SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

November 8, 1976

Mr. Lewis H. Young
Editor-in-Chief
Business Week
McGraw-Hill Building
1221 Avenue of the Americas
New York, New York 10020

Dear Mr. Young:

The October 11, 1976 issue of Business Week contained an article which stated that the "SEC's enforcer is in over his head" and that the Securities and Exchange Commission "is in a very dangerous situation." In a related editorial comment, under the caption "Back Room Enforcement," you urged that "it is time for the Commission to review its policy and make negotiation [in the context of Commission-initiated civil enforcement proceedings] the exception rather than the rule."

While I welcome any serious evaluation of the Commission's enforcement program, such an evaluation must proceed from an understanding of the statutory scheme that defines the Commission's primary task and within which the program is conceived and carried out. I noticed, and I must admit with some concern, that this important perspective was absent from both the October 11 article and its accompanying editorial. It is a perspective without which I do not believe your readers can be in a position to evaluate your observations, criticisms and conclusions -- a perspective that I hope to supply.

The most important and unique characteristic of the enforcement authority conferred by the Congress on the Securities and Exchange Commission is its remedial nature. Congress saw fit to create a system of enforcing the securities laws that relied not only upon the initiative of the Securities and Exchange Commission but also upon that of individual investors and the resources and experience of the Department of Justice. Congress, in sum, viewed the enforcement of the securities laws as a joint, cooperative effort.

As a partner in this congressional enforcement scheme, the Commission was given the task, as was observed in 1972 by a prestigious advisory committee studying our enforcement policies and practices, of "protecting the public interest and the interest of investors in the oversight of the processes of capital formation and trading in securities." The Commission was directed by Congress to channel its limited resources into enforcement actions which would have substantial prophylactic effect upon the functioning of the securities markets. Thus, Congress granted broad remedial powers to the Commission to seek injunctive relief to prevent a recurrence of the alleged violative conduct. Invoking the equity powers of the courts, the Commission has also sought and obtained broad ancillary relief such as the disgorgement of profits unlawfully obtained, the creation of a fund to compensate the victims of a fraud, extending offers of rescission or redemption to shareholders, and the appointment of receivers or independent directors, auditors or counsel to investigate past management activities and practices and report on them to shareholders.

Over the past few years, the Commission has expanded its enforcement program, reflecting an effort to render its administration of the federal securities laws more effective as well as more expeditious. "[T]he old days" of the 1940's, to which the "professor" and "prominent authority on securities regulation" nostalgically refers, have long since melted away, as a review of the Commission's enforcement statistics demonstrates.

In fiscal year 1975, for example, the Commission was involved in 1,605 investigations of possible violations of the acts that it administers, as our Annual Report for that year indicates. Of these investigations, 317 were closed that fiscal year and 277 investigative orders were issued. The Commission, that year, instituted 174 suits for injunctive relief, and the Courts issued 453 injunctions against 749 defendants, and criminal cases referred to the Attorney General resulted in indictments against 199 defendants against whom 166 convictions were obtained. By contrast, in fiscal year 1966, a mere ten years ago, the Commission instituted only 67 injunctive actions, obtained only 63 injunctions, and enjoined only 258 defendants. Perhaps even more dramatic is the fact that, in fiscal year 1950, the Commission instituted only 18 injunctive suits, slightly over 50 percent more than in 1940,

and enjoined only 38 defendants. So much for the "good old days." Today, the Commission brings more than six times the number of injunctive proceedings it brought in most of the 1940's, and it is doing so with a staff that has only recently begun to exceed the size of the Commission staff at the beginning of the 1940's.

Moreover, while the Commission's enforcement activity in the federal courts has been increasing steadily, the time required to obtain a decision in these courts has been increasing at least as steadily. The Annual Report of the Director of the Administrative Office of the United States Courts for fiscal year 1976, for example, reveals that the median time interval from filing to disposition of all civil cases that go to trial in the district courts is 16 months, assuming that no appeal is pursued. In some individual districts, the median time interval is 30 months or more. When appeal time is added, the Report reveals that the median time from filing in the lower courts to final disposition in the appellate courts is 25.1 months, and is over 30 months in two circuits. And, while the Administrative Office did not have data computing litigation times through the Supreme Court, there can be no doubt that the time required to proceed through petitioning for certiorari, briefing, argument, and decision would add substantially to the already more than two-year undertaking, particularly if remand proceedings were to be ordered.

Were the Commission to litigate each, or even a substantial number, of the 174 suits that it brought in 1975 to completion or near completion through the courts, not only would the public be required to wait inordinate lengths of time to be protected, but the expense required to perform such a task would be prohibitive. Furthermore, the personnel that would be necessary to complete the job defies responsible projection.

The Commission has, as you accurately reported, settled 22 questionable corporate payment cases in the past year or so. Each of these settlements, in my view, represents the fullest remedial relief required in the public interest. In every one of those settlements, the full measure of available remedial relief provided

by statute -- an order of permanent injunction -- was obtained. In each instance, moreover, the equitable powers of the courts were also invoked to provide ancillary remedies to augment the remedial effect of the final injunctive orders entered. Thus, committees of outside directors were formed, assisted by independent counsel and auditors, to investigate fully the corporate conduct exposed in the Commission's action and report their findings to corporate shareholders and to the public. In many cases the process has resulted in the displacement of involved management and the creation of new systems of corporate governance and accountability with consequences which extend far beyond the specific problem areas that prompted the initial effort.

As a result, public confidence in the integrity of American enterprise has been strengthened, similar future violations of the securities laws have been effectively proscribed and the partnership between the private sector and the Commission in enforcing the securities laws has been relied upon to the fullest extent possible. Most significantly, delays, problems and costs of litigation have been avoided, while the public interest has been protected. Curiously, neither your article nor your editorial suggested that the relief the Commission has obtained in its "settled" cases was inadequate to protect the public interest or any less than the Commission could have obtained had the case been fully litigated. Significantly, the settlement of all Commission injunctive actions takes place in court, not "out of court," as your editorial stated, nor in any "back room." Rather, all court settlements take place only with the approval of the district judge involved.

These examples, to my mind, demonstrate the wisdom of one of the primary recommendations of the Advisory Committee on Enforcement Policies and Practices. More than four years ago, that Committee, well aware that "the old days" were gone forever, made the following recommendation to the Commission:

> The Committee recommends that the Commission revise its procedures to facilitate and encourage settlement of Commission proceedings. Opportunity for settlement is mandated by the

> Administrative Procedure Act, and, generally speaking, settlement is advantageous both to the Commission and the party named in the proceeding. From the Commission's point of view, settlement avoids delay and unnecessary expenditure of staff time and frequently achieves the same regulatory or enforcement effect as an order entered after a hearing. Settlement is also desirable from an adverse party's point of view, because, apart from the costs and expenditures of time involved, a prolonged proceeding is likely to result in repeated adverse publicity and may have other undesirable and, possibly, unintended effects.

Indeed, the Committee even suggested that the Commission go beyond its present methods of negotiation and "adopt procedures permitting discussions of settlement prior to the authorization of a proceeding."

In short, after its detailed evaluation of our enforcement practices, the Advisory Committee concluded that negotiated settlements should play a larger role in the Commission's enforcement program rather than the smaller role that you suggest. Since the Committee's recommendations were made in 1972, the Commission's highly acclaimed enforcement program has been increasing in its effectiveness while simultaneously expanding in scope; the Commission is conducting more investigations, seeking more forms of remedial relief against more violators, and proceeding in more courts with greater frequency than at any time in its history. And, largely as the result of this tenacious enforcement program, the House Commerce Subcommittee on Oversight and Investigations recently reported, after two years of study and analysis, that the Commission is the most effective of the nine regulatory agencies evaluated.

Thus, your suggestion that the Commission has "usually tried to avoid court battles" is, to some extent, factually true. Settlement, from our perspective, frequently allows the Commission to obtain all the remedial relief that it is empowered to seek consistent with its statutory scheme and the public interest, while avoiding the delays

and expenses of litigation. Since settlement, as the Advisory Committee quite properly observed, "frequently achieves the same regulatory and enforcement effect as an order entered after a hearing," and since it achieves this effect relying in large part upon the private sector as Congress had intended and at a relatively minimal cost to the public, I, as Chairman of the Commission, would be reluctant to suggest to my fellow Commissioners that we "make negotiation the exception rather than the rule."

This, however, is not to say that the Commission is reluctant to litigate. On the contrary, the Commission is of the view, as apparently are your editors, that "[i]f a case is worth bringing at all, it is worth bringing in court," and each of the Commission's attorneys performing enforcement work, apparently contrary to the views of your editors, is ready, willing, and able to represent the Commission and the public in court on any matter that the Commission is investigating or litigating. In fact, during the past year, Commission attorneys made no less than 1,034 court appearances. Indeed, our willingness to litigate is further demonstrated by the fact that the Commission has been represented in court on numerous occasions by its most senior staff.

Accordingly, it is my view that, as a general matter, your suggestion that the Commission "make negotiation the exception rather than the rule" is impractical and impracticable, and is to some extent inconsistent with the comprehensive statutory scheme of the securities laws. Most importantly from my perspective, I am convinced that litigation of even a substantial portion of the lawsuits that the Commission institutes would not achieve more effectively or more efficiently the broad remedial objectives of the Commission's enforcement programs.

Some of the other concerns expressed in your article may stem, in part, from the erroneous assumptions upon which they are based. For example, you state that settlement avoids the doctrine of "collateral estoppel" and that settlements prevent private litigants from obtaining access to information contained in the Commission's investigative files.

The courts have generally not applied the doctrine of "collateral estoppel" to Commission actions. The courts that have addressed themselves specifically to this issue have rejected its applicability to findings arising out of the Commission's injunctive actions. Thus, fully litigating a case to conclusion and having the court find that the defendants had engaged in the violations which were alleged would not necessarily enhance the posture of the plaintiff in subsequent private litigation. This should be contrasted with the results that flow from most antitrust cases where, by statute, such findings do at least constitute prima facie evidence of violations in subsequent private litigation.

Moreover, our settlements usually expedite the production of the Commission's investigative files for use in private litigation. Since the recent amendments to the Freedom of Information Act, the Commission's investigative files are made available to requestors when our enforcement efforts will not be compromised as a result of such production. The settlement of a case cannot provide a basis for refusing to turn over the contents of the Commission's investigatory files to private litigants. It does not take a public trial for this information to be publicly available.

That the Commission settles the vast majority of its enforcement actions is not, in my judgment, the source of any concern, provided that those settlements achieve the objectives sought in the litigation and envisioned by the federal securities laws. Without exception, our settlements achieve these objectives. One possible effect of violations of the securities laws is criminal prosecution by the Justice Department. Our settlements do not, as a matter of policy, settle any such proceedings. Indeed, our settlements merely dispose of the civil litigation and free our staff to assist the Justice Department in any criminal prosecution that seems appropriate.

Nothing could be further from the truth than to suggest, as your article states, that because of poor cooperation between the Justice Department and the Commission, we have resorted to consent settlements. At

this time, we probably have a greater degree of cooperation with the Justice Department than has ever existed. Just recently, the Justice Department and the Commission announced the formation of a task force to prosecute certain types of cases.

I am most disturbed when you suggest that compassion is "not the sort of thing you expect from a prosecutor." It is my experience that government without compassion is tyranny. Similarly, in my opinion, human beings without compassion are no longer human. In fact, having worked in government for some time now, and having worked closely with Stanley Sporkin for almost a year, I am compelled to conclude that it is in Stanley Sporkin's compassion that we find his success, a large part of his genius, and perhaps the greatest wisdom to be learned by the rest of us in government.

Sincerely,

Roderick M. Hills
Chairman