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ANCILLARY RELIEF AND REMEDIES:  
EXOTIC, EXTRAORDINARY OR JUST PLAIN EFFECTIVE?

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

ANCILLARY RELIEF AND REMEDIES:  
EXOTIC, EXTRAORDINARY OR JUST PLAIN EFFECTIVE?

I thank Irv Einhorn and Gerry Boltz for inviting me to speak to this distinguished group today.

My remarks today, which I am bound to warn you, reflect my own opinions and not necessarily those of the Commission or its staff concern one of the priorities on my personal agenda -- the enhancement and strengthening of the SEC's enforcement capabilities. In light of my background as a litigator, this focus should come as a surprise to none. I believe that the Commission must read its statutory mandate broadly and with a creative eye in order to enforce effectively the federal securities laws. Effective enforcement is particularly critical today in light of the deregulatory mode we are in. With effective enforcement of the securities laws as my theme, I would like to talk about ancillary relief and remedies.

First, my remarks will touch on some of the innovative remedies the Commission has used in the not too distant past and is beginning to employ with greater frequency. Secondly, I will focus on two newer remedies I believe should be pursued to their fullest.

Perhaps the best place to start is at the beginning -- for a securities lawyer, that's the 1930's. Those of you who have tensed may relax -- I am not going to treat you to a summary of the last 50 years. But I do wish to point out that the creation of the federal securities laws was aimed at insuring the integrity

of the American financial markets and the maintenance of investor confidence. To that end, both the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") empower the Commission to seek injunctive relief in the federal courts against persons who violate those statutes. In connection with those injunctive actions the Commission has obtained ancillary relief through the general equitable powers of the federal courts.

In addition, the Commission has administrative jurisdiction to "censure, place limits on the activities, functions or operations, suspend . . . or revoke the registration of certain securities professionals . . . ." The Investment Company Act of 1940 ("1940 Act") goes just a slight bit further. It provides expressly for the appointment of a receiver to manage the affairs of an investment company upon a showing of a material violation of the 1940 Act. As you can see, although the statutes could be broader, there is statutory authority expressly providing for a range of remedies in civil proceedings.

The question is how wide is that range. In its effort to craft relief designed to deter a repeat of a violation, the Commission has been actively shaping remedies that some have called exotic, others have called them extraordinary, but I call them effective! The more interesting of these remedies have taken the form of ancillary relief -- by that I mean a remedy/sanction other than and often imposed in addition to a traditional injunction, censure, suspension, or bar. Much of this innovative ancillary relief is not a by-product of litigated cases. By and

large, such relief has been imposed pursuant to negotiated consent decrees. This process has enabled the Commission and its staff to continue to weave meaningful relief from the thin cloth of the federal statutes.

Generally, the ancillary relief meted out by my colleagues in Washington, both past and present, falls roughly into three broad categories. First, and perhaps the oldest type of equitable relief imposed in the context of the securities laws, is the appointment of what I will call third party watch dogs, either a receiver, or special counsel or other expert to manage or monitor the affairs of a regulated entity. Second, the imposition of monetary relief, most frequently in the form of disgorgement of profits gained from one's illegal activity. Finally, many cases have remedied unlawful practices through the adoption of procedural undertakings and/or public disclosure of past transgressions (e.g. restatement of financials).

Before delving into some of the newer and, perhaps, more innovative approaches the Commission has used in some recent enforcement actions, let me just take a few minutes to discuss the more familiar ancillary remedies I have just mentioned.

Third Party Watchdogs: In a variety of situations, the Commission has effectively remedied different types of unlawful conduct by using variations on this theme. Receivers have been appointed when there was a fear that corporate assets may be wasted or when it appeared that the positions of corporate shareholders were in jeopardy due to mismanagement or fraud.

Similarly, the Commission has at times stepped into the world of corporate management, and, in egregious cases, insisted on the replacement of elected management with impartial third parties. It has also, on occasion, required the appointment of independent directors to a company's board (usually subject to prior court and Commission approval).

This type of ancillary remedy has included the appointment of a special counsel or consultant to review and investigate a registrant's internal procedures and then report the findings to the court. You may be aware of the Commission's much publicized settlement with First Jersey Securities, Inc. and its president, Robert Brennan a few months ago. First Jersey and Mr. Brennan consented to the entry of an injunction against future violations of the law. However, the consent further provided for a court-appointed independent consultant, with complete access to First Jersey's books and records, whose task was to review First Jersey's procedures and policies to insure its compliance with the appropriate statutory and self-regulatory guidelines. Upon completing his examination, the consultant made recommendations for improving procedures to First Jersey's Board of Directors in the form of a report.

Monetary relief. Justification for the imposition of monetary relief by the SEC can be made on the theory that violators of the law should not benefit by their illegal activity.

Today, it is fairly well settled that a court of equity, at the request of the Commission, can order disgorgement, rescission or restitution in the appropriate circumstances. Therefore, disgorgement is now a regular weapon in the SEC's enforcement arsenal and it is used, since the landmark decision in Texas Gulf Sulphur, to deprive securities laws violators of any ill-gotten gains received as a result of their unlawful conduct. The disgorgement remedy is most frequently used in insider trading cases such as SEC v. Thayer but is also to recoup monies generated in fraudulent securities offerings.

By enacting the Insider Trading Sanctions Act, ("ISTA") Congress has recently added to the monetary remedies available to the Commission. This statute permits the Commission to seek up to three times the amount of profits obtained or losses avoided by those who trade while in possession of material non-public information. I hope that the very existence of this statute and our demonstrated willingness to use it will act as a deterrent to insider trading.

Undertakings and Restatements: The final type of ancillary relief which is no longer considered "exotic" is the required filing with the Commission of corrected documents. Most frequently, this type of remedy is employed to rectify material omissions or misstatements made in connection with proxy statements or financial statements filed with the Commission. Other ancillary relief, such as undertakings, is often coupled with the restatement.

There is no doubt that the Commission has been imaginative in the past in tailoring remedies that effectively implement its Congressionally-mandated goals. We would like to think that this is part of the reason that the United States financial markets are secure, and that there is a favorable public perception of the integrity of those markets. Administrative sanctions and injunctive relief, along with the ancillary remedies I've discussed, serve as meaningful deterrents, as well as powerful remedial tools. But, the SEC's mission is far from complete. I have a growing concern that our enforcement tools could, perhaps, be more effective when we are dealing with those who commit more egregious violations of the securities laws, and in particular, when dealing with repeat offenders. I do not want the securities industry to be viewed as a revolving door for recidivists. Consequently, it appears that we may have to modify our approach in order to deter such violators.

Before discussing the two new approaches I mentioned earlier, I would like to point out that in our search for the "new" or "innovative" one sometimes overlooks readily available remedies which could be pursued. We should not ignore or shy away from any of the tools Congress has laid at our doorstep. For example, the Commission has the authority to seek either civil or criminal contempt when a previously entered injunction is violated. For some reason, the Commission has seldom exercised its right to initiate a contempt proceeding. I realize that there may be some unique problems in bringing contempt actions particularly in the criminal area, and after the passage of time. Nevertheless, some

of us at the Commission, including me, are focusing on this remedy. As a result, I expect you will be reading more and more frequently headlines announcing the Commission's involvement in contempt actions. Perhaps the specter of incarceration will have the desired deterrent effect on those recidivists who obviously are not troubled by the thought of yet another injunction.

Lately, another idea for ancillary relief has surfaced at the Commission which would allow the Commission greater flexibility in administering the federal securities laws -- that idea is to remedy egregious violations of the law, particularly by repeat offenders, by barring these persons from acting as corporate officers or directors and/or engaging in the securities business at all. What makes the idea novel is that the bar would be applied to non-securities industry professionals. Of course, the Commission has the statutory authority to bar registered representatives, brokers/dealers and investment advisors but that does not solve the problem of what to do about the irrepressible entrepreneur who consistently and repeatedly misleads the investing public through false offering prospectuses, registration statements and periodic reports. Some have questioned whether the Commission is entitled 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 an appropriate demand to make in the context of a settlement.

Dan Goelzer, the Commission's General Counsel, suggested in a speech earlier this year that as a result of amendments to



Section 15(c)(4) of the '34 Act corporate bars, as well as other innovative remedies, are now possible in an administrative context against individuals who are not securities professionals. Section 15(c)(4) was adopted by Congress last year as part of the Insider Trading Sanctions Act package. In its present formulation, that statute enables the SEC to institute public administrative proceedings against any person for violations of specified sections of the Securities Exchange Act. Even more important than who falls within Section 15(c)(4)'s scope, is the flexibility that Section 15(c)(4) now gives the SEC in meting out meaningful sanctions. The Commission is empowered, pursuant to the provision, to order violators to comply with the Act "upon such terms and conditions that the Commission may specify." This language should provide considerable latitude in fashioning relief. I like Mr. Goelzer's rationale and agree with his conclusions. I applaud the insight Congress had when it granted us the much needed flexibility to promote compliance with the laws we administer.

There are many instances in which it would be appropriate to forbid a non-securities professional from acting in a specified capacity for a limited but defined period of time. Or, perhaps to curtail the activities of an individual within a specified realm. Recently, the Commission has used the bar device in a couple of consent decree situations, one of which involved a settlement with Florafax International. A Commission investigation revealed that Florafax had employed improper

accounting practices which resulted in the material overstatement of its financial conditions. In addition, it was discovered that Florafax's Chief Executive Officer and Chairman knowingly engaged in the improper accounting practices and actively concealed the fraud from Florafax's independent auditors. Rather than litigating the case, the defendants offered to settle for an injunction against future violations and for a restatement of the prior financials. Moreover, the company's Chairman and Chief Executive Officer was enjoined and was required to resign from his position, as well as refrain from serving in the capacity of corporate officer of Florafax for a period of three years.

The bar on Joseph Hale was viewed as a novel twist to the settlement, and the question has been asked whether such extraordinary relief was justified. However, given the extent of Hale's involvement in the unlawful activities, his controlling interest in Florafax, and the multi-year nature of the violations, the Commission was convinced that nothing short of a bar would ensure Florafax's future compliance with the securities laws. I believe that it is appropriate to resort to this type of specialized ancillary relief where the facts of the case are sufficiently egregious and there is a well-founded concern on the part of the Commission (or the court, if the matter is litigated) that future violations are likely.

This is not to say that I think a bar from corporate office is appropriate in every case. Indeed, it should not be applied routinely, without regard for the circumstances. On the

other hand, I am reluctant to label the remedy as "extraordinary", and thereby, imply that it should rarely be invoked. As a Commissioner, I'm very concerned about recidivists, and if we have a tool effective for curtailing the activities of repeat offenders, it should be used.

Very recently, the Commission took a new approach to the concept of what constitutes appropriate ancillary relief when it voted to accept an offer of settlement from the broker-dealer firm of Thompson McKinnon involving payment of cash. A Commission investigation determined that Thompson McKinnon was using customers' fully-paid securities in its stock loan program in contravention of Commission rules on customer protection -- in our view, a serious violation. In trying to fashion an appropriate remedy for Thompson McKinnon, the Commission was somewhat constrained, not only by the language of Section 15(b)(4), but also by the size of Thompson McKinnon. You will recall that under Section 15(b)(4), the Commission could censure, suspend, or bar a broker-dealer for unlawful conduct. In my view, the facts of Thompson McKinnon required more than a censure but less than a bar or suspension. Focusing on the language of Section 15(b)(4), which permits the Commission to impose conditions or limitations on the operations or activities of a broker-dealer, the staff negotiated an innovative settlement with Thompson McKinnon. Pursuant to that settlement, Thompson McKinnon was required to tender

to the Securities Investor Protection Corporation ("SIPC") the profits it earned from its stock loan business over a predetermined 10-day period. This remedy was obtained by settlement in the context of an administrative proceeding, but I see no reason why it should not be available in a civil injunctive action.

Some might and indeed have questioned the SEC's authority to secure this type of relief -- some might call it a fine or a penalty. I, on the other hand, am not the slightest bit uneasy about this settlement. Section 15 of the 1934 Act clearly states that the SEC has the authority to impose limitations on the activities of registered broker-dealers. The payment to SIPC is just a limitation, novel perhaps, but certainly not ultra vires!

When one thinks about limited ways in which the SEC can sanction effectively certain violators of the law, it suggests we might need legislation granting the authority to obtain relief in the form of civil money penalties. The ability to impose fines would give the Commission flexibility and clout in sanctioning.

I noticed as I started to mention the possibility of fines some of you started to squirm in your seats, but the idea of a fine is far from new and certainly should not be especially discomfoting. Many regulatory agencies are already empowered by Congress to fine violators of the statutes they administer. Take for example, the Commission's sister agency, the CFTC. Since its inception, the CFTC has been fining commodities/futures law

violators for a wide range of infractions. Moreover, it is hard for me to conceive that the Commission, if given such authority, would abuse its discretion and impose arbitrary or capricious fines. After all, you don't see us running amuck and wantonly putting broker-dealer firms out of business pursuant to our current powers. The Commission has also applied the treble damage provisions of ITSA with restraint. Why would we be expected to operate differently when it comes to imposing fines?

What are some of the advantages that would be derived from the imposition of civil money penalties? First, the imposition of fines could be used to call attention to the egregiousness of a particular violation. A fine, coupled with an injunction, or an administrative remedy would signal the seriousness with which the Commission views the violative conduct. Similarly, the imposition of fines would be meaningful in distinguishing between different levels of culpability. The flip side of that example is that a civil money penalty may be used in the appropriate situation instead of what would otherwise be a draconian sanction such as the revocation or suspension of a broker-dealer firm. With respect to large firms, the use of civil money penalties may help us get around the "all or nothing" dilemma of sanctioning.

Another benefit of fines is the deterrent effect they may have on repeat offenders who sometimes, I think, take pride in scoring another notch on their belt each time they are enjoined.

A recent letter to the editor of the L.A. Times \*/ questioned the meaningfulness of Commission injunctions as a deterrent to future violators and suggested that they say no more than "go, my child, and sin no more." If that is the case, fines will increase the downside risk of violating the securities laws.

Opponents of civil money penalties argue that there are potential adverse consequences which will arise from the imposition of fines. They claim that the Commission's ability to settle cases will be impaired and that as a result, we will often be engaged in protracted litigation. I really do not understand why adding another weapon to our arsenal would make it more difficult to settle. It should make it easier. Another argument which has been raised by opponents of fines is that imposing and collecting fines will be cumbersome. They ask how will the penalties be assessed, who will determine the amount of the penalty, and to whom will the money be paid? These are important questions but they can be resolved easily either through legislation or rulemaking. There are certainly a number of models already in existence which the Commission could follow to overcome these obstacles. In any event, it is worth noting that the Commission seems to have no difficulty in imposing and collecting filing fees. Moreover, if the Commission is deemed competent to know when it is appropriate to censure or suspend or bar someone, certainly it should have sufficient acumen to impose appropriate fines in the appropriate circumstances.

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\*/ William K. Bachelder, "Letters to the Editor," The Los Angeles Times, August 4, 1985, Section 5, p. 3.

Conclusion. the Commission is charged with protecting our financial markets and with administering the federal securities laws. Innovation is the name of the game -- we must be at least as innovative as the lawbreakers, and they are innovative, indeed. I look forward, during the rest of my tenure at the Commission, to helping mold the clay that Congress has given us to insure that we meet our goals. I hope, too, that we will be so successful in shaping creative remedies that they will no longer be deemed to be "exotic" or "extraordinary" -- but just effective!

Thank you.