

**SEC HISTORICAL SOCIETY
ORAL HISTORIES COMMITTEE**

ROUNDTABLE ON ENFORCEMENT

A Brief History of the SEC's Enforcement Program 1934-1981

Irving M. Pollack
Stanley Sporkin
Co-Moderators

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Prepared by
Daniel M. Hawke¹

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I. Introduction

“People need to believe that we are everywhere, and that if you risk violations of law, you will get caught.”² When current SEC Chairman Harvey L. Pitt spoke these words recently, he distilled, as succinctly as one can, the mission of the U.S. Securities and Exchange Commission’s enforcement program.³ Implicit in Chairman Pitt’s statement is the longstanding recognition that, as a relatively small agency with notoriously scarce resources, the Commission cannot, in reality, be everywhere or stop all wrongdoing in the markets at once. Rather, it is through the Commission’s enforcement program that the Commission seeks to instill apprehension in the minds of would-be offenders that, if they violate the securities laws, they too will be caught and will suffer consequences similar to those that have preceded them – or worse. The Commission generally achieves its enforcement objectives by interpreting the securities laws and applying them to conduct that, when prosecuted in an enforcement action, will have the maximum and most efficient impact on the public consciousness.⁴ To this end, “[t]he Commission’s reputation as an effective law enforcement agency is well-established, rightfully earned and borders on the legendary.”⁵

Given the extraordinary challenges now confronting the Commission, it is particularly timely to revisit the history on which the enforcement program’s distinguished reputation is based. This paper examines the general themes and trends that characterize the history of the Commission’s enforcement program during the period 1934 through 1981.⁶ Focusing particularly on the Commission’s early years, this paper discusses the significant enforcement events that are representative of the eras in which they occurred and that provide opportunities for insight into how the Commission’s enforcement program evolved and expanded over time. Lastly, this paper provides chronological and historical context to the discussion of the Roundtable on Enforcement, particularly with regard to the following topics:

- The Commission’s early enforcement program during the period 1934 through 1944;
- The post-World War II period through the late 1950s when the Commission’s enforcement activity declined and in which scandal on Wall Street drew attention to major weaknesses in the Commission’s enforcement efforts;
- The 1960s, during which the home office began to develop a significant enforcement capability and through the innovation and creativity of the staff significantly expanded the interpretive contours of the federal securities laws;
- The establishment of the Division of Enforcement in 1972; and
- The 1970’s, during which the Enforcement Division relentlessly pursued corporate malfeasance and established a reputation for rigorously but fairly enforcing the nation’s securities laws.

II. Background

In August 1972, the U.S. Securities and Exchange Commission established its Division of Enforcement.⁷ Prior to this time, responsibility for enforcing the federal securities laws had been decentralized among the Commission's various operating divisions and regional offices. In 1934, at the time the Commission was established, the Commission's "Legal Division" was responsible for conducting investigations, representing the Commission in "cases to enjoin violations of law," and referring cases to the Department of Justice for criminal prosecution.⁸ Within a year or two, the Commission reorganized the functions of its divisions and vested the Regional Offices with primary responsibility for conducting investigations and bringing enforcement actions. For most of the next four decades, the Regional Offices⁹ conducted "[n]early all of the investigations"¹⁰ of frauds and violations arising under the securities acts while the Commission's Trading and Exchanges Division played a largely supervisory and coordinating role supporting the regions and referring criminal cases to the Justice Department for prosecution. Although each of the divisions in the home office would develop an enforcement capability over time, the Regional Offices were "the first line of enforcement of the various laws administered by the Commission."¹¹

In its earliest days, the Commission's enforcement program was quite active. The Commission brought numerous injunction actions and stop order proceedings. By the end of its first year, the Commission reported that it had roughly 2300 cases under investigation.¹² The Commission used its enforcement powers during this period to bolster its investigation of investment trusts, support its attempts to regulate and reform the stock exchanges and to crack down on market manipulation and other frauds. By the late 1930s and early 40s, the Commission's enforcement program had achieved some successes: the Michael Meehan and Charles Wright market manipulation cases which resulted in the first expulsions of members of national stock exchanges,¹³ the investigation of the Richard Whitney embezzlement scandal which enabled the Commission to impose its regulatory regime on the self-regulating stock exchanges, the Commission's articulation in the Duker & Duker matter of what would later become known as the "Shingle Theory" of broker-dealer liability, and the Commission's enormous investigation of the McKesson & Robbins matter, which was the Commission's first major accounting fraud investigation. This period also resulted in the Commission's promulgation of Rule 10b-5 under Section 10(b) of the Securities Exchange Act of 1934¹⁴ (the "Exchange Act") and the Commission's adoption of Rule II (e) of its Rules of Practice to discipline persons appearing or practicing before it, both of which would figure prominently in the Commission's enforcement program decades later.

From the mid-40s through the late 1950s, as the Commission entered into the post-World War II era, the Commission's interest in enforcement waned. During this period, budget cuts and a shifting focus away from the stock exchanges to regional fraud investigations resulted in fewer cases originating out of the home office.¹⁵ As a result, the Commission's overall enforcement program, particularly with respect to the regulation of the exchanges, lost the momentum that had characterized its early years. Towards the end of the 1950s, however, scandal at the American Stock Exchange would re-direct the focus of the enforcement program back to the home office and would trigger

a series of events at the Commission that, eventually, led to the creation of the Division of Enforcement more than a decade later.

The 1960s marked a renewed interest in enforcement at the Commission. It is also a period distinguished by the staff's creativity and innovation in using enforcement actions to facilitate the interpretive development of the securities laws. During this period, the establishment of a home office enforcement program to combat securities frauds of national significance became a high priority. In 1961, the Commission issued its order in the Cady, Roberts matter, which established the rule that a corporate insider must disclose his knowledge of material, nonpublic information or abstain from trading before the information becomes public. In 1963, the Commission completed its landmark Special Study of Securities Markets, which provided the Commission with a long overdue understanding of the inner-workings of the securities markets and resulted in a "redistribution of power"¹⁶ from Wall Street to Washington. As a result of the Special Study, the Division of Trading and Exchanges was renamed the Division of Trading and Markets, a "little step"¹⁷ that would contribute, ultimately, to the formation of the Division of Enforcement. In 1968, the Second Circuit decided the seminal Texas Gulf Sulphur case in the Commission's favor, which greatly expanded its application of Rule 10b-5 to insider trading cases. Later, the Texas Gulf Sulphur case would become the first enforcement action in which the Commission obtained equitable relief in the form of disgorgement. Thus, the 1960s was a period in which the enforcement program grew to become "the life and breath of the Commission . . .the guts of the agency."¹⁸

By the early 1970s, each of the divisions in the home office had developed considerable enforcement capabilities of its own. The Division of Trading and Markets had built a particularly tenacious and energetic enforcement presence.¹⁹ Given the breadth of enforcement activity that was occurring throughout the Commission, then-chairman William J. Casey recognized the Commission's need to have one division devoted entirely to enforcement that could set priorities and that would have an overview of all enforcement activities around the country. As part of the Commission's restructuring in 1972, the Office of Enforcement within the Division of Trading and Markets and the enforcement branches of the Divisions of Corporation Finance and Corporate Regulation were consolidated and became the Division of Enforcement.

Once the Enforcement Division was established, it began a period of frenetic enforcement activity on a national scale. The 1970s resulted in groundbreaking enforcement actions in the questionable payments and corporate accountability cases. During this period, the Enforcement Division and the Division of Corporation Finance used the voluntary disclosure program to encourage securities law violators to come in from the cold and confess their misdeeds. The Enforcement Division also developed the "Access Theory" approach to enforcement in which the Commission sought to hold accountants and lawyers responsible for providing clients access to the markets under circumstances where they knew or should have known their clients were engaged in securities law violations. By 1981, the foundation of the Commission's modern enforcement program had been laid and the Enforcement Division's reputation for professionalism, integrity and effectiveness had been firmly established.

III. The Early Years: 1934 –1944

On June 6, 1934, President Franklin Roosevelt signed the Exchange Act into law. The Exchange Act established the Commission and transferred to it the administration of the Securities Act of 1933 (the “Securities Act”),²⁰ formerly administered by the Federal Trade Commission (FTC). The Securities Act and the Exchange Act conferred upon the Commission “broad powers to enforce the acts and the rules and regulations thereunder through investigations, hearings and injunctions.”²¹ The Commission’s initial enforcement actions largely resulted from investigations that the FTC had initiated. The Commission, however, quickly exercised its own investigative powers, bringing its first significant injunction action in a case that it described as a “gigantic swindle” within three months after it opened for business.²² By the end of its first fiscal year in June 1935, “the Commission [had] brought 22 suits for injunction and carried on 3 suits already brought by the [FTC] . . . permanent injunctions had been obtained against 32 defendants, temporary injunctions against 28 defendants, and temporary restraining orders against 19 defendants. Suits involving 72 defendants were awaiting hearing.”²³

A. “Flying Quizzes” and Other Characteristics of the Commission’s Early Enforcement Program

There are few contemporaneous public documents that describe the characteristics of the Commission’s enforcement program in its early years. The most descriptive information about the Commission’s enforcement activity during this period comes from its annual reports. From these reports, it appears that the processes and procedures that the Commission utilized in its formative days were not markedly different from those employed by the Division of Enforcement today, with some exceptions. Generally, investigations began as a result of complaints and inquiries from ordinary investors. Then, as now, the Commission received thousands of such complaints about possible securities law violations each year. Every complaint received a reply and “to the extent that the Commission’s powers and the subject matter [permitted], every complaint was investigated.”²⁴

The Commission has always conducted both formal and informal investigations. In formal investigations, the staff routinely issued subpoenas and conducted testimony, particularly in “cases where it [was] necessary for the Commission to reconstruct the market over an extended period of time.”²⁵ In particularly important investigations, the Commission conducted public investigative hearings. In “trading investigations,” the “Commission [kept] confidential the fact that trading in a security [was] under investigation lest knowledge of the existence of such an investigation react adversely upon the issuer or its securities.”²⁶ Informal investigations were similar to those that the Enforcement Division conducts today, with many being resolved without the need for a formal order. In conducting its investigations, the Commission was, as it remains today, concerned about the length of time that investigations took to complete. The 1930s equivalent of today’s “real time enforcement initiative” was known as the “flying quiz.” The flying quiz was a type of immediate investigation into trading activities that “enabled the enforcement staff substantially to increase the scope of its activity and reduce the time element involved in conducting investigations.”²⁷ According to the Commission’s Fourth Annual Report:

[Formal investigations] are frequently preceded by investigations which are conducted without the use of subpoena power and in that sense are informal in nature. To expedite its work, the Commission divides informal investigations into flying quizzes and preliminary investigations. The flying quiz is designed to detect and discourage incipient manipulation by a prompt determination of the causes for unusual market behavior. Often the results of a flying quiz point to a legitimate reason for the activity under review and the case is closed. Frequently they uncover facts which require a more extended investigation, in which case a preliminary investigation is undertaken.²⁸

B. Early Enforcement Efforts

The Commission brought hundreds of enforcement actions in its first ten years. Most of these were in the nature of injunction actions and stop order proceedings. These efforts appear to have been vigorous and largely successful, but not entirely without failure. From the outset, the Commission's enforcement authority was frequently questioned,²⁹ subpoenas went unanswered³⁰ and the constitutionality of its enabling statutes was challenged.³¹ In the Commission's injunction actions, courts were generally unwilling to expand the reach of their injunctive powers beyond the particular conduct before them. Thus, the injunctions that the Commission obtained were of limited value in that they were usually restricted to the individual's conduct or trading with respect to a particular stock. This allowed defendants to resume their unlawful activities by resorting to other securities as to which they were not enjoined.³² The following cases provide a glimpse into the Commission's early enforcement program.

1. Jones v. SEC

A little more than a year after the Commission was established, the agency suffered a setback when the Supreme Court ruled against it in Jones v. SEC,³³ a 1936 stop-order proceeding. J. Edward Jones, a dealer in oil royalty securities, filed a registration statement "covering a proposed issue of participation trust certificates."³⁴ The day before the registration was to become effective, the Commission's staff advised Jones that the registration statement "appeared to contain untrue statements of material facts and to omit material facts required and necessary." The staff directed Jones to appear before the Commission to show cause why a stop order should not be issued³⁵ and issued a subpoena compelling Jones to testify and produce certain records. In response, Jones attempted to withdraw its registration statement, thereby attempting to obviate the need for testimony and the Commission's inspection of its "private papers."³⁶ The Commission refused, "citing a rule that withdrawal could only occur with SEC consent."³⁷ Jones challenged the Commission's refusal to allow it to withdraw its registration statement on the grounds that the Securities Act did not grant the Commission such discretion and that, as a result, the Commission was "without authority to require petitioner to appear to testify or to submit his private books, records and papers for the inspection of the Commission."³⁸ Jones further challenged the constitutionality of the Securities Act on the grounds that it was an attempt to exercise powers reserved to the states.

The dispute quickly proceeded to the Supreme Court. The Court did not address the constitutionality of the Securities Act, “allowing court of appeals holdings affirming the act’s constitutionality to stand as controlling law.”³⁹ The Court did, however, find that the Securities Act contained no provision granting the Commission discretion to refuse a registrant’s unilateral right to withdraw a registration statement.⁴⁰ In a sharp rebuke to the fledgling agency, the Court held that “[t]he action of the Commission finds no support in right principle or in law” and that it was “wholly unreasonable and arbitrary” to refuse to allow Jones to withdraw its registration statement.⁴¹ The Court then chastised the Commission’s efforts to compel Jones’ testimony and production of documents. Its admonitions went to the core of the Commission’s investigation powers:

An official inquisition to compel disclosures of fact is not an end, but a means to an end; and it is a mere truism to say that the end must be a legitimate one to justify the means. The citizen, when interrogated about his private affairs, has a right to know why inquiry is made; and if the purpose disclosed is not a legitimate one, he may not be compelled to answer. Since here the only disclosed purpose for which the investigation was undertaken had ceased to be legitimate when the registrant rightfully withdrew his statement, the power of the commission to proceed with the inquiry necessarily came to an end

. . . If the action here of the commission be upheld, it follows that production and inspection may be enforced not only of books and private papers of the guilty, but those of the innocent as well,⁴² notwithstanding [that] the proceeding for registration, so far as the power of the commission is concerned, has been brought to an end by the complete and legal withdrawal of the registration statement.⁴³

The Commission considered the scope of the Court’s ruling in Jones to be limited to the facts of that case⁴⁴ and there is little to suggest that the decision hampered the Commission’s ability to conduct its investigations in years to come. Nevertheless, in the aftermath of the Jones decision, according to Dean Joel Seligman, a wider debate about the powers of independent agencies ensued, which left agencies possessing both investigatory and adjudicative powers like the SEC “inherently vulnerable.”⁴⁵ Dean Seligman states “. . . the combination in a single agency of prosecutorial and judicial functions appeared unfair This was particularly so for an agency like [the] SEC, with vague enabling statutes, an aggressive staff, and evolving hearing procedural rules.”⁴⁶

2. The Meehan and Wright Market Manipulation Cases

Following the Jones case, the Commission brought a series of successful enforcement actions in the mid and late 1930s that gave rise to the first evidence of “anti-SEC hostility” on Wall Street.⁴⁷ According to Dean Seligman, during this period, “[t]he effectiveness of the Commission’s enforcement activity, combined with the primitiveness of its initial hearing procedures, engendered intense animosity.”⁴⁸

In 1937, the Commission took its first enforcement action to expel a member of the New York Stock Exchange under section 19(a)(3) of the Exchange Act. In the matter

of Michael J. Meehan,⁴⁹ the Commission investigated suspected market manipulation of Bellanca Aircraft Corporation stock by Michael J. Meehan, a member of the New York Stock Exchange, the New York Curb Exchange and the Board of Trade of the City of Chicago. Meehan, through a network of close friends and associates, orchestrated a series of matched trades involving Bellanca stock that caused its price to rise. Following “[a]n exhaustive SEC investigation,”⁵⁰ the Commission found that Meehan violated Sections 9(a)1 and 9(a)(2) of the Exchange Act, when he “liquidated 29,000 shares in a total of 9 days’ trading, during which the market rose from a low of 4 to a high of 5½, and during which a total of 40,900 shares were traded.”⁵¹ Although the Commission could have suspended Meehan for up to 12 months, the Commission issued an “Order of Expulsion,” expelling Meehan from each of the national exchanges of which he was a member.

Soon after the Meehan case, the Commission decided the Charles C. Wright matter.⁵² Charles Wright was a member of several national securities exchanges who controlled substantial blocks of stock in Kinner Airplane and Motor Corporation, a stock whose daily trading volume averaged only 730 shares. On one day in September, 1935, Wright purchased 18,500 shares of Kinner stock in accounts that he controlled at or about the same time that he had pending sell orders in different accounts with his brokers. By executing buy orders that were filled, in part, with his pending sell orders, Wright was able to create the appearance of buying interest in Kinner stock, which increased its price. Wright then sold more than 52,000 shares into the rising market for Kinner stock. The Commission found that Wright’s trading violated Sections 9(a)(1) and 9(a)(2) of the Exchange Act and issued an order expelling him from all national securities exchanges of which he was a member.⁵³

These cases signaled the Commission’s willingness in its early investigations to dig deeply into complicated facts in search of possible securities law violations and to impose stiff sanctions where it could be shown that a clear violation had occurred. The Commission’s early success in these and other cases helped it earn its “reputation for being a vigilant watchdog of Wall Street.”⁵⁴

3. The Richard Whitney Embezzlement Scandal

Perhaps the most well known investigation that the Commission conducted in its pre-World War II years resulted from the Richard Whitney embezzlement scandal of 1938. The Whitney scandal figured prominently in the Commission’s efforts to regulate the New York Stock Exchange and the numerous other exchanges that had proliferated by this time. Richard Whitney was an influential figure on Wall Street who had been the president of the New York Stock Exchange, sat on numerous Exchange committees and was the treasurer of the New York Yacht Club. In the early 1930s, Whitney had testified before Congress in strong opposition to the legislation that ultimately culminated in the Exchange Act. Speaking on behalf of Wall Street, Whitney viewed the legislation, and subsequent Commission efforts to regulate and reform the Exchange, as threatening the existence of brokerage firms and resulting in unemployment for employees in the financial services sector.⁵⁵ Within the Commission, Whitney had come to be viewed as an uncompromising “obstructionist”⁵⁶ who opposed the Commission’s efforts to reform the Exchange. The Commission had been stymied in its efforts to regulate the exchanges,

in part by Whitney's vociferous opposition. Then-Chairman William O. Douglas "considered that 'it was high time for the SEC to see to it that teeth were put into the rules and laws restricting Exchange trading.'"⁵⁷

In March 1938, the Commission learned that Whitney had misappropriated securities belonging to his customers, including the New York Yacht Club, and to the Gratuity Fund, a fund established by the Exchange for the benefit of the families of deceased Exchange members. The Commission immediately ordered an investigation – "one of the most significant ever undertaken by the Commission"⁵⁸ – that ultimately revealed a massive fraud.⁵⁹ Whitney's activities had rendered his firm, Richard Whitney & Company, insolvent for at least three and a half years prior to its failure during which it conducted business as a member of the Exchange. The Commission further determined that the Exchange had delayed in disciplining Whitney after learning of his misappropriations. The Commission said that Whitney's "prominence and influential connections may well have been factors which influenced the judgment and dulled the suspicions of the Exchange officers and members concerning the conduct and condition of his business."⁶⁰

The Commission's investigation of the Whitney scandal was very significant, both because of Whitney's high profile and because of the magnitude of the investigation itself. According to the Commission's annual report, "[f]ifty-two witnesses, all officials, members, or partners of members of the New York Stock Exchange, or Commission experts, testified during the course of the hearings, which began on April 8, 1938 and ended on June 29, 1938. . . The printed record of the proceedings comprises 937 pages of testimony and over 100 exhibits."⁶¹ As a result of the Commission's investigation, Whitney eventually pled guilty to "grand larceny in the first degree for appropriating to his own use securities entrusted to him in a fiduciary capacity" and "was sentenced to a term of from 5 to 10 years in Sing Sing Prison."⁶² The Commission concluded that Whitney's defalcations and the failure of his firm, coupled with the Exchange's delay in disciplining Whitney, "make pertinent a consideration of the adequacy and the operation of the then existing machinery of the New York Stock Exchange for the supervision and surveillance of its members."⁶³ Thus, ironically, the man who so vigorously opposed the Commission's efforts to regulate the exchanges paved the way for the Commission to impose a regulatory regime on the exchanges that survives to this day.

4. Duker & Duker: The Shingle Theory

In December 1939, the Commission issued its order in the matter of Duker & Duker,⁶⁴ a proceeding to revoke the registration of a broker-dealer that had defrauded one of its customers. In Duker & Duker, William T. Duker, Jr. induced a client to deliver to the firm shares that the customer owned in the Chicago Towel Company. Duker sold the stock as agent for the customer but used a portion of the proceeds to purchase bonds for the firm's account. Duker held the bonds in a firm account for several days and then sold them to the customer's account at a marked-up price that did not bear a reasonable relation to the then-prevailing market price. The firm did not disclose that it had sold the Chicago Towel stock as agent for the customer or that it sold the bonds to the customer's account as principle for its own account.

In its order, the Commission found that

Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. It is neither fair dealing nor in accordance with such standards, to exploit trust and ignorance for profits higher than might be realized from an informed customer. It is fraud to exact such profits through the purchase or sale of securities while the representation on which the relationship is based is knowingly false. This fraud is avoided only by charging a price which bears a reasonable relation to the prevailing price or disclosing such information as will permit the customer to make an informed judgment upon whether or not he will complete the transaction.⁶⁵

Although the Duker firm consented to the revocation of its registration, the Commission nevertheless “took the opportunity to pronounce a new and higher standard of broker-dealer responsibility.”⁶⁶ The principle that a broker-dealer must deal fairly with its clients later became known as the “Shingle Theory” when Louis Loss coined the term in a 1948 law review article describing the Commission’s action in the Duker & Duker matter:

The theory is that even a dealer at arm’s length impliedly represents when he hangs out his shingle that he will deal fairly with the public. It is an element of that implied representation, the theory goes, that his prices will bear some reasonable relation to the current market unless he discloses to the contrary. Therefore, charging a price that does not bear such a relation is a breach of the dealer’s implied representation and works a fraud on the customer.⁶⁷

The Shingle Theory provided the doctrinal framework within which the law of broker-dealer liability evolved. The Commission’s order in Duker & Duker thus became one of the agency’s most enduring legacies of its early enforcement program.

5. The McKesson & Robbins Investigation

Soon after completing its investigation of the Richard Whitney matter, the Commission, in 1940, issued a report on its massive investigation in the Matter of McKesson & Robbins, Inc.⁶⁸ While the Richard Whitney scandal had resulted in the highest profile investigation the Commission had ever conducted, the McKesson investigation appears to have been the largest ever by the time it was concluded⁶⁹ and, more importantly, was the Commission’s first significant accounting fraud investigation.

McKesson was (and still is) a corporation involved in the drug business. McKesson’s auditor was Price Waterhouse (PW). PW certified McKesson’s annual financial statements for each year during the period 1934 through 1937. McKesson filed these financial statements, together with PW’s auditors report, with the Commission. In its 1937 annual financial statements, McKesson listed assets of \$87 million. Of these assets, \$19,000,000 was “known to have been entirely fictitious.”⁷⁰ The company further

misstated its revenues by \$18.2 million and its income by \$1.8 million. The scheme arose out of McKesson's "crude drug business" and was designed "to give an appearance of reality to the fictitious transactions."⁷¹ Through certain affiliates, McKesson purchased merchandise from fictitious vendors in Canada who purportedly held the merchandise in their warehouses for McKesson's account. At McKesson's direction, another fictitious company would then sell the merchandise for McKesson's account to non-existent customers. The Canadian vendors would then ship the goods directly to the customers. Payment for the "pretend" sales would be made by yet another fictitious entity for credit to McKesson's account.

The Commission's report in the McKesson matter tells an intriguing story of fraud and deception at the highest levels of an American corporation. Founded in 1833, McKesson had become a huge company by the 1920s. In the late 1920s, McKesson merged with Girard & Co., a firm headed by Frank Donald Coster. Coster became president of McKesson soon after the merger was completed. Coster, however, was not who he purported to be. In fact, F. Donald Coster was Philip Musica, a man who had previously been convicted of "commercial frauds" under the latter name.⁷² Once he gained control of McKesson, Musica brought his three brothers into the fraud, each of whom had also adopted his own alias to disguise his true identity.⁷³ Ultimately, when his fraud at McKesson was discovered, Philip Musica committed suicide.⁷⁴ His brothers George (alias George Dietrich), Robert (alias Robert Dietrich) and Arthur (alias George Vernard) – referred to by the Commission as the "notorious Musica brothers" – were indicted multiple times for violations of Exchange Act and other crimes, pled guilty and were sent to prison.⁷⁵

The McKesson case is most noteworthy, however, because of the Commission's intense scrutiny of PW's conduct as McKesson's auditor. In what still qualifies as one of the largest and most important financial fraud investigations in the Commission's history, the Commission thoroughly investigated PW's conduct, seeking to determine the scope and extent of the audit procedures that PW performed on McKesson's financial statements and whether PW complied with "generally accepted standards and requirements of audit procedure."⁷⁶ Fearing that the prevailing standards of auditing might be inadequate to enable detection of wrongdoing in other circumstances similar to the McKesson matter, the Commission was especially concerned with developing a "clear impression of what was considered generally accepted auditing procedure as practiced by representative firms."⁷⁷ In an extraordinary development, the Commission enlisted the assistance of partners from eleven major accounting firms who "offered to cooperate in any way possible." These expert witnesses testified extensively concerning their interpretation of then prevailing generally accepted auditing procedures. As a result, the Commission issued an exceptionally well-informed report as to PW's conduct in which it found that:

The firm of Price Waterhouse & Co. for fourteen years served as independent public accountants for F. Donald Coster's [Philip Musica's] enterprises. Within range of the procedures which they followed there were numerous circumstances which, if they had been recognized and carefully investigated by resourceful auditors, should have revealed the gross inflation in the accounts.

We are convinced that despite collusion and skillfully prepared false documents[,] these items repeated themselves to such an extent as to have permitted detection of the gross inflation by alert auditors intent upon knowing the truth about the foreign crude drug operations. Investigation of one item followed in turn by another and so on must, in time, have created a feeling of uneasiness which could not have been dispelled by explanations even from the highest officers of the Company but which should have caused the auditors to associate one unusual circumstance with another and to correlate their observations in such a way as to cast doubt upon the plausibility of the transactions under review the number of items and the period of time over which some of them repeated themselves gave ample opportunity for detection by alert and inquisitive auditors.⁷⁸

The Commission concluded that while generally accepted auditing standards were adequate, “there should be a material advance in the development of auditing procedures whereby the facts disclosed by the records and documents of the firm being examined are to a greater extent checked by the auditors through physical inspection or independent confirmation.”⁷⁹ The Commission acknowledged the accounting profession’s efforts to adopt procedures in light of the lessons learned in the McKesson case but made several proposals to improve the quality of the audit function, including the formation of audit committees. Perhaps most significantly, the Commission expressly declined to propose a “detailed prescription of the scope of and procedures to be followed in the audit for the various types of issuers of securities who file statements with us.”⁸⁰

C. Exchange Act Rule 10b-5 and Commission Rule II (e)

Among the rulemaking and regulatory developments that figured prominently in the evolution of the Commission’s enforcement program in its first decade was the Commission’s promulgation of Rule 10b-5 under the Exchange Act and Rule II (e) of the Commission’s Rules of Practice. While not initially a meaningful part of the Commission’s enforcement program at the time they were adopted, these rules would come to have a profound impact on the Commission’s program decades later.

1. Exchange Act Rule 10b-5

On March 21, 1942, the Commission adopted Rule 10b-5 under the authority contained in Sections 10(b) and 23(a) of the Exchange Act. In the release announcing its new rule, the Commission explained that:

[the rule prohibits] fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.⁸¹

In June 1943, the Commission issued its first public release concerning violations of Rule 10b-5. In the matter of The Purchase and Retirement of Ward LaFrance Trucking Corporation Stock,⁸² the Ward LaFrance Truck Corporation purchased its own stock from public shareholders without revealing its identity as the purchaser of the stock. The Company further failed to disclose that its earnings had improved as a result of war conditions and that it intended to acquire control of the publicly held shares to liquidate the company and transfer its remaining assets to another company. The Commission found that the conduct of the individuals in failing to disclose these transactions “placed the public shareholders at a distinct disadvantage in dealing with them.”⁸³ Because the parties attempted to mitigate the harm to the injured shareholders, the Commission took no action against them.⁸⁴ Instead, the Commission issued a report to “call attention to Rule X-10b-5 adopted under Section 10(b) of the [Exchange Act] and to call attention to [its] view that the activities disclosed were in violation of that Rule.”⁸⁵ In its annual report discussing the case, the Commission stated:

While this is the only case arising under Rule X-10B-5 in which the Commission has issued a public release, others have occurred and the number of violations is increasing. Although the Commission took no action in several such cases when rescission was extended shareholders by violators of the rule, the need for more drastic action to prevent violations of this type is becoming increasingly apparent.⁸⁶

Despite the Commission’s concerns about “the need for more drastic action,” Rule 10b-5 was “relatively little used during the next eighteen years because of uncertainty as to whether it applied to purchases or sales effected through securities exchanges.”⁸⁷

2. Rule II (e) of the Commission’s Rules of Practice

Rule II (e) – now known as Rule 102(e) – of the Commission’s Rules of Practice dates back to the second year of the Commission’s existence. In September 1935, the Commission adopted Rules of Practice “governing appearance and practice before the Commission.”⁸⁸ The Commission’s initial rules established a formal enrollment process – similar to a bar admission – pursuant to which the agency would review the applications of those wishing to appear or practice before it and maintain a register of those who it found were “of good moral character and [possessed] the requisite qualifications to represent others.”⁸⁹ These rules applied to attorneys and agents of other persons but did not expressly identify accountants, engineers or other experts as being among those persons whom the Commission considered for enrollment.

In 1938, the Commission adopted Rule II (e). Rule II (e) eliminated the enrollment process and deemed anyone who presented cases before or filed materials with the Commission as practicing before it. As to such persons, Rule II (e) provided the Commission with the ability to “disqualify, and deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to, any person who is found by the Commission after hearing in the matter (1) not to possess the requisite qualifications to represent others; or (2) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct.”⁹⁰ In its 1938 amendments, the Commission expressly defined “practicing before the Commission” as including “the preparation of

any statement, opinion or other paper by an attorney, accountant, engineer or other expert filed with the Commission . . . with the consent of such attorney, accountant, engineer or other expert.”⁹¹

In 1942, for the first time, the Commission “found it necessary to invoke against an accountant the sanctions found in Rule II (e) of its Rules of Practice.”⁹² The case, entitled In the matter of Abraham H. Puder and Puder & Puder,⁹³ was an independence case. Abraham Puder, an accountant, and his firm Puder & Puder, falsely certified the financial statements of A.H. Hollander & Son, Inc. Puder held stock in Hollander, and had made loans to and received loans from the principals of Hollander. With Puder’s knowledge, the principals of Hollander also used Puder’s name on an account falsely to conceal liabilities on the books of another entity that they controlled and that traded in Hollander’s stock. In considering the “cumulative effect” of these dealings, the Commission found that neither Puder nor his firm were independent and suspended them from appearing or practicing before the Commission for a period of three months.⁹⁴ When it decided the Puder case, the Commission could not have known of the significance that Rule II (e) would acquire in enforcement proceedings decades later.

D. A Decade of Accomplishment

The Commission accomplished impressive results in the first ten years of its enforcement program. By the early 1940s, as a result of successfully fending off challenges to its authority, the Commission had “obtained a basic set of precedents interpreting its statutory powers and duties.”⁹⁵ Many of these challenges originated out of the Commission’s enforcement efforts, which encountered “frauds and other statutory violations . . . [that were] as varied as human imagination and ingenuity can contrive.”⁹⁶ These consisted of express misrepresentations, ponzi schemes, “front money” rackets, “switch” schemes, bucket shops, investment scams, market manipulation, broker-dealer frauds, and many others.⁹⁷

As a result, the statistics generated by the Commission in its first ten years are impressive even by today’s standards. By 1944, the Commission had assembled data in its files “concerning an aggregate of 44,399 persons against whom Federal or State action had been taken with regard to securities violations.”⁹⁸ In civil actions brought by the Commission during its first decade, the Commission obtained permanent injunctions against 1,057 firms and individuals.⁹⁹ In criminal actions originating out of Commission enforcement activities, 95% were successfully prosecuted as to one or more of the individuals named in the indictment.¹⁰⁰ These accomplishments provided a strong foundation for future enforcement efforts. Like every young and successful institution of the New Deal era, however, the Commission would experience growing pains and other setbacks in the years ahead.

IV. The Dark Ages and then a “Re” of Light: 1944-1959

A. Budget Cuts and Shifting Priorities

The Commission’s enforcement program following World War II coincided with somewhat of a dark period in the Commission’s history. During the war, the Commission was designated a non-essential agency and relocated to Philadelphia, where it conducted its work out of the Pennsylvania Athletic Club.¹⁰¹ The Commission did not return to Washington until 1948 or so and when it did, it occupied temporary facilities constructed during the war that the staff referred to as the “tarpaper shack.”¹⁰² Statistically, in the immediate aftermath of the war, the Commission continued to bring a steady number of enforcement actions. By the late 1940s, however, the tremendous momentum characteristic of the Commission’s pre-war enforcement program slowed considerably. Budget cuts in the early 1950s reduced the Commission’s staff to a point lower than at any time in its history, including its first year of operations. Enforcement actions originating out of the home office declined significantly, resulting in only fifty cases during the entire decade.¹⁰³ According to Dean Seligman:

...the SEC’s enforcement program in 1954 and 1955 was curtailed. Memoranda were circulated to SEC regional administrators, encouraging them to rely on state authorities whenever possible to investigate and prosecute securities violations as one means ‘to save manpower’ . . . SEC investigations in 1955 led to conviction of only seven persons for securities fraud, the lowest figure in the Commission’s history. The preceding year, the Commission instituted no stop order proceedings and sought suspension of only one security for fraudulent claim of a small-issue exemption.¹⁰⁴

From a programmatic perspective, the lack of an aggressive and fully staffed enforcement effort throughout the 1950s stagnated the doctrinal evolution of the Commission’s enforcement program during this period. To some, this was a period in which the Commission’s stature dwindled.¹⁰⁵ To others, the Commission was “quite busy . . . more orderly and scandal-free” than in prior periods.¹⁰⁶ According to Dean Seligman, “the SEC during much of the Eisenhower administration had no enforcement program to prevent corporate executives, mutual fund advisers and officers, or stock exchange floor members, from engaging in securities fraud.”¹⁰⁷

To the extent there was an enforcement program in the 1950s, it resided in the Regional Offices,¹⁰⁸ whose focus during this period was on “boiler rooms, fraudulent penny stocks and exploitative broker dealers.”¹⁰⁹ The effect of focusing its enforcement efforts on regional fraud investigations was to divert sustained enforcement attention away from the exchanges. The reason for the shift was that the “SEC during the Eisenhower years tended to share with the [New York Stock Exchange] the assumption that securities fraud was unlikely to be perpetrated on the leading exchanges or by leading broker-dealers.”¹¹⁰ The Commission thus adopted a laissez-faire approach to exchange regulation in which the exchanges were left in the position of regulating themselves, the very problem that Richard Whitney scandal exposed less than twenty years earlier.¹¹¹ This approach, in combination with the Eisenhower administration’s

budget cuts and the Commission's focus on regional fraud investigations, "left wide gaps in the Commission's enforcement program" during the 1950s.¹¹²

B. The American Stock Exchange Scandals and the Re & Re Case

With no cop on the exchange beat, a series of scandals at the American Stock Exchange (AMEX) in the mid to late 1950s exposed the "wide gaps" that were plaguing the Commission's enforcement program. In response to the scandals, the Commission initiated a series of investigations into the conduct of various AMEX specialists who had engaged in the widespread sale of unregistered securities.¹¹³ In connection with these investigations, the Commission was criticized for being too "restrained" and "passive" in its prosecution of misconduct at the AMEX, particularly because the Commission imposed nominal penalties and "failed to take any affirmative action [to prevent subsequent violations from occurring] even though it had notice of numerous specific instances where the violations had officially come to its attention."¹¹⁴

The turning point for the Commission came about in the Commission's investigation of the Re, Re and Sagarese matter.¹¹⁵ Gerard A. Re and Gerard F. Re, father and son, were specialists on the American Stock Exchange. As specialists, the Res were responsible for maintaining fair and orderly markets for twenty different securities issued by eighteen corporations – they were among the most prominent specialists on the exchange "account[ing] for 4.4 percent of the total share volume on the American Exchange for the year 1959."¹¹⁶ The Res had information about the price and performance of the stocks for which they were responsible.¹¹⁷ Thus, the Res held positions of trust and confidence and owed a strict duty of loyalty, disclosure and fair dealing to their fiduciaries.¹¹⁸

According to the Commission, during the period between 1954 and 1960, the Res reaped enormous ill-gotten gains by taking "advantage of their pivotal position as specialists to rig the markets for securities in which they were effecting massive illegal distributions on the exchange."¹¹⁹ The Commission found that:

[the Res] stood ready and willing to purchase and distribute large blocks of stock held by persons who could not or would not market them through normal channels. Often the unmarketability of these securities stemmed from the fact that the financial condition of the companies could not tolerate the disclosure that would have resulted from compliance with the Securities Act. They were able to conduct their illicit activities without detection over an extended period of time by utilizing dummy accounts and failing to make and keep proper records and reports. Their techniques of manipulation also included coverage of short sales in their specialist account by transfers from their secret accounts . . . purchases for their own account while engaged in a distribution, short sales at prices below that of the last regular way sale, carefully timed purchases for discretionary accounts and closing transactions on the uptick. Loyalty, disclosure and fair dealing were concepts alien to their operations. Not only did [the Res] conceal adverse, material information acquired from corporate insiders, but they used their status as specialists to lend authenticity to numerous

false and misleading statements circulated in the course of their touting activities. Finally, when mere touting failed to generate sufficient interest at the retail level for their massive distributions, [they] attempted to bribe customers . . . for the purpose of enlisting their aid in these elicit schemes.¹²⁰

On May 4, 1961, immediately after an evidentiary hearing on the Res' conduct, the Commission issued an order expelling the Res from the American Stock Exchange.¹²¹ The order was unprecedented both for the swiftness with which the Commission acted and because it preceded by eighteen months the Commission's formal findings and opinion in the case. Chairman Cary was particularly incensed that the elder Re had sought leniency from the Commission for his son, whom the father suggested was just a kid and didn't know any better. When Chairman Cary learned that the "kid" was 38 and had engaged in the fraud for at least 6 years, he was shocked¹²² and did not want the Res "wandering around south of Canal Street tomorrow morning."¹²³ Cary himself characterized the Commission's rapid expulsion order as "a dramatic way of announcing shock."¹²⁴ The order apparently made an impression, particularly on the Res. Soon afterwards, as the Commission was preparing a criminal referral to the U.S. Attorney's Office for the Southern District of New York, the staff learned that the Res might be trying to flee the country. Citing a provision in the Exchange Act that prohibited specialists from accepting discretionary orders, the staff quickly "swore out a complaint and . . . had them arrested for accepting a discretionary order."¹²⁵ After a ten-week trial, the government obtained convictions against the Res and others for conspiracy to violate the securities acts.¹²⁶

Soon after ordering the expulsion of the Res, the Commission opened an investigation into the rules and practices of the American Stock Exchange.¹²⁷ This investigation coincided with, and was conducted as part of, the Commission's landmark Special Study of Securities Markets that the Commission completed in 1963. The Special Study would provide the Commission with an in-depth understanding of the securities markets that had been severely lacking within the agency, as evidenced by the Commission's less than vigorous response to the first signs of scandal at the AMEX. As discussed below, the Special Study would have a lasting impact on the Commission's development of a national enforcement program.

V. The 1960s: Creativity, Innovation and "Doctrinal Ingenuity"

With the Commission's decision in the Re & Re case, "enforcement cases became much more significant."¹²⁸ The Re & Re case had a sobering impact on the Commission and convinced Chairman Cary that "the Commission needed a home office pre-emptive strike capability."¹²⁹ Cary assigned Irving Pollack, the Commission's Assistant General Counsel responsible for the criminal referrals program, to be the Associate Director of the Trading Exchanges Division. Cary tasked Pollack with building the home office's enforcement program.¹³⁰ Pollack recruited top attorneys from within and outside the Commission, including Stanley Sporkin, Thomas Rae and Ira Pearce.¹³¹ According to Dean Seligman, largely as a result of Pollack's efforts, "[d]uring the three years of Cary's chairmanship, the home office of the Trading and Exchanges Division initiated approximately as many cases as it had in the previous twenty six years of the SEC's

existence, averaging forty new cases per year as compared with the 1950s' annual average of five."¹³²

A. The Special Study

Among the key events in the revitalization of the Commission's enforcement program in the early 1960s was the Special Study of Securities Markets. The Re & Re scandal had exposed serious weaknesses in the Commission's understanding of how the markets operated. Following the Re & Re case, in September 1961, Congress ordered the Commission to conduct a "broad study of the rules, practices and problems in the securities business and the securities markets."¹³³ The Special Study was a huge and enormously complex undertaking by an independent group within the Commission to investigate the securities markets and to determine what the Commission knew and, more importantly, what it did not know about how the markets operated. The Commission's staff studied virtually every facet of the securities industry and produced a voluminous report detailing the operations of the exchanges, broker-dealers, investment companies and others in the industry. As a result of this report, the Commission and its staff gained a thorough understanding of the securities industry and the operation of the markets. The result of the Special Study and the reforms that followed was a shifting of the balance of power between the industry and the Commission. According to Stanley Sporkin:

We had a redistribution of power which started, I think, with the Special Study. It went away from Wall Street down here to Washington. The Commission was always a secondary player up until that time. Wall Street was run by [people who] treated the SEC like it was some secondary organization. . . .But starting with the Special Study, it was the emergence of the SEC as the power broker. Everybody looked to it. It became a dynamic organization. It [controlled] things. Everybody looked to the SEC. We had [Irving Pollack] with his enforcement program that was driving things. And so it really started this redistribution of power
.....¹³⁴

The Commission staff who worked on the study received an excellent education concerning how the markets operated and where opportunities for fraud and other misconduct might present themselves.¹³⁵ According to Robert Birnbaum:

The education of the SEC staff and people who stayed . . .everybody picked up a lot of knowledge. I think it made the Commission a much more aggressive agency for a long time, up to today, I would say.¹³⁶

By the time the Special Study concluded, there were more than twenty attorneys working in the enforcement unit of the Division of Trading and Exchanges.¹³⁷ More than a few of these attorneys had worked on the study and were bringing their knowledge of the markets to the developing enforcement program. Thereafter, pursuant the recommendation of the Special Study, the Commission renamed the Division of Trading and Exchanges as the Division of Trading and Markets. This "little step was an indication of the changes that were going to take place within the Commission."¹³⁸

B. “Novel Approaches to Traditional Things”

At the outset of his chairmanship, William Cary recognized that the Commission’s focus was not on frauds of national significance. He also recognized that as to certain areas of the Commission’s enforcement program, there were weaknesses in the interpretive development of the securities acts, particularly in the area of insider trading. According to Dean Seligman:

Only with respect to securities litigation did Cary’s Commission consider itself unrestricted by the political limitations that bound its legislative and rule-making program. In broadening the bases for private litigants to bring damages actions against corporate officers and directors who exploited inside information or distributed false and misleading proxy statements, Cary’s SEC fundamentally altered securities law enforcement.¹³⁹

Two cases in the 1960s exemplify the Commission’s efforts to broaden the scope of the securities acts: the Cady, Roberts matter and the Texas Gulf Sulphur case.

1. Cady, Roberts

Prior to the 1960s, the law of insider trading had been slow to develop. Although insider trading was widely considered as a “nefarious, corrupt practice,”¹⁴⁰ there were, nevertheless, many who regarded insiders’ access to nonpublic information as a corporate perk – something to which corporate insiders were entitled by virtue of the value they contributed to the corporation. At common law, the issue of insider trading revolved around the question of whether those having access to inside information owed a fiduciary duty to disclose the information to those with whom they dealt prior to a transaction in the company’s stock. The law recognized that insiders had such a duty to existing shareholders but not to non-shareholders. As to transactions consummated through a national securities exchange, however, the common law recognized no duty to disclose because, the thinking went, it was not possible for an insider to know the identity of the party on the other side of transaction.¹⁴¹ With the adoption of Rule 10b-5 in 1942, the Commission itself was undecided for many years as to whether the rule applied to transactions occurring over a national securities exchange.

Chairman Cary’s “one priority . . . from the start of his chairmanship” was to use Section 10(b) of the Exchange Act to reverse the common law doctrine that had prevented enforcement action against insider trading for so long.¹⁴² In November 1961, soon after he became chairman, Cary authored the Commission’s order in the Matter of Cady, Roberts & Co.¹⁴³ In November 1959, the price of Curtiss-Wright stock had been rising on positive news regarding the company’s development of a new type of internal combustion engine.¹⁴⁴ On November 25, 1959, the Curtiss-Wright Board of Directors met to decide whether to declare a quarterly dividend. The company had declared a dividend in each of the previous three quarters. The board determined that it would declare a dividend but at a reduced rate. Given recent public interest in the company, this fact would have a materially adverse impact on the price of the company’s stock. Before the news of the dividend reduction was made public, a Curtiss-Wright director, who was

also a registered representative of Cady, Roberts & Co., a brokerage firm, communicated the nonpublic information to a broker at Cady, Roberts. Upon receiving this information, the broker at Cady, Roberts placed sell orders and short sale orders in numerous customer accounts. When the news was announced, the price of Curtiss-Wright stock dropped significantly, resulting in losses avoided and profits to the various accounts in which Cady, Roberts had traded.

The question in Cady, Roberts, which Cary described as one of “first impression” and “signal importance,” was whether Cady, Roberts & Co. and its broker, as corporate outsiders, violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 by selling shares of the Curtiss-Wright Corporation while in possession of information that Curtiss-Wright was going to announce a dividend reduction on its stock before such information became public. In articulating what became known as the “disclose or abstain rule,” the Commission observed:

Analytically, the obligation [not to engage in insider trading] rests on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In considering these elements under the broad language of the anti-fraud provisions we are not to be circumscribed by fine distinctions and rigid classifications. Thus, it is our task here to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities. Intimacy demands restraint lest the uninformed be exploited.¹⁴⁵

Applying these principles, the Commission held that a person possessing inside information must either disclose such information to those to whom he seeks to sell stock or from whom he seeks to purchase stock or abstain from trading until the information becomes public, regardless of whether the trade was conducted face-to-face or over a national securities exchange. The Commission rejected the common-law doctrine that a pre-existing fiduciary duty must exist between an insider and the person with whom he trades and extended the duty to disclose or abstain from trading to anyone whose access to material inside information was superior to others.¹⁴⁶ The Cady, Roberts decision was particularly significant in that it resolved the question that for years had shackled the interpretive development of Rule 10b-5. Following Cady, Roberts, there would be little resistance to the idea that the rule applied to securities transactions consummated through the national exchanges.

2. Texas Gulf Sulphur

The Commission’s decision in Cady, Roberts fit neatly within the Commission’s efforts to develop a national enforcement program. Chairman Manuel Cohen would adopt the approach of his predecessor in using “enforcement actions to expand the potential targets of SEC civil litigation and the interpretive contours of the securities laws.”¹⁴⁷ The Commission would use Cady, Roberts to build the legal foundation upon

which it would argue for further extension of Rule 10b-5. In 1965, the Commission charged Texas Gulf Sulphur Co. and twelve of its officers and employees with violating Section 10(b) and Rule 10b-5 for trading on information concerning the results of exploratory drilling for base metals in Canada. The District Court dismissed the Commission's complaint as to the company and ten of the defendants but found violations as to two of the defendants.¹⁴⁸ The Commission appealed.

On August 13, 1968, the Second Circuit Court of Appeals¹⁴⁹ "handed down its decision affirming unanimously the decision below insofar as it had been favorable to the Commission and reversing (7-2 on most issues) that decision in every major respect in which it had been unfavorable to the Commission."¹⁵⁰ Citing with approval the Commission's decision in Cady, Roberts, the Second Circuit held that a corporate insider in possession of important inside information about his corporation may not trade in the corporation's stock without disclosing that information, even though his transactions are not face-to-face but on a national securities exchange.¹⁵¹ The Court defined when inside information is considered material and observed that corporate outsiders or "tippees" could also be held liable if they traded before the information was publicly disseminated.¹⁵² In the Commission's own words at the time, the ruling in the Texas Gulf Sulphur case was a "landmark" decision in advancing the law of insider trading.¹⁵³

As reflected in the Cady, Roberts and Texas Gulf Sulphur cases, the Commission's approach to the law of insider trading symbolized the creativity and innovation of the Commission's staff during the 1960s. Such expansive thinking would become the driving force behind the Commission's rapidly developing home office enforcement program. Explaining the success that the Commission had achieved in expanding the scope of the securities laws in the 1960s, Irving Pollack credited his colleagues, whom he described as "imaginative, ingenious people who could come up with novel approaches to traditional things."¹⁵⁴

C. Ancillary Relief

As the Commission sought to expand the reach of the securities acts with respect to insider trading, it also began thinking creatively about the remedies that were, or might be, available to it in enforcement actions. Since the Commission's earliest days, it had used its broad authority under the securities acts to obtain injunctive relief against wrongdoers. There is little evidence, however, that the staff had made a concerted or sustained effort to invoke the court's equitable powers beyond the injunctive remedy expressly provided in the statutes. Many courts were reluctant to issue injunctions that went beyond the scope of the conduct or the particular stock that was the subject of the Commission's enforcement action. The staff of the Division of Trading and Markets, however, did not consider themselves limited to the plain language of the statutes in considering what equitable remedies a Court might be willing to grant them in an enforcement action. Irving Pollack recalled that the

We established the restitution, disgorgement, the ancillary remedies, and that was critical. We pushed that way to where it is, and I think now you see its accepted today. In our days, it was heavily litigated. I remember one commissioner named Adams, who came from New England

somewhere. When I presented the first case where I was asking for a receiver he said, “Where in the statute does it say we can get a receiver? We have an Investment Company Act. You don’t have any other act where it counsels that.” I said, “Well, look, it’s an ancillary remedy. If the court says we can get it, we’ll get it. If the court says we can’t, we can’t. There’s nothing to prevent us from asking for it.” And we were successful, of course, in getting it.¹⁵⁵

Dean Seligman attributes the success that the Commission realized in obtaining ancillary relief during the 1960s to the “doctrinal ingenuity” of the staff. He cites the Commission’s action in SEC v. VTR,¹⁵⁶ Inc. as the first in “a long series of civil cases obtaining ancillary relief, rather than merely an injunction against further misconduct.”¹⁵⁷ In the VTR case, the Commission had sought an injunction and the appointment of a receiver in connection with a control group’s misappropriation of company funds. The defendants agreed to settle by consenting to an injunction “requiring them to make an accounting and restitution” for their violations. Rather than appointing a receiver, the Court “directed the controlling group to cause the election of four independent directors (of a five-man board) designated by the court to supervise the filing of proper annual reports and proxy statements with the Commission and to supervise a determination of the exact amount misappropriated.”¹⁵⁸

In the area of ancillary relief, the Commission’s action in the Texas Gulf Sulphur case would come full circle and result in yet another precedent-setting ruling concerning the availability of disgorgement to remedy the harm suffered by defrauded investors. In 1971, the Second Circuit ruled that certain of the corporate insiders at Texas Gulf Sulphur who had violated Section 10(b) and Rule 10b-5 by trading in advance of public knowledge about a mineral strike would be required to disgorge their trading profits. Acknowledging that it was not the purpose of the Exchange Act to “circumscribe the courts’ power to grant appropriate remedies,” the Court stated:

We deem [the courts’ power to grant appropriate remedies beyond injunctive relief] to be fully applicable in enforcement actions by the SEC. Thus we hold that the SEC may seek other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment.¹⁵⁹

The Second Circuit’s decision in Texas Gulf Sulphur thus marked the first case in which the Commission successfully obtained equitable relief in the form of monetary damages.

VI. The Establishment of the Division of Enforcement and Its Aftermath: 1970 –1981

It has been observed that “[t]he Commission’s enforcement presence in the late 1960s and the 1970s personified the agency’s tenacity and energy.”¹⁶⁰ This “tenacity and energy” was undoubtedly a major factor in the Commission’s decision to establish the Division of Enforcement in 1972. Given the enforcement program’s success in the

1960s, there was scarcely a better time in the Commission's history than the early 1970s in which to consider establishing a division dedicated solely to enforcement activities.

A. Roots in the Late 1950s

The Division of Enforcement has its roots in the late 1950s, at or about the time the Commission was awakening to the American Stock Exchange scandal. As discussed above, throughout most of the Commission's history prior to the late 1950s, the Regional Offices conducted virtually all of the Commission's investigations. By the late 1950s, the Commission's operating divisions had begun to develop their own enforcement branches to carry out their respective responsibilities under the various securities acts that they administered. The Division of Trading and Exchanges continued, as it always had, to supervise and coordinate the work of the regions, to communicate with the Commission about regional investigations and to allocate personnel to assist the regions in substantial investigations. Among the jobs that the Commission's home office performed was preparing the Commission's criminal referrals to the Department of Justice and building relationships with the U.S. Attorneys offices around the country.

In 1957, the Commission highlighted the "Enforcement Program" on page one of its annual report.¹⁶¹ Indicating that it was encountering "enforcement problems unprecedented in the Commission's experience," the Commission reported that "[c]onditions at present require a more vigorous and accelerated program including new measures of enforcement."¹⁶² By 1959, the Commission reported for the first time that a "special investigations unit" of the Division of Trading and Exchanges had been established and was conducting "investigations dealing with matters of particular interest or urgency either independently or assisting the regional offices."¹⁶³ The Commission also highlighted the role that the Division of Corporation Finance played in initiating and conducting investigations "where necessary to assist in ascertaining facts" to determine compliance with the requirements of the Securities Act and the Exchange Act.

Over the next few years, the "special investigations unit" of the Division of Trading and Exchanges would evolve into the "Office of Special Investigations," the "Branch of Special Investigations, Trial and Enforcement," and, eventually, into the "Office of Enforcement" of the newly renamed Division of Trading and Markets.¹⁶⁴ The renaming of the Division of Trading and Exchanges as the Division of Trading and Markets was a small but significant event – it was the last significant organizational hurdle to the establishment of the Division of Enforcement. By 1969, "the enforcement program of the home office of the SEC's Division of Trading and Markets Division had grown to a staff of over a hundred people."¹⁶⁵ This figure did not include a significant number of people in the Divisions of Corporation Finance and Corporate Regulation who conducted investigations in the areas under their respective jurisdictions.¹⁶⁶

B. The 1972 Restructuring

In 1972, under the chairmanship of William J. Casey, "[t]he Commission undertook a sweeping review of its enforcement operations. . . . [and] restructured its staff into five operating divisions instead of three. The overall effect is to concentrate resources by focusing all enforcement and investigative activity in one division"¹⁶⁷

As a result of this restructuring, the Division of Trading and Markets was divided into two divisions: the Division of Enforcement and the Division of Market Regulation.

There is remarkably little that is publicly known about the deliberations that preceded the Commission's decision to establish a division of enforcement. This is an area fertile for further research and inquiry. Nevertheless, what is generally known is that there was a recognized need for a stand-alone division that would provide the Commission with a more complete picture of nationwide enforcement activities than was possible under the structure that had existed since the Commission's creation in 1934. By concentrating enforcement activities in one division, the thinking went, the Commission would have an easier time identifying, establishing and following through on national enforcement priorities. Other concerns expressed were that the Commission's enforcement activities had become so demanding on all the Commission's operating divisions that the staff was being diverted from its regulatory oversight and rulemaking responsibilities.¹⁶⁸

There is little to suggest, however, that serious turf battles or infighting arose during the deliberations over the 1972 restructuring. By most accounts, there seemed to be general support among the senior staff for the idea that the time had come for the formation of a division in which all enforcement activities could be centralized.¹⁶⁹ Although little is publicly known concerning the extent of Chairman Casey's consultations, it is known that he solicited the views of his various division directors and that they were generally supportive of the idea. Alan Levenson, then the Director of Corporation Finance, recalls Chairman Casey calling him on the telephone and asking for his views on the advantages and disadvantages of a division dedicated solely to enforcement.¹⁷⁰ After discussing the "pros and cons" with Chairman Casey, Levenson told Casey "you should do it,"¹⁷¹ a notably selfless piece of advice, given that the establishment of a new division almost certainly meant that the Division of Corporation Finance would lose staff from its enforcement branch. Casey replied to Levenson, "we'll get it done."¹⁷²

At the time, Casey was planning on leaving the agency.¹⁷³ According to Irving Pollack, then the Director of Trading and Markets, Casey saw the need for an enforcement division and wanted to get it done before he left. There was also, apparently, another reason that Casey had for wanting to establish an enforcement division. According to Pollack:

Well, from my own personal discussions with Casey, I think it came out that one of the reasons -- [it] may not have been the sole reason -- was because I was both in the regulation and enforcement areas. We had some divergent views on how far things should be pushed in the regulation area. He was about to leave the Commission and he felt that if I was still in the regulation area, I might influence its subsequent successes to un-do some of the things or to push in areas that I might have been more aggressive in than he was in terms of that.

My personal feeling at that time was that he wanted to get somebody else to do the regulation so that my impact would be less effective in that area.

The enforcement didn't change. I mean, the scope of enforcement was the same. He may have felt that by concentrating it in a single division, getting it back, might give it more effectiveness. I remember talking to him when he was about to leave, saying, when we were discussing this, "I don't think, Bill, that you're going to be able to keep some of the things that you now have, that events are going to overtake it." . . .

Casey was that kind of a candid, open guy and I had that relationship with him and he said, "You're probably right, Irv, but its too late for me to change my mind, in effect, or do anything else." . . . Even though he may have done it possibly for other reasons, I think maybe the decision in the long run proved to be an appropriate one.¹⁷⁴

With the creation of the Division of Enforcement in August 1972, Irving Pollack became its first director. Stanley Sporkin, Pollack's longtime deputy director from the Division of Trading and Markets, succeeded him in 1974 as the second Director of Enforcement and would serve in that position until 1981.

C. Major Enforcement Initiatives in the 1970s

1. The Questionable Payments Initiative

The formation of the Division of Enforcement coincided with the Watergate scandal that was enveloping the country in 1972.¹⁷⁵ The Commission, through its newly created Enforcement Division, would play a key role in investigating certain of the corporate scandals that Watergate spawned. Chief among such investigations was the Division of Enforcement's questionable payments initiative. During the Watergate hearings in 1974, Stanley Sporkin became "intrigued by revelations" that "certain U.S. companies had kept corporate funds 'off-the-books' to be used for purposes such as political contributions"¹⁷⁶ Sporkin, a lawyer and an accountant, questioned how these corporations were "accounting for the cash and for the payments, and whether shareholders, the various boards of directors, or the outside directors were informed of this use of corporate assets."¹⁷⁷

As Director of Enforcement, Sporkin had the ability to obtain the answers to the questions he was asking himself. He initiated a series of investigations that "revealed that violations had indeed occurred."¹⁷⁸ These "investigations culminated in the institution of injunctive actions against nine corporations during the one-year period following the Spring of 1974."¹⁷⁹ Subsequent cases involving questionable or illegal foreign and domestic payments and practices followed.¹⁸⁰

True to the goal of building a national enforcement program in which the Commission could prioritize investigations of frauds having national significance, Sporkin used his platform to call attention to rampant corruption among some of the country's largest corporations. In speeches around the country, Sporkin listed a litany of illegal activities – corporate bribery, slush-funds, kickbacks, illegal campaign contributions and other fraudulent acts – that the Enforcement Division's investigations

were uncovering. In a speech to the Chief Executive's Forum in Santa Barbara, California in April, 1976, Sporkin stated:

The Securities and Exchange Commission has brought cases against many of our nation's major public corporations for the undisclosed improper use of corporate funds. Time and again we have found slush funds established and maintained by the outright falsification of corporate books and records. These funds have been used for domestic and foreign payoffs and kickbacks, illegal political contributions, and highly suspicious payments to foreign agents.

It is fundamental to the economic system of our country and the integrity of our securities markets that all corporate funds are accounted for within a system of financial accountability. Those persons involved in establishing, maintaining, or concealing slush funds have seriously subverted that essential system of accountability. It is particularly distressing that in virtually all of the cases brought by the Commission we are finding that those individuals directly responsible for establishing these slush funds or otherwise participating in such activities have been high executives in the corporation. In many instances, high executives have even served in transporting funds for foreign and domestic payoffs.¹⁸¹

Among the issuers against whom the Commission brought enforcement actions for illegal foreign payments were the American Ship Building Company, Ashland Oil, Inc., Gulf Oil Corporation, Minnesota Mining and Manufacturing Company, Phillips Petroleum Company, Northrop Corporation, Braniff Airways, Inc., General Tire & Rubber Corporation, Kalvex, Inc. Lockheed Aircraft Corporation, Missouri Public Service Company, Sanitas Service Corporation, United Brands Company, and Waste Management, Inc.¹⁸² These actions – unprecedented in terms of the number of brand-name corporations involved – demonstrated that an enforcement program centralized in one division enabled the Commission to advance a national enforcement agenda in ways that had never before been possible.

The Division of Enforcement's questionable payments initiative was so successful that the number of potential investigations that were resulting from its inquiries nearly overwhelmed the division and began to drain resources away from the Commission's other divisions.¹⁸³ By 1975, there was recognition within the Commission that it did not have the resources to investigate every instance of corrupt or illegal payments. To allow the Division of Enforcement to focus on the most egregious violations, Sporkin, together with Alan Levenson, then the Director Division of Corporation Finance, implemented the Commission's "voluntary disclosure program" through which corporations guilty of engaging in illegal payments could self-investigate and report to the Commission and shareholders the nature and extent of their illegal activities.¹⁸⁴

2. The Voluntary Disclosure Program

The idea behind the voluntary disclosure program was for companies who had made illegal payments without disclosure to come to the Commission before the Commission came to them. In consideration of such self-reporting, the Commission would generally agree to settle on terms that required the companies to cease their unlawful activities, make full public disclosure to shareholders, and report their conduct in their filings with the Commission for a year or more. Moreover, “[w]hile the Commission promised no immunity from follow-up scrutiny or prosecution, those companies participating in the program were promised fair consideration by the agency as to whether further action would be taken.”¹⁸⁵ According to one description of the program:

The genius of Sporkin’s approach was that it shifted the burden of law enforcement from government to industry. No longer was the SEC merely a cop on the Wall Street beat, whistling on the proverbial street corner with its eyes open for suspicious activity. Instead, Sporkin projected an image of the commission as a kind of regulatory confessional. Wrongdoers of every stripe, but especially those at the country’s largest corporations, were invited to admit their sins voluntarily in the SEC’s public filing room – or else face the commission’s wrath.¹⁸⁶

As a result of the Division of Enforcement’s questionable payments initiative, the Commission’s enforcement actions and voluntary disclosure program “revealed that over 450 issuers had tampered with their accounting records or concealed the payment of illegal gratuities in foreign or domestic transactions.”¹⁸⁷ Of these, “sixty-two firms’ questionable payments would be proven in SEC enforcement actions.”¹⁸⁸ These actions would ultimately prompt the Congress to enact the Foreign Corrupt Practices Act of 1977.¹⁸⁹

3. The Corporate Accountability Initiative

Sporkin also made corporate accountability a cornerstone of the Division of Enforcement’s national agenda. Corporate accountability involved similar issues to those raised by the questionable payments cases but had farther-reaching implications. The corporate accountability cases “saw corporate directors taken to task publicly for a variety of misdeeds ranging from neglecting the affairs of their company, to permitting an issuer to issue unduly optimistic press-releases in spite of its knowledge that the company was in grave financial distress.”¹⁹⁰ Sporkin observed:

What I find particularly troubling in the attitude of corporate executives is the extent to which they define their responsibility to shareholders only in terms of the bottom line. They are willing to disclose the amount of their company’s earnings, but not the manner in which those earnings have been achieved. They attempt to argue that shareholders are not interested in this information, despite its reflection upon the quality of the company’s earnings and management.

To prevent the continuation of secret slush funds, it will be necessary to reaffirm the traditional concept of corporate responsibility to shareholders. We must bring corporate officers and directors to an understanding of their role as fiduciaries acting on behalf of the shareholders. We must constantly remind them that a fiduciary has an essential duty to account for all the funds committed to his discretion. Above all, we must establish the fact that while it is not wrongful for a company to honestly lose money after truthfully disclosing all the risks, it is wrongful for a company to disguise the manner in which its money is made.¹⁹¹

In advancing its corporate accountability agenda, “the Commission did not commence enforcement proceedings in many of these cases, but chose to invoke its publication authority under the Exchange Act to publish reports of its investigations.”¹⁹² Nevertheless, the Enforcement Division’s corporate accountability initiative provoked sharp attacks on the SEC from Wall Street and elsewhere for proselytizing about corporate behavior that was not expressly proscribed by the securities acts. To Sporkin, however, the issue was as much about disclosure as it was about the underlying conduct. He blunted the thrust of such attacks by acknowledging, “the SEC does not claim a congressional mandate to establish and impose a set of moral standards on American corporations. It does, however, have a mandate to protect the public investors by requiring compliance with standards of financial accountability and public disclosure.”¹⁹³

4. The Access Theory

One of the most important and controversial enforcement innovations during the 1970s was the staff’s development of the “access theory” of securities law enforcement. The “access theory” was predicated on the notion that “the ‘keys’ to the securities marketplace are often controlled by a limited number of well-positioned individuals – securities professionals, accountants and lawyers . . . [and that by] vigorously enforcing the federal securities laws against such individuals, the Commission . . . could prevent many more violations of law than simply proceeding against wrongdoing principles.”¹⁹⁴ In a 1976 speech to the Corporate Counsel Institute, Sporkin articulated his definition of the access theory:

The Commission has found that the impact of its enforcement efforts is best maximized by concentrating those efforts on the strategic access points to our securities market. What I am describing is an “access” approach to enforcement.

We all recognize that a major securities fraud cannot be perpetrated by a corporation, its officers and directors without access to our financial markets. Such access can only be provided through the activities of broker-dealers, banks, insurance companies, et al. In addition, systematized frauds frequently depend on the cooperation, intentional or otherwise, of professionals such as lawyers and public accountants. Many of the most egregious frauds of the past few years – frauds resulting in losses to investors of hundreds of millions of dollars – have involved the full panoply of professional participation.¹⁹⁵

Implementing the access theory meant investigating the conduct of lawyers and auditors and bringing enforcement actions against them for their conduct in connection with securities law violations by their clients. To some, the Commission's use of the "access theory" was considered a "scare tactic."¹⁹⁶ At the SEC, such arguments were considered "nonsense."¹⁹⁷ This much is certain: between 1973 and 1981, the Commission brought a series of extraordinary and unprecedented enforcement actions against major accounting firms and law firms. Among the accounting firms subject to enforcement or disciplinary proceedings were: Laventhol, Krekstein, Horwath & Horwath,¹⁹⁸ Touche, Ross & Co.,¹⁹⁹ Arthur Andersen & Co.,²⁰⁰ Peat, Marwick, Mitchell & Co.,²⁰¹ Price Waterhouse & Co.,²⁰² Haskins & Sells,²⁰³ Ernst & Ernst,²⁰⁴ and Lester Witte & Co.²⁰⁵

In these and other cases, the Commission brought actions pursuant to Rule 2(e) of the Commission's Rules of Practice or in federal court for civil injunctive relief.²⁰⁶ The firms settled virtually every one of the cases, without admitting or denying the Commission's findings or allegations against them. In the settlements, the Commission obtained wide-ranging relief that was typical of the creative and innovative enforcement approaches that characterized the Division's thinking about ancillary relief in the 1970s. For instance, some firms consented to injunctions in which they agreed to be enjoined from engaging in securities law violations in connection with work done on behalf of a particular issuer. Other firms agreed to be censured. Still others agreed to the imposition of an order barring the firm, or the firm's branch offices involved in the misconduct, from accepting new audit engagements for public companies for certain periods of time. Almost every order contained a variety of prophylactic undertakings imposing new quality control procedures or requiring internal reviews to prevent future violations.

The Commission also brought numerous actions against lawyers and their law firms in the 1970s. Among the most notable of these enforcement proceedings were actions against the law firm of White & Case in connection with the National Student Marketing Corp.²⁰⁷ matter and against lawyers at the firm of Brown, Wood, Ivey, Mitchell & Petty in connection with the National Telephone Company²⁰⁸ matter.²⁰⁹ These actions were particularly controversial and generated heated debate over whether the Commission had the authority to discipline lawyers and law firms under Rule 2(e) of its Rules of Practice.²¹⁰

The numerous cases that the Division of Enforcement brought utilizing the "access theory" in the 1970s, while controversial, are illustrative of the Commission's historical efforts to achieve the "maximum (and most efficient) enforcement impact from its available resources."²¹¹ These cases also demonstrate, for better or worse, the Commission's ability to pursue a national enforcement agenda in a manner that would not have been nearly as easy or practical in the decades prior to the establishment of the Division of Enforcement in 1972.

D. "A Distasteful Task"

The Division of Enforcement under Stanley Sporkin in the 1970s involved perhaps the most intense period of enforcement activity in the Commission's history. This period provided many lawyers in the division with opportunities and experiences

unmatched at any other time in the agency's history, except, perhaps, for the 1930s when the Commission was first established. During the 1970s, there was a palpable sense of mission within the Division of Enforcement:

Working for Sporkin, jetting around the country, negotiating with top defense lawyers and their powerful clients, investigators in the SEC's enforcement division felt with good reason that they made a difference in the world. It was a far cry from the work at other bureaucracies around the capital, where the institutions seemed too often stagnant captured by the industries they regulated. At the SEC, Sporkin's lawyers felt they wore the white hats."²¹²

Others have observed:

The SEC investigators I got to know during the mid-1970s were hardworking and committed. Their dedication was dramatically underscored by the eerily empty Washington streets – deserted by a far less devoted group of government employees rushing out of the city at the earliest possible moment – I would discover after SEC enforcers called it a day. Staff morale was extraordinarily high. The vigorous enforcement program had captured the interest and imagination of investigators. Conversations over lunch, coffee, and after-work drinks were filled with the exploits of newly discovered offenders and legal strategies and maneuvers that were being developed to control them. SEC enforcers were often heady from their newfound power. These young attorneys, many of them only a few years out of law school, were dictating to top executives of major corporations. They had the reputation of being young, bright, serious, ambitious, 'hot shot kids out of Harvard' who could be 'rigidly and evenly arrogantly moral.' They made the SEC exciting, energized, frenetic and unique in a lethargic federal bureaucracy.²¹³

Dean Seligman, perhaps the foremost authority on the Commission's history, has recognized:

No history of the Securities and Exchange Commission would be complete without noting the competence and ingenuity of the Commission's Enforcement Division under its second director, Stanley Sporkin. Sporkin played a major role in initiating the SEC's questionable payments program and in directing the Commission's attention to such related problems as domestic commercial bribery and misuse of executive perquisites. Each of these controversial programs not only illustrated the political integrity of the division, but also its doctrinal ingenuity.²¹⁴

Ultimately, Sporkin himself summarized the work of the Division of Enforcement during his tenure as follows:

At the beginning, there were many persons who were critical about our program. The comment was frequently made that we were hurting

American business. Time has passed and the tide has turned. Now there is, by and large, a great deal of constructive effort and a movement afoot to put the system back in order.

Let me make it clear, that although some at the SEC at times have been criticized, we have at all times worked within the system, trying to make it work as designed. I have been in government service for nearly 19 years. I assure you that the SEC and its Enforcement Division take little pleasure in exposing corrupt business practices by American corporations. In many ways, it is a distasteful task, but the SEC has a job that it must and will do.²¹⁵

VII. Conclusion

To many of those who have worked in the Division of Enforcement, in the Regional Offices or in the other divisions that have had enforcement responsibilities in the past, there has always been a strong sense of mandate and an appreciation for the legacy that they inherited. To others, there may be less familiarity with or interest in the past but, nevertheless, a strong sense of history in the making. From either perspective, most people who have worked in enforcement recognize that each time the Commission exercises its enforcement powers, its credibility and, by extension, the reputation for fairness and integrity that it has earned over many years, is in some small way at stake. It is the Commission's enduring ability to balance the "need to make people believe we are everywhere" with the need to be fair and just in the manner in which the Commission discharges its enforcement responsibilities that defines the history of the Commission's enforcement program.²¹⁶

¹ Branch Chief, Division of Enforcement, U.S. Securities and Exchange Commission. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.

² Eleanor Clift, *From Lap Dog to Pitt Bull*, Washington Post (September 17, 2002) at <http://www.washingtonpost.com/wp-dyn/articles/A27934-2002Sep17.html>.

³ Chairman Pitt has long articulated the view that "an essential predicate for any effective enforcement program is its visibility. In essence, a law enforcement agency like the SEC seeks to create 'illusion of three dimensions;' that is, that the agency is omnipresent, and is more likely than not to detect illegal behavior if someone is foolish enough to attempt it." Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement*, 7 Yale J. on Reg. 149, 183 (Winter 1990) ("Pitt & Shapiro").

⁴ See Pitt & Shapiro at 171.

⁵ *Id.* at 302.

⁶This paper is not intended to be a comprehensive history of the SEC, far from it. As has been said in a similar context:

Scholars and practitioners who assess this article undoubtedly will criticize its selectivity. It is, however, simply not possible to identify every significant enforcement development over the past decade [much less, the last six decades], and it is even more difficult to discuss every significant enforcement development we are capable of identifying. We do not purport to do so. Instead, we attempt to identify a number of enforcement trends, and discuss those trends in the context of instances of enforcement initiatives.

Pitt & Shapiro at 158, n.25. For the seminal history of the Commission, see Joel Seligman, The Transformation of Wall Street, A History of the Securities Exchange Commission and Modern Corporate Finance, (1995 Ed.) (“J. Seligman”).

⁷ Thirty Eighth Annual Report of the Securities and Exchange Commission, at xxvii (1972) (Commission Annual Reports are hereinafter referred to by volume number -- e.g., “Thirty Eighth Annual Report”).

⁸ First Annual Report at 3.

⁹ The Regional Administrator for each region was “responsible for all administration, investigation, and enforcement activities of the Commission within his respective zone.” First Annual Report at 7.

¹⁰ Sixth Annual Report at 182.

¹¹ Sixth Annual Report at 182. According to Irving Pollack, the Regional Offices became “omnipotent” in their dominion over the enforcement program. Securities and Exchange Commission Historical Society Interview with Irving Pollack (January 16, 2002) at 6 (“Pollack Interview”).

¹² First Annual Report at 31. This is an extraordinary number given that “[t]he Commission and its staff, [as of June 30, 1935], consisted of 696 persons.” Id. at 38. By contrast, today’s Division of Enforcement, alone consisting of more than 800 lawyers, accountants and staff nationwide, has roughly 2500 investigations open at any given time.

¹³ J. Seligman at 346.

¹⁴ Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78aa-78mm (1994 & Supp. II 1996)).

¹⁵ J. Seligman at 360.

¹⁶ Comment of Stanley Sporkin, Transcript of the Roundtable on the 1963 Special Study at 78 (October 4, 2001) (“Transcript of the Special Study Roundtable”).

¹⁷ Comment of Fred Siesel, Transcript of the Special Study Roundtable at 43.

¹⁸ Good People, Important Problems and Workable Laws, 50 Years of the U.S. Securities and Exchange Commission, at 46 (1984) (“50 Years of the SEC”) quoting Arthur Matthews.

¹⁹ Pitt & Shapiro at 191.

²⁰ Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1994 & Supp. II 1996)).

²¹ First Annual Report at 30.

²² First Annual Report at 31.

²³ First Annual Report at 31.

²⁴ Fourth Annual Report at 59.

²⁵ Fourth Annual Report at 81.

²⁶ Fourth Annual Report at 81.

²⁷ Fifth Annual Report at 91.

²⁸ Fourth Annual Report at 82. It is not too difficult to imagine the apprehension that a putative fraudster in the 1930s might have experienced upon learning that he was the subject of a flying quiz. Indeed, the statistics of the time show that he had some reason to worry. The Commission reported that of sixty six flying quizzes in progress during the fiscal year ending in June, 1938, 19 developed into preliminary investigations, 35 were closed and 12 were still in progress at the end of the year. Id.

²⁹ In a suit alleging “fraudulent activities in violation of the Securities Act” against Robert Collier & Co., the Southern District of New York dismissed the Commission’s complaint on the grounds that the “Commission was not entitled to appear except by the United States attorney or the Attorney General.” First Annual Report at 32. The Second Circuit reversed holding that “in proceedings brought under section 20(b) of the Securities Act the Commission was entitled to appear by its own counsel.” Id.

³⁰ In an investigation of American Bond & Share Corporation in 1935, “[t]he Commission met with the refusal to answer subpoenas issued by officers of the Commission and petitions to enforce these subpoenas were filed in the Federal courts at Atlanta, Ga., and Wilmington, Del.” First Annual Report at 33.

³¹ Jones v. SEC, 298 U.S. 1 (1936).

³² According to Irving Pollack, in the early days, “[t]here was no meat to our injunctions, there was no effectiveness. [The Courts] just said, ‘Don’t do it again.’” Pollack Interview at 25.

³³ 298 U.S. 1 (1936).

³⁴ 298 U.S. at 12.

³⁵ Id.

³⁶ 298 U.S. at 28.

³⁷ J. Seligman at 150.

³⁸ 298 U.S. at 14.

³⁹ J. Seligman at 150.

⁴⁰ 298 U.S. at 23. The Court observed that the withdrawal of the registration statement would have accomplished the same result as the stop order and that “it is a strange conclusion that the registrant is powerless to elect to save himself the trouble and expense of a contest by withdrawing his application.” Id.

⁴¹ Id. at 24

⁴² Ironically, this is precisely the Commission’s practice today. The Commission routinely issues document and testimony subpoenas to witnesses who, while having no involvement in the securities law violations that may have occurred, may be able to provide facts concerning those who did.

⁴³ 298 U.S. at 28.

⁴⁴ Second Annual Report at 119.

⁴⁵ J. Seligman at 152.

⁴⁶ J. Seligman at 152 (emphasis in original). Dean Seligman cites one commentator at the time who wrote “It is difficult . . . to reconcile any nobility of purpose with the present discretionary authority of the SEC, which permits its officials to act as plaintiff, witness, prosecutor, judge and jury.” Id.

⁴⁷ J. Seligman at 150.

⁴⁸ Id. at 150.

⁴⁹ 2 S.E.C. 588 (Jul. 31, 1937).

⁵⁰ J. Seligman at 150.

⁵¹ Meehan, supra, 2 S.E.C. 588.

⁵² 3 S.E.C. 190 (Feb. 28, 1938).

⁵³ On appeal, the Second Circuit reversed the Commission’s order because it found that there was no evidence to support the Commission’s conclusion that Wright had timed his orders to create a false appearance of active trading in violation of Section 9(a)(1). The Court upheld the Commission’s finding that Wright violated Section 9(a)(2) but remanded the case to “allow [the Commission] to determine whether its order was too harsh, in view of the ruling that only a single statute had been violated.” Wright v. SEC, 134 F.2d 733, 734 (2d Cir. 1943). The Commission declined to modify its expulsion order finding that Wright “was thoroughly familiar with the nature of his acts and the prohibitions of the statute, had assumed a leading role in the manipulative scheme, and committed gross breaches of fiduciary relationship in executing the scheme.” Securities Exchange Act Release No. 3308, Sept. 17, 1942. On Wright’s subsequent appeal, the Second Circuit hinted at its disapproval of the Commission’s findings but nonetheless affirmed the Commission’s expulsion order finding that it did not have reason to “upset this exercise of the Commission’s discretionary power.” Wright, 134 F.2d at 734.

⁵⁴ J. Seligman at 150.

⁵⁵ 50 Years of the SEC at 9-10.

⁵⁶ J. Seligman at 75, 88.

⁵⁷ 50 Years of the SEC at 19-20.

⁵⁸ Fourth Annual Report at 89.

⁵⁹ In addition to stealing securities from his clients, Whitney was involved in “promotional and speculative ventures . . . that carried him far afield of the brokerage business into the production and marketing of such unrelated products as applejack, peat humus, and mineral colloids.” Report on Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 in the Matter of Richard Whitney et al., at 9 (1938) (“Whitney Section 21(a) Report”).

⁶⁰ Whitney Section 21(a) Report at 6.

⁶¹ Fourth Annual Report at 89-90.

⁶² Fourth Annual Report at 89.

⁶³ Whitney Section 21(a) Report at 1.

⁶⁴ 6 S.E.C. 386 (Dec. 19, 1939).

⁶⁵ Duker & Duker, supra, 6 S.E.C. 386.

⁶⁶ Weiss, A Review of the Historic Foundations of Broker-Dealer Liability for Breach of Fiduciary Duty, 23 J. Corp. L. 65, 89 (Fall, 1997).

⁶⁷ Weiss, supra, at 88 citing Louis Loss, The SEC and the Broker Dealer, 1 Vand. L. Rev. 516, 518 (1948).

⁶⁸ Report on Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 in the Matter of McKesson & Robbins, Inc. (1940) ("McKesson Section 21(a) Report").

⁶⁹ In McKesson, forty-six witnesses were examined resulting in a record that consisted of 4587 pages of testimony and 285 exhibits comprising in excess of 3000 pages. McKesson Section 21(a) Report at 2.

⁷⁰ Id. at 3.

⁷¹ Id. at 4.

⁷² Id. at 3.

⁷³ Id.

⁷⁴ Fifth Annual Report at 110-11.

⁷⁵ Fifth Annual Report at 110-11; Sixth Annual Report at 168-169. George Musica received two years and six months; Arthur Musica received three years; and Robert Musica received one year and six months.

⁷⁶ McKesson Section 21(a) Report at 2, 361-445,

⁷⁷ Id. at 363.

⁷⁸ Id. at 438-439.

⁷⁹ Id. at 445.

⁸⁰ Id.

⁸¹ Securities Exchange Act Release No. 3230 (May 21, 1942).

⁸² Securities Exchange Act Release No. 3445 (June 12, 1945).

⁸³ Id. at 6.

⁸⁴ It is unclear why the Commission did not simply seek an injunction against them.

⁸⁵ Id.

⁸⁶ Tenth Annual Report at 82.

⁸⁷ J. Seligman at 346.

⁸⁸ Second Annual Report at 61.

⁸⁹ Id. at 65.

⁹⁰ Fourth Annual Report at 99-100.

⁹¹ Id. at 100.

⁹² Eighth Annual Report at 45.

⁹³ Securities Exchange Act Release No. 3073 (November 18, 1941); see also Securities Exchange Act Release No. 2777 (February 6, 1941).

⁹⁴ In its annual report discussing the its decision in the Puder matter, the Commission stated “[w]hile the Commission has cooperated with the accounting profession to secure a common objective of high professional standards, . . . it has, as it must, reserved to itself the right to invoke sanctions against accountants who willfully or carelessly violate its rules.” Eighth Annual Report at 45.

⁹⁵ Tenth Annual Report at 185.

⁹⁶ Id. at 190.

⁹⁷ Id. at 190-194.

⁹⁸ Id. at 2.

⁹⁹ Id. at 3.

¹⁰⁰ Id.

¹⁰¹ 50 Years of SEC History at 27.

¹⁰² Id. at 32.

¹⁰³ J. Seligman at 360.

¹⁰⁴ J. Seligman at 268-269 (citations omitted).

¹⁰⁵ 50 Years of SEC History at 32.

¹⁰⁶ 50 Years of SEC History at 33.

¹⁰⁷ J. Seligman at 360.

¹⁰⁸ J. Seligman at 278-279. In its 1951 Annual Report, the Commission reiterated the lead role that the Regional Offices continued to take in conducting investigations: “The primary responsibility for investigation rests with the Commission’s regional administrators whose investigators conduct most of the field work. The principle office also temporarily assigns personnel to assist regional offices in investigations.” Seventeenth Annual Report at 154.

¹⁰⁹ J. Seligman at 279. In its annual report in 1957, the Commission stated:

The Commission has utilized all available enforcement techniques to meet the problem [of boiler rooms]. As a result, it is believed that most of the larger ‘boiler rooms’ whose activities created such concern in the past year are no longer in operation. In lieu thereof, there are appearing a great number of smaller firms using the ‘boiler room’ techniques with only a few high pressure salesman. This cancerous diffusion makes the enforcement work of the Commission more difficult and requires continued emphasis upon this phase of the enforcement program.”

Twenty-Third Annual Report at 2.

¹¹⁰ J. Seligman at 278-279.

¹¹¹ 50 years of SEC History, at 36.

¹¹² J. Seligman at 279.

¹¹³ See Re: The Crowell-Collier Publishing Company, Release No. 5562 (August 12, 1957); In the Matter of Gilligan, Will & Co., 38 S.E.C. 388, Release No. 5689 (May 7, 1958).

¹¹⁴ J. Seligman at 284 (quoting a January 1959, report of the House Special Subcommittee on Legislative Oversight commenting on the Commission's record in the Crowell-Collier matter).

¹¹⁵ See In the Matter of Re, Re and Sagarese, Release No. 6551 (May 4, 1961) and In the Matter of Re, Re & Sagarese, Release No. 6900 (September 21, 1962).

¹¹⁶ In the Matter of Re, Re & Sagarese, Release No. 6900, 41 S.E.C. 230 (September 21, 1962).

¹¹⁷ A specialist is prohibited from disclosing the information in his "book" to anyone other than an official of the Exchange or the SEC.

¹¹⁸ Id.

¹¹⁹ Id.

¹²⁰ In the Matter of Re, Re & Sagarese, Release No. 6900, 41 S.E.C. 230 (September 21, 1962).

¹²¹ In the Matter of Re, Re and Sagarese, Release No. 6551 (May 4, 1961); 50 Years of SEC History at 36.

¹²² 50 Years of the SEC at 36 quoting David Silver.

¹²³ Comment of David Silver, Transcript of the Special Study Roundtable at 41.

¹²⁴ J. Seligman at 305.

¹²⁵ Pollack Interview at 61-62 (comments of David Silver). Pollack attributed the U.S. Attorney's willingness to act so promptly in the Re & Re case to "our relationships with the U.S. Attorney. I don't know whether today they could walk into a U.S. Attorney and get the same thing accomplished. We had those tremendous relationships . . . It was that relationship. They had tremendous respect for the agency. It was that respect that made a lot of the cases so easy to prosecute." Pollack Interview at 62.

¹²⁶ See United States v. Re et al., 336 F.2d 306 (2d Cir. 1964) cert. den. 85 S. Ct. 188-189 (1964).

¹²⁷ Securities Exchange Act Release No. 34-6559 (May 15, 1961).

¹²⁸ Comment of Ralph Saul, Transcript of the Special Study Roundtable at 42.

¹²⁹ J. Seligman at 361 quoting Stanley Sporkin.

¹³⁰ J. Seligman at 361.

¹³¹ Id.

¹³² J. Seligman at 361.

¹³³ Report of the Special Study of Securities Markets of the Securities and Exchange Commission, 88th Cong., House Doc. 95, Part 1 at 1 (1963).

¹³⁴ Comment of Stanley Sporkin, Transcript of the Special Study Roundtable at 78-79.

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- ¹³⁵ Pollack Interview at 35 (“There again the Special Study was really an education superb to the Commission in giving it an understanding of the how the markets work, in addition to educating the staff.”).
- ¹³⁶ Comment of Robert J. Birnbaum, Transcript of the Special Study Roundtable at 68.
- ¹³⁷ J. Seligman at 361.
- ¹³⁸ Comment of Fred Siesel, Transcript of the Special Study Roundtable at 43.
- ¹³⁹ J. Seligman at 344.
- ¹⁴⁰ Pollack Interview at 24.
- ¹⁴¹ See Goodwin v Agassiz, 283 Mass. 358, 186 N.E. 659 (1933).
- ¹⁴² J. Seligman at 344.
- ¹⁴³ In the Matter of Cady, Roberts & Co., 40 SEC 907 (1961).
- ¹⁴⁴ J. Seligman at 346.
- ¹⁴⁵ In the Matter of Cady, Roberts & Co., 40 SEC 907 (1961).
- ¹⁴⁶ Mark K. Harder, Getting the Federal Securities Laws Moving Again After Chiarella and Dirks: A Proposal for Reform, 10 J. Corp. L 711, 718 (Spring 1985).
- ¹⁴⁷ J. Seligman at 362.
- ¹⁴⁸ SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D.N.Y. 1966).
- ¹⁴⁹ SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).
- ¹⁵⁰ Thirty-Fourth Annual Report at 6-7.
- ¹⁵¹ Id. at 7.
- ¹⁵² Id.
- ¹⁵³ Id. at 6. According to Irving Pollack “[t]here’s no question that Texas Gulf was a seminal case. Not only did it effectively get to the insider trading as an endemic industry, but it also established some of the basic principles. . . .Of course, we didn’t have the statute like they have it today, so we laid the groundwork in Texas Gulf for that.”¹⁵³
- ¹⁵⁴ Pollack Interview at 61 describing Eugene Rotberg and Stanley Sporkin.
- ¹⁵⁵ Pollack Interview at 24.
- ¹⁵⁶ Thirty-Second Annual Report at 116 citing SEC v. VTR, Inc., Civil Action No. 65-2621 (S.D.N.Y.).
- ¹⁵⁷ J. Seligman at 362.
- ¹⁵⁸ Thirty-Second Annual Report at 116-117.
- ¹⁵⁹ SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).
- ¹⁶⁰ Pitt and Shapiro at 191.

¹⁶¹ Twenty Third Annual Report at 1.

¹⁶² Id.

¹⁶³ Twenty Fifth Annual Report at 185.

¹⁶⁴ Susan Shapiro, Wayward Capitalists, Target of the Securities and Exchange Commission (1984) at 139-140.

¹⁶⁵ J. Seligman at 362-363.

¹⁶⁶ Thirty-Sixth Annual Report at 95.

¹⁶⁷ Thirty Eighth Annual Report at xxvii.

¹⁶⁸ According to Irving Pollack, “When we began the national program, most offices were so great in having us have somebody that could help them or take over cases from them [because] they had enough to do.” Pollack Interview at 38.

¹⁶⁹ Eventually, there was some skirmishing between the home office and the regional offices concerning the allocation of investigations. According to Irving Pollack, “There was some jealousy that developed, I can remember, from, let’s say, the New York office calling Stanley and complaining that the [home] office was doing some cases. . . .It was only when we really got a big case . . .and I would say principally this was New York. I never remember any other regional office calling Stanley or calling me and saying “Why are you guys doing this particular case? Or why are you doing that?” . . . the centralization will always have that problem, that people will say, “Why did you steal this case from me? We should have done it, not you,” particularly as these cases became much more important in the public arena.” Pollack Interview at 38.

¹⁷⁰ Telephone Interview with Alan B. Levenson, August, 2002.

¹⁷¹ Id.

¹⁷² Id.

¹⁷³ In November, 1972, President Nixon announced the nomination of Chairman Casey as Undersecretary of State for Economic Affairs. Thirty Eighth Annual Report at ii.

¹⁷⁴ Pollack Interview at 36-37.

¹⁷⁵ When the Commission restructured itself in 1972, Casey appointed G. Bradford Cook, then the general counsel of the Commission, to become the Director of Market Regulation. Upon Casey’s resignation from the chairmanship, President Nixon nominated Cook to succeed Casey as Chairman. During his confirmation hearings, Cook made misleading statements to the Congress about the nature and extent of contacts he had had with the Nixon White House concerning the Commission’s Robert Vesco investigation. Although Cook was confirmed as Chairman, subsequent revelations about his misrepresentations to Congress forced his ouster after only seventy-four days as SEC Chairman. See J. Seligman at 446-447.

¹⁷⁶ William R. McLucas, Mark B. Lewis and Alma M. Angotti, Common Sense, Flexibility and Enforcement of the Federal Securities Laws, 51 Bus. Law. 1221, 1223 (August, 1996) (“McLucas et al.”).

¹⁷⁷ Id.

¹⁷⁸ Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices, 94th Cong., 2d Sess. (Comm. Print 1976) at 3.

¹⁷⁹ Id.

¹⁸⁰ Id.

¹⁸¹ Stanley Sporkin, Restoring Integrity to American Business, Speech to the Chief Executives Forum, Santa Barbara, California (April 29, 1976).

¹⁸² McLucas et al. at 1224, n.13 citing Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices, 94th Cong., 2d Sess. (Comm. Print 1976).

¹⁸³ J. Seligman at 541 (“By mid-1975, the number of SEC questionable payments investigations had increased so rapidly that the full Commission concluded it could no longer afford to deal on a case-by-case basis with determining what specific disclosures each firm publicly would be required to make.”).

¹⁸⁴ McLucas et al. at 1224.

¹⁸⁵ McLucas et al. at 1225 (“The clear implication was that cooperation would be rewarded.”).

¹⁸⁶ David A. Vise and Steve Coll, Eagle on the Street at 13 (1991).

¹⁸⁷ Pitt & Shapiro at 194 -195.

¹⁸⁸ J. Seligman at 542.

¹⁸⁹ Pitt & Shapiro at 195, n. 192.

¹⁹⁰ Pitt & Shapiro at 195-196 (citations omitted).

¹⁹¹ Stanley Sporkin, Speech to the UCLA Dean’s Forum, Los Angeles, California (January 15, 1976).

¹⁹² Pitt & Shapiro at 195 (citations omitted).

¹⁹³ Stanley Sporkin, Speech to the UCLA Dean’s Forum, Los Angeles, California (January 15, 1975).

¹⁹⁴ Pitt & Shapiro at 171-172 (citations omitted).

¹⁹⁵ Stanley Sporkin, SEC Enforcement Practices Against Corporations, Speech to the Corporate Counsel Institute, Chicago, Illinois (October 7, 1976).

¹⁹⁶ Robert W. Emerson, Rule 2(e) Revisited: SEC Disciplining of Attorneys Since In Re Carter, 29 Am. Bus. L.J. 155, 159 (Summer 1991).

¹⁹⁷ Id.

¹⁹⁸ In the Matter of Laventhol, Kreckstein, Horwath & Horwath, Exchange Act Release No. 34 -10172, 1 S.E.C. Docket 26 (May 23, 1973).

¹⁹⁹ In the Matter of Touche, Ross & Co., Exchange Act Release No.10, 654, 3 S.E.C. Docket 594 (February 25, 1974).

²⁰⁰ In the Matter of Arthur Andersen & Co., Securities Act Release No. 33-5512, 45 S.E.C. 601 (July 8, 1974).

²⁰¹ In the Matter of Peat, Marwick, Mitchell & Co., Exchange Act Release No. 34-11517, 7 S.E.C. Docket 301 (July 2, 1975).

²⁰² Litigation Involving Price Waterhouse & Co., Acctg. Series Release No. 238, [1937-1982 Accounting Series Releases Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,260 (January 16, 1978).

²⁰³ In the Matter of Haskins & Sells et al., Exchange Act Release No. 14,450 [1937-1982 Accounting Series Releases Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,263 (February 10, 1978).

²⁰⁴ In the Matter of Ernst & Ernst et al., Acctg. Series Release No. 248 [1937-1982 Accounting Series Releases Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,270 (May 31, 1978).

²⁰⁵ In the Matter of Lester Witte & Co. et al., Securities Exchange Act Release No. 17423 [1937-1982 Accounting Series Releases Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,307 (January 7, 1981).

²⁰⁶ For a list of cases against accountants, see Pitt & Shapiro at 171, n. 97.

²⁰⁷ SEC v. National Student Marketing Corp., et al., Litigation Rel. No. 7012, 12 S.E.C. Docket 336 (May 2, 1977). Without admitting or denying the Commission's findings, White & Case stipulated to an order which required it to comply with the federal securities laws and which ordered the firm to "to adopt, effectuate and maintain procedures in connection with its representation of clients in matters involving the federal securities laws." Among the procedures were "provisions relating to the taking on of certain new clients, review of certain registration statements by a second partner of the firm experienced in securities matters who is not otherwise involved in the transaction, and identification of certain circumstances involving the issuance of securities to the public where consultation with other partners within the firm is required." Id.

²⁰⁸ In the Matter of William R. Carter and Charles J. Johnson, Exchange Act Release No. 17597, 22 S.E.C. Docket 292 (February 28, 1981) (Opinion of the Commission); and In the Matter of William R. Carter and Charles J. Johnson, 47 S.E.C. 471 (February 28, 1981) (Order dismissing proceedings). Although the Division of Enforcement's action against the lawyers was dismissed, the order dismissing the proceedings has been described as nonetheless having been a victory for the Commission "which announced a high standard of conduct henceforth expected from lawyers whose clients continue to disobey securities disclosures requirements." R. Emerson at 200.

²⁰⁹ For a list of cases against lawyers, see Pitt & Shapiro at 171, n. 98.

²¹⁰ See In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982 (July 2, 1979). In Keating, the Commission disciplined a Cincinnati law firm under Rule 2(e) for its role in transactions that were the subject of untrue statements of material fact in filings on behalf of two clients with the Commission. In dissent, Commissioner Roberta Karmel strenuously questioned the Commission's authority to discipline attorneys under Rule 2(e). She stated her belief that "it is repugnant to our adversary system of legal representation to permit a prosecutorial agency to discipline attorneys who act as counsel to regulated persons." Chairman Harold Williams responded to Commissioner Karmel's arguments by pointing out that the "[f]ederal courts have recognized the authority of agencies generally to discipline professionals who practice before them" and by asserting that he could not "accept that the Commission should now, as a matter of law, reverse itself, conclude that it lacks an authority which it has repeatedly exercised, and deny its ability to shield its administrative mechanisms from those professionals who have demonstrated a capacity and willingness to abuse those processes."

²¹¹ Pitt & Shapiro at 171.

²¹² David A. Vise and Steve Coll, Eagle on the Street at 4 (1991).

²¹³ S. Shapiro at 142-143 (citations omitted).

²¹⁴ J. Seligman at 540.

²¹⁵ Stanley Sporokin, Speech to the National War College, Washington, D.C. (February 3, 1977).

²¹⁶ This balance is symbolized in the Commission’s official seal. The seal depicts a vigilant American bald eagle, bearing an American flag in the shape of a shield and clutching an olive branch in one talon and an arsenal of sharpened arrows in the other.