U. S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 272-2650

News Release

Remarks to

Twentieth Annual Rocky Mountain State-Federal Provincial Securities Conference
Denver, Colorado

October 16, 1987

Aulana L. Peters
Commissioner

The views expressed herein are those of Commissioner Peters and do not necessarily represent those of the Commission, other Commissioners, or the staff.

I am very pleased to have this opportunity to address Bob Davenport's famed Rocky Mountain Securities Conference.

In Commissioner Cox' two appearances at this conference, he addressed the question of what remedies were available to the Commission to deal with securities laws violators. 1/ In 1985, Charles suggested that the Commission should be prosecuting vigorously unlawful conduct by "indifferent" and "chronic" violators. 2/ I wholeheartedly agree. I would like to address this same issue but from a different perspective. There may be something in the water or the air of Denver that inspires SEC Commissioners to talk about "indifferent" or "chronic" violators of the securities laws. However, it is more likely that this recurring focus is caused by the fact that the rampaging Dow Jones industrial average of the current bull market (which has

---

1/ Commissioner Charles C. Cox, "Making the Punishment Fit the Crime -- A Look at SEC Enforcement Remedies," Remarks to the Eighteenth Annual Rocky Mountain State - Federal - Provincial Cooperative Securities Conference (October 18, 1985) (published by the SEC); Commissioner Charles C. Cox, "Small Issuer Disclosure Policy and the Fringes of Merit Regulation," Remarks to the Nineteenth Annual Rocky Mountain State - Federal - Provincial Cooperative Securities Conference (October 3, 1986) (published by the SEC).

2/ See Commissioner Charles C. Cox, "Making the Punishment Fit the Crime -- A Look at SEC Enforcement Remedies," Remarks to the Eighteenth Annual Rocky Mountain State - Federal - Provincial Cooperative Securities Conference at 4-7 (October 18, 1985) (published by the SEC).

been acting a little bearish recently) provides an almost irresistable lure to the unsophisticated investor, and thus, provides a fertile field for operations by the "indifferent" and "chronic" securities laws violator.

Investors, in their eagerness to share in the pot of gold promised by the bull market, seem willing to buy anything, and the Commission is making it easier for them to do so. During the last decade the Commission has undertaken several initiatives to facilitate the raising of capital by small corporate issuers, and thus has made it easier and less costly to reach investors. Therefore my remarks on remedies will focus on abuses of two specific Commission initiatives designed to facilitate access to capital by small businesses -- namely Regulation D and Form S-18.

Both Form S-18 and Regulation D have had a significant impact on the ability of small enterprises to raise capital from the public. The Commission adopted the Form S-18 Registration Statement in 1979 as a means of providing small issuers easier and faster access to capital markets through a simplified registration form. For example, registrants using the form need only two years of audited financial statements as opposed to the three years required by other forms. In addition, Form S-18 may be filed with the SEC regional offices where the staff specializes in handling this type of filing. Form S-18 may be used for cash

offerings by certain domestic and Canadian corporate issuers that are not reporting companies under the Securities Exchange Act of 1934. Initially, use of Form S-18 was limited to offerings of $5 million or less. In 1984, the Commission amended the form to raise the ceiling to $7.5 million.

According to a 1985 study by James G. Manegold, 3/ Form S-18 has been adopted by the majority of firms eligible for its use. The Manegold Study shows that from 1979 to 1984 approximately 80 to 85 percent of all the registrations of $10 million or less were for offerings under $5 million and "[t]he share of these small offerings going to Form S-18 relative to Form S-1 has been constantly increasing." 4/

> [I]t is clear that the growth in the number of effective registrations coincides with the availability of Form S-18. The implication is that the Commission's sensitivity to the needs of smaller concerns that are interested in going public, as witnessed by the adoption of Form S-18 and the continued broadening of its eligibility requirements may have encouraged more public offerings. 5/

Professor Manegold also suggests that the existence of Form S-18 may encourage some companies to go public that would not do so in its absence.

3/ See J. Manegold, "An Empirical Analysis of the New Issues Securities Markets: The Effects of the Form S-18 Registration Statement" (November 1985) (published study).

4/ Id. at 13-14.

5/ Id. at 36.

In 1982, the Commission took another step towards facilitating access to capital when it adopted Regulation D which simplifies and coordinates exemptions from the registration provisions of the Securities Act of 1933. The Securities Act of 1933 has always contained exemptions from its registration provisions for private placements 6/ and for "small" offerings below a certain dollar amount. 7/ Although these exemptions have always existed, the adoption of Regulation D 8/ changed the equation with respect to them in several ways, two of which are pertinent to the point I wish to make today.

First, through Regulation D, the Commission raised 9/ the small offering exemption from $2 million to $5 million. At the same time, the Commission raised the ceiling for offerings in which no specific disclosures must be given to purchasers from $100,000 to $500,000. Second, Regulation D makes the small offering exemption available to limited partnerships whereas its predecessor rule had been available only to corporations. These changes, taken together, transformed the manner in which

---

6/ Securities Act of 1933, Pub. L. No. 73-22, §4 (1), 48 Stat. 74, 77 (1933) (codified as amended at 15 U.S.C. 77d(2)).

7/ Id., §3(b), 48 Stat. 74, 76-77 (1933) (codified as amended at 15 U.S.C. 77c(b).

8/ Securities Act Release No. 6389 (Mar. 8, 1982).

9/ Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, § 301, 94 Stat. 2275, 2291 (1980) (codified at 15 U.S.C. 77c(b)).

unregistered offerings of securities are organized and marketed. In fact, Regulation D may be the single most important regulatory initiative contributing to increased access to capital markets during the last decade. 10/

Of course, as a regulator, the Commission is very much interested in and concerned with implementing new approaches that make the capital raising process less burdensome. However, by making that process easier, we may be making fraudulent conduct easier as well. Therefore, we must not permit our desire to facilitate access to capital to overshadow our obligation to protect the investing public. We must continue to balance the benefits gained from facilitating access to capital through deregulation with those costs paid in terms of investor protection. The balance is one that is tricky to maintain, but maintain it we must.

I hasten to add that the Commission's experience with Regulation D and Form S-18 does not suggest that, on an absolute scale, there are many more problems of fraud associated with the use of these forms than with other capital raising methods. The Manegold Study, which includes a risk analysis, indicates that

---

10/ The Commission recently adopted Rule 3(a)(12)(9) which eventually may rival Regulation D as a money raising device. Although securities issued pursuant to Rule 3(a)(12)(9) must be registered, they may be sold on an installment basis.

there is no detectable risk differential pattern for common stocks of IPO's registered under Form S-18 than there is for those registered under Form S-1. The Manegold Study's conclusions suggest that Form S-18 has not generated any significant new problems. 11/ Moreover, I am informed that the incidence of fraud and abuse are not any greater in the Regulation D area than any other. Nevertheless, based on the nature of enforcement actions initiated during my tenure, I have become concerned that Regulation D and S-18 offerings are a perfect haven for persons Commissioner Cox has identified as "indifferent" or "chronic" violators of the securities laws.

Since 1982, the number of securities issued under Regulation D has increased dramatically. In 1986, approximately $60 billion in securities were offered pursuant to Regulation D exemptions as compared to approximately $15.5 billion during the first full year Regulation D was available. What is troublesome is that we seem to be encountering more frequent use of Regulation D by "financial planners"/investment advisers marketing limited partnership interests in planner/adviser sponsored investments which are usually highly speculative and very risky. The persons involved in these questionable offerings tend to fall within the category of "indifferent" or "chronic" violators.

11/ Supra note 3 at 38-41.

I have similar concerns about S-18 offerings. In 1984 and 1985, the number of "blank check" filings on Form S-18 increased substantially. Upon investigation, the Denver Regional Office discovered that many of these filings involved undisclosed promoters financing start up companies using parking lot attendants and gas station employees as nominal officers and directors. Moreover, the persons funding and controlling the offerings (and at times misappropriating offering proceeds) all too frequently had a history of securities laws violations.

I do not believe that the answer to my concerns is a retreat from the liberalization of the rules governing the capital raising process. Quite to the contrary, I think it is safe to say that most people at the Commission consider Regulation D and Form S-18 viable, important alternatives in the capital formation process for young unseasoned companies and others. In my opinion, the answer is more forceful remedies. That is a solution which focuses on the problem -- namely unscrupulous promoters and issuers -- rather than the procedures being abused.

This brings me to a theme I have sounded in different contexts and other fora. There is a forceful remedy available to the Commission that is infrequently and reluctantly invoked that would be appropriate to deal with the abuses in the Regulation D and S-18 areas. The idea is to remedy egregious violations of the law, particularly by "indifferent" or "chronic" offenders, by barring these persons from acting as promoters, managers, or

advisors for or being associated in any way with issuers using Regulation D and Form S-18 to raise capital. In the past, I have espoused the benefits of such a remedy in a much broader context. I am limiting the scope of my argument today simply to avoid some thorny issues such as whether corporate bars imposed as a sanction for securities laws violations would be an impermissible, or at the very least an ill-advised, federal incursion into areas of corporate governance. For the record, I do not believe it is.

Before launching into a discussion of why I believe an officer/director/promoter bar would be not only a useful tool, but also a necessary one in the Regulation D/S-18 context, I will indicate why, in my view, the traditional remedies available to fight S-18 and Regulation D abuses, may be inadequate in some circumstances. Injunctions and, in appropriate cases, disgorgement as ancillary relief, are the remedies most frequently used in Commission enforcement actions against issuers and their managers. 12/ However, injunctive relief is not always an effective remedy against recurring securities laws violations, fraud and other egregious conduct.

12/ The Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) authorizes the Commission to seek a treble civil penalty in insider trading cases. Section 15(c)(4) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(c)(4) as expanded by the Insider Trading Sanctions Act of 1984, enables the Commission to institute administrative enforcement proceedings against any person subject to Sections 12, 13, 14 or 15(d) of the Securities Exchange Act who has failed to comply with those provisions.

First, courts seem to be increasingly unwilling to issue injunctions to the SEC simply for the asking. In the late 1970's and early 1980's the courts started demanding proof of likelihood of future misconduct in order to support a finding of irreparable injury. 13/ In many cases it is not possible for the Commission to meet such a burden of proof. As recently as last October, in SEC v. Tenney, 14/ a District Court refused to issue an injunction notwithstanding its conclusion that the law had been violated. The Court found that the defendant had violated Sections 17(a)(2) and (3) of the Exchange Act but refused to issue an injunction because of the defendant's lack of scienter. Just last week, in SEC v. Nordic Inc., Ltd., 15/ a District Court declined to issue an injunction notwithstanding findings of liability under the antifraud provisions of both the 1933 and 1934 Acts. Why? Because of the lack of proof or the likelihood of future violations. Although the burden may be more easily satisfied in the case of a recidivist, there is still no guarantee the injunction will issue.

13/ See, e.g., SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90 (2nd Cir. 1978); SEC v. Scott, 565 F. Supp. 1513 (S.D.N.Y. 1983), aff'd sub nom, SEC v. Cayman Islands Reinsurance Corp., Ltd., 734 F.2d 118 (2d Cir. 1984); SEC v. Geon Industries, Inc., 531 F.2d 39 (2d Cir. 1976); United States v. Mumford, 1980 Fed. Sec. L. Rep. (CCH) ¶ 97,648 (4th Cir. 1980).

14/ See SEC v. Tenney, C.A. No. C85-365J (D. Utah 1987).

15/ SEC v. Nordic Inc., Ltd., Civil No. C-86-291w (Utah October 8, 1987).

Secondly, the persons against whom the bar would be the most efficacious remedy, namely the "indifferent" and "chronic" violators, are the least likely to feel the opprobrium of an injunction. For the "indifferent" or "chronic" violator an injunction holds no or minimal sting and therefore has no or little deterrent effect.

Finally, injunctions have proven to be difficult to enforce at times. Injunctions, although framed in broad statutory language, generally refer to the specific unlawful conduct which was the subject of the enforcement proceeding in which the injunction is issued. Often in the case of a second or third proceeding against a recidivist subject to an outstanding injunction, the unlawful conduct differs from that upon which the injunction is based. In such cases there is a general reluctance to bring a criminal contempt proceeding because a court may construe the injunction narrowly and deny the Commission the requested relief. Notwithstanding these problems, the Commission has been filing more contempt actions lately. Nevertheless, a contempt proceeding is not the perfect solution in all cases. 16/

Setting aside for the moment, the question of whether a court would be willing to grant what may be perceived as a more drastic remedy than an injunction which it may already be

---

16/ Administrative orders issued pursuant to Section 15(c)(4) suffer from similar drawbacks, namely, lack of sting and difficulty in enforcement. The latter is a problem because enforcement requires the initiation of a judicial proceeding.

reluctant to issue, a bar or suspension does not suffer from any of the drawbacks I have enumerated. They have a very definite sting both psychological and economic. They deliver an unequivocal message that unlawful conduct will not be tolerated while depriving the violator of a potential source of income. In addition, it ensures protection of investors by removing a source of potential injury to the investor. Furthermore, bars and suspensions should be easier to enforce. Such remedies involve a blanket prohibition of any involvement in generic activity rather than a prohibition of specific conduct. Therefore, a violation of their terms should be more easily proved.

Finally, it should be easier to persuade the court to grant suspensions and bars as a matter of legal theory since arguments based on the defendants prior misconduct, lack of remorse and opportunity to commit future violations provide a perfectly legitimate and persuasive factual basis for issuance of a bar or suspension but may provide, at most, a tenuous basis for an injunction. Outside of the securities area, injunctions are usually granted where there is ongoing unlawful conduct or unlawful conduct about to occur. They are infrequently granted where the conduct is a fait accompli.

I realize that to the extent the courts are refusing to issue injunctions in SEC actions because they find injunctive relief draconian, they may be reluctant to grant a bar or sus-

pension. However, I am not arguing for abandonment of injunctive relief as a remedy, I am pointing out that a corporate bar is a preferable alternative or adjunct to injunctive relief in certain circumstances.

The Commission, of course, has the statutory authority to bar registered representatives, broker-dealers and investment advisers from the securities industry. Moreover, through Rule 2(e) it has some measure of control over those who practice law and accountancy before it. Nevertheless, the concept of a corporate bar or suspension is viewed by some as novel and controversial.

It is fair to say that not everyone at the Commission is as enthusiastic about this remedy as I. Although it has been applied in several cases involving recidivists and egregious violations of the securities laws, 17/ the Commission and the

---

17/ See SEC v. Florafax International, Inc., No. 84-C-937-B (N.D. Okla. Nov. 27, 1984), Litigation Release No. 10617 (Nov. 27, 1984), 31 SEC Docket 1425 (the SEC barred a repeat violator who was a key officer and majority shareholder of the corporation; in the absence of a bar, this individual would have had the opportunity and the incentive to cause the corporation to violate the law again). See also SEC v. San Saba Nu-Tech, Inc., No. 84-2921 (D.D.C. Sept. 19, 1984), Litigation Release No. 10531 (Sept. 19, 1984), 31 SEC Docket 625 (the two key officers were barred for five years because of their egregious conduct in connection with an attempted public offering of common stock); SEC v. Oak Industries, Inc., No. 85-1507 (KI) (S.D. Cal. June 25, 1985), Litigation Release No. 10801 (June 25, 1985), 33 SEC Docket 740 (the former Chairman of the Board and Chief Executive Officer of Oak Industries, Inc. was barred as a result of his participation in an extensive accounting fraud).

staff have proceeded with caution, mindful that some might question whether it is good policy for the Commission, in the absence of express statutory authority, to bar persons from holding corporate office. For my part, I have no doubt that such relief could be granted by a court in an injunctive action. Therefore, such a bar is a legitimate and appropriate demand to make in the context of a judicial proceeding, whether settled or litigated. Moreover, as a result of amendments to Section 15(c)(4) of the Securities Exchange Act of 1934, 18/ corporate bars against individuals who are not securities professionals should be available in an administrative context. 19/ Arguments to the contrary notwithstanding, 20/ I think it is clear that the language of the statute is broad enough to support such relief. Significantly, the Commission has already exercised similar authority in adopting the bad boy provisions of Rule 505(B)(2) (ii) and 252(c),(d),(e) or (f) of the Securities Act of 1933 which act as a de facto administrative bar under Regulation D and Regulation A respectively. It would be appropriate, at the very least, to carry the remedy over into the Form S-18 area, if not further.

18/ Securities Exchange Act of 1934, §15(c)(4), 15 U.S.C. 78o(c)(4).

19/ Daniel L. Goelzer, "Where Should the Buck Stop? -- Individual Responsibility in SEC Enforcement Actions," Address to the American Bar Association Committee on Federal Regulation of Securities at 15 (November 17, 1984) (published by the SEC).

20/ Howland, The Insider Trading Sanctions Act of 1984: Does The ITSA Authorize The SEC To Issue Administrative Bars?, 42 Washington and Lee Law Review 993 (1985).

Moreover, if the Commission has the authority to adopt a rule imposing an automatic, predetermined bar as a sanction for securities laws violations, a fortiori, it has the authority to seek the same remedy in the context of an administrative proceeding to enforce its own rules where the propriety of the sanction may be contested.

It has been argued that pursuit of the remedy of a bar from office in a publicly-held corporation is an inappropriate incursion into an area generally governed by state law (namely, the determination of who is qualified to serve as an officer or director of a corporation.) Moreover, it is also said that such a remedy runs counter to the federal philosophy of protecting shareholders through disclosure. In my view, assuming without admitting that this remedy constitutes an incursion into state law, it is a permissible one that is well within the area already designated as necessary and appropriate for federal control. More importantly, the approach suggested here would not constitute an a priori barrier to the national market place. It would operate as in a post facto denial of a privilege based on violations of the rules from which the privilege derives.

The chief concern expressed about the Commission's use of a corporate bar or suspension as a remedy is that it amounts to a denial of access to our national capital markets and smacks of merit regulation. In response to the objection I would point out that:

-- Since 1933 there has been no unfettered "right" to access to the national capital markets -- access is conditioned on compliance with federal securities laws.

-- Imposition of a bar does not preclude first time entry or even second time entry -- it operates against those who can not or will not comply with the law.

-- The remedy does not say the offender cannot be a businessman or entrepreneur, just that he or she within a narrow context cannot raise money from the public, or within a broader context, cannot manage a public corporation.

In the broader context, it is worth pointing out that Congress empowered the Commission to seek equitable relief for violations of the securities laws through the courts. While Section 21 of the 1934 Act specifies the kind of relief the Commission may seek, it does not expressly preclude requests for other kinds of relief. Moreover, both the Commission and the courts have acted under the assumption that the Commission may, as may any other litigant, appeal to the court's plenary equitable powers to fashion appropriate relief. Thus, the Commission has been able to obtain ancillary relief under the 1934 Act in the form of receivers, disgorgement, audit committees and accountings. In the context of a judicial proceeding, a bar from corporate office is simply another form of ancillary relief. It is certainly no more intrusive into corporate governance than requiring the formation of an audit committee or the appointment of a special master to examine corporate policies and procedures

with a view to recommending reform remedies the Commission has consistently and repeatedly obtained. 21/

Conclusion

I believe that it is appropriate to seek a bar or suspension of corporate officers, directors or promoters where the facts of the case are egregious and there is a well-founded concern on the part of the Commission that an injunction or an administrative order would be inadequate to deter future violations. I take comfort from the fact that there are others besides myself who endorse this idea. The Commission's General Counsel, Daniel Goelzer has suggested that corporate bars may be an available remedy under Section 15(c)(4). 22/ Moreover, the National Commission on Fraudulent Financial Reporting headed by former Securities and Exchange Commissioner James Treadway, recommended increased use of the corporate bar. 23/ The

---

21/ See, e.g., SEC v. Mattel, Inc., 4 S.E.C. Doc. 724, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,754 (D.D.C. 1974) where Mattel consented to a judgement that required it to appoint two unaffiliated directors, establish an audit committee and a "Litigation and Claims Committee." See also, SEC v. Mattel, Inc., 5 S.E.C. Doc. 241, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,807 (D.D.C. 1974) where Commission obtained Mattel's consent to a wide range of ancillary relief including the appointment and maintenance of a majority of unaffiliated directors for five years on a new executive committee and on the entire board, and the selection by the unaffiliated directors of a special counsel to select a special auditor.

22/ Supra note 19.

23/ Report of the National Commission on Fraudulent Financial Reporting (October 1987).

Commission stated that "a strong and effective regulatory and legal environment plays a critical role in preventing, detecting and deterring fraudulent financial reporting" and concluded that "stiffer penalties for corporate officers and directors involved in egregious conduct would be an effective deterrent.

The Treadway Commission's comments are relevant to the entire capital raising process and are particularly applicable to corporate financings under Regulation D and S-18. In this context the remedy would not be a bar from corporate office but would be a bar to use of Form D and Form S-18 to access the public capital markets. Moreover, to eliminate the threat to the investing public posed by the indifferent and chronic violator, I think the corporate bar or suspension in the broader sense would be the most effective remedy and one which the Commission should avail itself in the appropriate circumstances.