the agency if the thresholds to liability have been pulled down. The insistence on hindsight de-substantiates the scienter and the materiality standards.<sup>182</sup> The result may be good for the public image of the agency, but it is destructive of the larger responsibility of a government litigant, namely, to promote the integrity of the justice system in this country and to serve the public's interests rather than the agency's own.

To switch for a moment, but not getting off this subject, the classical intertwining of quasi-executive,<sup>183</sup> quasi-legislative<sup>184</sup> and quasi-judicial<sup>185</sup> functions in an administrative agency raises

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that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* (footnote omitted).

<sup>180</sup> The executive branch generally executes and enforces federal law via its appointment power. WILLIAM BENNETT MUNRO, *THE GOVERNMENT OF THE UNITED STATES: NATIONAL, STATE, AND LOCAL* 190 (5th ed. 1947). Such is evident within the Securities Exchange Commission because the President is responsible for appointing the agency's five board members. *Id.* at 238. See *supra* SODERQUIST, note 147.

<sup>181</sup> The requisite proofs for a Rule 10b-5 violation include an affirmative showing of various elements. See *Basic Inc.*, 485 U.S. at 231 (material act or statement); *Chiarella v. United States*, 445 U.S. 222, 227 (1980) (duty to disclose); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976) (scienter); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463-64 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952) (conduct that occurs in connection with purchase or sale of securities).

<sup>182</sup> See *supra* note 170 (scienter); notes 178-79 (materiality).

<sup>183</sup> Federal commissions are generally quasi-executive in nature because they have numerous delegated advisory and oversight functions and its commissioners are presidential appointees. See *generally* *United States v. Knox*, 694 F. Supp. 777, 781 (W.D. Wash. 1988) (President's power to remove members of Sentencing Guidelines Commission held proper under separation of powers doctrine).

<sup>184</sup> "The power of an administrative agency to engage in rule-making." BLACK'S, *supra* note 35, at 1245. A commission's function is quasi-legislative when it spawns guidelines that become substantive law. *Knox*, 694 F. Supp. at 781.

<sup>185</sup> Quasi-judicial applies "to the action, discretion, etc., of public administrative

similar issues. In case A, the agency has authorized prosecution<sup>186</sup> and approved a consent settlement,<sup>187</sup> implicitly recognizing that both stages state the agency's view of the law. The investigation and the consent order implicitly recognize and establish what the agency's current view of the law is as applied to the facts.<sup>188</sup> This same process occurs in subsequent cases. Then along comes a case in which the indictment may be deliberately misused. The indictment stage<sup>189</sup> is exactly the same as in the prior cases, and the Commission approves the order. But in this case, however, litigation gets substituted for settlement. After trial by an administrative law judge, *de novo* review<sup>190</sup> comes back to the very same agency heads<sup>191</sup> who went through the process in all the prior cases, and who have now authorized the prosecution of this particular case. To some extent, they already have a commitment to a view of the facts. I would articulate that, perhaps in terms of a presumption of the propriety of the view of the

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officers or bodies, who are required to investigate facts, or ascertain the existence of facts, hold hearings, weigh evidence, and draw conclusions from them, as a basis for their official action, and to exercise discretion of a judicial nature." BLACK'S, *supra* note 35, at 1245. Quasi-judicial power involves the ability of an administrative agency to adjudicate the rights of parties before it. *Id.*

<sup>186</sup> See STEINBERG, *supra* note 143, § 12.01.

<sup>187</sup> Utilizing its own internal standards, the Commission may decide whether to litigate or settle cases. *Id.* § 12.06.

<sup>188</sup> There are no policies or guidelines which determine when and where the SEC decides to begin an investigation. This power is vested in the agency's discretion. Cases generally arise as a result of complaints from the public, as referrals from self-regulatory organizations such as the stock exchange, or simply by SEC personnel reading the newspapers. Interview with Robert Anthony, Esq., Staff Counsel, Securities Exchange Commission, in New York, N.Y. (Sept. 16, 1992).

<sup>189</sup> The SEC district office responsible for conducting the investigation will compose a memorandum to the Commission in Washington, D.C. suggesting whether there has been, in the opinion of the region office, a violation of securities laws. *Id.*

<sup>190</sup> *E.g.*, *Doe v. United States*, 821 F.2d 694 (D.C. Cir. 1987). *De novo* review means that the court's review of the agency decision is not restricted to the administrative record, but may instead pursue whatever avenue of inquiry it deems appropriate. *Id.* at 697-98. *De novo* review is intended to be a "fresh, independent determination of 'the matter' at stake." *Id.* There is no deference to the agency's conclusion. *Id.*

<sup>191</sup> The SEC district office which initiated and coordinated the investigation will make the recommendation to investigate to the Commission and will exercise subpoena power to require the production of records, call witnesses, take testimony under oath and inspect offices and other documents. The district office will also present the case to the administrative law judge and, in the case of an appeal, to the Commission itself. Interview with Robert Anthony, Esq., Staff Counsel, Securities Exchange Commission, in New York, N.Y. (Sept. 16, 1992).

facts on which they gave the approval for the indictment, they have really made a commitment to an active prosecution which was absent in antecedent cases. After all, didn't they have a broad purpose in mind in proposing the rule that is in question or requesting the legislation that is at issue? Have not they applied the law just this same way in the earlier cases?

Now, are the prior consent decree cases precedent? Even if not formal precedent, we all have to understand that they bespeak the agency's view of the law. How do these administrators, who are human beings after all, divorce themselves from the performance of their quasi-executive billy-club responsibilities to discharge their quasi-judicial black robe responsibilities in some neutral way? Does the system really depend simply on the change of personnel as an antidote to precommitment?

These are issues of constitutional dimensions. The constitutional dimensions were put to rest years ago.<sup>192</sup> But the fairness dimensions, the appearance of disinterest, and again, the larger responsibility of a government agency to promote the integrity of the justice system and thereby to serve the public's interest became apparent to me. That is why the opportunity to prosecute in the Article Three Courts<sup>193</sup> rather than in the administrative process should be pursued as often as possible. That is why alternatives to prosecution, methods to encourage law compliance through the judiciary's use of the carrot as well as the stick, should be pursued as broadly as feasible.

Finally, we demand greater integrity of our law enforcement officers and our law enforcement agencies than of any other participants in our American society. We know that public prosecutorial enforcement is not only the handiest, but also the most reputation-building tool that any agency or any regulatory official has available. There is no other method that rivals prose-

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<sup>192</sup> See, e.g., *Withrow v. Larkin*, 421 U.S. 35 (1975). The Supreme Court has maintained that even where investigative and adjudicative functions are combined, there remains a presumption of integrity and honesty in those serving as the adjudicators. *Id.* at 47. "The case law, both federal and state, generally rejects the idea that the combination [of] judging [and] investigating functions is a denial of due process . . . ." *Id.* at 52 (quoting 2 KENNETH C. DAVIS, *ADMINISTRATIVE LAW TREATISE* § 1302, at 175 (1958)).

<sup>193</sup> "The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." U.S. CONST. art. III, § 1.

cution for broad-based lawmaking, deterrence of conduct whether it is lawful or unlawful, or creation for the notoriety of the public press, which are the soliloquies to public and congressional attention in the peculiar theater we call Washington, D.C. The larger responsibility of a government agency demands that jurisdiction not speak for personal aggrandizement. Rather the government agency must always be kept subservient to the goals of law compliance, market efficiency and promotion of the justice system. In this way, a government agency could serve at least in this one field, the goals that are mandated by Congress and the President in the name of the public for its protection and interest.

***Leonard M. Leiman***

Thank you Ed. This is a subject that, as Roberta Karmel suggested, has a long history and a large body of learning. It is a subject that we will probably not be able to advance any further today. I will close by saying that, as moderator, I have viewed my role as something akin to a substitute teacher. I am suppose to maintain order and not teach very much myself. So I can say, as we conclude, that this discussion was at a level of sophistication that I have not heard often in my years at the Bar and participating on other panels. I think you really owe the panel members a hearty thanks for their participation.