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**News
Release**

**MAKING THE PUNISHMENT FIT THE CRIME --
A LOOK AT SEC ENFORCEMENT REMEDIES**

Remarks to

**Eighteenth Annual Rocky Mountain
State-Federal-Provincial
Cooperative Securities Conference**

**Denver, Colorado
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**Charles C. Cox
Commissioner
Securities and Exchange Commission
Washington, D. C.**

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

Over the past several years, the Commission has wrestled with various ways to expand or modify the remedies available for use against those who violate the federal securities laws. In 1981, the Commission announced a long-range study of enforcement remedies, with a view toward legislative recommendations. 1/ More recently, the Commission incorporated a novel idea -- a civil fine -- into the Insider Trading Sanctions Act of 1984. 2/ And there have been discussions by Commissioners and staff about other forms of relief, such as different types of administrative proceedings, or the use of a court's equitable powers to bar an individual from being an officer or director of a public company. 3/ I'm not suggesting that all of these alternatives should be adopted, but they are proposals that suggest, if not a trend at the SEC, at least a certain restlessness when faced with different types of violations of the laws which we are charged to enforce.

1/ In the Fall of 1981, the Director of the Division of Enforcement, John M. Fedders, announced that the Division would conduct a review of the adequacy of the sanctions and remedies available to the Commission, involving three distinct inquiries:

1. Whether there are ways to increase the level of risk for those who violate the securities laws;
2. Whether the Commission should have greater ability to tailor remedies in enforcement proceedings to the circumstances of a particular case; and
3. Whether it is possible to enhance the ability of the public to distinguish between violations of the federal securities laws.

The results of this study were legislative recommendations presented to Congress in 1984. See letter of Feb. 28, 1984 to Hon. Alfonse M. D'Amato, Chairman of the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs from John S.R. Shad, Chairman, Securities and Exchange Commission, transmitting amendments to Sections 15(c)(4), 17A(c)(3)(A), and 24 of the Securities Exchange Act of 1934.

2/ See Section 21(d)(2)(A) of the Securities Exchange Act of 1934. For a discussion of enforcement remedies in the insider trading area, see H. Rep. No. 355, 98th Cong., 1st Sess. 7-8 (1983).

3/ See "Where Should the Buck Stop? Individual Responsibility in SEC Enforcement Action," Address to the American Bar Ass'n Committee on Federal Regulation of Securities (Nov. 17, 1984) (remarks of General Counsel Daniel L. Goelzer); 16 Sec. Reg. & L. Rep. (BNA) 1487 (Sept. 14, 1984) (remarks of Commissioner James C. Treadway, Jr.).

The problem responsible for all of this discussion and head-scratching, as I see it, is this: there is a diverse population of securities law violators, whom the Commission must meet with an essentially uniform response. Whether in administrative proceedings or injunctive actions, the Commission's prime remedy is to exact a promise from the violator that he, she or it will not violate the securities laws in the future. You notice that I avoided stating that the violator promises never to do it again, for typically these individuals officially "neither admit nor deny" that they have violated the law. ^{4/} Some observers have suggested that this promise is an inadequate tool -- and that it is being overwhelmed by diverse, novel and repeat violations. However, it appears to me that this promise can be carefully crafted -- "tailored," if you will, to fit our "customer," the securities law violator. The concern of the SEC as a tailor, of course, is not the comfort of our customer, but rather to make the garment as binding as the circumstances require.

When the Commission relies on this promise as its major enforcement remedy to be applied in many varying situations, there are different parts of the promise to which it must give careful attention:

- ° what the violator promised to do or not to do,
- ° how long the promise runs, and
- ° the fate of a broken promise.

It is in these areas that the Commission has the most potential for meting out remedies which fit the violation.

But who are we trying to tailor these remedies to fit? To answer this question, and to do some rudimentary tailoring, I will first look closely at our "customers," that is, the different types of securities law violators.

Variations on a Theme of Illegal Conduct

As I have heard enforcement cases which are brought before the Commission, I have identified at least four different types

^{4/} This posture stems from Commission policy against denials in settlements. Rule 5(e) of the Commission's Rules for Informal and Other Procedures, 17 C.F.R. § 202.5(e), provides that, in accepting consents in civil suits or administrative proceedings, "it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur."

of violators. I will discuss them roughly in order from the least serious to the most serious.

First, there is the "inadvertent violator." This may be, for example, a mutual fund out of compliance with one of the Commission's many requirements under the Investment Company Act, 5/ or a registrant under the Securities Act who has attempted a novel accounting or disclosure treatment. Often in these cases, the threat of Commission action may alone be an adequate remedy.

Second, there is the "repentant violator." This may be a promoter who, although having proceeded with a fraudulent unregistered offering, undertakes to disgorge the proceeds and submit to a permanent injunction or bar if one is applicable. Although sometimes the sincerity of these penitents may be questioned, usually the normal Commission remedies are adequate.

Third, there is the "indifferent violator." This may be an individual who deftly sidesteps previous Commission actions, complying with the letter but ignoring the spirit of previous injunctions or orders. Or it could be a registered representative who is temporarily barred by the Commission only to be rehired with a substantial raise by another firm, because his or her sales practices, although questionable, bring results. Or it could be an issuer who has adopted an incorrect accounting or disclosure method, but firmly believes it was correct. These violators admit that the Commission did indeed find a violation, but they attach no approbation to it. It is no condemnation, no censure, but rather one of the many costs of operating in a regulated environment.

Finally, there is the "chronic recidivist." This individual may personally view the Commission's programs as a bane to free enterprise, and its punishments as wholly unnecessary. To these individuals an SEC injunction is not even a cost of doing business, but merely a temporary annoyance to be endured, consented to, and then forgotten.

Needless to say, I believe that the violators in these last two groups -- the indifferent violator and the chronic violator -- are the Commission's toughest customers when it comes to tailoring effective enforcement remedies. Let's look at these two types in a little more detail.

5/ Certain rules under the Investment Company Act of 1940 require daily computations in order for a registrant to comply, for example, the pricing of money-market funds and other redeemable securities. See Investment Company Act Rules 2a-1, 2a-4, 22c-1. Failure of compliance for even a day or two is considered a serious matter. See, e.g., the time allowed to make alternate foreign custody arrangements under Rule 17f-5, discussed in Investment Company Act Release No. 14548, 50 Fed. Reg. 24540, 24541 (1985).

The Indifferent Violator

The person whom I call the "indifferent violator" does not attach any approbation to a violation of the federal securities laws, but rather proceeds in business apace as if nothing had changed. Two recent examples of cases before the Commission which I believe could be said to involve such individuals are the cases involving First Jersey Securities 6/ and Mr. Adrian Antoniu. 7/ First Jersey is a case that doesn't involve a "violator" as such, for as Mr. Brennan was quick to point out, the firm did not admit to any violations of the federal securities laws. Nonetheless, it consented to an injunction against future violations of SEC Rule 10b-6, which prohibits sales by a broker-dealer while engaged in a public distribution. The Commission turned to some unique remedies in the First Jersey case, including the appointment of a consultant to review the firm's procedures. 8/ Mr. Antoniu, on the other hand, can be appropriately termed a violator, for he pled guilty to criminal violations of the federal securities laws. In his positions at Morgan Stanley and Kuehn, Loeb and Company, he provided inside information on several occasions to accomplices who traded while in possession of that information. Although he was prosecuted for this conduct, 9/ Mr. Antoniu recently applied to become associated with a broker-dealer. Apparently, Mr. Antoniu believed that, since his rehabilitation was complete, there was no further reason to prevent his future dealings in the securities industry. In that case, the Commission responded by denying Mr. Antoniu's request for association. 10/

6/ See SEC v. First Jersey Securities, Inc., 83 Civ. 0483 (S.D.N.Y.), Litigation Release No. 10616, 31 SEC Docket 1423 (Nov. 26, 1984).

7/ See Securities Exchange Act Release No. 22383, 33 SEC Docket 1574 (Sept. 3, 1985).

8/ See Litigation Release No. 10616, 31 SEC Docket at 1424. Alan R. Bromberg was originally appointed as a consultant, but was replaced by Benjamin Lubin, who completed his report to the court on June 15, 1985.

9/ United States v. Antoniu, 80 Crim. 742 (S.D.N.Y. Nov. 13, 1980). Antoniu received a 39-month suspended sentence and probation, and was fined \$5,000. There were six other criminal prosecutions on these facts, as well as an unsuccessful civil suit. See United States v. Newman, 664 F.2d 12 (2d Cir. 1981); Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983).

10/ See Securities Exchange Act Release No. 22383, 33 SEC Docket at 1575-76. For another recent similar case, see Stephanie J. Hibler, Securities Exchange Act Release No. 22067, 33 SEC Docket 205 (May 23, 1985).

One issue that frequently arises with respect to individuals whom I call "indifferent violators" is the length of time that a Commission remedy should remain in effect. This may come up when originally structuring the settlement of an injunction or an administrative proceeding, or in later applications for relief from an injunction or Commission order. In First Jersey, for example, the special examiner was to make one report within ninety days, although the injunction is permanent. In the case of Mr. Antoniu, his bar from association with a broker-dealer was made permanent.

My experience indicates that the word "permanent" may not always mean what it says. It is apparently accepted wisdom that inside every permanent SEC order or injunction -- despite its broad, unwavering terms -- is a temporary one struggling to get out. For example, individuals have applied to the Commission for relief from "permanent" remedies one or two years after they have been imposed. 11/ The applications may be accompanied by detailed statements of hardship that the individual or firm may be suffering due to the SEC action. 12/ The same arguments are often made in settlement negotiations, before the relief is structured and presented to the Commission for approval.

Although I do not mean to suggest that the Commission does or should turn a deaf ear to those who bring forth instances where our remedy has swept beyond or outlived its original usefulness, there are many cases which highlight the "indifferent violator" who merely assumes that the SEC simply didn't say what it meant or mean what it said when the original proceeding was concluded. I believe the assumption in such cases should be that the Commission did mean to do exactly what it did. The natural consequence of a bar from association with a broker-dealer, or an investment adviser, or a permanent injunction from future violations of the registration provisions, or an undertaking to adopt special procedures, or a provision for disgorgement, is that substantial hardships may result. The Commission is aware that its remedies may impose restraints for what appears to be a very long time. If an individual or firm petitions for relief based not on changed circumstances but on a general belief in

11/ Such petitions for relief are authorized under Securities Exchange Act Rule 19h-1, 17 C.F.R. § 240.19h-1, and Rule of Practice 29, 17 C.F.R. § 201.29.

12/ This information is, of course, relevant but not specifically requested for relief from administrative orders. See Securities Exchange Act Rule 19h-1(e)(3); Rule of Practice 29(d). Hardship is, however, a specific consideration in modification or dissolution of injunctions. See Block & Barton, SEC Enforcement Actions -- Time for the Self-Dissolving Injunction, 11 Sec. Reg. L. J. 163 (1983); SEC v. Clifton, 700 F.2d 744 (D.C. Cir. 1983) (refusal to dissolve injunction affirmed).

the clemency or forgetfulness of the Commissioners and staff, I believe this is a prime indicator that we have an "indifferent violator" on our hands, and that modification of the remedy is not warranted.

The Chronic Violator

The person whom I term the "chronic violator" appears less than indifferent about the federal securities laws. The indifferent violator, while perhaps not believing that he or she did anything wrong, at least realizes that the costs of an SEC or court proceeding and remedy make a repeat of such conduct unwise or at least impracticable. In contrast, the chronic violator would attach no significance to the violation he or she committed, and would ignore the remedy as well. Consider the circumstances of Joseph Hale and his careers at World-Wide Coin Investments and Florafax International. During Mr. Hale's tenure at World-Wide Coin, he engaged in violations of the antifraud, financial reporting, and accounting controls section of the Securities Exchange Act. The Commission injunction in that case 13/ was followed by a criminal conviction for securities fraud and perjury. 14/ Nonetheless, after his career at World-Wide Coin, Mr. Hale turned to Florafax International, purchased a substantial portion of its stock, and directed further violations of the financial reporting and accounting controls provisions. Mr. Hale consented to a second permanent injunction, disgorgement, and a three-year bar from the executive offices of Florafax. 15/

I believe that the story of the chronic violator is especially appropriate here in the land of "penny stocks" involving speculative oil or mining developments. It has been my experience that many chronic violators may search out several of these kind of schemes. We find individuals whose names recur in Commission enforcement memoranda. The violations typically involve the fraudulent sale of unregistered undivided interests in some type of promised natural resource, or elementary market manipulation by individuals

13/ See SEC v. World-Wide Coin Investments, Inc., 567 F. Supp. 724 (N.D. Ga. 1983).

14/ Hale's conviction was recently affirmed on appeal. United States v. Hale, No. 85-8128 (11th Cir. Sept. 24, 1985).

15/ SEC v. Florafax International, Inc., No. 84-C-937-B (N.D. Ok.), Litigation Release No. 10617, 31 SEC Docket 1425 (Nov. 27, 1984).

or their brokers in thinly traded and unlisted stocks. 16/ In each case, little significance is attached to the one or more cases of the same name which preceded it.

Efforts to Tailor the Commission's Response to Illegal Conduct

I believe this gives a good picture of our "customer"-- the individual or firm for whom we must fashion an appropriate remedy. It is someone -- natural or corporate -- who characterizes an injunction as a victory, who pursues business as usual until the SEC comes around again to find the same kind of misconduct, or who subscribes to the apparently widely-held view that time heals all wounds, or alternatively that the Commission has a very short institutional memory.

The problem can be simply stated: the individuals or firms involved do not take the SEC's remedy seriously. In some cases, the Commission appears to be wholly without adequate remedies. Disgorgement may not be possible where the fraudulent profits have long since dissipated; injunctions against the major malefactors may be impossible or ineffective since they have or soon will retire from the business, only to enter under a different name or in a different capacity. The Commission finds its injunctions, if issued, are forgotten only a few years later -- and its permanent bars are the subject of applications for relief in the same period of time. It is ironic that a permanent bar in an administrative proceeding may be viewed as a less severe remedy than a time-limited bar, in the same sense that a sentence of three-to-twenty years, subject to early parole, may actually be shorter than a fixed sentence of two years. But if the problem is simple, the answer is equally simple: the SEC must impose remedies that are to be taken seriously. I believe there are several different ways that this can and should be done.

The Commission brings various types of administrative proceedings against broker-dealers, investment companies and advisers, attorneys, accountants, and others. 17/ We can and do seek significant remedies in cases of serious misconduct. In most cases, this should include a bar from reassociation which

16/ See State Moves to Restrict Blind-Pool Investments, Salt Lake Tribune, Sept. 29, 1985, discussing the Salt Lake "blind pool" market, "where money is raised simply on salesmen's promises," followed by "promoters trading among themselves to artificially raise the price."

17/ See, e.g., Sections 15(b)(4), 15(b)(6), 15(c)(4) and 19(h) of the Securities Exchange Act of 1934; Sections 203(e) and (f) of the Investment Advisers Act of 1940; Section 9(b) of the Investment Company Act of 1940; Rule 2(e) of the Commission's Rules of Practice.

runs for a significant period of time, and often a permanent bar from acting in many capacities is appropriate. Consider the analogous situation involving misconduct and bars relating to investment companies; Congress has determined that serious bars are appropriate. Section 9(a) of the Investment Company Act provides for an automatic bar from association with any investment company or adviser of any person who has been convicted of a crime or is subject to an injunction involving any one of several areas of conduct related to the securities industry. The bar can be relieved by the Commission, if it finds that the terms are unduly or disproportionately severe, or that the bar would be against the public interest or the protection of investors. This reflects sound judgment that, absent a specific finding by the Commission, individuals who have shown propensities for misconduct should not be allowed any access to large, liquid pools of other people's money.

Although the further remedy of a bar from the boardrooms of public companies has been suggested, I do not believe that such a remedy should be pursued by the Commission. Such a bar would be analogous to those which the Commission is explicitly empowered to levy against persons dealing with investment companies and against broker-dealers, as I just discussed. ^{18/} However, the Commission is charged with direct oversight of these industries -- "merit regulation" in some senses -- that is absent in its regulation of other public companies, which is premised instead on full disclosure. I do not believe that the Commission should assume a fiduciary role if it is not explicitly given to us. Surely we have enough to do keeping the houses of the securities industries in order. Where public companies are concerned, I believe that our full-disclosure mandate should prevail in this area as well. So long as the past violations of an existing or hopeful officer or director are disclosed to the shareholders, they should be permitted the choice. Where the power to bar is specifically granted, however, I believe it is important for the Commission to use it liberally.

Another way in which the Commission can ensure that its remedies are taken seriously is to place follow-up conditions on relief. These are provisions that would require continuing oversight by someone approved by the Commission, or further disclosure by the violator, or some coercive measures to ensure compliance. For example, the Commission has required that an individual or firm hire a special counsel or other individual to report to the Commission on modifications made in accordance with the Commission's order. Alternatively, this obligation is sometimes imposed on the individual or firm itself, who

^{18/} See supra note 17. The most recent case seeking a bar from public companies is SEC v. Forma, 85 Civ. 3820 (CSH) (S.D.N.Y.) (filed May 24, 1985), Litigation Release No. 10766, 33 SEC Docket 317 (May 24, 1985).

undertakes to report back to the Commission, certifying that it has complied with its earlier promises. 19/ In some cases, further or earlier review is required by private sector professional organizations, or by self-regulatory organizations. 20/ In proceedings involving accountants, broker-dealers, investment advisers, and exchanges, the Commission has imposed a ban on new investment products or solicitation of new customers or clients until existing problems are corrected. Each of these suggests ways in which the Commission can tailor its remedies to the "indifferent violator," the individual or firm that simply waits for the Commission to come around again. The remedies place the burden on the violator to establish its present and continuing compliance.

However, to me the problem of overriding importance is the chronic recidivist -- the individual or firm to whom an SEC action means little or nothing. I believe that the Commission must take steps to realign the priorities of the recidivist, to indicate that repeat violations will not be tolerated. Such steps would include broad injunctions or orders prohibiting future violations, encompassing the area of the present violation and all areas which are reasonably related to it. Unquestionably an important part of such a program is an unfaltering contempt and criminal referral program. The Commission can and should seek to invoke criminal sanctions against recidivists. Repeat violations are often of an egregious nature suitable for a criminal referral, and a violation of an existing injunction needs to be called to the attention of the issuing court by the Commission, with coercive or punitive measures to be imposed as

19/ See generally, Dent, Ancillary Relief in Federal Securities Law: A Study in Federal Remedies, 67 Minn. L. Rev. 665 (1983); Hazen, Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Methods, 31 Hastings L. J. 427, 446-47 (1979); Farrand, Ancillary Remedies in SEC Civil Enforcement Suits, 89 Harv. L. Rev. 1779, 1792-93 (1976); Treadway, SEC Enforcement Techniques: Expanding and Exotic Forms of Ancillary Relief, 32 Wash. & Lee L. Rev. 679 (1975).

20/ In Rule 2(e) proceedings involving accountants, a typical condition imposed by the Commission is that the individual or firm involved receive an unqualified opinion in a peer review conducted according to the standards of the SEC Practice Section of the Division for Firms of the American Institute of Certified Public Accountants. Recent examples are Schoenfeld & Mendelsohn, Securities Exchange Act Release No. 22467, 34 SEC Docket 108, 117 (Sept. 26, 1985); David G. Rogers, Securities Act Release No. 6600, 33 SEC Docket 1330, 1341 (Aug. 12, 1985); and Winter & Co. P.A., Securities Exchange Act Release No. 22221, 33 SEC Docket 1039, 1043 (July 11, 1985).

the court deems appropriate. SEC-watchers may note that the number of contempt cases brought by the Commission has notably declined in recent years, from fourteen in fiscal 1983, to four in 1984 and three in 1985. 21/ I can assure you, however, that there is no conscious effort to disregard this important aspect of our remedial program. Commission orders and injunctions must be obeyed -- this is an elemental concept, but yet still ignored by a surprising number of individuals and firms. It is vital that their priorities be reordered; compliance with Commission directives must be given a higher priority than profit-taking at the expense of public investors.

In addition, perhaps the time has come for the Commission to again look outside the existing statutes for new ways in which to make their remedies effective. The study of enforcement remedies which began in 1981 eventually concluded that a broad program of civil fines or Commission cease-and-desist orders should not be recommended to Congress. However, in the one area in which a fine was recommended by the Commission -- the Insider Trading Sanctions Act -- it was immediately accepted by the Congress. And the Commission currently has authority analogous to cease-and-desist orders where registration statements are concerned. 22/ The idea of such orders under other areas of SEC regulation is one which might be profitably reexamined now.

As a brief aside, I would note that the problem of remedies which are not taken seriously can be addressed quite succinctly from an economic viewpoint -- and as an economist I am often situated at just such a viewpoint. I believe that the indifferent violator and certainly the chronic violator constantly engages in at least an implicit balancing of the profits gained or costs avoided by illegal or at least questionable activity against the costs and probabilities of getting caught. At some point, the costs are sufficiently great and the probability of those costs being incurred is sufficiently high as to be greater than the perceived benefits, and the illegal or questionable activity

21/ The fiscal 1983 figure includes both civil and criminal contempt. No criminal contempt actions were sought by the Commission in 1984 and 1985.

22/ See Section 8(d) of the Securities Act of 1933 (authority to suspend effectiveness of registration statements); Section 12(j) of the Securities Exchange Act of 1934 (same, but only after an administrative hearing).

will be avoided. 23/ This is law enforcement in the absence of morals, ethics, or self-regulation -- which, by the way, some would say accurately characterizes some aspects of our securities markets. This economic deterrence relies on rational choices of maximizing wealth. Our job is to increase the expected cost of SEC enforcement so that a rational wealth-maximizing individual or firm chooses not to violate the law.

Critics of this philosophy might object -- and many have -- that it's not the SEC's job to mete out punishments, but only to keep our nation's markets in order. I would respond that measures to increase the expected cost of an SEC enforcement action are definitely intended to be remedial and not punitive. Remedies are sought in order to redress discovered violations; prudent administration of remedies requires that some thought be given to preventing new violations, as this is much more efficient than responding in a piecemeal fashion to each individual. 24/ This, I contend, is the keeping of order in our nation's financial markets, rather than meting out punishment. The SEC seeks no retribution.

Impact of Enhanced Enforcement in the Over-the-Counter Market

As the above philosophizing and examples indicate, I believe that it is important for the SEC to be taken extremely seriously, and that there are measures we can adopt to those ends. "Fine," you may say, "that's all very tough talk from Commissioner Cox -- but how could that impact the market here in the Rocky Mountain area?" As I had indicated earlier, I believe that the over-the-counter market in the Rocky Mountain area is one which could

23/ This was the rationale of the civil penalty authorized by the Insider Trading Sanctions Act of 1984. The House Committee noted that

[d]isgorgement of illegal profits has been criticized as an insufficient deterrent, because it merely restores a defendant to his original position without extracting a real penalty for his illegal behavior. The risk of incurring such penalties often fails to outweigh the temptation to convert nonpublic information into enormous profits.

H. Rep. No. 355, 98th Cong., 1st Sess. 7-8 (1983).

24/ Similarly, under Rule 29 of the Commission's Rules of Practice, for example, the proposed relief must be on terms "reasonably designed to prevent a recurrence of the conduct that led to imposition of the bar." See Rule 29, Preliminary Note.

especially benefit from such a program. The Commission's Hot Issues Report, 25/ completed over a year ago, stated that the major abuses in the hot issues market concerned manipulative practices by broker-dealers in the aftermarkets of speculative companies. This is precisely the type of activity which I alluded to earlier in discussing repeat offenders selling interests in various natural resources. Consider the following illustrations from that report. One "hot issue" case described in the Commission's report chronicles the aftermarket activities in the stock of a speculative new issuer exploring oil and gas leases. The underwriter of the company's initial public offering was a Denver broker-dealer. The subsequent manipulative scheme is described in detail in the following passage from the Commission's report:

The brokerage firm dominated and controlled the market and raised the price at will, hoping to pay for its purchases from its customers by correctly guessing the amount of short selling by other brokers from whom it also was purchasing the issuer's securities. Interposed were the numerous public investors who had purchased the stock at the ever-increasing price from the firm and other brokers. The public was unaware that the price rise was artificial and bore no relationship to the value of the securities. 26/

Or consider the aftermarket activities of another broker-dealer in the Denver hot-issue market:

The broker-dealer is alleged to have managed to control the supply of stock in the aftermarket by, among other things, directing sales in the underwriting to controlled accounts and obtaining, prior to the opening of aftermarket trading, a substantial block of aftermarket limit orders at prices five times the public offering price. It is alleged that, to generate demand for the stock, salesmen were told during the offering period by senior officials of the broker-dealer to advise their customers that the company had good financial prospects and that its stocks would open in the aftermarket at a

25/ Report of the Securities and Exchange Commission Concerning the Hot Issues Markets (Aug. 1984) (hereinafter Hot Issues Report).

26/ Hot Issues Report, appendix, Case No. 8. See SEC v. Investment Bankers, Inc., Litigation Release No. 9402, 23 SEC Docket 166, 167 (July 23, 1981). The same facts yielded a later criminal indictment by the State of Colorado. See Litigation Release No. 9439, 23 SEC Docket 785 (Sept. 4, 1981).

substantial premium. It also is alleged that, in one instance, salesmen were reportedly advised that the stock was "going to the moon." 27/

These cases often involve manipulations in the securities of a number of issuers, because as I stated earlier, repeated operation is required to make these substantial profits. Another case cited in the Hot Issues Report discusses the activities of a Denver underwriter who has been the subject of two administrative proceedings and one injunction. 28/

The Hot Issues Report concluded that the major violations in these securities have been with broker-dealers in aftermarket activities, and not with issuer disclosure or other areas of the securities laws. 29/ And just last week, Rick Ketchum, Director of the Commission's Division of Market Regulation, told the National Securities Traders Association that this over-the-counter market needs closer regulation. The gist of Mr. Ketchum's remarks was that the Commission lacks effective programs to deal with abuses in the pink-sheet or so-called "under-the-counter" securities, and that regulators, including the Commission, need more timely and accurate information to curb trading abuses in these often highly speculative issues. 30/

I believe this provides the outline of an answer to the question I posed earlier -- what does all this tough talk mean for the Rocky Mountain area? It means that broker-dealers' unlawful trading practices must be met with SEC enforcement remedies that make those practices unprofitable and impractical as well.

27/ Hot Issues Report, appendix, Case No. 13. See SEC v. OTC Net, Inc., Litigation Release No. 9731, 25 SEC Docket 1432 (Aug. 10, 1982), Litigation Release No. 9709, 25 SEC Docket 1058 (July 1, 1982).

28/ Hot Issues Report, appendix, Case No. 3. See American Western Securities, Inc., Securities Exchange Act Release No. 19275, 26 SEC Docket 1284 (Oct. 26, 1982) (administrative proceedings); Litigation Release No. 9622, 24 SEC Docket 1741 (Mar. 22, 1982) (injunction).

29/ Hot Issues Report at 41-42. Adequacy of disclosure can also be a problem, however. See supra note 16, Hot Issues Report at 56. Usually, however, the risks involved in a "hot issue" are fully disclosed. Hot Issues Report at 42.

30/ Mr. Ketchum noted that the OTC markets are "wholly anonymous," with the only tools to detect manipulative activity being annual examinations and complaint letters. See generally OTC Stocks That Are Less Widely Traded Need More Regulation, SEC Aide Says, Wall St. J., Oct. 8, 1985, at 47.

There are several components of a serious enforcement program involving broker-dealers, the major component being an effective and pervasive bar on future unlawful conduct. I believe the bar should be long in duration and wide in scope, extending to and slightly beyond the range of activities involved in the particular case, so that the Commission can prevent future violations as well. In cases involving new-issue aftermarket trading abuses, for example, this may mean that an individual registered representative should be barred from acting without supervision, and perhaps even precluded from accepting unsolicited customer orders; the firm may face a suspension of all new underwritings for a certain period of time; individual supervisors in the firm may be subject to a suspension or bar.

Cases involving more serious misconduct merit court attention, including broad based injunctions reaching to and beyond the specific unlawful conduct. Undertakings to adopt new firm procedures or to submit to earlier inspections by a special counsel or the broker-dealer's SRO would also be considered. In cases involving trading while in the possession of material nonpublic information, I believe the penalties authorized under the Insider Trading Sanctions Act should be sought to the maximum extent available from the individual or firm. The Commission should seek in each manipulation case an accounting and disgorgement of profits resulting from the manipulation.

Most importantly, repeat violators should be met with an effective criminal program. A broad injunction should result in a criminal contempt proceeding when the next violation is brought to the Commission's attention. Even a first violation, or one following an administrative proceeding, may merit a referral to federal or state criminal authorities. I believe it is these ultimate criminal sanctions, and the Commission's willingness to urge their use, that can best indicate that the Commission takes its remedies seriously.

Conclusion

I would like to conclude my remarks today with a caveat that a call for a more vigorous remedies program at the SEC is not one which needs be met with apprehension by the majority of individuals in the industry. I am certain that most broker-dealers and other participants are great and professional contributors to our nation's efficient financial markets. When violations of the federal securities laws occur, I would estimate that most of the violators fall into the two categories I described at the outset but did not discuss in detail: the "inadvertent violator" and the "repentant violator." However, with that caveat, I would emphasize that there is increasing agitation at the Commission when we are faced with individuals to whom our remedies have no meaning.

The Commission is often accused, in fashioning regulations for the securities industry, of "painting with a broad brush." While I am certainly opposed to adopting remedies where there is no wrong to be remedied, it seems to me that when one has a barn rather than a window-frame to be painted, then a broad brush is the right tool for the job.

Although our program of remedies needs to be serious, I believe it can be administered without a punitive design. Punishment seeks to rewrite the past; a remedy seeks rather to redirect the future. And it is, after all, the future which has the greatest long-run benefits for the industry involved as well as our nation's public investors.

The task of designing remedies to correct wrongs in our nation's financial markets is not new. One scholar had observed earlier in this regard, that a person designing such remedies:

must pick his weapons blindly from an armory of whose content he is unaware. The devices are numerous and their uses various. The criminal penalty, the civil penalty, the resort to the injunctive side of equity, the tripling of damage claims, the informer's share, the penalizing force of pure publicity, the license as a condition of pursuing certain conduct, the confiscation of offending property -- these are the samples of the thousand-and-one devices that the ingenuity of many legislatures has produced. Their effectiveness to control one field and their ineffectiveness to control others, remains yet to be explored. 31/

That statement was made in 1931 by James Landis--later a Federal Trade Commissioner and inaugural member of the SEC -- prior to taking pen in hand to draft what would become the Securities Act of 1933. I believe that Mr. Landis' statement is as applicable to my remarks today as it was over fifty years ago when it was made. I would look forward, as he did, to such exploration.