Securities and Exchange Commission Historical Society

Federal Securities Law Update Presenter:

Eric Summergrad

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P R O C E E D I N G S

ANNOUNCER: The University of Texas School of Law presents the 17th Annual Conference on Securities Regulation and Business Law Problems. The following presentation was recorded live at the Fairmont Hotel in Dallas, in March of 1995.

MALE SPEAKER: We trust we'll be enlightening, and informative, and interesting. We know that the first topic will be something of interest to us all. We're going to be updated on Federal Securities Law by Eric Summergrad who is the Principal Assistant General Counsel in the Appellate Litigation Group of the Office of General Counsel of the SEC in Washington.

Mr. Summergrad has been with the Commission since 1984. Prior to that time, he was with the D.C. law firm of Arnold & Porter, and he is a graduate of NYU Law School.

Mr. Summergrad?

[Applause.]

MR. ERIC SUMMERGRAD: Well, thank you. I'm delighted to be here. I've always had a soft

spot in my heart for Texas, although I was under the impression that it was a Southern State.

[Laughter.]

MR. ERIC SUMMERGRAD: I guess as Humphrey Bogart said in Casablanca, "I was misinformed." If and when I get home to Washington, I will double-check the map.

As Bob was saying, I am with the Appellate Litigation Group at the Commission in the Office of General Counsel, and we handle all of the Commission's work in the Supreme Court and in the Courts of Appeals, and we also handle all of its work in filing amicus curiae briefs in all courts.

What I would like to talk about today are some of the more important cases that we've had in the last year, including mostly cases where we have gotten decisions, some cases that are still pending where we have filed briefs.

I should mention that all of the cases I will be talking about today are discussed in the outline, which is part of your materials. There are a number of other cases that are also discussed in

that outline. I should also mention -- although I can see Pandora's box opening as I say this -- that we are always glad to provide copies of any briefs we have filed, if anybody wants to give our office a call, we'll be glad to do it. Please don't call me directly; I can just see being inundated with it. But if you'll call the General Counsel's Office, somebody will get back to you and get you a copy of the briefs.

I would also, at the end, try about five minutes at the end to talk about the latest addition to the Commission's amicus program, which doesn't so much involve any particular case that we are involved in or will be involved in as a, sort of a new programmatic effort. This is a new unit, which is called the Litigation Analysis Unit. Everybody immediately acronym-izes it and says the "LAU" but it was originally going to be called the Litigation Oversight Unit, and would have been known as the "LOU." So, I think that's something of an improvement -- in which we are looking at District Court cases and are considering going in to give the

District Courts guidance on frivolous litigation and ways in which they might deal with cases that might be dismissed at an early stage.

Before I begin discussing any of the cases, let me give the usual disclaimer that you heard from Marty Dunn this morning. Those of you who attended the lunch heard it from Colleen Mahoney, also, it is actually required by Federal regulation. I am speaking only for myself and the views that I state here today are not necessarily those of the Commission, or of any other Commission staffer.

Now, with that out of the way, let me begin, and let me begin at the top with Supreme Court cases and, as advertised by Marty Dunn this morning, let me begin with Gustafson v. Alloyd.

The -- on Tuesday of this week, the Court decided the Gustafson case. The facts of Gustafson are fairly simple; there was a private transaction in which a business was sold through the purchase of securities. The -- as you probably know, a number of years ago, not that many years ago -- the Supreme

Court held that a sale of business affected through a securities transaction is still a securities transaction and is subject to the various anti-fraud provisions of the securities laws.

What happened in Gustafson was that the purchaser believed, after the fact, that there were misrepresentations that had been made in the contract of sale, and they sued under Section 12-2 of the Securities Act to rescind the purchase. As you may know, Section 12-2 is essentially a negligence-based provision, unlike 10(B)(5), which requires scienter. And it applies to any sale of a security, quote, "by means of a prospectus or oral communication," and the case turned on the question of what is a prospectus, in this context.

There had been, prior to this case, a number of recent Court of Appeals decisions, divided on this issue. There had been a lot of literature, a lot of debate in the literature over this issue; some very good articles by Professor Louie Loss and others which basically turned on this issue. Section 12-2 uses the term "prospectus," it doesn't

say any written communication, unlike most of the other anti-fraud provisions. But the Securities Act contains a definition which broadly defines prospectus to mean, quote, "any prospectus," a bit of a tautology there, "notice, circular, advertisement, letter, or communication, written or by radio or television which offers any security for sale or confirms the sale of any security.

Now, the Commission had argued that the term means just what the definition says. It includes, quote, "Any communication which offers any security for sale."

The Court, however, in a 5-4 decision and -- for appellate litigators before the Supreme Court, a 5-4 decision is the worst you could get because you have to stay up nights worrying what you could have done that might have changed that one vote. But in a 5-4 decision by Justice Kennedy, held that it would give the term prospectus, as used in 12-2, a more restrictive meaning.

And basically, what the Court said, was that it would only give the term the meaning that it

believed it had under Section 10 of the Act, that is, a prospectus used in the public offering of securities and, although it's not completely clear from the decision, perhaps only a prospectus that is the type of prospectus used pursuant to Section 10. That is to say, that even if you have a public offering of securities, there may be other written communications under the Court's decision to which this does not apply.

Now, as far as oral communications goes, the Court sort of neatly side-stepped the question because they statute uses the term "oral communication," it doesn't use anything that might be construed as a term of art. The Court said, "Well, oral communication is restricted to oral communications that relate to a prospectus."

What the Court held was, I'm going to quote a few key provisions from the decision -- there is a lot in the decision I'm not going to get into, they got into legislative history, there were disputes on both sides about that, they got into how you construe the sequence of words in the

definition, I'm not going to get into that. The lynchpin of the decision was, seems to me, the Court said, quote, "In seeking to interpret the term 'prospectus,' we adopt the premise that the term should be construed, if possible, to give it a consistent meaning throughout the Act. That principle follows from our duty to construe statues, not isolated provisions." A general proposition which, I must say, we agree with and we have a case before the D.C. Circuit in a wholly unrelated context where we made precisely that argument. That's a very good general proposition.

The Court noted that Section 10 was not limited to some prospectuses, it speaks in terms of all prospectuses, it says, "a prospectus shall contain information contained in the registration statement."

The Court concluded that, quote, "If the Act is to be interpreted as a symmetrical and coherent regulatory scheme, one in which the operative words have a consistent meaning throughout," unquote, then the meaning of the term

prospectus must be no broader than it is under Section 10. Since the document in Gustafson was, by no means, a prospectus under Section 10, it was not required to meet the requirements of Section 10, the Court reasoned it could not be a prospectus for any other purpose in the Securities Act.

The Court stated that, quote, "an examination of Section 10 reveals that whatever the term prospectus -- whatever else prospectus may mean -- the term is confined to a document that, absent an overriding exemption, must include the information contained in the registration statement, by and large, only public offerings by initial offers of a security or by controlling shareholders of an issuer require the preparation and filing of registration statements. It follows, we conclude, that a prospectus under Section 10 is confined to documents related to public offerings by an issuer or its controlling shareholders.

The Court went on to conclude that, quote, "The primary innovation," and this, by the way, I should say, what I am about to quote now, even

relates to some of the policy concerns that were underlying the decisions beyond the sort of dry analysis of how one construes statutes, where you have terms that may be somewhat ambiguous, the Court said, "The primary innovation of the 1933 Act was the creation of Federal duties, for the most part, registration and disclosure obligations in connection with public offerings. We were reluctant to conclude that Section 12-2 creates vast additional liabilities that are quite independent of the new substantive obligations the Act imposes."

Now, the Court did recognize that, while the 33 Act is primarily aimed at public offerings of securities, that there were some provisions -- most notably, Section 17-A, which is a general anti-fraud provision which the Commission can enforce, but which -- under which there is no private right of action -- that 17-A is not limited that way, but it pointed out, and the Court had held in United States versus Naftalan a number of years ago, that 17-A was not limited to public offerings. But, the Court observed that 17-A, unlike 12-2, did not use the

term "prospectus," and that there was clear legislative history indicating that it had a very broad sweep.

The Court concluded by saying that it was understandable that Congress would provide buyers with a right to rescind without proof of fraud or reliance as to misstatements contained in a document prepared with care, following well-established procedures relating to investigations with due diligence and, in the context of a public offering, by an issuer or the controlling shareholders but it was, quote, "not plausible to infer that Congress created this extensive liability for every casual communication between buyer and seller in the secondary market," unquote. And there, I think, the Court was expressing the concern that a lot of people have expressed, that if you have a mere negligence-based statute, that it vastly expands the potential for liability in private lawsuits. And that it's one thing if you can prove fraud under 10(B)(5), but that 12-2 should not be used in respect to every single transaction.

Now, there are a number of things I could say about this decision. Most of them would not be politic, a lot of them would not be printable --

[Laughter.]

MR. ERIC SUMMERGRAD: -- but let me just make two points.

One is that the Court seems, to me at least, to somewhat misapprehend the way the 33 Act works. The 33 Act has provisions which speak broadly, appear on their face to impose broad requirements, and then in other provisions takes back those requirements. And I think, putting it very simply, what the Court may not have appreciated is that Section 10 is really given its operative force by Section 5, and that Section 5, in turn, is limited by the exemptions in Sections 3 and 4, so that it is entirely plausible to say that, yes, you can give prospectus a broad reading in Section 10, but Section 10 is only going to come into play where you have a public offering that is required to be registered under Section 5. So -- and it is in that fashion that Congress attempted to limit the scope

of Section 10.

It would be almost like saying that, since Section 5 broadly says that you have to register when you have any sale, and since everybody knows that Section 5 only applies to public offerings, we are going to construe the term "sale" to mean a public offering or a public sale in a public offering, and then we are going to take that definition and apply it wherever else the term "sale" applies.

Now, that obviously is -- would be ridiculous because it's not the way the statute works, and we have to take into account the fact that 5 is limited by 3 and 4, and I think taking it one step further, that's the way 10 should be read, as well.

On the second point, the other thing that is troubling about the decision is that, as a matter of statutory construction, it seems inconsistent with what the court did last year in the Central Bank decision. And let me turn, for a second, to Justice Thomas's dissent in the Gustafson case,

because he said it quite pungently. It's interesting, by the way, the four dissenters were arguably the two most conservative and the two most liberal justices on the Court. Thomas wrote a dissenting opinion, which was joined in by Scalia, Ginsburg and Breyer, and Ginsburg dissented separately, and her opinion was joined by Justice Breyer.

Justice Thomas's dissent said, just last term in holding that Section 10-B of the 1934 Act did not create liability for aiders and abettors, we said, "If Congress intended to impose aiding and abetting liability, we presume it would have used the words 'aid and abet' in the statutory text; but it did not. This rule of construction can cut both ways. If the Central Bank of Denver Congress's failure to use aid or abet limited liability under the securities law, and here the absence of public law issuers or some similar limitation surely suggests that Congress sought to extend Section 12 to private and secondary transactions." And, in a rather heated conclusion, he said, "When one

interprets a contract provision, one usually begins by reading the provision and then ascertaining the meaning of any important or ambiguous phrases by consulting any definitional clauses in the contract. Only if those inquiries prove unhelpful does the Court turn to intrinsic definitions or to structure. I doubt that the majority would read in so narrow and peculiar a fashion most other statutes, particularly one intended to restrict causes of action in securities cases."

That's all I'm going to say about that decision. Obviously it doesn't affect the Commission's enforcement. I think it does have a negative effect on private rights of action. A few years ago, we might have considered some sort of Congressional action in response to it. I suspect that that is not likely in the cards.

Now, as I just mentioned, the other important decision which we got in the past year from the Supreme Court was the Central Bank of Denver decision. It was another 5 to 4 decision, also written by Justice Kennedy, and there the Court

held that private plaintiffs cannot sue aiders and abettors of securities fraud under Rule 10(B)(5). It's kind of interesting, just as an aside, that this was not an issue. This was not the issue on which cert had been sought. The issue on which the petition was filed asked the Court to review the issue of whether recklessness sufficed in an aiding and abetting action.

The reason why the petitioners likely did not seek review of whether an aiding and abetting action was available at all, was because every Court of Appeals that had considered the issue, and virtually all of the Courts of Appeals had considered the issue had held that there was a private right of action which just goes to show you -- and we've seen this before -- until the Supreme Court actually rules on something, one should never assume that it is -- even if every Court of Appeals has ruled in a particular way that that is the last word.

When certiorari was granted, the Court, sua sponte, asked the parties to brief the issue of

whether there was a private right of action against aiders and abettors. The Commission filed an amicus brief arguing that there was such a private right. And when the decision came down, what was perhaps most interesting about it was not just that they found that there was no private right, the Court has not been hospitable to private rights of action, but that the analysis which the Court used has suggested -- perhaps more than suggested -- that aiding and abetting liability may not be available in Commission actions, as well. What the Court said was, that -- looked at the text of 10(B) and said that the text of the 1934 Act does not, itself, reach those that aid and abet the Section 10(B) violation.

Now, the question for us has been, do we concede that Central Bank applies to our actions? And, if not, what do we do about it? There was, pretty promptly, talk about legislative action, again, that is sort of in limbo. To the extent -- and the next panel may talk about this a little bit more -- to the extent that we've been able to go

after people as primary violators or as aiders and abettors or causers of violations in administrative proceedings, we have done so. But, as the Chairman made clear when he testified about this, we have not ruled out test cases to test the proposition whether Central Bank applies to us.

And we actually had an opportunity to test the proposition pretty quickly, because about two days, I think, after Central Bank came down, we had a case pending in the 11th Circuit called SEC versus Zimmerman. Zimmerman had been found liable as an aider and abettor, he had assisted a friend of his who was a stock broker in a number of rather dramatic frauds committed on her clients, and he promptly moved to remand the case with instructions to dismiss in light of Central Bank.

We responded to it by saying, "Well, the facts show, in any event, that he's a primary violator, even though he wasn't expressly charged as that, so the Court can either affirm on that ground and provided some authority for that, or it could remand to allow him to be re-charged as a primary

violator through an amendment of the complaint and we can proceed on that basis.

But, we argued that the Court did not have to do any of those things, because we said Central Bank did not apply to us, and basically the argument -- and I'll be very brief about this -- rests on several theories. For those of you who are interested in a more elaborate explanation of it, the General Counsel of the Commission, Cy Lauren, had an article written in the form of a mock Supreme Court opinion, detailed these theories, which is at 49 Business Lawyer 1467. And Zimmerman's counsel then responded with their own mock Supreme Court opinion, which is at 50 Business Lawyer 19.

The arguments are these: There's no question that there is such a thing as aiding and abetting securities fraud. One can be held criminally liable for aiding and abetting securities fraud. One can also be subject, under Section 21(D)(3) of the Exchange Act to civil penalties for aiding and abetting. And we believe it would be inconsistent with the overall statutory scheme,

which recognizes this, which provides criminal and civil penalties for aiding and abetting to say that a court lacks the power even to just subject such a person to an injunction.

Second, we have pointed out that courts have traditionally exercised broader injunctive powers in cases involving the public interest than merely in the private damage cases and that they may order injunctive relief to the extent necessary to prevent recurrences of violations.

Finally, and related to the second argument, we've taken the position that injunctions of aiders and abettors are necessary in certain cases for Commission enforcement to be effective and complete, and that that is within the inherent approval power of the Court.

The Zimmerman case was argued last September, and in October, the Court remanded it to the District Court with instructions to consider whether to allow amendment to charge Zimmerman as a primary violator, and then only if appropriate, to consider the Central Bank issue in the first

instance.

In the meantime, we have a second case, SEC versus Fehn in which the issue may be ruled on. It's a 9th Circuit case. Fehn is an attorney who was found liable for aiding and abetting anti-fraud violations by a client. And, unlike Zimmerman, we are not arguing that he can be held liable as a primary violator. The case has not been scheduled for oral argument yet, I know it has not been argued yet, and the chances are much greater that the Court will actually have to reach the Central Bank issue.

We have one more Supreme Court case, this one is still pending and we're hoping the third time is the charm. This case is called Master Bono versus Cheerson, Lehman, Hutton. It was argued in January and it deals, basically, with the question of whether punitive damages are available in arbitration with brokerage firms.

The case involves customers who took a brokerage firm to arbitration; actually, I think they were compelled to arbitrate under a pre-dispute arbitration clause -- and they sued -- they filed

claims under the Federal Securities laws which don't allow for punitive damages, and also under State law which did allow for punitive damages. The arbitrator awarded punitive damages, and the firm sought review under the Federal Arbitration Act.

The District Court vacated the award, saying that the parties, in their agreement, had agreed to be bound by New York law, and that under New York law, under, I believe, it's called the Garraty decision, punitive damages are not allowed in arbitration, and the Court of Appeals affirmed.

The Commission noted that the NASD has, since 1989, had a rule which says that agreements cannot limit the right to any damage award that a person otherwise would have in arbitration. And we have -- we construed that, and the Commission construed that to mean, at the time it approved the rule that a -- if a person could, in State court, and even in New York, wanted to get punitive damages in State court, get punitive damages, then they cannot be denied that in arbitration.

The problem in the Master Bono case is

that the NASD rule postdated the signing of their agreement. There was also some dispute as to what the NASD rule actually means, but regardless of how one construes that, there are likely to be any number of cases which would not be governed by the NASD rule, and where this would be an issue.

The Commission argued that the arbitrator was correct in concluding that it was -- that they were authorized to award punitive damages. The Commission noted that the Federal Arbitration Act was intended to counteract traditional hostility to arbitration, while the New York rule on punitive damages evinces just that hostility. And the Commission pointed out that if New York law was chosen, not because the parties have chosen it, but because of choice of law principles, there is authority for the proposition that the Federal Arbitration Act -- which is intended to encourage arbitration -- would override the New York rule.

The Commission said that it recognized that the parties could agree -- apart from the NASD rule, which does not allow such an agreement -- but

apart from that, the parties could agree not to allow punitive damages. But it said that, in light of the policies in the Federal Arbitration Act, such an attention should not be presumed, and it should not be found unless it is clearly stated in the contract and here, for a variety of reasons, the Commission argued it was not clearly stated.

I don't know when we'll get a decision on that case. As I said, it was argued in January. I expect it could be any time between, you know, sometime this month and the end of the term.

Now, beyond the Supreme Court cases, the Commission has been involved in a number of cases, and the courts have appealed this year, and let me go through this as quickly as I can.

We've had a couple of cases dealing with the definition of security. Well over a year ago we had a case in the 2nd Circuit called Bank of Espanol, which dealt with the question of whether loan notes are securities. Loan notes are a hybrid; they are modeled -- they're basically commercial loans which major money-center banks would make and

then immediately participate out. But unlike traditional loan participations, they wouldn't participate them out just to other lending institutions, they would participate them out to all sorts of institutions, corporations, and the like.

We had argued, in the Bank of Espanol case, that these were securities. That they were largely salt entities, they were not in the lending business, they were marketed as investments, they were sold on the basis of their competitive concern, and they were advertised, quite boldly, as a commercial paper equivalent.

The Court of Appeals, nonetheless, held that they were not securities, and what troubled us -- the result troubled us, but what was of greatest concern -- we were not totally surprised by the results, I would say, because the plaintiff in the Bank of Espanol case were, themselves, banks. Even though these were largely sold to non-banks, these plaintiffs, themselves, were banks. They had brought in million-dollar-plus denominations and it was a little bit difficult to see that a court would

have great sympathy for them.

What concerned us, though, was not just the outcome with respect to these particular plaintiffs. What was of greatest concern was the Court had suggested that the purchase of a note for a short-term gain was a commercial transaction as opposed to an investment transaction, and it also suggested that, so long as the loan had originally been a commercial loan, once it was participated out, it remained a commercial loan and never became a security. And our concern was that, somebody taking this to the next step --

[Music plays.]

MR. ERIC SUMMERGRAD: -- to million-dollar chunks, but into thousand-dollar chunks and participated out generally to the public and rely on this to say that it still was not a security. So, re-hearing was sought and we filed a brief in connection with that. And while the Court didn't grant re-hearing, it amended the decision and it added limited language to say that Security Pacific's program -- that was the bank in the case -

- was structured in such a way to, quote, "prevent the loan participations from being sold to the general public, thus limiting eligible buyers to those with the capacity to acquire information about the debtor."

Well, this past year, we had another case called Pollack v. Laidlaw which didn't involve banks, it involved orthopedics.

[Laughter.]

MR. ERIC SUMMERGRAD: And they weren't buying in million-dollar chunks, they were buying in fifty-thousand-dollar-whatever chunks; these were interests in mortgages which were being sold, and the District Court, relying on Bank O, nonetheless, held that this was not a securities transaction, it was a commercial loans transaction.

We filed an amicus brief in the 2nd Circuit, and the 2nd Circuit reversed, and it limited Bank O in two important ways.

The first was, it said that the fact that the case involved, quote, "Broad-based, unrestricted sales to the general investing public, supported

finding that these were securities." This clearly recognized limitations in Bank O that we -- that had been added on re-hearing.

Second, and this is, I think, even more important, the Court of Appeals rejected the view that the purchasers were commercially motivated, merely because they received interest on their investment at a fixed rate. The Court held, quote, "It is not even a close question," unquote, that the purchasers had an investment motive, and it said that if this was not an investment motive, than any type of investment in short-term commercial instruments also would not involve an investment motive, yet such instruments are regulated as securities.

Finally, the Court said, and this, I think, was also very important, that in determining whether the motivation -- and under the -- let me back up and just say, those of you who are not familiar, commercial motivation versus investment motivation is essentially the lynchpin of the Reeves Test for determining whether a note is a security.

The Court said that in determining whether the motivation was commercial or investment, it was not critical to balance everybody's interest. That is, the seller might have a commercial motivation. The important thing -- and this was a point that we had stressed -- was that the key motivation is that of the investor because, after all, the securities laws are designed to protect investors, and if the invest -- the person purchasing the instrument has an investment motivation, that should be sufficient under the Reeves Test.

A second case, which is pending right now, again, dealing with the definition of security, let me deal with this very, very quickly is interesting because it's a, I guess, an ever-increasing type of scam that is being seen, so-called "wireless cable partnerships." This particular case is, SEC versus Continental Wireless Cable Television, Inc. And the basic structure of this is simple: a company sells interests in what it terms a general partnership It says it will undertake to develop and then turn over, on a turn-key basis, a cable television

system, or it could be some other type of high-tech system, and that the investors will then be general partners, and they will have responsibility for managing the enterprise.

Meanwhile, while they are developing this, they're syphoning off the money. In this case, the defendant sold to some 2,000 investors in 46 States; over $38 million in interest in two systems. Only $7 million was used to develop the systems, $11 million was spent on salaries and commissions for the defendants, and millions more were spent on items wholly unrelated to the deal.

Well, the defendants argue that this is not an investment contract under the Howie Test because these people who invested are going to be general partners, they are not dependent upon the entrepreneurial or managerial efforts of others, and therefore this is just like any other general partnership.

And the point which we made in the brief -- we obtained a preliminary injunction against this, and on appeal, the point that we've made is two-

fold. One, and perhaps most critically is, these people had not power during the critical time preceding when the system was turned over to them, they had no power, either de facto or de jure -- this was entirely in the control of the people who were promoting the venture, yet this was the time when all of the money was being syphoned off. Who cared what sort of power they had once this thing was turned over; the damage had been done already.

And the second thing is, is that when you're dealing with this sort of thing where this was sold through cold calls, it was sold through television advertisements, there was one woman who said, "Well," she said, "Well, I invested because they had somebody named Roy Clark on there." And I guess it's the country singer who -- it's a great singer, but I wouldn't turn to him for investment advice, "and he seemed like a responsible person." And, based on that, she invested. And these people had no sophistication about business at all, they really had no business experience at all, they were widely separated across the country, there was no

real opportunity for them to exercise any power, even after this venture was turned over and under all of these circumstances we think that's a securities transaction.

The case hasn't been scheduled for oral argument, yet. It was just filed a couple of months ago.

I'm going to spend about five minutes on two remedies cases, and I'm not sure if these were discussed last year, I'm going to discuss them, anyway, because I think they're important, and they're also cases that I handled, so that makes them even more important.

[Laughter.]

MR. ERIC SUMMERGRAD: The first one -- they both involved notorious corporate raiders. One is the Bill Zarian case, the other one is the Pozner case. The Bill Zarian case in the D.C. Circuit, Bill Zarian had engaged in some parking schemes, he failed to timely file schedule 13Ds, when he did file them, he misstated -- overrepresented -- his ability to affect certain tender offers, White

Knights were brought into the deal and he was ultimately bought out. And we sued him -- got summary judgment against him because he had been criminally convicted on the same charges and got $33 million in disgorgement representing the amount that he had inflated the stock price when he was bought out by his false 13Ds.

The two important aspects of the decision, first, the Court reiterated the principles it had articulated in the First City Financial case, regarding the burden of proof in making disgorgement calculations, and basically, what the standard is, is that all the Commission has to do is present a reasonable approximation of what the illicit profits were, and the burden then shifts to the defendant to show that some other measure should be used. And here, Bill Zarian had not done that.

The second issue is the fact that Bill Zarian had been previously criminally convicted, and ordered to pay $1.5 million in fines. He claimed that the disgorgement order was a second punishment and that it was constituted double jeopardy under

the Supreme Court's decision in U.S. v. Halper, and the Court rejected this and I think it's a first Court of Appeals decision to deal with the scope of Halper in this context.

It said, quote, "The reach of the Halper decision is short," unquote, and applies only in the, quote, "rare case," unquote, where a civil monetary sanction is overwhelmingly disproportionate to the damage caused. And here, they said, there was no such disproportionate measure of disgorgement.

The Court also said that, quote, "the disgorgement order is remedial in nature, and does not constitute punishment within the meaning of double jeopardy," unquote.

Before I get to the Litigation Analysis Unit, let me just see if there were -- let me just mention this, very briefly, in passing. We've had a number of markup cases in the last couple of years. Up until fairly recently there were only, perhaps, one or two Court of Appeals decisions dealing with markup principles. I suppose it's because there are

a lot of Commission decisions that have come out in this area. We have seen a tremendous number of appellate cases in the last couple of years dealing with excessive price markups. Which, for those of you who don't know, under the NASD rules, a firm that is selling securities as principal is only entitled to take a reasonable markup over, essentially, the wholesale interdealer price in charging their retail customers.

And, basically, what a lot of this litigation has turned around is, what is the prevailing wholesale price? Let me just mention, there are a few decisions, they are written up in the -- in the outline, and there was the Horner case a couple of years ago, the First Independence Group case -- both of those in the 2nd Circuit -- the Amato case in the 5th Circuit, and perhaps the most extensive case, the Orkin case in the 11th Circuit which endorses a number of the principles that the Commission, in its recent markup decisions, has articulated.

In the last few minutes I have, let me

just turn to the Litigation Analysis Unit. As you know, there's tremendous talk about litigation reform; it has accelerated since the last election. Even before that, the Commission was greatly concerned about frivolous litigation because obviously, while we believe -- and the Supreme Court has stated -- that private actions under the Securities laws are not just useful or good, they're a necessary adjunct to our own limited ability to being enforcement cases, there is no denying that frivolous litigation, litigation brought for no purpose other than to gin up a settlement, imposes unnecessary costs on the markets of all types, may deter useful disclosure and a variety of other direct and indirect costs.

The issue is being debated heatedly before Congress, that's beyond the scope of what I'm going to talk about, but what we have done is, we have started to look for cases where we could go in and give the Court some guidance as to when a case is frivolous, when it might be dismissed, and try and develop some standards as to how to guide the courts

in that manner.

We have, so far, only taken action in one case. In early November, the Commission sent a letter to the parties in a case called Frank v. Cooper Industries, and it expressed the view that, based on the facts and the complaint, the complaint was without merit and should be dismissed. I must say that, by the way, the motion to dismiss was denied which may indicate how much weight we have in this regard.

The letter expressed the Commission's views that the complaint did not adequately plead the nature and extent of the negative information, that the defendants were alleged to have failed to disclose the time when the alleged negative events occurred, and the Commission concluded, quote, "a complaint that is as vague and unenlightening as the one in this action as presently stated is not, in the Commission's view, adequately pleaded, and is not in the best interest of investors to allow an action based on the complaint to proceed.

Now, this effort became formalized this

past January when Chairman Leavitt announced the formation of the Litigation Analysis Unit, and he stated that, "The Unit will evaluate the claims and the legal support for private cases, and where appropriate, it will provide our views to investors, corporations, lawyers and judges." The General Counsel's Office has since issued a litigation release. It is -- it was issued on February 14th, it is Exchange Act Release Number 35374, it is also under Litigation Release Number 14411, which discusses the program in more detail, and encourages people who have concerns about abuses they may see to bring them to the attention of the Office. Again, don't bring them to my personal attention, because I'm not directly involved in the Unit's work, and I will just have to pass them onto someone else. If you address -- if you do want to bring anything to the attention of our office, address it to the General Counsel and it will get directed to the right person.

Among other things, the release says, "The Commission will consider filing briefs at the trial

court level on, among other things, motions to dismiss or for summary judgment complaints or defenses in motions for sanctions. The Commission will also consider filing briefs in securities class actions on such issues as class certification, notices to the class, settlements, attorney fee awards and other issues under Rule 23 of the Federal Rules of Procedure."

We expect that the Commission will particularly express its views with respect to procedural developments that have the potential to affect a wide variety of cases, and among the issues -- and this is all very much in the formative stage, because we are really feeling our way into unchartered territory -- such matters as greater qualitative analysis in the selection of class counsel, for example, some courts have used competitive bidding and other techniques in the selection of class counsel, greater and more meaningful participation by class members, and evaluating a class action, and allowance of some limited discovery before dismissal of an action with

prejudice.

The release finally concludes by saying, "For those of you who wish to do so, you should send us a letter, it should briefly describe the significance of the issue or issues warranting Commission participation," and I would say, by the way, that for those of you who are seeking amicus participation from us in any case, let alone these types of cases, the earlier you get to us, the better. The more detailed you can be in making the request, the better. The more documents, in terms of pleadings in the lower courts, or whatever, that you can provide, the better. The more information we have to work with, the more we can quickly evaluate whether we want to go in. The -- and this, again, also applies to all cases, set forth the Court schedule in the matter, and this doesn't necessarily apply, include 5 copies of relevant pleadings and legal memoranda of all parties in the case.

I don't know where this is heading, I think that it may wind up being a very useful

enterprise, and may give the Court some true guidance in this area.

MALE SPEAKER: Thank you very much, Eric.

[Applause.]

ANNOUNCER: This completes the recording of this presentation. For information on other recordings of this conference, or other similar conferences, please contact Reliable Communications at 1-800-388-5709.

[Whereupon the presentation was concluded.]

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