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COMMENT

SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical Analysis of the SEC's New Enforcement Approach

The U.S. Securities and Exchange Commission (SEC) has not been shy about promoting its use of monetary punishments under new Chair Mary Jo White.[1] In September 2013, White asserted that "we must make aggressive use of our existing penalty authority, recognizing that meaningful monetary penalties—whether against companies or individuals—play a very important role in a strong enforcement program."[2] Co-Director of Enforcement Andrew Ceresney was even more blunt in an address several days later: "Monetary penalties speak very loudly and in a language any potential defendant understands . . . . Enforcement needs to be aggressive in our use of penalties."[3]

Although the rhetoric is new, the SEC's growing reliance on monetary penalties preceded White's appointment.[4] The amount of penalties that the SEC has assessed against securities law violators in judicial and administrative proceedings since 1990 has increased at a calculated annual growth rate of 22%,

1. White was sworn in on April 10, 2013. *SEC Biography: Chair Mary Jo White*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/commissioner/white.htm [http://perma.cc/W6SU-S8TR].

2. Mary Jo White, Chair, Sec. & Exch. Comm'n, Remarks at the Council of Institutional Investors Fall Conference in Chicago, IL: Deploying the Full Enforcement Arsenal (Sept. 26, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202 [http://

2. Mary Jo White, Chair, Sec. & Exch. Comm'n, Remarks at the Council of Institutional Investors Fall Conference in Chicago, IL: Deploying the Full Enforcement Arsenal (Sept. 26, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202 [http://perma.cc/NC83-6BAQ].

3. Jean Eaglesham, *SEC Ramps Up Fine Amounts to Deter Misconduct*, WALL ST. J., Oct. 1, 2013, http://online.wsj.com/news/articles/SB10001424052702303918804579109554149460532 [http://perma.cc/9MPE-Z7NC].

4. *See infra* Figure 1.

compared to only a 4% increase in total cases filed annually.[5] Since 2000, the growth has been even more striking: penalties have grown 30% year-over-year, compared to 3% growth in cases filed. The maximum fee assessed has also skyrocketed: Xerox's 2002 $10 million civil penalty was then "the largest ever levied in a Commission action against a public company for financial fraud."[6] By 2006, one commentator noted that "[t]oday, a $10 million SEC penalty would probably be considered a 'victory' for most entities settling SEC fraud charges."[7] From 2000-2013, the mean payment by corporate defendants in SEC issuer reporting and disclosure cases was $57.9 million.[8] Although that figure includes several outliers, the median payment was still $9 million.[9]

Despite the increase in the sums assessed, most of the money collected goes where it always has: to the U.S. Treasury General Fund. Compensating harmed investors was not historically an agency priority,[10] but the Sarbanes-Oxley Act of 2002 (SOX) fundamentally shifted the SEC's approach to distributing funds collected—at least nominally. Section 308 authorized the SEC to use penalty funds, in addition to disgorgements, to compensate harmed investors via Federal Account for Investor Restitution (Fair) Funds. The agency's response has been seemingly enthusiastic, with multiple proclamations about its efforts on behalf of shareholders.[11] However, based on

5. All data were collected from SEC Annual Reports and analyzed by the author. Penalties assessed are not necessarily identical to penalties collected, as the SEC may take ability to pay into account in collections (for example, if the debtor has no assets, the SEC may not collect or may reduce the amount owed proportionally).

6. *SEC Annual Report 2002*, SEC. & EXCHANGE COMMISSION 5 (2002), http://www.sec.gov/pdf/annrep02/ar02full.pdf [http://perma.cc/7J5X-59XS].

7. Paul S. Atkins, Comm'r, Sec. & Exch. Comm'n, Remarks Before the U.S. Chamber Institute for Legal Reform (Feb. 16, 2006), http://www.sec.gov/news/speech/spch021606psa.htm [http://perma.cc/G2PJ-CEAL]. Note that these figures represent the *maximum* level of penalties, not median payments.

8. Jason Hegland & Michael Klausner, *SEC Practice in Targeting and Penalizing Individual Defendants*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 3, 2013, 9:23 AM), http://blogs.law.harvard.edu/corpgov/2013/09/03/sec-practice-in-targeting-and-penalizing-individual-defendants [http://perma.cc/9F27-MTSL]. Note that these figures relate to a specific subset of SEC cases: those involving nationally listed firms for violation of disclosure-related rules (e.g., fraud, books and records, and internal control rules).

9. *Id*.

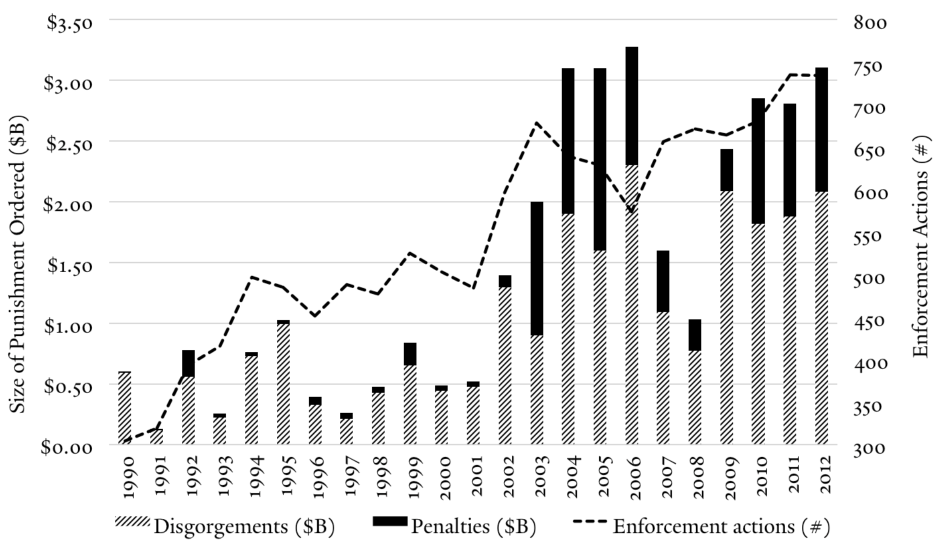
10. For example, Commissioner Richard B. Smith made clear in 1968 that "the Commission attempts to avoid being a collection agency for injured investors." Richard B. Smith, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at Program of Continuing Education of the Bar of the State of California: The Interest of the Securities and Exchange Commission in Private Civil Actions Under the Securities Acts 14 (Jan. 12, 1968), http://www.sec.gov/news/speech/1968/011268smith.pdf [http://perma.cc/E7UC-DH93].

11. For example, a report by the Government Accountability Office (GAO) noted that "SEC staff demonstrated support for the provision [§ 308] by promoting an aggressive approach

an analysis of SEC data, this enthusiastic rhetoric does not reflect reality. Efforts to distribute funds to harmed investors have tapered off over time, such that the vast majority of sums collected are still deposited in Treasury's General Fund. This ensures that the SEC contributes more revenue to the government than any other independent agency.[12]

Figure 1.

GROWTH IN SEC MONETARY PUNISHMENTS COMPARED TO ENFORCEMENT ACTIONS[13]



in seeking, where appropriate, disgorgement orders in cases where CMPs [civil monetary penalties] are also being sought. For example, attorneys have obtained disgorgement for as little as $1 in settlements in order to obtain authorization from the SEC Commission to create a Fair Fund." U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-670, SEC AND CFTC PENALTIES: CONTINUED PROGRESS MADE IN COLLECTION EFFORTS, BUT GREATER SEC MANAGEMENT ATTENTION IS NEEDED 11 (2005), http://www.gao.gov/assets/250/247566.pdf [http://perma.cc/ZW63-3BMS]. The SEC's 2003 Annual Report was also the agency's first to elevate investor compensation to a "main objective." *SEC Annual Report 2003*, SEC. & EXCHANGE COMMISSION 24 (2003), http://www.sec.gov/pdf/annrep03/ar03full.pdf [http://perma.cc/7M89-DBVK].

12. *See infra* notes 53-57 and accompanying text.

13. SEC fiscal years run through September of the respective calendar years. Totals refer to orders obtained in SEC judicial and administrative proceedings requiring securities violators to pay penalties or to disgorge illegal profits. All data were collected from corresponding SEC annual reports, located at *Annual Reports*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/annrep.shtml [http://perma.cc/SR57-HQ49] and *Reports*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/secreports.shtml [http://perma.cc/U6EG-46CR].

The dramatic increase in monetary sanctions with minimal changes in the location to which the money goes raises certain questions: Does the new strategy improve the SEC's efforts to police the securities markets and protect investors? What are the strategy's larger implications for corporations and their shareholders? I address these issues and argue that the net consequence of the SEC's new approach is negative. My focus is on corporate violators, both because they have incurred the steepest fines and because they implicate the unique concerns that arise when third parties (that is, shareholders) foot the bill. This Comment is organized as follows: Part I explains where the sums that the SEC collects go. Part II examines the effectiveness of fines on corporations and the implications for deterrence when shareholders pay for management misdeeds. Part III highlights additional concerns stemming from the SEC's self-interest in setting its enforcement agenda, while Part IV argues that this dynamic is particularly troubling in light of the SEC's near-total discretion, absent effective judicial scrutiny. Part V concludes.

I. WHERE DOES THE MONEY GO?

The SEC has loudly championed its ability to collect billions of dollars from securities law violators every year, but it has not been as clear in identifying where all of this money goes. The answer to that question, which I addressed by sifting through SEC Annual Reports and the Office of Inspector General (OIG) Semi-Annual Reports, is threefold: (1) Fair Funds; (2) the new Investor Protection Fund; and (3) the Treasury General Fund. But how much is distributed to each, and who decides, are more complicated questions.

Fair Funds are relatively new; § 308 of SOX[14] granted the agency authority to compensate harmed investors with Fair Funds composed of both penalty funds and disgorgements. Before 2002, the vast majority of funds collected by the SEC were directed to the General Fund.[15] Although disgorgements were available to compensate harmed investors, the SEC made limited use of the remedy. Only after SOX was passed did investor compensation become an explicit goal of the agency.[16] SOX gave the SEC total discretion to direct that funds be distributed to harmed investors; neither corporations nor their

14. Sarbanes-Oxley Act of 2002 § 308, 15 U.S.C. § 7246 (2012).

15. *See* Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1113 & n.42, 1117-18 (2012).

16. SEC Rule 1100: Creation of Fair Fund, 17 C.F.R. § 201.1100 (2005).

shareholders can object to the creation of such a fund.[17] Although the text of § 308 does not explicitly encourage the SEC to elevate investor compensation as an agency priority, and the available legislative history focuses on the use of disgorgements as a tool to penalize wrongdoers rather than to benefit their victims, the SEC nonetheless interpreted the provision as requiring a shift in agency policy. In its 2003 Annual Report, the agency listed "[w]herever practical, continue to seek to return recovered funds to defrauded investors" as one of its "main objectives" going into 2004.[18] Moreover, the agency's 2006 *Statement Concerning Financial Penalties*—intended to clarify the SEC's decision-making process in seeking monetary penalties—explicitly included "[t]he degree to which the penalty will recompense or further harm the injured shareholders" as one of its two principal considerations in assessing a financial penalty against a corporation.[19] Deterring future misconduct, historically the SEC's foremost priority, was demoted to an "additional" concern.

Despite the SEC's vocal support, the creation of new Fair Funds has dropped dramatically over time. In 2004, more than twenty funds were created from corporate violators; only one such fund was created in 2010.[20] The total amount in such funds has also decreased: the average fund created in 2005-2006 contained more than $90 million at inception, versus $24 million for funds created between 2007 and 2013.[21] Distribution takes a long time: 67 of

17. SEC Rule 1106: Right to Challenge, 17 C.F.R. § 201.1106 (2005). However, the SEC is required to publish notice of the proposed plan of disgorgement or Fair Fund plan for comment by non-parties under 17 C.F.R. § 201.1103.

18. *SEC Annual Report 2003*, *supra* note 11, at 24.

19. The other principal consideration was "[t]he presence or absence of a direct benefit to the corporation as a result of the violation." Press Release, Sec. & Exch. Comm'n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), http://www.sec.gov/news/press/2006-4.htm [http://perma.cc/V2YB-6KC7].

20. *See infra* Figure 2. All data were collected from a list that the SEC makes publicly available. *Distributions in Commission Administrative Proceedings: Notices and Orders Pertaining to Disgorgement and Fair Funds*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/litigation/fairfundlist.htm [http://perma.cc/AB8A-3WCL]. Data include corporate violators only. There may be additional funds created from corporate violators that are not included on the SEC's publicized list. *See* Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distribution*, 67 STAN. L. REV. (forthcoming 2015) (on file with author). However, Velikonja's larger dataset displays the same pattern over time. *Id.* at 26.

21. *See infra* Figure 3. The $200 million paid by JPMorgan increased the average significantly; the two other Funds created in 2013 together totaled less than $5 million. *Id.* (data on file with author).

the 93 funds created from corporate violators since 2003 are still extant.[22] Each step of the fund distribution process takes time; for example, the average delay between the initial order creating the fund and the proposed distribution plan is over two years (816 days). For those funds that have terminated, the average time between initial order and termination was over five years.[23]

One potential reason for the SEC's disinclination to create new funds is the administrative burden of distribution. Because the SEC historically has focused on enforcement, fund distribution is not a core competency.[24] As a result, the publicity surrounding Fair Funds has often been less than positive. Critics have focused on the SEC's lack of coherence in its distribution policy, beyond "reacting to pressure to negotiate large funds."[25] The agency has also struggled in its efforts to actually distribute collected funds. Two cases in particular highlight the agency's disorganization. In one, an enforcement against seven specialists, an approximately $250 million fund was created for investor compensation. Although seven years passed between the initial order creating the fund (March 30, 2004) and the date of termination (May 26, 2011), the administrator "encountered a number of obstacles in its efforts to identify injured investors," such that $160 million remained at the end.[26] There was vigorous opposition on the part of one Commissioner, who argued in dissent that closing the fund with so much money remaining was premature.[27] Similarly, a 2003 case against ten investment banks and two individual analysts resulted in a $1.4 billion "Global Research Analyst Settlement,"[28] which went from "much-heralded" to "embarrassing," in the words of Judge Pauley

22. *See infra* Figure 2 and underlying data (on file with author). Among terminated funds, an average of $8 million remained, although one outlier accounted for 84% of the total undistributed funds. The calculations for outstanding funds are on file with the author.

23. *See infra* Figure 4.

24. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-448R, SECURITIES AND EXCHANGE COMMISSION: INFORMATION ON FAIR FUND COLLECTIONS AND DISTRIBUTIONS 3 (2010), http://www.gao.gov/assets/100/96667.pdf [http://perma.cc/LSB4-MDKE] (describing steps the SEC has taken to measure and improve its performance in Fair Funds management).

25. Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW 317, 335 (2008).

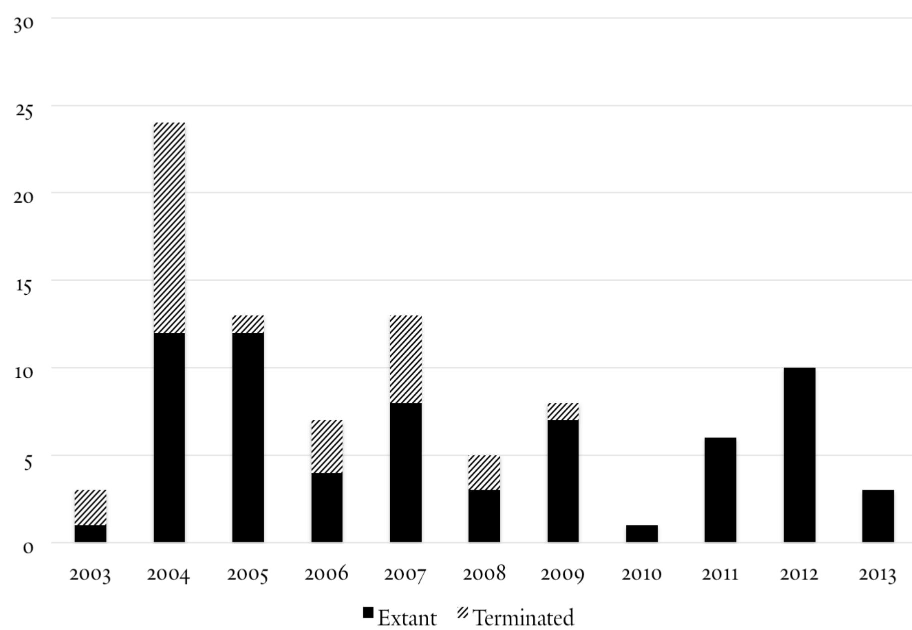
26. Order Approving Transfer of Remaining Distribution Funds to the U.S. Treasury, Exchange Act Release No. 64,553, 101 SEC Docket 781, at 5-6 (May 26, 2011), http://www.sec.gov/litigation/admin/2011/34-64553.pdf [http://perma.cc/8Q7P-3DM3].

27. *See id.* at 10 n.5.

28. Press Release, Sec. & Exch. Comm'n, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), http://www.sec.gov/news/press/2003-54.htm [http://perma.cc/V5SJ-SBTW].

Figure 2.

NUMBER OF FAIR FUNDS CREATED AND CURRENT STATUS (TERMINATED OR EXTANT)[29]



29. All data were collected from *Distributions in Commission Administrative Proceedings: Notices and Orders Pertaining to Disgorgement and Fair Funds*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/litigation/fairfundlist.htm [http://perma.cc/W9P5-AGQ6]. Data include corporate violators only, and exclude Fair Funds composed of disgorgements and/or penalties paid by individual violators, including where entities were co-respondents but were not ordered to disgorge profits or pay penalties. There may be additional Fair Funds not advertised on the SEC's website, although that would contradict the agency's purpose in distributing the money. The SEC's case against JPMorgan Chase & Co. increased the average fund in 2013 significantly; the $200 million in penalties dwarfed the two other funds created, which together totaled less than $5 million. Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Exchange Act Release No. 70,458, 107 SEC Docket 4, at 19 (Sept. 19, 2013), http://www.sec.gov/litigation/admin/2013/34-70458.pdf [http://perma.cc/JV64-HVRE].

Figure 3.
TOTAL DOLLARS AWARDED TO FAIR FUNDS (TOTAL AND MEAN) BY YEAR[30]

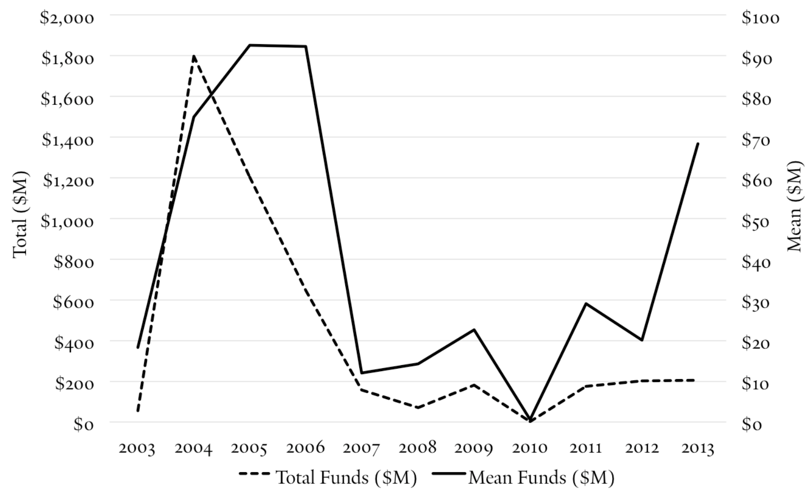
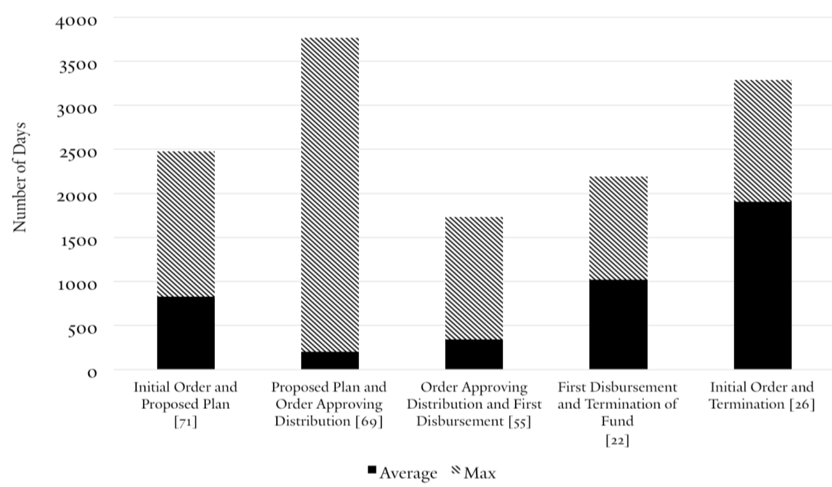


Figure 4.
TIME DELAYS IN FAIR FUND DISTRIBUTIONS[31]



30. *Distributions in Commission Administrative Proceedings*, *supra* note 29. Some of the cases are no longer available on the SEC website and are on file with the author.

31. *Id.*; *see also supra* note 23 and accompanying text (discussing time delays). The numbers in brackets represent the number of funds that have reached each milestone.

who presided over the case.[32] Most damningly, Judge Pauley noted:

> Of course, the April 2003 headlines regarding the "Global Research Analyst Settlement" had faded by September, and the SEC as well as these Defendants were indifferent to the mechanics of restitution. . . . In the final analysis, this Court does not question the SEC's interest in bringing to an end improper conduct. Nor does it question the SEC's interest in recompensing investor victims and deterring future violations. However, whether the SEC has the institutional resolve and commits adequate resources to reach these goals is an open question.[33]

By the time that fund was closed in 2009, almost $80 million of the originally earmarked $432.5 million was remitted to the U.S. Treasury rather than to the investors for whom it was intended.[34] These administrative hassles, compounded by the resulting bad publicity, may have dampened the agency's enthusiasm for creating new funds.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) also created a new destination for collections: the Investor Protection Fund.[35] Under Dodd-Frank, monetary sanctions not otherwise earmarked to disgorgements or Fair Funds (or remaining in Fair Funds upon termination) can be used for two purposes: to pay whistleblower awards[36] or to fund the SEC Office of the Inspector General's Employee Suggestion Program.[37]

The whistleblower program is designed to incentivize individuals with "specific, credible, and timely information" to proactively contact the SEC.[38] Would-be informers have responded exactly as Congress intended; the number of whistleblowers grew from 3,001 in FY2012 to 3,238 in FY2013.[39]

32. SEC v. Bear, Stearns & Co., 626 F. Supp. 2d 402, 403-404 (S.D.N.Y. 2009).

33. *Id.* at 411, 419-20.

34. *SEC v. Bear, Stearns & Co.*, 626 F. Supp.2d at 420 (directing the SEC to transfer monies remaining in the Funds to the Treasury Department); Velikonja, *supra* note 20, at 30, 60.

35. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841-49 (2010).

36. Securities Exchange Act of 1934 § 21F(g), 15 U.S.C. § 78u-6(g)(2)(2012).

37. Securities Exchange Act of 1934 § 4D(e); 15 U.S.C. § 78d-4(e) (2012).

38. *2013 Annual Report to Congress on the Dodd-Frank Whistleblower Program*, SEC. & EXCHANGE COMMISSION 1 (2013), http://www.sec.gov/about/offices/owb/annual-report-2013.pdf [http://perma.cc/FKR6-3CZN].

39. *Id.* at 8. Per the *2013 Annual Report*, these figures include only those who included the required whistleblower declaration. *Id.* at 8 n.10. Only seven weeks of whistleblower data was available for 2011, *id.* at 8 n.11, during which time there were 334 complaints, *id.* at 8.

However, very few whistleblowers received compensation: in 2011-2012, only one whistleblower received an award, for less than $50,000.[40] In 2013, the agency distributed $14,831,965.64, but more than $14 million went to one whistleblower; four others split the remainder.[41] Nearly $440 million remains of the initial disbursement of about $450 million to the fund.[42] Consequently, no additional amounts have been deposited since its inception: if the balance exceeds $300 million, new collections cannot be added.[43]

The SEC also uses Investor Protection Funds for its Employee Suggestion Program. Before Dodd-Frank, SEC employees were not without recourse to address their complaints; the Office of Human Resources (OHR) had a similar program that it discontinued in 2011.[44] Much as with Fair Funds, use of the new program has tapered off, from 48 suggestions and allegations lodged in FY2011 (including holdovers from the previous program) to 27 in FY2013. The vast majority of suggestions do not involve serious concerns, and few lead to agency action.[45] For example, the Program received an allegation that many employees received their second choice of new laptop computers, and a suggestion that the SEC limit distribution of paper copies of the Code of Federal Regulations to save $21,000 per year.[46] Receiving and investigating these allegations and suggestions has cost the Investor Protection Fund

40. *2012 Annual Report on the Dodd-Frank Whistleblower Program*, SEC. & EXCHANGE COMMISSION 8 (2012), http://www.sec.gov/about/offices/owb/annual-report-2012.pdf [http://perma.cc/L543-G74S].

41. *Id.* at 15.

42. *Id.* at 16. The total includes $650,206.56 earned in investments in FY2013.

43. 15 U.S.C. § 78u-6(g)(3)(A)(i) (2012).

44. Office of Inspector Gen., *Semiannual Report to Congress*, SEC. & EXCHANGE COMMISSION 124 (2011), http://www.sec.gov/about/offices/oig/reports/reppubs/2011/sar_fall_2011_final_508.pdf [http://perma.cc/ZU23-QYR3]. There were problems with OHR's program, however. *See* Office of Inspector Gen., *Audit of SEC's Employee Recognition Program and Recruitment, Relocation, and Retention Incentives*, SEC & EXCHANGE COMMISSION 25 (2011), http://www.sec.gov/oig/reportspubs/492.pdf [http://perma.cc/V7W9-99YR]. In fact, some of the initial suggestions made to the Employee Suggestion Program in 2011 were actually leftovers from the previous program. *Semiannual Report to Congress*, *supra*, at 20-21.

45. Office of Inspector Gen., *Semiannual Report to Congress*, *supra* note 44, at 124; Office of Inspector Gen., *Semiannual Report to Congress*, SEC. & EXCHANGE COMMISSION 27-30 (2013), http://www.sec.gov/about/offices/oig/reports/reppubs/2013/oig_fall2013.pdf [http://perma.cc/XYD2-Q7HA].

46. Office of Inspector Gen., *Semiannual Report to Congress*, SEC. & EXCHANGE COMMISSION 29 (2013), http://www.sec.gov/about/offices/oig/reports/reppubs/2013/oig_fall2013.pdf [http://perma.cc/PAV6-W6DY]; *Semiannual Report to Congress*, *supra* note 44, at 20.

$233,556.65 over the past three years; in two of those years, the allocation exceeded the sum paid to whistleblowers.[47]

Figure 5.

INVESTOR PROTECTION FUND BUDGET AND ACTIVITIES[48]

$M	FY 2010	FY 2011	FY 2012	FY 2013
Balance of Fund at beginning of preceding fiscal year (FY)	-	451.91	452.79	453.43
Amounts deposited into or credited to Fund during preceding FY	451.91	-	-	-
Amount of earnings on investments during preceding FY	-	0.99	0.76	0.65
Amount paid from Fund during preceding FY to whistleblowers	-	-	0.05	14.83
Amount disbursed to OIG during preceding FY	-	0.11	0.07	0.05
Balance of Fund at end of the preceding FY	451.91	452.79	453.43	439.20
# whistleblowers	N/A	334	3001	3238
# awards	N/A	0	1	4

If the SEC is not creating new Fair Funds or adding money to its Investor Protection Fund, then where is the SEC putting the sums it collects? Where it always has: the U.S. Treasury General Fund. Despite the SEC's rhetoric about compensating harmed investors, funds earmarked for its two investor compensation programs have declined dramatically as a percentage of the SEC's total assets, from approximately 28% in 2005 to 13% in 2013.[49]

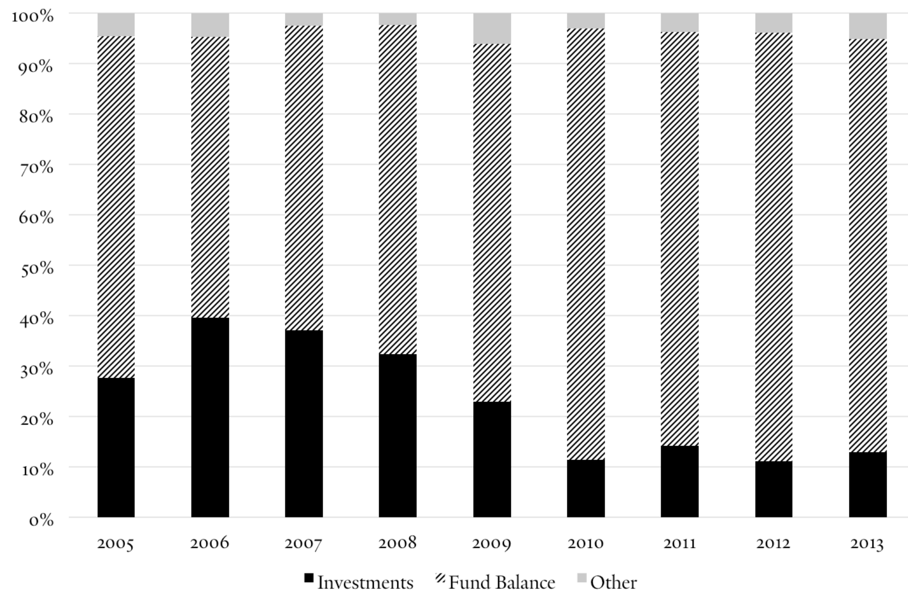
47. *See infra* Figure 5 and underlying data.

48. All data were collected from the SEC Office of the Whistleblower annual reports. *See 2013 Annual Report*, supra note 38, at 1, 15-16; *Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2012*, SEC. & EXCHANGE COMMISSION 10 (2012), http://www.sec.gov/about/offices/owb/annual-report-2012.pdf [http://perma.cc/ZS2X-YQTR]; *Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2011*, SEC. & EXCHANGE COMMISSION 5, 9 (2011), http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf [http://perma.cc/B4XH-5F62].

49. All data were collected from SEC Annual Reports. *See infra* Figure 6 and underlying data (on file with author).

Figure 6.

PERCENTAGE OF SEC ASSETS ALLOCATED TO FUND BALANCE WITH TREASURY VS. INVESTMENTS (DISGORGEMENT AND PENALTIES FUND AND INVESTOR PROTECTION FUND)[50]



50. All data were collected from the SEC's corresponding annual reports. *See Fiscal Year 2013 Agency Financial Report*, SEC. & EXCHANGE COMMISSION 34 tbl.1.2 (2013), http://www.sec.gov/about/secpar/secafr2013.pdf [http://perma.cc/6VS9-QMUU]; *Fiscal Year 2012 Agency Financial Report*, SEC. & EXCHANGE COMMISSION 32 tbl.1.2 (2012), http://www.sec.gov/about/secpar/secafr2012.pdf [http://perma.cc/D5QL-S98D]; *FY 2011 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 32 tbl.1.2 (2011), http://www.sec.gov/about/secpar/secpar2011.pdf [http://perma.cc/FKP5-N7R6]; *FY 2010 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 82, 101 n.13 (2010), http://www.sec.gov/about/secpar/secpar2010.pdf [http://perma.cc/88BD-L9ZR]; *Putting Investors First: 2009 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 64, 82 n.12 (2009), http://www.sec.gov/about/secpar/secpar2009.pdf [http://perma.cc/XSF4-SUTG]; *2008 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 59, 75 n.12 (2008), http://www.sec.gov/about/secpar/secpar2008.pdf [http://perma.cc/RZR7-PEXB]; *2007 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 14 tbl.1.3 (2007), http://www.sec.gov/about/secpar/secpar2007.pdf [http://perma.cc/Y3L4-UHDB]; *2006 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 33 exh. 1.8, 60-61, 77 n.6, 78 n.7 (2006), http://www.sec.gov/about/secpar/secpar2006.pdf [http://perma.cc/QD73-F2Z6]; *2005 Performance and Accountability Report*, SEC. & EXCHANGE COMMISSION 30 exh. 1.8 (2005), http://www.sec.gov/about/secpar/secpar2005.pdf [http://perma.cc/ZS9-2KLD].

Although disgorgements and penalties cannot be used directly for SEC expenses, it is a point of pride within the agency that it is a net contributor to the Federal Government's budget and any appropriations from Congress are "fully offset."[51] To be sure, the SEC would be a net contributor even without violator fines: securities transactions fees alone fully offset the SEC's total FY2013 budget request.[52] Up to $50 million in additional registrant filing fees are deposited in the SEC's Reserve Fund, created under 15 U.S.C. § 78d(i) to be used "as the Commission determines is necessary"; the remainder of those fees also go to the General Fund.[53] Even if these additional funds are not factored into actual SEC expenses, though, they are considered to be part of the SEC's total budget, which has steadily increased as a result.

There are only six other entities that are expected to provide any net contributions to the Treasury General Fund in 2014, and none provide sums remotely close to the SEC's expected $737 million contribution.[54] Potentially as a result of its generosity to the rest of the government, the SEC has enjoyed rapid expansion in the past five years. According to one analysis, the SEC's budget grew by 46% from FY2008-FY2013, compared to 24% for the Federal Government as a whole, and 14% GDP growth.[55] This disproportionate growth does not look like it will soon slow: the SEC's 2014 budget represents a nearly 30% increase over 2013 ($1.608 billion vs. $1.254 billion).[56] By comparison, the

51. *In Brief FY 2013 Congressional Justification*, SEC. & EXCHANGE COMMISSION 2 (Feb. 2012), http://www.sec.gov/about/secfy13congbudgjust.pdf [http://perma.cc/K5JZ-QXXW].

52. *Id.*

53. *See FY 2014 Congressional Budget Justification*, SEC. & EXCHANGE COMMISSION 18 n.1 (2014), http://www.sec.gov/about/reports/secfy14congbudgjust.pdf [http://perma.cc/MS8R2LSM] (describing this statutory provision).

54. Those funds were generated by: Civilian Property Realignment Board ($120 million), District of Columbia ($1 million), Federal Communications Commission ($251 million), Federal Maritime Commission ($1 million), Nuclear Regulatory Commission ($1 million), and Vietnam Education Foundation ($5 million, although the entirety of that amount is contributed by other federal governmental agencies, USDA, and USAID). Negative subsidies from loans made by the Export-Import Bank of the United States are excluded. *The Budget for Fiscal Year 2014: Other Independent Agencies*, OFF. MGMT. & BUDGET (2014), http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/oia.pdf [http://perma.cc/79L4-RJQS].

55. David Burton, *Lack of Resources Is Not the Reason for SEC Tardiness*, HERITAGE FOUND.: THE DAILY SIGNAL (Dec. 10, 2013), http://dailysignal.com/2013/12/10/lack-resources-reason-sec-tardiness [http://perma.cc/8ZUJ-9R3Y].

56. *The Budget for Fiscal Year 2014: Other Independent Agencies*, *supra* note 54, at 1313.

total outlay for all "discretionary" programs shrunk by 2% between 2013 and 2014.[57]

II. DO FINES DO ANY GOOD?

Given the magnitude of monetary penalties, it is surprising that there is little evidence of their effectiveness in deterring securities law violations. Indeed, for public companies, evidence suggests that the opposite may be true. There is ample evidence that *individuals* can be deterred by the threat of financial penalties when they pay the cost themselves.[58] However, if their employer (or its shareholders) pays, the deterrent effect is undermined. Corporate fines for securities law violations present a classic example of the agency problem: managers who violate securities laws may gain from misconduct, especially in the short-term, while long-term losses from fines are spread across shareholders.[59] As former SEC Commissioner Cynthia Glassman once noted in voting against the imposition of a fine on a corporation, "When the boards and management are agreeing to these penalties, they're agreeing to pay with other peoples' money."[60]

Depending on how punishments are structured, even a massive fine may not directly affect executive compensation; instead, the sum is effectively split among shareholders. To borrow a phrase from an eminent securities law professor, this system is "akin to punishing the victims of burglary for their failure to take greater precautions."[61] Although executives may be deterred by other means—including the possibility of being fired by the corporation for the

57. *Fiscal Year 2015 Budget of the U.S. Government*, OFF. MGMT. & BUDGET 170 tbl.S-5, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/budget.pdf [http://perma.cc/F4B3-AT3J]. "Discretionary" is a technical term for government spending on programs other than Social Security, Medicare, Medicaid, and other mandatory programs.

58. *See, e.g.*, Todd L. Cherry, *Financial Penalties as an Alternative Criminal Sanction: Evidence from Panel Data*, 29 ATLANTIC ECON. J. 450, 450 (2001). *See generally* A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. ECON. LITERATURE 45 (2000).

59. The agency problem, or moral hazard, arises from the mismatch in incentives between shareholders and corporate managers. *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

60. Deborah Solomon, *As Corporate Fines Grow, SEC Debates How Much Good They Do*, WALL ST. J., Nov. 12, 2004, http://online.wsj.com/news/articles/SB110021198122471832 [http://perma.cc/W8EK-HMW2].

61. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1562 (2006).

original misconduct or of being assessed a fine individually by the SEC—they are not personally liable for fines assessed against the corporation.

Although the circularity problem is particularly troubling when shareholders do not share in any of the initial benefits of misconduct (for example, accounting fraud), the concern is not limited to these violations. Circularity is exacerbated by a temporal disconnect: if the company has sufficient liquidity, then shareholders enriched by the initial misconduct have likely already sold their stock. Remaining shareholders are then doubly penalized: by the penalty itself and the "reputational penalties" that companies suffer after SEC actions, which can be higher than the fines themselves.[62] Enforcement actions also can divert management's attention, leading to further lost revenue. This timing issue has distributive consequences; it benefits investors who sell rapidly (for example, hedge funds) and penalizes those who hold for longer periods (for example, retail investors).[63] This is not to suggest that corporate fines are never appropriate. For example, requiring a corporation to disgorge the profits gained from a price-fixing scheme appropriately requires the beneficiary of the violation to pay, and this may deter similar future misconduct. However, these considerations suggest the importance of paying careful attention to the particular factors involved before any fine is assessed.

Indeed, Congress explicitly urged such caution in fining public corporations when it initially granted the SEC the authority to seek civil monetary penalties. The legislative history of the 1990 Securities Enforcement and Penny Stock Reform Act includes the following passage:

> [B]ecause the costs of such penalties may be passed on to shareholders, the Committee intends that a penalty be sought when the violation results in an improper benefit to shareholders. [When] shareholders are the principal victims of the violations, the Committee expects that the SEC, when appropriate, will seek penalties from the individual offenders acting for a corporate issuer.[64]

62. *See generally* Jonathan M. Karpoff et al., *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581 (2008) (arguing that reputation losses impose the largest penalties for financial misrepresentations). Karpoff's study was limited to accounting fraud. However, Engelen and van Essen demonstrate that companies suffer reputational penalties from a wide range of misconduct, at least so long as the misconduct directly involves related parties. *See generally* Peter-Jan Engelen & Marc van Essen, *Reputational Penalties in Financial Markets: An Ethical Mechanism?*, *in* RESPONSIBLE INVESTMENT IN TIMES OF TURMOIL, at 55 (Wim Vandekerckhove et al. eds., 2011).

63. Coffee, *supra* note 61, at 1560.

64. S. REP. NO. 101-337, at 17 (1990).

Deterring future misconduct is not merely a positive side effect of enforcement; according to Congress, it is one of the primary reasons we have the securities law regime we do.

The legislative history of the Reform Act makes clear that broadening monetary penalties was "intended to permit the Commission to achieve the appropriate level of deterrence."[65] To quote Judge Rakoff, "Where management deceives its own shareholders, a fine most directly serves its deterrent purposes if it is assessed against the persons responsible for the deception."[66] If these penalties do not produce the desired deterrent effect because they are assessed against the corporation, rather than the individuals engaged in misconduct, then it is hard to argue that they are worth the costs.[67]

III. WHOM DOES THE SEC TARGET?

Inability to deter misconduct is one problem with corporate monetary penalties, but it is not the only one. At least two additional, related issues prompt consideration: the way in which the SEC prioritizes enforcement, and the lack of meaningful checks on the agency. This Part addresses the former; the following Part discusses the latter.

The SEC has considerable latitude to prioritize its enforcement agenda. This raises the possibility that the SEC will select targets not because they are the worst violators, but for improper reasons such as agency or individual self-aggrandizement. For example, empirical evidence suggests that the SEC targets "deep pockets" for whom large-dollar fines will not induce insolvency, as well as violators whose cases will engender positive press. One study found a marked increase in enforcement actions targeted at larger companies starting in

65. H.R. REP. NO. 101-616, at 13 (1990).

66. SEC v. Bank of Am. Corp., Nos. 09 Civ. 6829(JSR), 10 Civ. 0215(JSR), 2010 WL 624581, at *5 (S.D.N.Y. Feb. 22, 2010) (Rakoff, J.).

67. There is some evidence that some types of enforcement actions may result in reputational penalties for management, including reducing compensation or firing individuals. *See generally* Anup Agrawal & Tommy Cooper, Corporate Governance Consequences of Accounting Scandals: Evidence from Top Management, CFO and Auditor Turnover (Oct. 2007) (unpublished manuscript), http://ssrn.com/abstract=970355 [http://perma.cc/S5YM-6FSS]. *But see* JONATHAN MACEY, THE DEATH OF CORPORATE REPUTATION (2013). Macey argues that reputational penalties are no longer sufficient to discipline management because even those who are criminally indicted, like Michael Milken, emerge with their reputations largely intact. *Id.* at 111-13. It is also important to keep in mind that executives may suffer reputational penalties from the discovery of the underlying misconduct, separate and apart from specific regulatory penalties.

2002.[68] After 2002, the mean market capitalization of companies facing SEC action was over six times greater than that of companies facing private litigation alone; pre-2002, the reverse was true.[69] Comparing private and public enforcement provides strong evidence that the SEC is not just pursuing more egregious violations in prioritizing larger companies; private litigants have even more incentive to target "deep pockets."[70] Another study, focusing on the options backdating scandal, supports a publicity-seeking theory: it found that the SEC increased related investigations—and decreased investigations of other crimes—as the level of media scrutiny of option backdating increased.[71] More troubling, the quality of investigations declined over the period, suggesting the SEC was scraping the barrel to accommodate public outrage, rather than investigating substantive violations.[72]

Although focusing on a "hot" issue may bring in fewer dollars,[73] both the "deep-pockets" theory and the "publicity-seeking" theory can be explained by the incentives faced by the agency and its officials. Niskanen's model of the budget-maximizing bureaucrat is helpful in understanding how these incentives operate.[74] Niskanen posits that bureaucrats attempt to maximize their agencies' discretionary budgets in order to maximize their own utility, and that they are largely successful in these attempts.[75] A bureaucrat's utility is determined by, *inter alia*, "salary, perquisites . . . , public reputation, power, . . . [and] output."[76] The "revolving door" of modern political careers adds an important gloss; even if salaries are standardized across federal agencies,

68. James D. Cox et al., *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893 (2005).

69. *Id.* at 902.

70. This incentive is generated partially because of the failure of the Private Securities Litigation Reform Act. *See* Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 972-73.

71. Stephen J. Choi et al., *Scandal Enforcement at the SEC: The Arc of the Option Backdating Investigations*, 15 AM. L. & ECON. REV. 542, 542-44 (2013).

72. *See id.* at 576. The study looked at stock price reactions to SEC announcements of investigations, follow-on private litigation, criminal prosecutions, the outcome of the SEC's investigation, and the magnitude of the accounting error as proxies for the quality of an investigation, all of which declined over the period. *Id.*

73. For example, companies targeted for backdating were smaller than those accused of other accounting fraud, and later investigations were less likely to generate monetary penalties. *Id.* at 565, 570-73.

74. *See* THE BUDGET-MAXIMIZING BUREAUCRAT: APPRAISALS AND EVIDENCE 4-6 (André Blais & Stéphane Dion eds., 1991).

75. *Id.*

76. WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 38 (1971).

officials within more powerful agencies with more complex regulatory regimes can demand higher wages upon entering the private sector.[77]

IV. ARE THERE ANY MEANINGFUL CHECKS ON SEC ENFORCEMENT?

The force of the incentives that the SEC faces in prioritizing its agenda is particularly troubling given the lack of meaningful checks on SEC enforcement power. Although all administrative agencies are theoretically "checked" by judicial review, in practice the judiciary does not provide much of a constraint on SEC enforcement actions. Like all administrative agencies, the SEC enjoys considerable deference in judicial review.[78] Because of the SEC's particular focus, it might receive even greater latitude: "[F]or the field of technical and economic regulations, agency expertise leaves the Justices less equipped to understand the issues than specialized agencies."[79] As a result, the SEC has a high win rate at trial: 80% since 2011, according to Chair White.[80]

Moreover, the SEC can avail itself of administrative proceedings that effectively bypass the judiciary. Administrative proceedings are overseen by administrative law judges—employees of the SEC—rather than Article III judges. There is no jury, and no right to discovery.[81] Consequently, the timeline for administrative cases is condensed compared to trial: administrative hearings must be completed within 270 days of the SEC's complaint. SEC reliance on these adjudications has grown rapidly; whereas civil cases outnumbered administrative proceedings as recently as 2005, there were nearly

77. MACEY, *supra* note 67, at 14; *see also* David Lucca et al., *Staff Report No. 678: The Revolving Door and Worker Flows in Banking Regulation*, FED. RES. BANK N.Y. (June 2014), http://www.newyorkfed.org/research/staff_reports/sr678.pdf [http://perma.cc/4795-4W3W].

78. Agency interpretations of their own regulations receive deference unless they are not "reasonable." Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 845 (1984) (citing United States v. Shimer, 367 U.S. 374, 382-83 (1961)).

79. William N. Eskridge, Jr. & Lauren E. Baer, *The Supreme Court's Deference Continuum, An Empirical Analysis (*Chevron *to* Hamdan*)*, 96 GEO. L.J. 1083, 1144 (2008); *see also* Steven Croley, The Scope of *Chevron* 2-3 (July 2001) (unpublished manuscript), http://www.americanbar.org/content/dam/aba/migrated/adminlaw/apa/chevronscopejuly.doc [http://perma.cc/U3KU-XBGY] ("The Supreme Court has made it clear that *Chevron* deference is not to be confined to interpretations occasioned by agency rulemaking, however, but extends also to agency interpretations made in connection with a formal adjudication, including enforcement actions.").

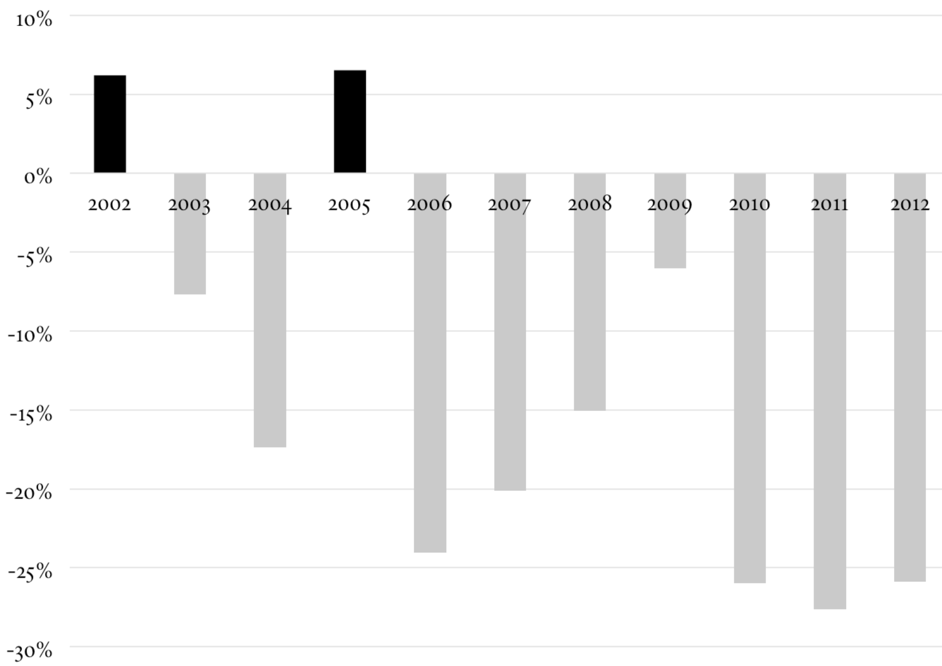
80. Andrew Tangel & Jim Puzzanghera, *SEC's Mary Jo White Wants Companies to Fess Up*, L.A. TIMES, Jan. 1, 2014, http://articles.latimes.com/2014/jan/01/business/la-fi-sec-white-20140102 [http://perma.cc/UB23-NGS9].

81. *See* John H. Sturc et al., *SEC Investigations and Enforcement Actions*, *in* SECURITIES LITIGATION: A PRACTITIONER'S GUIDE 15-30 (Jonathan Dickey ed., 2011).

twice as many administrative proceedings as civil actions in 2012.[82] Commentators expect this trend to continue, particularly because Dodd-Frank broadened the reach of these proceedings by enabling the SEC to impose financial penalties on any offender, rather than only those it directly regulated (for example, broker-dealers and investment advisors), as before.[83]

Figure 7.

ENFORCEMENT ACTIONS INITIATED: PERCENTAGE OF CASES BROUGHT AS CIVIL ACTIONS VS. ADMINISTRATIVE PROCEEDINGS[84]



82. *See infra* Figure 7. The SEC did not provide the 2013 breakdown between civil actions and administrative proceedings, contrary to previous practice.

83. *See, e.g.*, *2013 Mid-Year Securities Enforcement Update*, GIBSON DUNN 3 (July 15, 2013), http://www.gibsondunn.com/publications/Documents/2013-Mid-Year-Securities-Enforcement-Update.pdf [http://perma.cc/S8YB-P9HV].

84. Each bar represents the percentage of civil actions minus the percentage of administrative proceedings. For example, in 2002, 53.1% of cases were brought as civil actions and 46.9% as administrative proceedings, resulting in a 6.2% difference in favor of civil actions.

In reality, few public companies go through either judicial or administrative proceedings because most opt to settle instead. Litigation is particularly risky for a public company: even if it ultimately prevails, the uncertainty of pending litigation can be disastrous. The paradigm example of this phenomenon is Arthur Andersen. The Supreme Court ultimately overturned Andersen's guilty verdict, but it was "little more than a Pyrrhic victory": "Andersen . . . lost its clients after being indicted on obstruction of justice charges and has no chance of returning as a viable enterprise."[85] Moreover, "the pendency of an investigation places a cloud over the corporation that may inhibit its access to capital markets, chill relationships with vendors and customers, and distract and demoralize management."[86] Depending on the structure of the settlement, companies can also avoid an onslaught of follow-on private suits.[87]

Settlement is also preferable from the SEC's perspective, given the costs of litigation. Since "settled injunctive actions rarely receive any detailed judicial scrutiny,"[88] these actions ensure a quick "victory" that can be publicly touted.[89] Indeed, many critics have lamented the rise in "sue-and-settle" cases, in which the SEC charges a corporation, settles for large sums, but does not require

85. Linda Greenhouse, *Justices Unanimously Overturn Conviction of Arthur Andersen*, N.Y. TIMES, May 31, 2005, http://www.nytimes.com/2005/05/31/business/31wire-andersen.html [http://perma.cc/33BY-4KUE].

86. Sturc et al., *supra* note 81, at 15-2 to -3.

87. Admitting guilt in a settlement could expose defendants to "collateral estoppel": "This means that a defendant could, as a result of the admission in the SEC settlement, be precluded from challenging liability in the private civil litigation." *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. 79 (2013) (statement of Robert Khuzami, Director, Div. of Enforcement, U.S. Sec. & Exch. Comm'n).

88. Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 394 (2008) (emphasis omitted). The legal travail surrounding the SEC's settlement with Citigroup is also a case in point. The Second Circuit Court of Appeals overturned Judge Rakoff's rejection of the settlement deal with Citigroup on the grounds that "it is not within the district court's purview to demand 'cold, hard, solid facts, established either by admissions or by trials' . . . as to the truth of the allegations in the complaint as a condition for approving a consent decree." SEC v. Citigroup Global Mkts., Inc., 752 F.3d 285, 295 (2014) (quoting SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011)).

89. *See* MACEY, *supra* note 67, at 92 (quoting Peter J. Henning, *Behind Rakoff's Rejection of Citigroup Settlement*, N.Y. TIMES: DEALBOOK, (Nov. 28, 2011, 5:14 PM), http://dealbook.nytimes.com/2011/11/28/behind-judge-rakoffs-rejection-of-s-e-c-citigroup-settlement [http://perma.cc/Q62M-D526]).

anyone to admit responsibility.[90] The SEC recently restricted neither-admit-nor-deny settlements, but it is too soon to gauge the impact of this move.[91]

Even before the settlement or litigation phase of an enforcement action, the SEC's policy of penalizing non-cooperation further skews the outcome in the SEC's favor. It is surely sound public policy to encourage defendants to cooperate with investigations—some analysis even suggests that optimal enforcement requires some degree of self-reporting and compliance[92]—but the SEC has been accused of exerting undue pressure on defendants to divest themselves of appropriate legal protections, including the attorney-client privilege.[93] One study found that cooperation increased over time, particularly after the 1990 Remedies Act, and even more so after 2000.[94] Between 1978 and 1989, only 3.1% of enforcement actions cite company cooperation, compared to 63.4% in 2010.[95] Furthermore, researchers found that larger firms are more likely to cooperate than smaller firms; the average market capitalization of cooperators is $13.1 billion compared to $4.0 billion for non-cooperators.[96] In addition to the deep pockets hypothesis discussed above and the likelihood that large public companies will settle rather than litigate, the increased likelihood of cooperation on the part of large public companies provides yet another reason for the SEC to target them. The SEC can investigate with the company's help and then garner headlines by assessing hefty monetary penalties that firms

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90. *See, e.g.*, *id*. at 272-73; *see also* Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS, Jan. 9, 2014, http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions [http://perma.cc/RE29-SWMM] (discussing the reasons for the recent lack of prosecutions against high-level executives).

91. White, *supra* note 2.

92. Rebecca Files et al., Does It Pay for Firms to Cooperate with Regulators? 7-8 (July 7, 2014) (unpublished manuscript) (citing Jennifer Arlen, *Stumbling into Crime: Stochastic Process Models of Accounting Fraud*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 44 (Alon Harel & Keith N. Hylton eds., 2012)), http://ssrn.com/abstract=2026282 [http://perma.cc/VHW2-3GR8].

93. The Seaboard Report apparently generated a widespread perception that companies must waive attorney-client privilege to be seen as sufficiently cooperating (the so-called "culture of waiver"), which proved controversial for the SEC and DOJ. *See, e.g.*, Sturc et al., *supra* note 81, at 15-22 to -24.

94. Rebecca Files et al., The Monetary Benefit of Cooperation in Regulatory Enforcement Actions for Financial Misrepresentation 16 (Oct. 2012) (unpublished manuscript) (on file with author) [hereinafter Files et al., Monetary Benefit]. For a more recent version of the study, see Files et al., *supra* note 92.

95. Files et al., Monetary Benefit, *supra* note 94, at 16.

96. *Id*. at 19.

see as merely a "cost of doing business,"[97] all with only minimal checks to ensure that the agency is penalizing the appropriate actors or targeting the most egregious violations.

CONCLUSION

By every available metric—litigated cases won, billions of dollars assessed, number of headlines generated—the SEC's enforcement division has been remarkably successful in the past few years. Whether these efforts have been effective in protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation is not as clear. The SEC's use of monetary sanctions has grown rapidly, without much critical consideration given to the effects of the new focus on the alleged violators themselves or the market as a whole.

There are multiple reasons to be concerned. Particularly for public corporations, the source of the largest sums garnered and circularity and temporal problems may prevent optimal deterrence. The absence of deterrence is particularly concerning given that the SEC's budget grows in tandem with the growth in monetary penalties. The SEC's near-total discretion over its enforcement strategy raises an additional issue: if the SEC targets those with the deepest pockets or those most likely to garner publicity, then other equally or more culpable violators might be able to operate with impunity. Insofar as those violators will not otherwise be sanctioned by private investors, the SEC's approach is suboptimal. Yet without any checks, including judicial review, it is difficult to discern whether the SEC's approach is the right one in any individual case, let alone systematically.

The SEC has not always sought monetary penalties from securities law violators, as a punishment in itself or on behalf of harmed investors. Indeed, the SEC's initial remedies for violations of the 1933 and 1934 Acts were limited to injunctions and disgorgement of profits, although the latter was not widely used until the 1970s.[98] The SEC was not authorized to seek civil monetary sanctions until 1984, and then only for insider trading violations.[99] Indeed, both Congress and the SEC itself historically warned against the imposition of fines against public corporations. The legislative history of the Securities

97. MACEY, *supra* note 67, at 23; *see also id.* at 215-16 (concluding that "SEC regulators seek to enhance the power of their organization . . . [and] advance their own careers," and that "regulation has entirely lost its value as a signal of weak reputation").

98. Atkins & Bondi, *supra* note 88, at 383.

99. *See* Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, § 2, 98 Stat. 1264, 1264 (codified as amended at 15 U.S.C. § 78u-1(a)(1) (2012)).

Enforcement Remedies and Penny Stock Reform Act of 1990,[100] which initially granted the SEC authority to seek civil monetary penalties in enforcement cases, indicates that Congress was particularly concerned about inadvertently penalizing shareholders:

> [B]ecause the costs of such penalties may be passed on to shareholders, the [Senate] Committee [on Banking, Housing, and Urban Affairs] intends that a penalty be sought when the violation results in an improper benefit to shareholders. In cases in which shareholders are the principal victims of the violations, the Committee expects that the SEC, when appropriate, will seek penalties from the individual offenders acting for a corporate issuer.[101]

Similarly, in a 2006 statement,[102] the SEC differentiated between cases where penalties assessed against corporate violators would be appropriate and where they would not be:

> [T]he strongest case for the imposition of a corporate penalty is one in which the shareholders of the corporation have received an improper benefit as a result of the violation; the weakest case is one in which the current shareholders of the corporation are the principal victims of the securities law violation.[103]

This historical background suggests that there are viable alternatives to the current strategy. The SEC need not always impose monetary sanctions against corporations, and when it does so, it can tie the amount to the gains generated by wrongdoing. The SEC can also refocus its monetary penalties on individuals within corporations, potentially strengthening the deterrent effect of these penalties. Long before the SEC had the authority to pursue monetary sanctions, it availed itself of other regulatory tools, including censures, deregistrations, and cease-and-desist orders. All of these tools are still available—and are still used by the SEC—but they do not raise the concerns regarding self-interest or agency aggrandizement articulated above. Given the clear costs of centering its enforcement program around large-dollar sanctions and absent clear benefits of that strategy over alternatives, the SEC would be best served by refocusing its enforcement agenda accordingly.

100. Pub. L. No. 101-429, 104 Stat. 931 (codified in scattered sections of 15 U.S.C.).

101. S. REP. NO. 101-337, at 17 (1990) (quoted in *Statement of the Securities and Exchange Commission Concerning Financial Penalties*, *supra* note 19).

102. *See supra* note 19 and accompanying text.

103. *Statement of the Securities and Exchange Commission Concerning Financial Penalties*, *supra* note 19.

Because the SEC's current incentives likely preclude the agency itself from desiring such a change, other actors may need to intervene. Congress could clarify the goals toward which the enforcement program should be oriented. The courts could likewise meaningfully assess SEC actions and settlements, rather than "rubber-stamping" the cases that the agency brings. The result might just be a more robust and fair market that protects investors and deters potential violators better than the current system.

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