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Civil Penalties Against Public Companies in SEC Enforcement Actions: An Empirical Analysis

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CIVIL PENALTIES AGAINST PUBLIC COMPANIES IN SEC ENFORCEMENT ACTIONS: AN EMPIRICAL ANALYSIS

David Rosenfeld*

ABSTRACT

Civil penalties have become an increasingly important part of the Securities and Exchange Commission's (SEC) enforcement program. The SEC now routinely obtains large civil penalties in enforcement actions, regularly trumpets those penalties in press releases, and highlights the penalty amounts in its end-of-the-year statistics. Civil penalties are defended on the ground they are necessary to make unlawful conduct costly and painful, and thereby deter misconduct and promote adherence to lawful and ethical standards of behavior. But with respect to one category of cases, civil penalties have always been controversial: when civil penalties are assessed against public companies, the cost of the fines are ultimately borne by the shareholders who are not responsible for the misconduct, and who indeed may have already been harmed thereby. Nevertheless, over the last decade the SEC has moved decidedly in favor of assessing civil penalties when public companies engage in violative conduct. Civil penalties are now the norm and a standard part of the resolution of most public company enforcement actions. This Article is the first attempt to synthesize and analyze a comprehensive dataset of SEC enforcement actions against public companies with an eye to civil penalties. It shows that penalties are not only routine but a central element in most negotiated resolutions of enforcement actions against public companies, as part of a package of relief that reflects what appears to be a studied compromise between statutory charges and monetary sanctions. One trend, which has become more pronounced over the last several years, is for the SEC and public companies, particularly those in the financial services industry, to settle enforcement proceedings through the entry of in-house administrative orders that include non-scienter-based

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charges, the payment of a civil penalty, and no individual charges.

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I. INTRODUCTION

Over the past twenty or so years, civil penalties have become an increasingly important part of the Securities and Exchange Commission’s (SEC) enforcement program. The SEC now routinely obtains large civil

penalties in enforcement actions, regularly trumpets those penalties in press releases, and highlights the penalty amounts in its end-of-the-year statistics. SEC officials frequently point to the amount of penalties assessed as a measure of the diligence, rigor, and success of the agency's enforcement efforts. Penalties are referenced to indicate the toughness of the agency's approach to securities law violations and are touted as an effective means to deter future misconduct.

The SEC's use of civil penalties as an enforcement tool is a relatively new phenomenon. Until the 1980s, the SEC did not have any authority to assess civil penalties and it first obtained the authority only with respect to insider trading cases. It was not until 1990 that the SEC obtained broader penalty authority, including the authority to obtain civil penalties in federal court actions and, with respect to certain registered persons, in administrative proceedings. For the first decade after that, the SEC proceeded cautiously when it came to penalties, but the accounting scandals around the turn of the millennium altered that approach and the agency began to seek penalties with increasing frequency and in ever larger amounts. The financial crisis of 2008 further accelerated the move towards a penalty regime, and the enactment of the Dodd-Frank Act in 2010 gave the agency further power by allowing the Commission to obtain civil penalties against any person in SEC in-house cease-and-desist proceedings.

Civil penalties are defended on the ground that they are necessary to make unlawful conduct costly and painful, in ways that a simple injunction cannot, and thereby deter misconduct and promote adherence to lawful and ethical standards of behavior. But with respect to one category of cases, civil penalties have always been controversial: when civil penalties are assessed against public companies, the cost of the fines are ultimately borne by the shareholders who are not responsible for the misconduct, and who indeed may have already been harmed thereby—either as a direct result of the illicit acts or because of a drop in the price of the company's stock upon its discovery—and are thus made to suffer twice for someone else's wrongdoing.

Concerns of this sort were expressed at the outset when the SEC first obtained civil penalty authority and have been repeated at various intervals since then. In response, the agency originally stressed that it would not seek penalties against public companies in every instance, but rather primarily in those situations where it could be shown that the shareholders had somehow benefitted from the misconduct. The agency later sought to articulate a set of guidelines for penalties in public company cases that recognized the competing interests involved—the need to deter misconduct and the desire to protect innocent shareholders.

Over the last decade, however, the pendulum has swung decidedly in favor of assessing civil penalties when public companies engage in violative conduct. Civil penalties are now routine in such cases, and although the overall amount of penalties may have shown a decline in the last two years, the frequency with which penalties are assessed has not diminished in the new administration: the fact is that penalties for public companies are now the norm and a standard part of the resolution of most public company enforcement actions.

This Article is the first attempt to synthesize and analyze a comprehensive dataset of SEC enforcement actions against public companies with an eye to civil penalties. It shows that penalties are not only routine but a central element in most negotiated resolutions of enforcement actions against public companies, as part of a package of relief that reflects what appears to be a studied compromise between statutory charges and monetary sanctions. One trend, which has become more pronounced over the last several years, is for the SEC and public companies, particularly those in the financial services industry, to settle enforcement proceedings through the entry of in-house administrative orders that include non-scienter-based charges, the payment of a civil penalty, and no individual charges.

In part II of this Article, I trace the development of the SEC's penalty authority and the controversy over penalties for public companies. In part III of this Article, I describe and analyze a dataset of nine years-worth of SEC enforcement actions against public companies covering the fiscal years (FY) 2010 through 2018. In part IV of this Article, I draw some conclusions from these findings and propose a few thoughts for going forward.

II. THE SEC'S PENALTY AUTHORITY

A. *The Development of the SEC's Penalty Authority*

When the SEC was first created, the agency had no authority to seek or impose civil penalties in any forum. The SEC's enforcement powers were originally limited to obtaining injunctive relief in federal district court actions, a power that was later held to include certain ancillary relief, such as disgorgement of ill-gotten gains and pre-judgment interest,¹ or the

1. The federal securities laws do not specifically allow the agency to obtain disgorgement in civil court proceedings. But, starting in the 1970s, courts held that disgorgement (or restitution) is an appropriate ancillary remedy in SEC actions emanating from a district court's broad *equitable* powers. See *Sec. Exch. Comm'n. v. Texas Gulf Sulphur*, 446 F.2d 1301 (2d Cir. 1971) (listing precedent that indicates restitution to be an

appointment of a receiver to take over a company.² The SEC could also bring an enforcement action as an administrative proceeding but only against certain regulated persons, principally broker-dealers and investment advisers, and persons associated with them, with respect to certain types of misconduct. Typically, the only sanction that the SEC could obtain in administrative proceedings was an order suspending or revoking the registration of the regulated entity or barring an individual from associating with a regulated entity.³

It was not until the 1980s that the SEC obtained any civil penalty authority, and that authority was originally limited to insider trading cases.⁴ The Insider Trading Sanctions Act of 1984⁵ allowed the Commission to seek, in a federal district court action, penalties up to three times the amount of ill-gotten gains or losses avoided by the insider-trader, in addition to the traditional equitable relief of an injunction and disgorgement. Four years later, the SEC's insider trading penalty authority in federal court actions was expanded to cover control persons.⁶ Also around this time, the Foreign Corrupt Practices Act (FCPA) was amended to allow for limited penalties

appropriate ancillary remedy). In *Kokesh v. Sec. Exch. Comm'n.*, 107 S. Ct. 1635 (2017), the Supreme Court held that disgorgement actually operates as a penalty—and applied the statute of limitations for civil fines to an action for disgorgement—which could implicate the SEC's authority to obtain disgorgement in federal court proceedings. See Stephen M. Bainbridge, *Kokesh Footnote Three Notwithstanding: The Future of the Disgorgement Penalty in SEC Cases*, 56 WASH. U. J.L. & POL'Y 17 (2018) (questioning whether the disgorgement remedy will survive). The issue is now before the Supreme Court. See *Liu v. Sec. Exch. Comm'n.*, No. 18-1501. The SEC does have specific statutory authority to obtain disgorgement in administrative and cease-and-desist proceedings. Securities Exchange Act of 1934 § 21B(e), 15 U.S.C. § 78(e) (2018) [hereinafter Exchange Act].

2. See generally Daniel J. Morrissey, *SEC Injunctions*, 68 TENN. L. REV. 427 (2001) (describing one of the first reported cases granting ancillary relief in an SEC injunctive action, which involved the appointment of a receiver to safeguard property that was the subject of litigation); George W. Dent, Jr., *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865 (1983) (noting that ancillary relief can include the appointment of a receiver to take over a company).

3. Exchange Act §§ 15(b)(4) and 15(b)(6), 15 U.S.C. §§ 78o(b)(4) and 78o(b)(6) (2018). The SEC could also proceed administratively against public companies, but the relief there was typically limited to obtaining a stop-order limiting distribution of the companies' securities or halting trading.

4. There was one narrow exception: prior to 1984 the SEC could obtain a penalty of \$100 a day against an issuer that failed to file certain required documents and reports. The penalty, characterized as 'forfeiture,' could be recovered in a civil suit. Exchange Act § 32(b), 15 U.S.C. § 78ff(b) (2018).

5. The Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, 15 U.S.C. § 78a (1984).

6. The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, 15 U.S.C. § 78u-1 (1988).

against persons engaged in foreign bribery.⁷

The passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act)⁸ ushered in a whole new era of SEC enforcement powers.⁹ The Remedies Act introduced significant changes affecting both federal district court actions and administrative proceedings. Most important, the Remedies Act gave the SEC broad authority to seek civil penalties in federal court actions with respect to all securities law violations, and authority to seek penalties in administrative proceedings against regulated persons. The Remedies Act also broadened the SEC's administrative powers by providing the agency the authority to issue cease-and-desist orders.¹⁰

While the SEC's new penalty authority extended to all persons in federal district court actions,¹¹ the authority to obtain penalties in administrative proceedings was limited to a specifically enumerated set of actions against industry professionals like broker-dealers, persons associated with broker-dealers, and persons participating in offerings of penny-stock,¹² along with registered investment advisers and certain persons working at or

7. 15 U.S.C. § 78ff(c)(2) (2018); Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 2901 (1988).

8. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931, 15 U.S.C. § 78a (1990). The Remedies Act expanded the penalty authority in federal court actions to all persons except those already covered by the Insider Trading Sanctions Act.

9. See generally Ralph Ferrara et al., *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 BUS. LAW. 33 (1991) (discussing the expansion of enforcement powers and their impact under the Remedies Act); Matthew Scott Morris, *The Securities Enforcement Remedies and Penny Stock Reform Act of 1990: By Keeping Up with the Joneses, the SEC's Enforcement Arsenal is Modernized*, 7 ADMIN. L.J. AM. U. 151 (1993) (same).

10. Securities Act of 1933 § 8A, 15 U.S.C. § 77h-1 (2018) [hereinafter Securities Act]; Exchange Act § 21C, 15 U.S.C. § 78u-3 (2018); Investment Company Act of 1940 § 9(f), 15 U.S.C. § 80a-9(f) (2018) [hereinafter Company Act]; Investment Advisers Act of 1940 § 203(k), 15 U.S.C. § 80b-3(k) (2018) [hereinafter Advisers Act].

11. Exchange Act § 21(d)(3)(A); 15 U.S.C. § 78u(d)(3)(A) (2018) ("Whenever it shall appear to the Commission that any person has violated any provision of this title, [or] the rules or regulations thereunder . . . the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose . . . a civil penalty to be paid by the person who committed such violation"); Securities Act § 20(d), 15 U.S.C. § 77t(d) (2018); Company Act § 42(e), 15 U.S.C. § 80a-41(e) (2018); Advisers Act § 209(e), 15 U.S.C. § 80b-9(e) (2018).

12. Exchange Act § 21B(a), 15 U.S.C. § 78u-2(a) (2018) ("In any proceeding instituted pursuant to Sections 15(b)(4), 15(b)(6), 15D, 15B, 15C, 15E, or 17A of this title against any person, the Commission . . . may impose a civil penalty."). Other industry professionals covered by this provision include municipal securities dealers, government securities brokers or dealers, securities analysts, statistical ratings organizations, clearing and settlement agents.

associated with registered investment companies.¹³ The penalty provisions with respect to federal court actions and administrative proceedings both provided for three tiers of penalties depending on the nature of the violation and the severity of the harm. The penalty range was also the same, running from \$5,000 to \$100,000 per violation for individuals, and \$50,000 to \$500,000 per violation for entities.¹⁴ The only significant difference was that in federal court actions, as an alternative, the SEC could obtain a penalty equal to the gross amount of the pecuniary gain.¹⁵

The Remedies Act also expanded the scope of the SEC's administrative powers in two significant ways. First, it gave the SEC the power to issue cease-and-desist orders against any person who has violated, or is about to violate, any provision of the federal securities laws.¹⁶ Second, it gave the SEC the power to obtain certain forms of equitable relief—disgorgement of ill-gotten gains and accountings—against any person in a cease-and-desist proceeding.¹⁷

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010,¹⁸ once again changed the landscape dramatically. Among many other things, Dodd-Frank further enhanced the SEC's regulatory and enforcement powers in significant ways. For purposes here, the most significant was a series of amendments to the federal securities laws that for the first time authorized the Commission to obtain civil penalties against *any* person in SEC cease-and-desist proceedings, for violations of *any* provision of the federal securities laws.¹⁹

13. Advisers Act § 203(i), 15 U.S.C. § 80b-3(j) (2018); Company Act § 9(d), 15 U.S.C. § 80-a9(e) (2018).

14. The penalty amounts are periodically adjusted for inflation. 17 C.F.R. § 201.1001. For the current figures, see *Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission*, SEC. & EXCH. COMM'N (Jan. 15, 2019), <https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm> [<https://perma.cc/46KA-JT4H>].

15. Exchange Act § 21(d)(3)(B), 15 U.S.C. § 78u(d)(3)(B) (2018); Securities Act § 20(d)(2), 15 U.S.C. § 78t(d)(2) (2018); Company Act § 42(e)(2), 15 U.S.C. § 80a-41(e)(2) (2018); Advisers Act § 209(e)(2), 15 U.S.C. § 80b(e)(2) (2018).

16. Securities Act § 8A, 15 U.S.C. § 77h-1 (2018); Exchange Act § 21C, 15 U.S.C. § 78u-3 (2018); Company Act § 9(f), 15 U.S.C. § 80a-9(f) (2018); Advisers Act § 203(k), 15 U.S.C. § 80b-3(k) (2018).

17. Securities Act § 8A(e), 15 U.S.C. § 77h-1(e) (2018); Exchange Act § 21C(e), 15 U.S.C. § 78u-3(e) (2018); Company Act § 9(e), 15 U.S.C. § 80a-9(e) (2018); Advisers Act § 203(j), 15 U.S.C. § 80b-3(j) (2018).

18. The Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 5301 (2010) [hereinafter Dodd-Frank].

19. Dodd-Frank § 929P(a)(1)-(4) (amending the Securities Act, Exchange Act, Company Act, and Advisers Act). SEC "Cease-and-Desist Proceedings" are administrative

As it currently stands, the Commission can impose a civil penalty in a cease-and-desist proceeding against any person, if the Commission finds, after notice and opportunity for a hearing, that the person is violating, or has violated, any provision of the Securities Act, the Exchange Act, the Company Act, or the Advisers Act, or any rule or regulation thereunder, or was the cause of any such violation.²⁰ There are three tiers of penalties mirroring, in most respects, the three tiers applicable in federal district court actions. The lowest tier applies to any violation; the second tier applies to violations involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and the third tier applies when such fraudulent, deceitful or manipulative conduct, or disregard of a regulatory requirement, results in substantial losses to other persons or resulted in substantial pecuniary gain to the person committing the violation.²¹ Except with respect to the Securities Act, the maximum amount of the penalty ranged from \$5,000 to \$100,000 for each act or omission constituting a violation in the case of a natural person, and from \$50,000 to \$500,000 per violation in the case of any other person, such as a corporation.²² With respect to the Securities Act, the maximum amount of the penalty ranged from \$7,500 to \$150,000 per violation for natural persons, and from \$75,000 to \$725,000 per violation with respect to any other person.²³ The amounts

proceedings, but they are technically distinct from SEC “Administrative Proceedings” (which are brought against regulated persons), because the two types of actions are authorized under different statutory provisions. Compare Exchange Act § 15(b)(4), 15 U.S.C. §§ 78o(b)(4) (2018) with Exchange Act Section 21C, 15 U.S.C. § 78u-3 (2018) (showcasing that former can be brought only against regulated persons while the latter can be brought against any person). As a result, SEC orders separate the two in ways that might be confusing: the actions are often styled as “Administrative and Cease-and-Desist Proceedings.” See Douglas Davison, Mathew Martens, Nicole Rabner, John Valentine & Natalie Rastin, *Litigating with—and at—the SEC*, 48 REV. SEC. & COMMODITIES. REG. 103, 104–05 (2015) (noting that the SEC typically initiates an agency proceeding as both an administrative and a cease and desist proceeding). Both types of proceedings are referred to as administrative proceedings in statutory provisions authorizing civil penalties, such as Exchange Act § 21B, 15 U.S.C. § 78u-2 (2018) (Civil Remedies in Administrative Proceedings), and both are referred to as administrative proceedings herein.

20. Securities Act § 8A(g)(1), 15 U.S.C. § 77h-1(g)(1) (2018); Exchange Act § 21B(a)(2), 15 U.S.C. § 78u-2(a)(2) (2018); Company Act § 9(d)(1)(B), 15 U.S.C. § 80a-9(d)(1)(B) (2018); Advisers Act § 203(i)(1)(B), 15 U.S.C. § 80b-3(i)(1)(B) (2018).

21. Securities Act § 8A(g)(2), 15 U.S.C. § 77h-1(g)(2) (2018); Exchange Act § 21B(b), 15 U.S.C. § 78u-2(b) (2018); Company Act § 9(d)(2), 15 U.S.C. § 80a-9(d)(2) (2018); Advisers Act § 203(i)(2), 15 U.S.C. § 80b-3(i)(2) (2018).

22. Exchange Act § 21B(b), 15 U.S.C. § 78u-2(b) (2018); Company Act § 9(d)(2), 15 U.S.C. § 80a-9(d)(2) (2018); Advisers Act § 203(i)(2), 15 U.S.C. § 80b-3(i)(2) (2018).

23. Securities Act § 8A(g)(2), 15 U.S.C. § 77h-1(g)(2) (2018). The Securities Act also adds a requirement that the Commission may impose a civil penalty only if it finds that “such penalty is in the public interest.” *Id.* at § 8A(g)(1)(B).

of all SEC fines are periodically adjusted for inflation; for example, the maximum fines for Securities Act violations in cease-and-desist proceedings currently range from \$8,671 to \$173,437 per violation for natural persons and \$86,718 to \$838,275 per violation for any other person, for conduct occurring after November 3, 2015.²⁴

B. Civil Penalties Against Public Companies

1. The Remedies Act

When the Remedies Act was passed, there were generalized concerns voiced about the SEC's ability to obtain fines in in-house proceedings, however limited that power was at the time.²⁵ Many in the private bar complained that the SEC's new cease-and-desist and fining authority would allow the agency to bypass the courts and thereby deprive defendants of important due process safeguards.²⁶ The American Bar Association's Subcommittee on SEC Practice and Enforcement Matters opposed what it considered a broad grant of penalty authority and warned of due process concerns when there was also potentially criminal liability.²⁷

But more specific concerns were raised with respect to public companies. The civil penalty provisions apply to both entities and natural persons, and that proved controversial from the start, even if the fines were limited at the time to federal court actions. Proponents of civil penalties for entities argued that they would act as a powerful deterrent to corporate

24. 17 C.F.R. § 201.1001 (2016); *Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission*, SEC. & EXCH. COMM'N (Jan. 15, 2019), <https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm> [<https://perma.cc/47Z4-G845>].

25. See, e.g., Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149, 244–50 (1990) (expressing concern about granting the SEC authority to circumvent the constitutional right to a jury trial and impose punitive sanctions either by in-house or administrative proceedings).

26. See, e.g., Remarks of Philip R. Lochner, Jr. Comm'r, "The SEC's New Powers Under the Securities Enforcement Remedies and Penny Stock Reform Act of 1990," Sec. & Exch. Comm'n News Release (Oct. 4, 1990) 15–16, <https://www.sec.gov/news/speech/1990/100490lochner.pdf> [<https://perma.cc/HZP3-SLKU>] ("One of the most frequently heard complaints has been that the Commission's new authority to impose fines and issue cease and desist orders will allow the Commission to bypass the federal courts and thereby deny defendants the procedural safeguards available to them in the courts.").

27. Letter from the ABA's Subcommittee on SEC Practice and Enforcement Matters to Senator Donald Riegle, Jr., Chairman of the Senate Committee on Banking, Housing, and Urban Affairs (May 14, 1990).

misconduct.²⁸ Critics, on the other hand, pointed out that the cost of fines was ultimately borne by the shareholders, who were not responsible for the misconduct and indeed may have been victimized by it.²⁹ These competing views were present at the outset and the debate has raged on ever since, informing the ebbs and flows of the Commission's policy—and shifts in policy—over the years.

When what eventually became the Remedies Act was first introduced, the SEC stated that in cases involving corporate issuers, penalties would “be imposed or sought only where the violation resulted in an improper benefit to shareholders.”³⁰ The SEC also stated that it “may properly take into account its concern that civil penalties assessed against corporate issuers will ultimately be paid by shareholders who were themselves victimized by the violations,” and noted that in many such situations it would be “inequitable” to impose a penalty.³¹

The Senate Banking Committee considering the Remedies Act echoed this concern and put forth its view that civil penalties should be imposed on public companies only in cases where the shareholders had received a benefit from the misconduct. The Banking Committee Report further noted that, in assessing whether and to what extent to impose a fine, courts should take into account whether shareholders who had been victimized would bear the cost of the penalty.³² In such cases, the Report concluded, the expectation

28. *The Securities Law Enforcement Remedies Act of 1989; Hearing on S. 647 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 101st Cong. 8–9 (1990) (statement of Richard C. Breeden) (arguing that penalties are necessary to deter misconduct and incentivize institutions to allocate resources in order to comply with securities laws).

29. See, e.g., Arthur B. Laby & W. Hardy Callcott, *Patterns of SEC Enforcement Under the 1990 Remedies Act: Civil Money Penalties*, 58 ALB. L. REV. 5, 14–15 (1994) (noting concerns that penalties imposed on issuers would be borne by shareholders).

30. Memorandum of the Securities and Exchange Commission in Support of the Securities Law Enforcement Remedies Act of 1989 at 5 (Apr. 1, 1988) [hereinafter SEC Memorandum], reprinted in *The Securities Law Enforcement Remedies Act of 1989; Hearing on H.R. 975 Before the Subcomm. on Telecommunications and Finance of the H. Comm. on Energy and Commerce*, 101st Cong. 44–59 (1989) (statement of David S. Ruder, Chairman, Sec. & Exch. Comm'n, attachment A).

31. SEC Memorandum at 4. The SEC stated that “[i]n a typical case of financial fraud in which an issuer overstates its earnings and revenues, for example, the only shareholders who reap a direct economic benefit are those who sell their shares at an inflated price before the fraud is exposed. By the time that an enforcement action is brought, a large percentage of the shareholders may consist of persons who purchased shares at a price that was artificially inflated as a result of the fraud. To assess a civil penalty in such a case against the issuer, as opposed to the individual officers who were responsible for the fraud, would appear to be inequitable.” *Id.*

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

would be that the SEC would, if appropriate, seek penalties from the individuals responsible for the misconduct.³³ Then SEC Chairman Richard Breeden confirmed that the SEC intended to seek penalties against corporations only when the violation resulted in an improper benefit to shareholders.³⁴ Finally, the Senate Report noted that it was not anticipated that the SEC would seek a monetary penalty in every case, especially in cases involving “isolated and unintentional conduct.”³⁵ In written testimony, Gary Lynch (a former Director of Enforcement who was then in private practice) urged that penalties should not become the ‘sine qua non’ of all Commission enforcement actions, but rather should be reserved for a limited class of cases, namely those involving deliberate fraud.³⁶

2. The Growth of the Penalty Regime

Following the passage of the Remedies Act there were a few big ticket penalty assessments, all involving regulated entities: Salomon Brothers paid a \$122 million penalty in 1992 for engaging in a scheme to evade Treasury Department limitations by placing false bids for US Treasury securities;³⁷ Prudential Securities Inc. paid a \$10 million penalty in 1993³⁸ and PaineWebber Group Inc. paid a \$5 million penalty in 1996³⁹ in cases involving fraud in the sale of limited partnership interests.

But it was only in the wake of the accounting scandals around the turn of the millennium that SEC fines really began to take off, particularly with

33. *Id.*

34. *The Securities Law Enforcement Remedies Act of 1989; Hearing on S. 647 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 101st Cong. 433 (1990) (Letter from Richard C. Breeden, Chairman, Sec. & Exch. Comm’n, to Donald W. Riegle, Jr., Chairman, Committee on Banking, Housing, and Urban Affairs (Apr. 6, 1990)).

35. S. REP. NO. 101-337, at 11–12 (1990).

36. *The Securities Law Enforcement Remedies Act of 1989; Hearing on S. 647 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 101st Cong. 121, 128–29 (1990) (statement of Gary G. Lynch, Former Director of Enforcement, Sec. & Exch. Comm’n).

37. 1992 SEC ANN. REP. 4.

38. In addition to the \$10 million paid to the SEC, Prudential also paid some \$31 million in fines to state authorities and other regulators and agreed to pay about \$330 million to compensate injured investors. Kurt Eichenwald, *Prudential Agrees to Pay Investors for Fraud Losses*, N.Y. TIMES, Oct. 22, 1993, at D2.

39. In addition to the \$5 million paid to the SEC, PaineWebber also paid \$5 million in fines to state regulators and agreed to set aside funds to compensate injured investors. Scott Paltrow, *PaineWebber Agrees to Pay \$302.5 Million in Fraud Case*, L.A. TIMES (Jan. 19, 1996), <https://www.latimes.com/archives/la-xpm-1996-01-19-fi-26277-story.html> [<https://perma.cc/LD3L-E377>].

respect to public companies.⁴⁰ In April 2002, Xerox agreed to pay a \$10 million civil penalty to resolve allegations of improper revenue recognition, which was described as the largest penalty ever assessed against a public company for financial fraud.⁴¹ That amount, however, was dwarfed a year later when the SEC settled a massive accounting fraud case against WorldCom that included a \$750 million civil penalty.⁴² In its brief in support of the WorldCom settlement, the Commission stressed that it had “historically been reluctant to impose civil penalties on public companies because of the negative impact such a penalty can have on shareholders who have already been victimized by the conduct being penalized” and noted that as result the Commission had “sought and obtained civil penalties against public companies in financial fraud cases on only a handful of occasions.”⁴³ The Commission went on to justify the penalty by stressing that the “primary purpose of the penalty statutes” is to deter future fraud both by the settling defendant and by others who might be tempted to engage in similar misconduct.⁴⁴

40. See, e.g., Stephen M. Cutler, Director, Div. of Enf't, Sec. & Exch. Comm'n, Remarks at the University of Michigan Law School (Nov. 1, 2002) (noting the move away from the Commission's reluctance to obtain large fines, particularly in financial fraud cases).

41. Xerox Corp., Litigation Release No. 17,645, 77 SEC Docket 971 (Apr. 11, 2002). News articles at the time noted how exceptional the penalty was in light of the shareholder harm issue. See, e.g., James Bandler & Mark Maremont, *Xerox Will Pay \$10 Million Penalty to Settle SEC Case*, WALL ST. J., Apr. 2, 2002, at A4 (“The SEC rarely assesses penalties against public corporations, believing that such sums are ultimately paid by shareholders, who are the ones most visibly harmed by the company's actions. But in some egregious cases, SEC senior staffers believe big penalties help send a message that certain behavior can't be tolerated.”). A few months after the Xerox case, the SEC settled a case against Dynegy Inc. which included a payment of a \$3 million penalty, which was described as the second largest penalty assessed by the Commission in a financial fraud case. In that case, the litigation release stressed that in reaching the settlement the Commission was “mindful of the impact that a penalty on a corporate entity can have on the entity's innocent shareholders” and noted that the size of the penalty “[reflected] the commitment of the company's present board of directors to cooperate with the Commission and certain remedial actions undertaken by the company, as well as a careful balancing by the Commission between the need to encourage full cooperation and the desire to avoid imposing the economic consequences of a penalty on shareholders.” Dynegy Inc., Exchange Act Release No. 46,537, 78 SEC Docket 1493, 1494 (Sept. 25, 2002).

42. Barnaby Feder, *WorldCom Agrees to Pay 750 Million in S.E.C. Suit*, N.Y. TIMES (Jul. 8, 2003), <https://www.nytimes.com/2003/07/08/business/technology-worldcom-agrees-to-pay-750-million-in-sec-suit.html> [<https://perma.cc/6RW9-JMS2>].

43. Submission of the Securities and Exchange Commission Addressing the Issues Identified in the Court's May 19, 2003 Order Concerning the Proposed Settlement of the Commission's Monetary Claims Against WorldCom at 5, Sec. & Exch. Comm'n v. WorldCom, Inc., No. 02-CV-4963 (S.D.N.Y. 2003).

44. *Id.* at 14.

After the WorldCom settlement, the Commission obtained large civil penalties in a series of cases, mostly relating to the ever burgeoning accounting fraud scandals, including among many others, significant penalties against Time Warner (\$300 million),⁴⁵ Qwest Communications (\$250 million),⁴⁶ Computer Associates (\$225 million),⁴⁷ Royal Dutch Petroleum (\$120 million),⁴⁸ and Bristol-Myers Squibb (\$100 million).⁴⁹ In April 2004, then-Director of Enforcement Stephen Cutler gave a speech in which he noted that in barely a decade the SEC had “gone from a regime in which monetary penalties were imposed only rarely to one in which large penalties seem to be part of virtually all significant settlements.”⁵⁰ Cutler went on to state that in considering whether to impose penalties, the starting point is a “presumption that any serious violation of the federal securities laws should be penalized with a monetary sanction,” and listed various factors that would be taken into account in rebutting this presumption, and in determining the amount of the penalty.⁵¹ In particular, Cutler focused on three “core” factors, the most basic being the type of violation at issue and “[s]pecifically, whether it involved fraud, and if so, the degree of scienter, if any, that was present. In short, there is fraud, and then there is fraud.”⁵² The second core factor focused on “the degree of harm resulting from the violations. Significant harm will very often lead to a significant penalty.”⁵³ The third core factor Cutler described was the extent of cooperation as

45. Press Release, Sec. & Exch. Comm’n, SEC Charges Time Warner with Fraud, Aiding and Abetting Frauds by Others, and Violating a Prior Cease-and-Desist Order; CFO, Controller, and Deputy Controller Charged with Causing Reporting Violations (Mar. 21, 2005), <https://www.sec.gov/news/press/2005-38.htm> [<https://perma.cc/TZ24-UNNT>].

46. Press Release, Sec. & Exch. Comm’n, SEC Charges Qwest Communications International Inc. with Multi-Faceted Accounting and Financial Reporting Fraud (Oct. 21, 2004), <https://www.sec.gov/news/press/2004-148.htm> [<https://perma.cc/9Y87-ULNF>].

47. Press Release, Sec. & Exch. Comm’n, SEC Files Securities Fraud Charges Against Computer Associates International, Inc., Former CEO Sanjay Kumar, and Two Other Former Company Executives (Sept. 22, 2004), <https://www.sec.gov/news/press/2004-134.htm> [<https://perma.cc/W68X-MPFR>].

48. Press Release, Sec. & Exch. Comm’n, Royal Dutch Petroleum Company and the “Shell” Transport and Trading Company, P.L.C. Pay \$120 Million to Settle SEC Fraud Case Involving Massive Overstatement of Proved Hydrocarbon Reserves (Aug. 24, 2004), <https://www.sec.gov/news/press/2004-116.htm> [<https://perma.cc/6A56-9F9Z>].

49. Press Release, Sec. & Exch. Comm’n, Bristol-Myers Squibb Company Agrees to Pay \$150 Million to Settle Fraud Charges (Aug. 4, 2004), <https://www.sec.gov/news/press/2004-105.htm> [<https://perma.cc/L6UX-A3ZQ>].

50. Stephen M. Cutler, Director, Div. of Enf’t, Sec. & Exch. Comm’n, Speech at the 24th Annual Ray Garrett Jr. Corporate & Securities Law Institute (Apr. 29, 2004).

51. *Id.*

52. *Id.*

53. *Id.*

measured by the standards set forth in the Commission's Seabord 21(a) Report.⁵⁴ In addition to the core considerations, Cutler pointed to other factors that would be considered in determining whether to impose a penalty and the amount thereof, including whether the defendant was a recidivist, the degree to which the person or entity benefitted from the misconduct, and the defendant's financial resources.⁵⁵ In defense of the new penalty regime, Cutler pointed to the fact that pursuant to the Sarbanes-Oxley Act of 2002, penalties obtained by the Commission could be added to a "fair-fund" which could be used to compensate injured investors.⁵⁶

The normalization of the penalty regime inevitably led to something of a backlash. Critics in the financial community and the private bar raised concerns that the agency was being heavy handed and needed to dial back its enforcement approach. Some complained that the penalty amounts seemed wholly arbitrary.⁵⁷ Many complained about overreaching and a fundamental disconnect between the size of the penalties and the statutory regime.⁵⁸ As criticism mounted, it exposed deep fault lines at the Commission, with two Commissioners publicly questioning the fairness and efficacy of large civil penalties at least when imposed on public companies. In a speech in early 2005, Commissioner Atkins questioned whether civil

54. *Id.* The "Seabord 21(a) Report" is a Commission Report of Investigation that broadly outlines how the Commission will assess an entity's cooperation in determining the sanctions it will seek in settlement, and even whether or not to bring an enforcement action at all. *See generally* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 34,44969, 76 SEC Docket, 220, 222 (Oct. 23, 2001) ("We set forth . . . some of the criteria we will consider in determining whether, and how much, to credit for self-policing, self-reporting, remediation and cooperation . . ."). The Report never mentions the company involved—Seabord—but the Report is widely referred to by that name.

55. Cutler, *supra* note 50.

56. Cutler, *supra* note 50. In any action where an order of disgorgement has been obtained, Section 308 of Sarbanes-Oxley allows the Commission to establish a "fair fund" by adding any civil penalties ordered in that action to the disgorgement fund so that the penalty money can be distributed to injured investors. Prior to the passage of Sarbanes-Oxley, penalty money collected in SEC enforcement actions went to the US Treasury. For the development of SEC "fair funds," see Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW. 317, 318 (2008) (explaining how Section 308 enabled the SEC to compensate victims of fraud with funds from penalties rather than the funds being paid to the Treasury).

57. *See, e.g.*, Eric Larson, *Amid Criticism, SEC Sets Standard for Penalties*, LAW360 (Jan. 4, 2006) (The SEC "has often been capricious in its determination of the amount of penalties.").

58. *See, e.g.*, Richard A. Spehr & Michelle J. Annunziata, *The Remedies Act Turns Fifteen: What Is Its Relevance Today?*, 1 N.Y.U. J. L. & BUS. 587, 611 (2005) (criticizing the SEC for imposing penalties that are many multiples of what the Remedies Act permits).

penalties simply harmed shareholders who had already been victimized by the illicit conduct: “Corporations fined for disclosure-based transgressions use shareholder money to pay for behavior of which the shareholders were the victims . . . By imposing such fines, are we not punishing the very people who might have already [been] punished through the marketplace when the stock price was clobbered?”⁵⁹ Commissioner Glassman echoed that sentiment and in the process ridiculed the idea that the use of “fair-funds” could somehow mitigate the problem:

I cannot justify imposing penalties indirectly on shareholders whose investments have already lost value as a result of the fraud. Our use of so-called Fair Funds . . . as a vehicle to return civil penalties to defrauded investors . . . leads to the anomalous result that we have shareholders paying corporate penalties that end up being returned to them through a Fair Fund . . . This gets a headline, but it makes no sense to me – it is form over substance.⁶⁰

In response, successive enforcement directors defended the use of penalties as a necessary and effective deterrent,⁶¹ and loudly proclaimed that they needed to be sizeable to have the desired effect.⁶² These views were apparently shared by at least some of the Commissioners, contributing to a deep division at the Commission which, according to published reports, may have adversely impacted certain Enforcement Division settlement recommendations.⁶³

3. The Penalty Statement

In early January 2006, the Commission issued what has become known as the “Penalty Statement” in order to provide clarity concerning the

59. Paul S. Atkins, Comm’r, Sec. & Exch. Comm’n, Remarks Before the Atlanta Chapter of the National Association of Corporate Directors (Feb. 23, 2005).

60. Cynthia A. Glassman, Comm’r, Sec. & Exch. Comm’n, *SEC in Transition: What We’ve Done and What’s Ahead* (June 15, 2005).

61. Stephen M. Cutler, Director, Div. of Enf’t, Sec. & Exch. Comm’n, Remarks Before the Directors’ Education Institute at Duke University: *Staying the Course* (Mar. 18, 2005) (“Civil money penalties speak loudly in a language that every defendant and respondent can understand. And in so doing, they help achieve deterrence.”).

62. Linda C. Thomsen, Director, Div. of Enf’t, Sec. & Exch. Comm’n, *Covering the Bases: Remarks before the Directors’ College* (June 21, 2005) (“[W]e need to . . . impose penalties that people will work hard to avoid. To be effective, penalties have to sting and must be seen as something more than a cost of doing business.”).

63. See, e.g., *No SEC Deal on Veritas Penalty*, L.A. TIMES, June 9, 2005, at C2 (“The Securities and Exchange Commission has deadlocked on a proposed fine for Veritas Software Corp. as Democrats and Republicans split along party lines . . .”).

imposition of civil penalties against corporate issuers.⁶⁴ The Penalty Statement recognized the simmering differences at the Commission: “Recent cases have not produced a clear public view of when and how the Commission will use corporate penalties, and within the Commission itself a variety of views have heretofore been expressed, but not reconciled.”⁶⁵

Harking back to the legislative history of the Remedies Act, and reflecting the concerns expressed about how penalties could have an adverse effect on shareholders, the Penalty Statement set forth a series of factors that the Commission would consider when deciding when and how penalties should be imposed against corporate issuers, focusing principally on whether the misconduct at issue had benefitted the corporation and whether the penalty would harm or benefit investors.⁶⁶ The two principle factors were: (1) “The presence or absence of a direct benefit to the corporation as a result of the violation”; and (2) “[t]he degree to which the penalty will recompense or further harm the injured shareholders.”⁶⁷ The Penalty Statement also listed a series of additional factors to be considered, many of which focused on deterrence, remediation, and cooperation: (1) “The need to deter the particular type of offense”; (2) “[t]he extent of the injury to innocent parties”; (3) “[w]hether complicity in the violation is widespread throughout the corporation”; (4) “[t]he level of intent on the part of the perpetrators”; (5) “[t]he degree of difficulty in detecting the particular type of offense”; (6) the “[p]resence or lack of remedial steps by the corporation”; and (7) the “[e]xtent of cooperation with Commission and other law enforcement.”⁶⁸

How the Commission evaluates cooperation was previously outlined in the Seaboard 21(a) Report, where the Commission described the factors that would be weighed in determining the appropriate sanction for entities in enforcement actions. These include the nature of the misconduct, how the misconduct arose, at what level of the organization the misconduct took place, how long the misconduct lasted, as well as various factors relating to detection, disclosure to, and cooperation with, the Commission and other authorities, as well as prompt remediation.⁶⁹

64. Press Release, Sec. & Exch. Comm’n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm> [<https://perma.cc/5UP2-SZD6>].

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement

Although the Penalty Statement was issued unanimously by the Commission,⁷⁰ deep divisions continued at the Commission level, with some Commissioners advocating tougher penalties and others seeking a lighter touch.⁷¹ There was also some concern among the Commissioners that the Enforcement Division staff was negotiating settlements that included high penalties and then presenting them to the Commission for approval in a way that left the Commission little input in the matter.⁷² As a result, then-Chairman Christopher Cox instituted a novel pilot program requiring the Enforcement Division staff to get pre-approval from the Commission before negotiating a settlement with a public company that included a civil penalty.⁷³ Under the program, the staff would get pre-authorization from the Commission to negotiate a penalty within a specified range, with the promise of quick Commission approval of a final settlement that fell within the approved range.⁷⁴ The pilot program was a radical departure from the way the enforcement staff had traditionally proceeded, and continued to proceed in all other cases.⁷⁵

But deep divisions persisted at the Commission, and in short order the pendulum swung back, fueled by external events and a change of administration. Just as the first push for stiffer penalties was driven by the accounting scandals at the turn of the millennium, the second wave occurred in the wake of the financial crisis of 2008. At the time, there was considerable public criticism of the agency—justified or not—for its failure to detect, pursue, and punish wrongdoing.⁷⁶

In December 2008, President-elect Obama nominated Mary Shapiro to be SEC Chairman, stating that “regulatory reform” was a top priority and

Decisions, Exchange Act Release No. 44,969 (Oct. 23, 2001), <https://www.sec.gov/litigation/investreport/34-44969.htm> [<https://perma.cc/C7Z8-ANGR>].

70. Press Release, Sec. & Exch. Comm’n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm> [<https://perma.cc/DQ6B-98PZ>].

71. *Id.*

72. *Id.*

73. Christopher Cox, Chairman, Sec. & Exch. Comm’n, Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference (Apr. 13, 2007).

74. *Id.*

75. Mark K. Schonfeld, *Back to the Future: Chairman Schapiro Ends Pilot Program for Corporate Penalties, Eliminates Commission Pre-authorization, Allows Staff to Negotiate*, 41 SEC. REG. & L. REP. 307 (2009).

76. See, e.g., *The Financial Crisis and the Role of Federal Regulators: Hearing Before the Comm. on Oversight and Gov’t Reform*, 110th Cong. (Oct. 23, 2008) (criticizing the SEC for its relaxed standards and inaction towards regulating Wall Street); Stephen Labaton, *SEC Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES, Sept. 26, 2008 (reporting on the SEC’s acknowledgment of certain failures to regulate Wall Street, which partially led to the global financial crisis).

noting the “failure of oversight and accountability” that had allowed frauds like Bernie Madoff’s to take place. Obama bluntly stated that Madoff’s fraud was “made possible in part because the regulators who were assigned to oversee Wall Street dropped the ball.”⁷⁷

One result was a renewed push for large civil penalties particularly in cases of perceived corporate misconduct. The pilot program instituted by Chairman Cox came under attack at the Commission for unduly hampering the settlement process and for reducing the penalties imposed against public companies. In a speech in January 2009, Commissioner Luis Aguilar noted a steep decline in the amount of penalties assessed against public companies each year from 2006 to 2008: excluding FCPA cases, Aguilar stated that penalties had declined from \$637 million in 2006, to \$310 million in 2007, and \$96 million in 2008.⁷⁸ Aguilar blamed the decline at least in part on a process that seemed designed to encourage the staff to seek lower corporate penalties or forego them altogether in order to get settlements approved.⁷⁹ Aguilar called for the immediate termination of the penalty pre-approval program and urged incoming Chair Shapiro to make that her first official act.⁸⁰ Just two weeks into her term as Chair, Mary Shapiro announced the termination of the pilot program on penalties,⁸¹ which was taken as a signal that she intended to “reinvigorate” the Commission’s enforcement program.⁸²

A few years later, her successor, Mary Jo White, gave a speech that emphasized the need to deter misconduct, and essentially eviscerated the earlier Penalty Statement.⁸³ Chair White first claimed that the Penalty Statement “was not . . . binding policy for the Commission or the staff.”⁸⁴

77. President-Elect Barack Obama, *Remarks as Prepared for Delivery – SEC, CFTC, and Federal Reserve Board Announcements*, CHANGE.GOV (Dec. 18, 2008), <https://archive.li/yZri> [<https://perma.cc/58FN-8AUT>].

78. Luis A. Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, Address Before the North American Securities Administrators Association’s Winter Enforcement Conference: Empowering the Markets Watchdog to Effect Real Results (Jan. 10, 2009), <https://www.sec.gov/news/speech/2009/spch0110091aa.htm> [<https://perma.cc/28L6-9ZBS>].

79. *Id.*

80. *Id.*

81. Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Address to Practising Law Institute’s “SEC Speaks in 2009” Program (Feb. 6, 2009), <https://www.sec.gov/news/speech/2009/spch020609mls.htm> [<https://perma.cc/PBL4-WQFL>].

82. See, e.g., Mark K. Schonfeld, *supra* note 75, at 4 (“In general, Chairman Schapiro’s first speech clearly signals an intent to make good on her promise to reinvigorate SEC enforcement.”).

83. Mary Jo White, Chairman, U.S. Sec. & Exch. Comm’n, Speech Before the Council of Institutional Investors: Deploying the Full Enforcement Arsenal (Sept. 26, 2013), <https://www.sec.gov/news/speech/spch092613mjw> [<https://perma.cc/ETM6-QPBZ>].

84. *Id.*

While noting that the Penalty Statement “sets forth a useful, non-exclusive list of factors that may guide a Commissioner’s consideration of corporate penalties,” she insisted that “each Commissioner has the discretion, within the limits of the Commission’s statutory authority, to reach his or her own judgment on whether a corporate penalty is appropriate and how high it should be.”⁸⁵ Chair White concluded: “The bottom line for me is that corporate penalties will be considered in all appropriate cases.”⁸⁶ Whether to seek a penalty and in what amount, she said, “are decisions that must be based on a consideration of all the facts and circumstances of each case and the objectives of a strong enforcement program.”⁸⁷

Soon after, Commissioner Aguilar stated that the Penalty Statement “constituted a fatally flawed approach to assessing the appropriateness of corporate penalties,” principally because it focused on benefit to the corporation and shareholder harm, rather than the “egregiousness” of the conduct.⁸⁸ Aguilar argued that the purpose of penalties is to punish wrongdoers and deter future violations and urged that the focus should be on the nature of the misconduct and the violation, including the intent of the violator and the degree of harm to investors.⁸⁹ Aguilar acknowledged that “equitable concerns” should also come into play—including whether shareholders who had previously been harmed by the misconduct would bear the cost of the penalty—but insisted that these factors should not be given “automatic priority.”⁹⁰

With the change in administration in 2017, the pendulum may have begun to swing back once again. For example, in a speech in 2018, Steve Peikin, Co-Director of Enforcement at the SEC, while noting that civil penalties can serve a “strong deterrent purpose,” insisted that “not every case warrants a penalty.”⁹¹ Peikin noted that “in matters involving corporate issuer misconduct, decisions about whether to recommend the assessment of penalties require careful and thoughtful balancing of many factors including,

85. *Id.*

86. *Id.*

87. *Id.*

88. Luis Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, Speech Before the 20th Annual Securities Litigation and Regulatory Enforcement Seminar: A Stronger Enforcement Program to Enhance Investor Protection (Oct. 25, 2013), <https://www.sec.gov/news/speech/2013-spch-1025131aa> [<https://perma.cc/FQ46-X2Y3>].

89. *Id.*

90. *Id.*

91. Steven Peikin, Co-Dir., Div. of Enf’t, U.S. Sec. & Exch. Comm’n, Remedies and Relief in SEC Enforcement Actions (Oct. 3, 2018), <https://www.sec.gov/news/speech/speech-peikin-100318> [<https://perma.cc/SY3T-6TPL>].

of course, the nature of the misconduct.”⁹² Among the factors to be considered is the extent of the company’s cooperation and remediation efforts.⁹³ Commissioner Peirce, in turn, commended the new enforcement division leadership “for trying to lead the enforcement program in a direction that focuses on serious violations and deemphasizes penalties and case counts.”⁹⁴ At least one study claims to show an overall decline in penalties in the first twenty months of the Trump administration,⁹⁵ and some commentators have suggested that the Commission may be altering its approach to corporate penalties.⁹⁶

III. PENALTIES BY THE NUMBERS

In light of the vigorous debates and controversy that have surrounded the imposition of penalties against corporate issuers, and the frequent pendulum shifts in the Commission’s approach to the issue, a comprehensive analysis of public company penalties is in order. In particular, it is useful to understand how frequently civil penalties⁹⁷ are assessed against public companies, in what types of cases and with what types of charges, against what types of entities, and whether individual wrongdoers are charged along with the company.

92. *Id.*

93. *Id.*

94. Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, Lies and Statistics: Remarks at the 26th Annual Securities Litigation and Regulatory Enforcement Seminar (Oct. 26, 2018), <https://www.sec.gov/news/speech/peirce-speech-lies-statistics-102618> [<https://perma.cc/FQH8-LUT3>].

95. Ben Protess, Robert Gebeloff & Danielle Ivory, *Trump Administration Spares Corporate Wrongdoers Billions in Penalties*, N.Y. TIMES, Nov. 3, 2018, <https://www.nytimes.com/2018/11/03/us/trump-sec-doj-corporate-penalties.html> [<https://perma.cc/LHU8-52CR>].

96. *4-Person SEC May Shift Away from Corporate Penalties*, LAW360 (Mar. 18, 2019), <https://www.law360.com/articles/1139757/4-person-sec-may-shift-away-from-corporate-penalties> [<https://perma.cc/SS2G-4KN9>].

97. One caveat: references herein to “civil penalties” include only those specifically denominated as such—and obtained pursuant to the specified statutory authority—and do not include “disgorgement” or other monetary relief such as pre-judgment interest. In *Kokesh v. Sec. & Exch. Comm’n*, 137 S. Ct. 1635 (2017), the Supreme Court held that disgorgement is actually a “penalty” at least for the purpose of applying the relevant statute of limitations. The reasoning of *Kokesh* is suspect, and the holding entirely counter-intuitive: disgorgement refers to giving up ill-gotten gains, money the holder has no legitimate right to. It is much like a bank robber who is caught outside the bank with a sack of cash he has just stolen: the robber may be subject to numerous sanctions, including jail time and criminal penalties, but he has no claim to retain the money, and requiring him to hand it over does not seem like a “penalty” at least as most people would understand the term. Nonetheless, the *Kokesh* holding is what it is. But for purposes of this study, I am including only actual civil penalties.

A. *The SEED Data and the Dataset*

The Securities Enforcement Empirical Database (“SEED”) is a publicly available database compiled by NYU’s Pollack Center for Law and Cornerstone Research that tracks and records information on SEC enforcement actions against public companies.⁹⁸ The SEED database has information on enforcement actions filed against public companies that trade on major US exchanges and their subsidiaries⁹⁹ starting October 1, 2009 (the beginning of the 2010 fiscal year),¹⁰⁰ excluding delinquent filings cases. The database is updated weekly.¹⁰¹ The SEED data has been summarized in a series of research reports put out by Cornerstone Research.¹⁰² For my analysis, I used information in the database from inception up to September 30, 2018 (the end of the 2018 fiscal year), which amounts to nine full years of data (FY 2010 through FY 2018). I then checked the data against SEC litigation releases and administrative orders and made a few adjustments to create my own dataset (the “Dataset”).¹⁰³

98. *Securities Enforcement Empirical Database*, NYU POLLACK CTR. FOR L. & BUS., <http://www.law.nyu.edu/centers/pollackcenterlawbusiness/seed> [<https://perma.cc/KLE2-NT7B>].

99. SEED uses the following definition of public company: “Public companies are defined as those that traded on a major U.S. exchange as identified by the Center for Research in Security Prices (CRSP) at the time the enforcement action was initiated, or otherwise within the five-year period preceding the initiation. Thus, public companies that traded over-the-counter or on major non-U.S. exchanges are excluded, as are companies that did not become publicly traded until after the enforcement action was initiated.” *Methodology*, NYU POLLACK CTR. FOR L. & BUS., <http://www.law.nyu.edu/centers/pollackcenterlawbusiness/seed/methodology> [<https://perma.cc/4KZ8-ZX7A>]. SEED uses the following definition for subsidiaries: “Subsidiaries are defined as those entities that had a publicly-traded parent company at the time the enforcement action was initiated, or otherwise within the five-year period preceding the initiation.” *Id.*

100. *Id.* The SEED data tracks the SEC’s fiscal year, which runs from October 1st to September 30th.

101. *Id.*

102. The Cornerstone Research reports are available at <https://www.cornerstone.com/Publications/Reports> [<https://perma.cc/4CWG-449P>].

103. The overall number of cases in the Dataset is marginally lower than in the Cornerstone reports (*see infra* note 104), principally because of what appears to be some double-counting and the inclusion of a few cases that had actually been initiated in an earlier time frame. The SEED database is updated on a regular basis: new cases are added, and discrepancies and errors are corrected when they are discovered. As a result, the numbers cited in the various Cornerstone reports sometimes differ as the data gets refined. For example, the midyear 2019 update indicates a total of 49 actions for FY 2010 (*see* CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY: PUBLIC COMPANIES AND SUBSIDIARIES – MIDYEAR FISCAL 2019 UPDATE 3 (2019)), while the 2018 year-end report

The Dataset contains a total of 529 actions against public companies and subsidiaries of public companies. The following table provides a broad summary of these actions broken down by year. The numbers are further broken down to reflect how many of the cases were filed in the administrative forum and how many were filed as federal district court actions. The table further breaks down the number of public company actions that were filed as settled actions, how many included a civil penalty, and finally how many public company actions also had individual defendants or respondents.

indicates a total of 51 actions for FY 2010 (*see* CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY: PUBLIC COMPANIES AND SUBSIDIARIES – FISCAL YEAR 2018 UPDATE 4 (2018)). The Dataset is based on information available on the SEED database as of February 2019, checked against SEC releases.

TABLE 1

	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Public Co. Actions ¹⁰⁴	44	48	40	37	51	81	92	64	72	529
Admin. Actions	14	23	17	19	41	75	84	57	61	391
Civil Actions	30	25	23	18	10	6	8	7	11	138
Public Co. Actions Filed as Settled ¹⁰⁵	40 ¹⁰⁶	45 ¹⁰⁷	32	33	47	77	89	63	70	496
Public Co. Actions w/ Penalties ¹⁰⁸	22 (21)	24 (23)	25 (19)	25 (23)	43 (40)	73 (72)	78	55	62	407
Public Co. Actions w/ Individuals	19	8	17	15	10	11	17	9	16	122

Looking at the overall top line numbers, a few big picture items emerge rather clearly.

First, the number of actions involving public companies has risen fairly

104. The numbers in the Dataset differ slightly from the numbers listed in the Cornerstone Research report, SEC Enforcement Activity: Public Companies and Subsidiaries – Midyear Fiscal 2019 Update [hereinafter Cornerstone Report] as follows: (1) overall the Cornerstone Report indicates 534 cases from FY 2010 through FY 2018, versus 529 in the Dataset; (2) for 2010, the Cornerstone Report indicates 49 actions instead of 44 in the Dataset; (3) the numbers in the Cornerstone Report also differ slightly from those in the Dataset for other years: for 2015 there are 81 cases in the Dataset and 82 in the Cornerstone Report; for 2016 there are 92 cases in the Dataset and 91 in the Cornerstone Report; for 2017, there are 64 cases in the Dataset and 65 in the Cornerstone Report; for 2018, there are 72 cases in the Dataset and 71 in the Cornerstone Report.

105. This row includes actions that were filed as settled actions, meaning that a consent judgment was filed along with the complaint (in a federal district court action), or the Order Instituting Proceedings (in an Administrative or Cease-and-Desist proceeding) also included findings and the entry of an Order imposing sanctions (entered with the consent of the respondent). The vast majority of actions that are filed as contested actions later settle.

106. This number includes the Bank of America case, which is a bit of an oddity: the case was filed as a settled action in 2009, but Judge Rakoff rejected the settlement and set the case for trial. The SEC subsequently filed additional charges in 2010, also with a consent judgment, which was eventually approved by Judge Rakoff. *See infra* note 206.

107. Two of the three unsettled matters were stop orders.

108. The top number reflects the number of cases filed in that FY for which a penalty was obtained; some penalties were obtained in subsequent years: the number in parentheses indicates the number of cases for which penalties were obtained in the same FY as filing.

significantly over the last four fiscal years: for the period from 2010 through 2014, the SEC averaged 44.8 public company cases per fiscal year; from 2015 through 2018, the SEC averaged 76.75 public company cases per fiscal year.¹⁰⁹ However, these numbers could be a bit misleading because the SEC conducted a one-time sweep of municipal bond issuers and underwriters in 2015 and 2016, which provided very favorable settlement terms for entities that self-reported abuses, which a large number of entities chose to do.¹¹⁰ During FY 2015, there were twenty-five public company entities that were part of the sweep, and in 2016 there were an additional eight.¹¹¹ Backing out of those cases would bring the FY 2015 number down to fifty-six but would still leave the FY 2016 number at eighty-four, which overall still reflects a significant rise over the last four fiscal years (an average of sixty-nine public

109. The true numbers may be even starker. As Urska Velikonja has pointed out, looking at the number of SEC “actions” can be misleading because the SEC sometimes brings multiple actions against the same person for the same misconduct, usually a civil court action and an administrative proceeding. Urska Velikonja, *Reporting Agency Performance: Behind the SEC’s Enforcement Statistics*, 101 CORNELL L. REV. 901 (2016). This is less of an issue following the passage of Dodd-Frank because the agency can now get pretty much the same relief in either forum, so for the most part there is no longer a reason for bringing two separate actions. But the early years of the Dataset predate Dodd-Frank, and so for 2010 and 2011 there are several instances where the SEC brought simultaneous actions in both federal court and in the administrative forum against the same persons for the same misconduct (SEC v. Natco Group and In the Matter of Natco Group are both filed on January 11, 2010, and each counted as a separate action by the SEC and in the Dataset. Securities and Exchange Commission v. NATCO Group Inc., Civil Action No. 4:10-CV-98 (S.D. Tex. Jan. 11, 2010); In the Matter of Natco Group Inc. Exchange Act Release No. 61,325 (Jan. 11, 2010). SEC v. Office Depot, Inc. and In the Matter of Office Depot, Inc. are both filed on October 21, 2010 and counted as separate cases. Securities and Exchange Commission v. Office Depot, Inc., Civ. Action No. 9:10-cv-81239 (S.D. Fla. Oct. 21, 2010); In the Matter of Office Depot, Inc., Exchange Act Release No. 63,152 (Oct. 21, 2010)). The “real” number of actions for FY 2010 and 2011 is thus lower than indicated in the table.

110. The sweep was known as the Municipalities Continuing Disclosure Cooperation (MCDC) initiative. Press Release, Sec. & Exch. Comm’n, SEC Launches Enforcement Cooperation Initiative for Municipal Issuers and Underwriters (Mar. 10, 2014), <https://www.sec.gov/news/press-release/2014-46> [<https://perma.cc/Y6A7-YPSE>].

111. Lists of the actions that were part of the MCDC initiative can be found at: Press Release, Sec. & Exch. Comm’n, SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative (Aug. 24, 2016), <https://www.sec.gov/news/pressrelease/2016-166.html> [<https://perma.cc/6QCL-55LX>]; Press Release, Sec. & Exch. Comm’n, SEC Completes Muni-Underwriter Enforcement Sweep (Feb. 2, 2016), <https://www.sec.gov/news/pressrelease/2016-18.html> [<https://perma.cc/6Q5D-DPV6>]; Press Release, Sec. & Exch. Comm’n, SEC Charges 36 Firms for Fraudulent Municipal Bond Offerings (June 18, 2015), <https://www.sec.gov/news/pressrelease/2015-125.html> [<https://perma.cc/KD3C-HGD8>]; Press Release, Sec. & Exch. Comm’n, SEC Sanctions 22 Underwriting Firms for Fraudulent Municipal Bond Offerings (Sept. 30, 2015), <https://www.sec.gov/news/pressrelease/2015-220.html> [<https://perma.cc/NZ9W-NZTW>].

company cases per year).

Second, while the number of public company actions has typically been a relatively small percentage of the total number of new actions filed in a given year, the amount of the fines collected in public company cases is a disproportionate percentage of the total fines the SEC has assessed in any given fiscal year. Although the penalty percentage varies widely, it is always considerably more than the case percentage, and in a few instances the penalties obtained from public companies constitute the overwhelming majority of the total penalties assessed. For example, during the last four fiscal years (FY 2015 to FY 2018), public company cases constituted roughly 12 to 14% of the total new actions (excluding delinquent filing cases) brought by the SEC;¹¹² during that same time frame, penalties assessed in public company cases constituted 46% of the total penalties assessed by the SEC in FY 2017; 56% of the total in FY 2015; 84% of the total in FY 2018 and 86% of the total in FY 2016. As reflected in the chart below, the lowest total was 31.4% (FY 2014) and the highest was almost 97% (FY 2010).¹¹³ (The penalty numbers are in millions and have been rounded off.)

112. In FY 2015, the number of public company cases was 73 and the total number of new cases was 507 (14.3%); in FY 2016 the numbers were 78 and 548 (14.2%); in FY 2017 the numbers were 55 and 446 (12.3%); in FY 2018 the numbers were 65 and 490 (13.2%).

113. In FY 2010, the SEC obtained penalties totaling \$997,800,000. The SEC also obtained a \$75 million penalty in a case (In the matter of Morgan Asset Management) that was filed in FY 2010, but the penalty was paid as part of a settlement reached in FY 2011. When a civil penalty was assessed in a different year than the year the case was filed, I have counted it in the year obtained rather than the year filed.

TABLE 2

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018
Public Co. penalties	998	513 ¹¹⁴	334 ¹¹⁵	919 ¹¹⁶	433 ¹¹⁷	658 ¹¹⁸	1,096	384	1,211
Top three public co. penalties	785	337	235	809	202	354 ¹¹⁹	635	152	931
Top five public co. penalties	935	391	271	863	278	440	790	186	1,001
Total SEC penalties ¹²⁰	1,030	928	1,021	1,167	1,378	1,175	1,273	832	1,439

Third, the total penalty numbers for every year in the Dataset are skewed by a very small number of cases involving very large penalties.¹²¹ This is true for every year in the Dataset: as reflected in the chart above, in only two years (FY 2014 and FY 2017) were the top three public company penalties less than 50% of the total public company penalties for that year (the lowest was 39.5% in 2017), and in some years the amount was considerably higher. For example, in FY 2010 the top three public company penalties accounted for 78% of all the public company penalties that year; in FY 2013 the top three accounted for 88% of the total; and in FY 2018 the top three accounted for just under 77% of the total. Indeed, in FY 2018 a single case accounted for 70% of the total public company penalties that year.¹²²

114. This number includes a \$75 million penalty in a case filed in 2010 (Morgan Asset Management, Exchange Act Release No. 64,720 (June 22, 2011)), but excludes a \$22 million penalty obtained in FY 2017 in SEC v. Stifel, Nicolaus & Co. Stifel, Nicolaus & Co., Inc., et al., Investment Advisers Act Release No. 5189 (Aug. 10, 2011).

115. This number excludes penalties totaling approximately \$41 million which were obtained in subsequent years with respect to six cases.

116. This number includes approximately \$3 million obtained in FY 2013 from cases filed in previous years but excludes \$113 million obtained in subsequent years.

117. This number excludes approximately \$3.5 million obtained in subsequent years but includes approximately \$9.4 million obtained from cases filed in prior years.

118. This number excludes approximately \$6.5 million obtained in subsequent years, but includes approximately \$119.6 million from prior year cases, including \$109.2 million obtained in a settlement in the SEC v. Bank of America case filed in FY 2013.

119. The second largest penalty obtained in FY 2015 was \$109.2 million which was from the SEC v. Bank of America case filed in FY 2013.

120. The total penalty numbers come from SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2017: ENFORCEMENT INFORMATION ONLY 2 (2018); U.S. SEC. & EXCH. COMM'N DIV. OF ENF'T, ANNUAL REPORT 11 (2018).

121. *Id.* (emphasizing the effect that relatively few cases have on overall penalty totals).

122. See *Petroleo Brasileiro S.A. – Petrobras*, Exchange Act Release No. 84,295 (Sept.

Looking at the top five public company penalties for each year in the Dataset yields even higher proportions. The top five penalty cases in 2010 and 2013 each accounted for 93% of the total public company penalties in those years; the top five for 2012 amounted to 81% of the total; for 2018, it was 82.6% of the total. In only one year (2017) did the top five amount to less than 50% of the total, and in every other year it was at least 64%.

Because so much of the penalties in any given year are attributable to a small number of cases, looking at the total amount of penalties imposed on public companies in any given year, or even at averages or medians, is not particularly useful in discerning trends, although looking at the overall top-line number may be indicative of the agency's general approach to penalties.

Fourth, civil penalties against public companies have become routine and the norm. Overall, civil penalties were assessed against public companies in 407 of the 529 total actions identified in the Dataset, or 76.9%, and in 407 of the 524 actions that have been resolved to date, or 77.6%. But more important, the percentage has gone up dramatically over the past five fiscal years: in the first two years of the Dataset, penalties were obtained in exactly half the cases; in the next two years, the number went up to 62.5% and 67.5% respectively; but from there it was off to the races: in the five fiscal years from 2014 through 2018, penalties were obtained in 311 of the 360 cases filed during that time frame, or 86.3% (or 87.35% of the 356 cases that were resolved during that time frame). The figure reached 90% in 2015. The numbers have remained fairly constant during the Clayton administration: penalties were obtained in 85% of the public company cases brought in FY 2017, in 86% of the public company cases brought in FY 2018, and 88% of the FY 2018 public company cases that were resolved in that time frame. Although, as discussed below, the total amount of the penalties may be trending down under Chairman Clayton, it is clear that penalties, even if they are smaller in size, are still being assessed as a matter of course.

Civil penalties were assessed even in cases where the company's cooperation was noted in connection with the settlement,¹²³ although it is impossible to tell how much the penalty may have been reduced as a result of cooperation. Cooperation resulted in no civil penalty on only a few

27, 2018) (imposing a penalty of \$853,200,000). The Petrobras case skewed the results for FY 2018, as discussed below. *See infra* note 152.

123. *See, e.g.*, Maxwell Technologies, Inc., Van M. Andrews, David J. Schramm, and James W. DeWitt, Jr., CPA, Securities Act Release No. 10472, Exchange Act Release No. 82,950 (Mar. 27, 2018) (noting that the Commission considered Maxwell's cooperation and ultimately imposed a \$2.8 million civil penalty).

occasions.¹²⁴

Moreover, many SEC actions where no penalties were assessed were cases charging violations of the Foreign Corrupt Practices Act (FCPA) where a penalty was imposed against the public company in a parallel criminal proceeding brought at the same time as the SEC action.¹²⁵ In those cases, it is clear—and typically explicitly stated—that the reason that the SEC did not seek a civil penalty is because a penalty was being paid to another authority; indeed, such cases are typically resolved as part of a global settlement, where the overall monetary resolution is agreed to and then allocated among regulators and criminal authorities. For example, of the forty-nine cases in the five fiscal years from 2014 through 2018, where no civil penalty was assessed, seventeen (or 37.7%) were FCPA cases; criminal fines were imposed in fifteen of those cases, and the SEC frequently made clear in the order itself that a civil penalty was not being imposed only because the defendant or respondent had agreed to pay a criminal penalty in a parallel action.¹²⁶ Overall, there are a total of ninety-three FCPA cases in the

124. *See, e.g.*, Provectus Biopharmaceuticals, Inc., Exchange Act Release No. 82,292 (Dec. 12, 2017) (entering a cease-and-desist order with no civil penalty); Koninklijke Phillips Electronics N.V., Exchange Act Release No. 69,327 (Apr. 5, 2013) (entering a cease-and-desist order and ordering payment of disgorgement and prejudgment interest but no civil penalty); The Goodyear Tire & Rubber Company, Exchange Act Release No. 74,356 (Feb. 24, 2015) (entering a cease-and-desist order with payment of disgorgement and prejudgment interest but no civil penalty). *See also* CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY: PUBLIC COMPANIES AND SUBSIDIARIES – FISCAL YEAR 2018 UPDATE 9 (2018) (noting that of the 49 settlements in FY 2018 that noted cooperation, 94 percent included monetary sanctions).

125. *See, e.g.*, Press Release, Sec. & Exch. Comm’n, Wire and Cable Manufacturer Settles FCPA and Accounting Charges (Dec. 29, 2016), <https://www.sec.gov/news/pressrelease/2016-283.html> [<https://perma.cc/7A4N-PMTM>] (describing a case charging violations of the FCPA where a parallel criminal penalty was imposed).

126. *See, e.g.*, LAN Airlines S.A., Exchange Act Release No. 78,402 (July 25, 2016) (noting that the “Commission is not imposing a civil penalty based upon its payment of a \$12,750,000 criminal fine as part of Respondent’s settlement with the United States Department of Justice”); Och-Ziff Capital Management Group LLC, Exchange Act Release No. 78,989 (Sept. 29, 2016) (noting that the “Commission is foregoing a one-time \$173,186,178 civil penalty for these charges based upon the imposition of a \$213,055,689 criminal penalty as part of Och-Ziff’s settlement with the United States Department of Justice”); JP Morgan Chase & Co., Exchange Act Release No. 79,335 (Nov. 17, 2016) (noting that the “Commission is not imposing a civil penalty based upon the imposition of a \$72,000,000 criminal fine as part of JPMorgan APAC’s settlement with the United States Department of Justice”); Credit Suisse Group Ag, Exchange Act Release No. 83,593 (July 5, 2018) (noting that the “Commission is not imposing a civil penalty based upon the imposition of a \$47 million criminal fine as part of Credit Suisse’s settlement with the United States Department of Justice”).

Dataset,¹²⁷ and penalties were obtained in almost exactly half of those cases. If the FCPA cases are removed from the Dataset, then penalties were obtained in 83.75% of the total cases resolved to date (361 out of 431).

Fifth, the vast majority of the cases against public companies were filed as settled actions. Most SEC actions in general are settled, either at the outset or at some point prior to trial, and a significant number of those cases are settled at the time of filing, but in the cases involving public companies the numbers are overwhelming.¹²⁸ 496 of the 529 actions were filed as settled actions (93.7%). The number of cases that were filed as contested actions was very small (33 of 529), and most of those subsequently settled. Only a handful proceeded to some form of trial. Moreover, the percentage of actions that are filed as settled actions has increased over the time period of the Dataset: in FY 2016 it was 96.7%, in FY 2017 it was 98.4%, and in FY 2018 it was 97.2%.

Sixth, a very large, and growing, percentage of the actions against public companies were brought in the administrative forum, rather than in federal court. Overall, of the 529 actions, 391 (or 65.6%), were administrative, while 138 were brought in federal court. The administrative turn began after the passage of Dodd-Frank in 2010 and accelerated starting in 2014: of the 360 actions in the Dataset filed in FY 2014 through FY 2018, 318 were administrative (88.3%) and forty-two were federal court actions.

B. *The Charges*

The following chart provides a breakdown of the charges involved in the cases in the Dataset, separating among scienter-based fraud charges (S Fraud), non-scienter-based fraud charges (NS Fraud), Foreign Corrupt

127. There are two additional FCPA cases in the Dataset that also included fraud charges and, as discussed below are being treated as fraud cases for purposes of the analysis herein.

128. There is some debate about how many SEC cases overall are “settled.” In 2013, then-Commissioner Aguilar stated that the SEC “currently settles approximately 98% of its Enforcement cases.” Comm’r Luis Aguilar, *A Stronger Enforcement Program to Enhance Investor Protection* (Oct. 25, 2013). Some scholars have also referenced very high numbers of settled actions. See, e.g., Ross MacDonald, *Setting Examples, Not Settling: Toward a New SEC Enforcement Paradigm*, 91 TEX. L. REV. 419, 421 (2012) (claiming that 98% of SEC cases were settled). An analysis by Urska Velikonja indicates that the actual number of cases that are settled at some point may be closer to 75%; the same study posits that the number of actions that are filed as settled actions varies from year-to-year, and in the period covered by the study years ranged from 32% to 48%. Urska Velikonja, *Are the SEC’s Administrative Law Judges Biased? An Empirical Investigation*, 92 WASH. L. REV. 315, 346 (2017). However, because most of the cases that do not settle are either dismissed or resolved on a motion for summary judgment, very few SEC actions go through to trial: Prof. Velikonja concluded that the number is around 3.6%. *Id.*

Practices charges (FCPA), books and records (B&R), miscellaneous other charges (which mostly involve technical rules governing regulated persons) (Other), and further separating the cases based on whether a penalty was obtained (P), whether there was no penalty (NP), and whether the case remains unresolved (U). Finally, the cases are separated by fiscal year and by whether they involved a company in the financial services industry (FS) or not (Non).¹²⁹

129. Many of the cases in the Dataset contain multiple charges: a defendant might be charged with scienter-based fraud, non-scienter-based fraud, books and records violations and other charges. I have categorized the cases by the most serious violation and only counted them once, even if there are multiple violations. Thus, if there are both scienter-based fraud charges and non-scienter-based fraud charges, the case is categorized as scienter-based and only counted once. I have ranked fraud charges (whether or not scienter-based) over all other charges: so, if there were FCPA and fraud charges, I have counted the case once as a fraud case. On a few occasions, there are charges under Section 17(a) of the Securities Act, without specifying a subsection. Section 17(a)(1) is scienter-based; Sections 17(a)(2) & (3) are non-scienter-based. Where there is an undifferentiated Section 17(a) charge, I have counted it as scienter-based, even though it was likely left ambiguous so the defendant could plausibly argue that there were not scienter-based charges. Technically, FCPA cases are mostly books and records cases, but they are treated as a distinct category by the SEC. To determine whether a company was in the financial services industry, I sorted the data using the Standard Industry Classification (SIC) codes, available at <https://www.sec.gov/info/edgar/siccodes.htm> [<https://perma.cc/2CGG-HK2T>].

TABLE 3

FY		S Fraud			NS Fraud			FCPA			B & R	Other			Total	
		P	NP	U	P	NP	U	P	NP	U		P	NP	U		
2010	FS	2	1		4	1					1	1		4		14
	Non	5	4			2		5	7		1	5		1		30
2011	FS	4	1		4	2						1		2	2	16
	Non	2	2		1			7	10		4	4		2		32
2012	FS	6	1		6				1			1		5	1	21
	Non	3	1	1	1	1		3	6		1	2				19
2013	FS		2		7			1			2	1		3	1	17
	Non	5	4		1			1	3		2	1		3		20
2014	FS	4			9	2					3			8		26
	Non	6	1		2	1		3	4		6			2		25
2015	FS	2			28	1		1			3			15		50
	Non	6	2		5	1		6	3		4	1		3		31
2016	FS	4	1		31						4			12		52
	Non	6	1	1	4	4	1	11	6		4			2		40
2017	FS	2			16				1		1			5	1	26
	Non	6	2		7	1		3	4		12			3		38
2018	FS	1			20			1	2		2			11		37
	Non	5	2	2	10	2		4			4	1		4	1	35
Total FS	25	6		1 2 5	6		3	4		1 6	4		6 5	5		2 5 9
Total Non-FS	44	19	4	3 1	12	1	4 3	43		3 8	14		1 7	4		2 7 0
Total	69	25	4	1 5 6	18	1	4 6	47		5 4	18		8 2	9		5 2 9

C. *Fraud vs. Non-Fraud*

The cases in the Dataset are divided almost evenly between fraud cases (273) and non-fraud cases (256), and overall penalties were obtained more often in fraud cases than in non-fraud cases, which makes intuitive sense. Penalties were obtained in 225 of the 273 fraud cases, or 82.4% (the figure is 83.9% when taking account of the five still unresolved matters in the Dataset), and in 182 of the 256 non-fraud cases, or 71%. However, ninety-three of the cases in the Dataset are FCPA cases, about half of which involved a penalty and half of which did not. As discussed above, in most of the FCPA cases where the SEC did not impose a penalty, the reason was because a penalty was assessed in a parallel criminal proceeding. Leaving out the FCPA cases, penalties were obtained in 136 of the 163 non-fraud cases, or 83.4%, which is almost exactly in line with cases involving fraud and indicates that overall the agency is not distinguishing between fraud and non-fraud charges when imposing a penalty on a public company.

D. *Scienter-Based Fraud vs. Non-Scienter-Based Fraud*

The federal securities laws contain several anti-fraud provisions. The state of mind requirement necessary to show a violation of these provisions differs, sometimes even within the particular provision. Some violations require a showing of scienter which has been defined as “a mental state embracing intent to deceive, manipulate or defraud.”¹³⁰ Recklessness meets the scienter requirement, although courts differ in the degree of recklessness required.¹³¹ Other violations are non-scienter-based, meaning that a showing of negligence is sufficient: intent or recklessness is not required. Anti-fraud provisions that are scienter-based include Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;¹³² Section 17(a)(1) of the Securities Act;¹³³ Section 15(c)(1) of the Exchange Act;¹³⁴ and Section 206(1) of the Advisers Act.¹³⁵ Anti-fraud provisions that are non-scienter-based include Sections

130. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

131. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (“Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required.”) (citing *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 343 (4th Cir. 2003)).

132. *Ernst & Ernst*, 425 U.S. at 197–212.

133. *Aaron v. Sec. & Exch. Comm’n*, 446 U.S. 680, 695–96 (1980).

134. *Sec. & Exch. Comm’n v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012); *Sec. & Exch. Comm’n v. George*, 426 F.3d 786, 792 (6th Cir. 2005).

135. *Sec. & Exch. Comm’n v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963).

17(a)(2) and (3) of the Securities Act;¹³⁶ Section 14(a) of the Exchange Act and Rule 14a-9 thereunder;¹³⁷ Sections 206(2) and 206(4) of the Advisers Act;¹³⁸ and Section 34(b) of the Company Act.¹³⁹

The distinction between scienter-based and non-scienter-based fraud charges is significant for three reasons. First, generally speaking, scienter-based fraud charges are considered more serious than non-scienter-based fraud charges because they are based on intentional rather than merely negligent conduct. Second, scienter-based fraud charges can also have onerous collateral consequences. For example, there are various “bad-boy” provisions under the federal securities laws that are triggered by the entry of fraud charges, but that are typically applied only in the case of scienter-based fraud. Third, an SEC charge involving scienter-based conduct is far more likely to trigger a private class action lawsuit than a negligence-based charge.

The first thing to note is that while the number of scienter-based fraud cases involving public companies has remained relatively constant year-over-year (typically there are ten to twelve cases each FY), the number of non-scienter-based fraud cases has grown exponentially, both in real terms and in relation to the scienter-based cases, a trend that is particularly acute in the later part of the Dataset. During the first four years in the Dataset (FY 2010 through FY 2013) there were more scienter-based cases (forty-four) than non-scienter-based cases (thirty); but in the last five years in the Dataset (FY 2014 through FY 2018), there were a total of fifty-four scienter-based fraud cases compared to 145 non-scienter-based fraud cases.

Overall, penalties were obtained in sixty-nine of the ninety-eight cases in the Dataset involving scienter-based fraud, or 70.4% (the number jumps to 73.4% when taking account of the four unresolved scienter-based cases (sixty-nine of ninety-four)). But oddly, penalties were obtained in 156 of the 175 non-scienter-based fraud cases in the Dataset, or 89.1% (the figure is 89.6% when taking account of the one unresolved non-scienter-based fraud

136. *Aaron*, 446 U.S. at 697.

137. *See, e.g.*, *Gerstle v. Gamble-Skogmo*, 478 F.2d 1281, 1301–02 (2d Cir. 1973) (ruling that liability under 14a-9 requires a “causal relationship between the violation and the injury”); *Sec. & Exch. Comm’n v. Das*, 723 F.3d 943 (8th Cir. 2013) (declining to extend scienter requirement to corporate officers). The Supreme Court has not ruled on whether scienter is required under Section 14(a). *Va. Bankshares Inc. v. Sandberg*, 501 U.S. 1083, 1090 n.5 (1991); *TSC Indus., Inc. v. Northway Inc.*, 426 U.S. 438, 444 n.7 (1976).

138. *Sec. & Exch. Comm’n v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (“Similarly, a violation of §206(2) of the Investment Advisers Act may rest on a finding of simple negligence.”).

139. *See id.* at 643 n.5 (applying a negligence standard with respect to section 34(b) of the Company Act); *William Blair & Co., L.L.C.*, Investment Advisers Act Release No. 4,695, Investment Company Act Release No. 32,621 (May 1, 2017) (“Proof of scienter is not required to establish a violation of Section 34(b) of the Investment Company Act.”).

case). In other words, penalties were obtained considerably more frequently in cases involving the less serious charges, which seems entirely counterintuitive. Indeed, the percentage of scienter-based fraud cases where a penalty was obtained (70.4%) is much closer to the overall percentage for non-fraud cases (71%) than it is to the percentage for non-scienter-based fraud (89.1%), and even considerably lower than the percentage for non-FCPA non-fraud cases (83.4%), as noted above. In other words, a public company was more likely to be subjected to a civil penalty in a *non*-fraud case than in one involving the most serious fraud charges.

The gap between penalties in scienter-based versus non-scienter-based cases has narrowed a bit in the last few years, but remains notable: for FY 2014 through 2018, penalties were obtained in forty-two of fifty-four scienter-based cases, or 77.7% (a number that jumps to 82% when excluding the three unresolved cases); during the same time frame penalties were obtained in 132 of the 145 non-scienter-based fraud cases, or 91% (91.6% excluding the one unresolved matter).

Finally, it should be noted that some of these numbers could be a bit skewed because the agency conducted the Municipalities Continuing Disclosure Cooperation (MCDC) initiative in FY 2015 and FY 2016. As part of that program, the SEC offered to settle on very favorable terms cases involving municipal issuers and underwriters who self-reported that they had made inaccurate statements in certain bond offering documents.¹⁴⁰ Specifically, the Division of Enforcement outlined a standardized settlement package that included a violation of Section 17(a)(2) of the Securities Act, along with specified undertakings, and in the case of underwriters, the payment of a civil penalty calculated according to a formula based primarily on the size of the offerings.¹⁴¹

The MCDC initiative produced a significant number of SEC enforcement cases, including a fairly large number of cases involving public companies, and because they were all settled on the same terms including non-scienter-based charges and a penalty, the initiative could have a distortive effect on the study sample.¹⁴² In FY 2015, twenty-five of the thirty-

140. Press Release, Sec. & Exch. Comm'n, SEC Launches Enforcement Cooperation Initiative for Municipal Issuers and Underwriters (Mar. 10, 2014), <https://www.sec.gov/news/press-release/2014-46> [<https://perma.cc/9XFD-WGRG>].

141. Sec. & Exch. Comm'n Div. of Enf't, *Municipalities Continuing Disclosure Cooperation Initiative*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml> [<https://perma.cc/4ZNX-WKGD>] (last modified Nov. 13, 2014) (specifying the formula to determine civil penalties for eligible underwriters).

142. In total there were 143 enforcement actions tied to the MCDC initiative in FYs 2015

five non-scienter-based fraud cases in the Dataset were part of the MCDC initiative, and in FY 2016, seven of the forty non-scienter-based fraud cases in the Dataset were part of the MCDC initiative. However, even if we back-out all thirty-two MCDC initiative cases from the Dataset, the numbers do not change significantly: without the MCDC cases, penalties were obtained in 124 of the 143 non-scienter-based fraud cases remaining in the Dataset, or 86.71% (the number is 87.3% if we discount the one unresolved case).

Moreover, the trend towards non-scienter-based fraud charges, and the penalty disparity in comparison to scienter-based charges has continued in the two fiscal years after the conclusion of the MCDC initiative: in each of FY 2017 and FY 2018 there were ten scienter-based-fraud cases, while there were twenty-four non-scienter-based cases in FY 2017 and thirty-two in FY 2018. Penalties were imposed in 80% of the scienter-based fraud cases in FY 2017 and in 75% of the resolved scienter-based fraud cases in FY 2018. On the other hand, penalties were obtained in 95.8% (twenty-three of twenty-four) non-scienter-based fraud cases in FY 2017, and in 93.75% (thirty of thirty-two) non-scienter-based fraud cases in FY 2018.

E. Financial Services Firms vs. Non-Financial Services

Financial services firms are the bread-and-butter of the SEC regulatory, oversight, and enforcement regimes: they are regulated entities that are typically required to register with the agency as broker-dealers, investment advisers, investment companies, or some combination, and their proper conduct is at the heart of the agency's mission. The cases in the Dataset are almost evenly divided between those involving financial services firms (259) and those involving non-financial services firms (270). However, financial services firms were charged with scienter-based fraud far less often than non-financial services firms: non-financial services firms were charged in sixty-seven of the ninety-eight scienter-based fraud cases in the Dataset (68.36%), while financial services firms were charged with scienter-based fraud in thirty-one of the ninety-eight cases (31.63%). On the other hand, financial services firms were far more likely than non-financial services firms to be charged with non-scienter-based fraud: financial services firms were named in 131 of the 175 non-scienter-based fraud cases in the Dataset (74.85%), while non-financial services firms were named in forty-four of the 175 cases (25.14%). Even backing out the thirty-two MCDC cases (all of which involved financial services firms), the numbers are still striking: financial

and 2016, which certainly skewed the overall enforcement numbers for those years. U.S. SEC. & EXCH. COMM'N DIV. OF ENF'T, ANNUAL REPORT 9 (2018).

services firms were charged with non-scienter-based fraud in ninety-nine of the 143 non-MCDC cases (69.23%) while non-financial services firms were charged in forty-four of the 143 cases (30.76%).

At the same time, financial services firms were more likely than non-financial services firms to be assessed a civil penalty, whether the charge was scienter-based or non-scienter-based fraud. Financial services firms were assessed a penalty in twenty-five of the thirty-one cases where they were charged with scienter-based fraud (80.64%), while non-financial services companies were assessed a penalty in forty-four of the sixty-three cases (69.84%) that have been resolved to date in which they were charged with scienter-based fraud (another four cases remain unresolved). More starkly, financial services firms were assessed a civil penalty in 125 of the 131 cases where they were charged with non-scienter-based fraud (95.41%), while non-financial services firms were assessed a penalty in thirty-one of the forty-three cases (72%) that have been resolved in which they were charged with non-scienter-based fraud (one case remains unresolved).

The trend towards charging financial services firms with non-scienter-based fraud (rather than scienter-based) has accelerated in the last five fiscal years. From FY 2014 through FY 2018, financial services firms were charged with scienter-based fraud in only fourteen cases in the Dataset; during the same time non-financial services firms were charged with scienter-based fraud in forty cases. The financial services cases comprise 25.92% (fourteen of fifty-four) of the total number of scienter-based fraud cases for those years in the Dataset. On the other hand, financial services firms were charged with non-scienter-based fraud in 107 cases in the Dataset during that time period, while non-financial services companies were charged with non-scienter-based fraud in thirty-eight cases. The financial services cases comprise 73.79% (107 of 145) of the total number of non-scienter-based fraud cases for those years in the Dataset.¹⁴³ At the same time, a penalty was imposed in all but three of the 107 financial services non-scienter-based fraud cases during that time period.

F. Non-Fraud Non-FCPA Cases

The trend towards routinizing civil penalties in public company enforcement actions is even more evident when it comes to non-fraud non-FCPA cases. These actions include books and records cases, as well as a variety of other violations, most typically broker-dealer cases. Overall, penalties were obtained in 75% of the books and records cases in the Dataset

143. Removing the 32 MCDC cases lowers the percentage to 66.37% (75 of 113).

(fifty-four of seventy-two), and in 90% of those categorized as “Other” (eighty-two of ninety-one). But these numbers do not reflect the whole story: in the first four years in the Dataset (FY 2010 through 2013), penalties were obtained in eleven of the twenty-seven books and records cases (40.7%), while no penalty was assessed in 59.2% of those cases, and penalties were assessed in seventeen of the twenty-four “Other” cases (70.8%). But in the last five years (FY 2014 through FY 2018), things have changed drastically: during that time frame, penalties were obtained in forty-three of the forty-five books and records cases (95.55%), and in sixty-five of the sixty-seven “Other” matters (97%).

G. Individuals

When it comes to charging individuals in the public company cases—or in related actions—a few trends emerge. Most notably, the percentage of public company cases where one or more individuals was charged has declined during the time frame of the study, and more important, the number of financial services cases where individuals were charged has declined significantly.

Although critics often point out the lack of individual charges particularly in prominent SEC enforcement actions, the cases in the Dataset show that individuals do in fact get charged, albeit in a minority of the cases. Overall, one or more individuals were charged in a public company action or related actions with respect to 122 of the 529 actions in the Dataset, or 23%. However, the percentage declines over time: from FY 2010 through FY 2013, individuals were charged in fifty-nine of the 169 actions (or in related actions), or 34.9%. From FY 2014 through FY 2018, individuals were charged in 63 of the 360 actions (or in related actions), or 17.5%.

With respect to financial services firms, the number of cases where individuals are charged has declined, and perhaps equally telling, the instances where individuals are charged in financial services cases involving major financial institutions has practically disappeared. In the early years in the Dataset, individuals were charged in a fair number of cases involving financial institutions, including major financial institutions. For example, there are forty-four public company actions in FY 2010. Overall, individuals were charged in nineteen of those cases (or in related actions), or 43%. Fourteen of the FY 2010 actions involved financial institutions; one or more individuals were charged in seven of those cases (or 50%). Moreover, individuals were charged in cases involving some of the biggest players in the financial services industry, including Goldman Sachs, JP Morgan, and Bank of America, as well as some smaller but still well-known players such

as Morgan Asset Management.

Although fewer individuals were charged in FY 2011, in FY 2012 and FY 2013 the numbers were back to previous levels. In FY 2012, there were a total of forty public company actions, and individuals were charged in seventeen of those actions (or related actions) amounting to 42.5%. Twenty-one of the FY 2012 actions involve financial institutions and one or more individuals were charged in seven of those actions (33.33%). Again, many of these actions involved prominent players, such as Wells Fargo and Credit Suisse. In FY 2013, there were a total of thirty-seven public company actions, and individuals were charged in fifteen of those actions (or related actions) amounting to 40.5%. Seventeen of the FY 2013 actions involve financial institutions and one or more individuals were charged in five of those actions (29.4%).

In the later part of the time frame, however, the numbers tell a different story. Overall, during the five years from FY 2014 through FY 2018, there were a total of 360 public company cases, and individuals were charged in sixty-three of those actions (or related actions), amounting to 17.5%. During that time frame, there were 191 cases involving financial institutions and individuals were charged in eleven of those actions (or related actions) amounting to 5.7%.

More specifically, in FY 2014 individuals were charged in ten of the fifty-one actions (19.6%), and individuals were charged in three of the twenty-six financial institution cases (11.5%). In FY 2015, individuals were charged in eleven of the eighty-one actions (13.5%); individuals were charged in two of the fifty financial services cases. Moreover, while those cases involved some large financial institutions they are mostly not household names (Blackrock Advisors and First Bancorp). In FY 2016, individuals were charged in seventeen of the ninety-two actions (18.4%); individuals were charged in four of the fifty-two financial services cases. With the exception of Morgan Stanley, none of these involved prominent financial institutions.

In FY 2017, there were a total of sixty-four public company cases, and individuals were charged in nine of those (or in related actions), amounting to 14%. No individuals were charged in any of the twenty-six financial institution cases that year.

In FY 2018, there was a total of seventy-two public company cases, and individuals were charged in connection with sixteen of those actions (22%). Individuals were charged in connection with only two of the thirty-seven financial institution cases filed that year (5.4%). Moreover, while one of those two cases involved scienter-based fraud charges, the other one (involving Deutsche Bank) was a failure to supervise case.

The trend seems clear: over the last five fiscal years, fewer and fewer individuals have been charged in connection with financial services cases, while the charges have increasingly trended towards non-scienter-based fraud. Overall, in the five fiscal years from 2014 through 2018, there were a total of 191 public company actions involving financial services firms; one or more individuals were charged in connection with only eleven of those actions (5.7%). 107 of the 191 actions involved non-scienter-based fraud charges, and individuals were charged in connection with seven of those cases (6.5%). Only fourteen of the 191 actions against financial services firms involved scienter-based fraud (7.3%); only two of those fourteen cases included charges against individuals.

At the same time, penalties were imposed in 104 of the 107 non-scienter-based cases against financial services firms during the period FY 2014 through FY 2018, or 97.19%. To be sure, the MCDC initiative, described above, played a role in this. The initiative accounted for twenty-five of the non-scienter-based fraud charge cases in FY 2015 and another seven in FY 2016, and a civil penalty was assessed in all of them. But even removing those thirty-two cases does not significantly alter the result: penalties were still imposed in seventy-two out of the seventy-five non-MCDC cases (96%). Moreover, the trend described here begins in FY 2014 (before the MCDC initiative) and has continued after the initiative ended in mid FY 2016.

H. Penalties and Disgorgement

One way to assess the penalty regime is to look at the relation between penalties and disgorgement. Disgorgement represents the amount of ill-gotten gains that can be tied to the unlawful conduct. Looking at the relation between disgorgement and penalties can be useful for a number of reasons: first, the fact that there is disgorgement in any particular case shows that there *were* ill-gotten gains, that is some kind of profit that was generated by the illicit scheme and with it a pecuniary motive behind the misconduct that may be indicative of willful behavior.

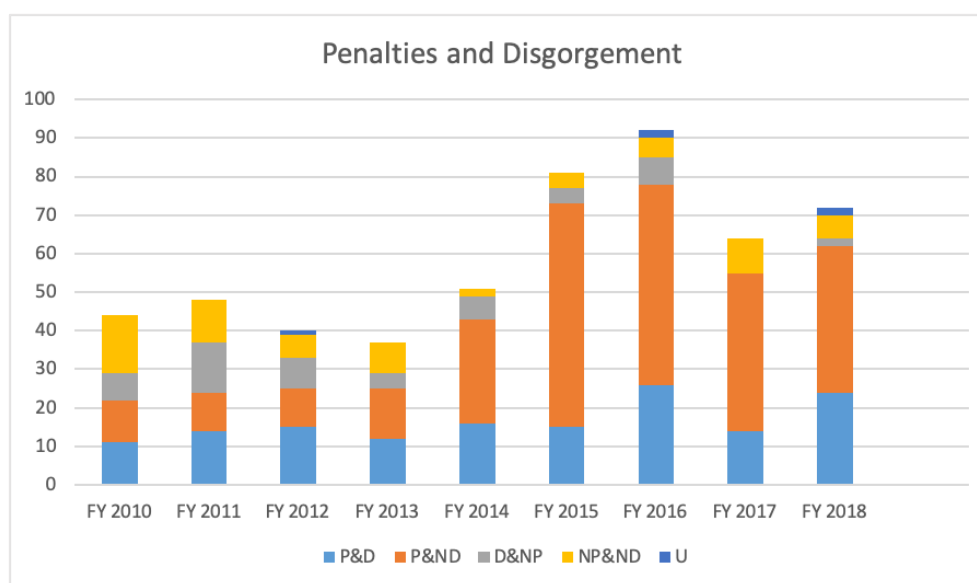
Second, the amount of disgorgement is a reflection of the extent of the illicit conduct: the larger the disgorgement, the greater the gains, which typically reflects a greater amount of misconduct, or a longer period of misconduct, or both. Third, the amount of ill-gotten gain can sometimes reflect the extent of the harm or the impact of the misconduct on third parties: in certain cases, such as offering frauds for example, the amount of ill-gotten gain also represents the amount of investor losses. Fourth, in public company cases, the presence of ill-gotten gains is one measure of whether

shareholders have profited (or stood to profit) from the illicit conduct, and shareholder gains was, at least in theory, one factor to be considered in determining whether or not a penalty should be imposed in those cases. Fifth, the presence of disgorgement is important because disgorgement is necessary in order to create a “fair fund” that can be used to distribute penalty money (along with the disgorgement and interest) to injured parties, including shareholders who may have been harmed by the misconduct. Finally, the amount of disgorgement might provide a reasonable formula for determining the appropriate amount of the penalty, as well as a means of comparing the treatment of similar cases.

Looking at the cases in the Dataset, however, reveals an actual disconnect between penalties and disgorgement, a disconnect that has become more pronounced in the later years. Overall, of the 524 total cases in the Dataset that have been resolved to date, almost exactly half (260) are cases where there were penalties but no disgorgement. Of the total 407 cases in the Dataset where penalties were imposed, 63.8% had no disgorgement.¹⁴⁴ Moreover, there is a notable and easily observable trend in that direction: in the first four years of the Dataset, the cases where penalties were imposed were divided not quite equally between cases where there were both penalties and disgorgement (52) and cases where there were penalties but no disgorgement (44), with a slight edge to cases with both forms of relief. In the later years, however, the ratio is reversed, and increasingly penalty cases have involved no disgorgement: for the five fiscal years from 2014 through 2018, there were ninety-five cases where there were both penalties and disgorgement, and 216 cases where there were penalties but no disgorgement.

144. In FY 2010, there were four penalty cases where there was nominal disgorgement of \$1, which reflects a lack of actual ill-gotten gains, but was used as a means of establishing the legal predicate for the creation of a fair fund. Those cases could be counted as no-disgorgement penalty cases; I have counted them as disgorgement penalty cases, largely because they led to the creation of distribution funds to compensate injured investors.

In the following chart the cases in the Dataset are broken down by whether they included penalties and disgorgement (P&D), penalties but no disgorgement (P&ND), disgorgement but no penalty (D&NP), no penalty and no disgorgement (NP&ND), or are still unresolved (U).



The numbers here are perhaps a bit skewed for FY 2015, and to a much lesser degree for FY 2016, because of the presence of the MCDC initiative cases, which were all settled using a standard template that included non-scienter fraud charges and penalties, but no disgorgement. Nonetheless, even excluding all the MCDC cases from the dataset does not materially change the conclusion: there were twenty-five MCDC cases in 2015 and removing them would leave a total of forty-eight penalty cases for that year of which thirty-three involved penalties but no disgorgement. For FY 2016, removing the eight MCDC cases leaves a total of seventy penalty cases of which forty-four involved penalties but no disgorgement.

Many of the cases in the Dataset in which there was disgorgement but no penalties, should arguably be viewed as more analogous to disgorgement plus penalty cases because they were FCPA cases in which the company was assessed a penalty in a parallel criminal action and the SEC specifically noted the payment of those penalties as the reason for not imposing a separate penalty. Of the fifty-one cases in the Dataset where there was disgorgement but no penalty, forty-one were FCPA cases, and criminal penalties were imposed in all but four of those cases. However, as reflected in the chart

above, the number of disgorgement but no-penalty cases appear to be on the decline: there were a total of nineteen such cases in the five fiscal years from 2014 through 2018 as compared to thirty-two in the first four fiscal years in the Dataset. In the last two fiscal years, there have been a total of only two such cases.

The lack of disgorgement in so many of the public company penalty cases reflects a lack of illicit company benefit that could be attributed to the unlawful conduct, which in turn reflects a lack of possible shareholder gains from the misconduct. This is important because improper shareholder benefit has often been advanced as one of the criteria for determining whether or not to impose a penalty: for example, the point was stressed in the early debates about giving the agency penalty authority¹⁴⁵ and the Penalty Statement posited that one of the most important factors in determining whether to impose a penalty was “the presence or absence of a direct benefit to the corporation.”¹⁴⁶ In addition, in justifying penalties against public companies, agency officials have noted that penalty money can be used to compensate injured parties, including shareholders who may have been victimized by the unlawful conduct. But the presence of so many non-disgorgement penalty cases weakens that argument: under the relevant statutory provisions, “fair funds” that include penalty money can only be created in cases where there has been disgorgement.¹⁴⁷ Without disgorgement the money simply goes to the US Treasury. In the first year of the Dataset there were four cases where the SEC obtained one dollar of disgorgement for the sole purpose of creating “fair funds,” but the agency has not resorted to this subterfuge in the remaining years in the Dataset. Because so many of the penalty cases here lack disgorgement, there have been very few fair funds set up with respect to the cases in the Dataset. Overall, there have been a total of only twenty-five fair funds set up with respect to the 524 resolved matters in the Dataset; over the last five fiscal years (2014 to 2018), there have been a total of fifteen fair funds set up with respect to the 358 resolved matters during those years, or just over 4% of the cases.

With respect to those cases where there has been both a penalty and

145. *See supra* note 30.

146. Press Release, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006).

147. *See* 15 USC § 7246(a) (2010) (“If, in any judicial or administrative action brought by the Commission under the securities laws, the Commission obtains a civil penalty against any person for a violation of such laws, or such person agrees, in settlement of any such action, to such civil penalty, the amount of such civil penalty shall, on the motion or at the direction of the Commission be added to and become part of a disgorgement fund or other fund established for the benefit of the victims of such violation.”).

disgorgement, it is very difficult to discern any relational pattern between the two. In a few instances, the penalty and disgorgement are clearly related: the agency has sometimes assessed a penalty equivalent to one time the disgorgement¹⁴⁸ (a formula that it has also used in insider trading cases),¹⁴⁹ and in certain instances it is clear that the penalty amount is some multiple (or fraction) of the disgorgement amount, although the agency never discloses why those particular ratios were used in any particular case, and no pattern readily emerges. Overall, in some instances the penalty is lower than the disgorgement, in other cases the penalty is higher than the disgorgement (sometimes much higher). There is no apparent connection between the type of case, or the charges, that could help explain the relation, if any, between the disgorgement amount and the penalty.

With respect to the size of the penalty, it is hard to find any pattern with non-disgorgement cases or overall. The one notable exception here involves the MCDC initiative, which was settled based on a standard formula that was keyed to the size of the municipal offerings at issue, a formula that was also thankfully publicly disclosed.¹⁵⁰

148. As noted below, the SEC is using the administrative forum more and more frequently to resolve the public company cases in the Dataset. To the extent that the agency actually is using a formula that equates the penalty amount to the disgorgement amount, it may be skirting the edges of its statutory authority: in federal district court actions the agency is authorized to seek penalties in three tiers with specified maximums, or it can obtain a penalty equivalent to the gross amount of the pecuniary gain; in administrative and cease-and-desist proceedings, the agency is authorized to seek the same three tiers of penalties, with the same maximum amounts, but it does not have the alternative to seek the gross amount of the pecuniary gain. Compare Exchange Act §21(a) and §21B. Of course, as noted below, the actual penalty amounts under the statute are almost infinitely malleable, so there may be a way of justifying the penalties in administrative proceedings even in cases where they clearly are predicated on the gross amount of pecuniary gain.

149. For many years, the SEC has used a standard one-and-one formula for resolving run-of-the-mill insider trading cases. See Stephen M. Cutler, Director, Div. of Enf't, Sec. & Exch. Comm'n, Speech at the 24th Annual Ray Garrett Jr. Corporate & Securities Law Institute (Apr. 29, 2004) (noting the long-standing policy of obtaining "one plus one" settlements in insider trading cases); see also Verity Winship, *Disgorgement in Insider Trading Cases: FY 2005-2015*, 71 SMU L. REV. 999 (2018) (noting that more than half the defendants in study paid a "one plus one" penalty in insider trading cases).

150. Sec. & Exch. Comm'n Div. of Enf't, *Municipalities Continuing Disclosure Cooperation Initiative*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml> [<https://perma.cc/4ZNX-WKGD>].

I. Amount of Penalties

The overall amount of penalties assessed in all SEC actions (not just public company actions) during the time frame of this study has ranged between 830 million and 1.44 billion, with the low and high numbers coming in the last two fiscal years respectively (FY 2017 and 2018), that is during the first year and a half of the Clayton administration.¹⁵¹ The low figure for FY 2017 led some to the conclusion that the SEC may be altering its approach to penalties under the new regime, while the high number for 2018 led some to proclaim that SEC enforcement fines were on the rebound.¹⁵² But the FY 2018 number is a bit skewed because a very large percentage of the overall civil penalties that year (70%) came from a single case—the Petrobras case (which is a public company case)—where the SEC ostensibly imposed an \$853 million fine.¹⁵³ The Petrobras case is problematic because the order in that case specified that the penalty was to be credited dollar-for-dollar against payments made to Brazilian authorities and the US Department of Justice totaling over \$767 million, meaning that the actual penalty to be paid in the SEC action amounted to only roughly \$85 million.¹⁵⁴ Backing out the Petrobras case, the overall penalty numbers for FY 2018 are actually the lowest since 2009.¹⁵⁵

A study by *The New York Times* comparing the last twenty months under the Obama administration and the first twenty months of the Trump administration concluded that there had been a sharp decline in enforcement activity at both the SEC and the Justice Department, including a 62% drop in SEC penalties and disgorgement under the Trump administration.¹⁵⁶

151. The overall penalty numbers for each year, in billions, are:

2010	2011	2012	2013	2014	2015	2016	2017	2018
1.03	.93	1.02	1.17	1.38	1.18	1.27	.83	1.44

152. Dave Michaels, *Wall Street Fines Rose in 2018, Boosted by Foreign Bribery Cases*, WALL ST. J., Nov. 2, 2018, at B 12.

153. *Petróleo Brasileiro—Petrobras*, Exchange Act Release No. 84,295 (Sep. 27, 2018).

154. *Id.*

155. As I have noted elsewhere. See Dave Michaels, *Wall Street Fines Rose in 2018, Boosted by Foreign Bribery Cases*, WALL ST. J., Nov. 2, 2018, at B 12.

156. Ben Protess, Robert Gebeloff, and Danielle Ivory, *Trump Administration Spares Corporate Wrongdoers Billions in Penalties*, N.Y. TIMES, Nov. 3, 2018, at 2, <https://www.nytimes.com/2018/11/03/us/trump-sec-doj-corporate-penalties.html> [<https://perma.cc/LHU8-52CR>]. The Times study is itself a bit misleading, because it compared the last part of one administration with the first part of another: at the beginning of a new administration there is turnover not only at the Chairman level at the SEC, but at the senior staff level as well, which could account for the dip in FY 2017. As the SEC noted in response to the Times study, a

Whether or not the SEC will continue to impose very large penalties going forward is thus a matter of some conjecture although, as noted above, the trend of imposing some civil penalty in public company cases has continued unabated under Chairman Clayton and remains the norm.

Finally, because a significant percentage of the overall penalty number in any given year is attributable to a very small number of cases,¹⁵⁷ looking at overall averages and even medians is unhelpful because the averages and medians bear little relation to what is actually typical.

IV. ANALYSIS AND CRITIQUE

A. *Lack of Standards, Transparency, and Consistency*

While civil penalties against public companies have become increasingly routine over the past decade, how those penalties are calculated and on what basis, and how the penalties relate to the underlying misconduct remains largely opaque. Although the Commission routinely touts the amount of penalties in press releases, it never explains how it arrived at the particular number and, to make matters worse, the statutory framework provides no real guidance, often leading to seemingly inconsistent results, and overall a penalty regime that, for the most part, lacks any discernable pattern or order. Because almost all of the public company penalty cases are settled, the penalty amounts are largely a product of negotiation, a process in which various elements, including the charges and even the defendants are part of the overall bargain.

1. Lack of Standards

As previously noted, the overall amount of civil penalties imposed by the SEC has ballooned over the years, with very high numbers coinciding with the start of the time period covered by the Dataset and remaining relatively constant therein.¹⁵⁸ There are many reasons for the increase (and perhaps for the more recent decrease if indeed there is one) mostly tied to the

more accurate comparison would have been the first 20 months of the Obama administration and the first 20 months of the Trump administration. *How the Trump Enforcement Numbers Were Calculated*, N.Y. TIMES, Nov. 3, 2018, at 1, <https://www.nytimes.com/2018/11/03/business/trump-corporate-penalties-methodology.html> [<https://perma.cc/4ECP-C9CX>].

157. See *supra* text accompanying notes 121–122.

158. In the two fiscal years preceding the period of the Dataset, the SEC imposed fines totaling 260 million and 350 million respectively. During the time period covered by the Dataset, the total fines ranged from 830 million to 1.44 billion, with most years being above a billion dollars.

policy goals and objectives of successive SEC chairs. But there is also a structural reason that has enabled the growth that is particularly important in the public company context: although the penalties are statutorily set, the penalty amounts are in fact almost infinitely malleable.¹⁵⁹

With one exception, the various statutory provisions allowing civil penalties are all structured with three carefully defined tiers, depending on the severity of the violation and the degree of harm, with specified maximum penalties for each tier.¹⁶⁰ As an alternative, in federal district court actions the penalty can be set up to the amount of the gross pecuniary gain. In theory, this provides a clear, defined and consistent framework for penalty calculations. The reality is quite different. In practice, there are no standards at all: the statutory provisions can be manipulated in numerous ways and provide no concrete guidance.

The reason for this is that the various statutory provisions all set maximum penalty amounts per “violation.”¹⁶¹ The federal securities laws never define what constitutes a “violation” and in most instances—and almost all instances involving public companies—there are various alternative ways to conceptualize what constitutes a violation which can lead to dramatically different results.¹⁶² Despite the statutory maximums, in some cases there is practically unlimited potential liability, which in turn gives rise to a penalty framework that is almost entirely discretionary. To provide one example, suppose a public company sends out a proxy statement containing a material misrepresentation to its shareholders. At one extreme the material misrepresentation could be characterized as a single violation subject to the statutory cap; at the other extreme, each copy of the document containing the material misrepresentation could be characterized as a separate violation for purposes of calculating the penalty. In the latter case each separate copy of the proxy statement sent to a shareholder would be deemed a separate violation, subject to a fine up to the statutory maximum.¹⁶³ If there are several hundred thousand shareholders, that would amount to several hundred thousand violations, each subject to the maximum fine. As a result,

159. See Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 24, 2016), <https://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/> [<https://perma.cc/BH5U-PFLY>] (noting that SEC penalty amounts are highly variable within a large range).

160. See *supra* text accompanying notes 14-24. The one exception involves federal district court insider trading cases where the penalty is set by the judge in an amount up to three times the gross amount of pecuniary gains or loss avoided. Exchange Act §21(a).

161. See, e.g., Exchange Act § 21(d)(3)(B).

162. See Eisenberg *supra* note 159 (outlining five different methodologies for calculating violations which lead to highly variant outcomes).

163. *Id.*

the amount of the fine that may be assessed can easily be expanded stratospherically.

The lack of clear standards with respect to penalties was recognized from the start. In a speech given shortly after the passage of the Remedies Act, then-Commissioner Lochner recognized the concerns that had been expressed about the agency's new penalty authority, and urged the adoption of clearer standards: "Although the tiering of fines provided for by Congress gives us some guidance, the Commission must develop some articulable guidelines to be used in determining the level of fines."¹⁶⁴ He warned that without such guidelines there was a "risk of inconsistent treatment of similar securities law violations" and the "grave risk of acting unfairly and arbitrarily."¹⁶⁵ Bill McLucas, then-Director of Enforcement, wrote about the pros and cons of a case-by-case approach versus the creation of standardized matrix along the lines of the federal sentencing guidelines, and concluded that while the Commission might follow the former approach at first, once it developed sufficient experience with the new penalty authority "some more formal guidelines may become appropriate."¹⁶⁶ Some practitioners foresaw the "per violation" problem and how it could lead to a dramatic escalation of the fines imposed.¹⁶⁷

The Commission, however, has never adopted any clear standards or even guidelines for calculating penalties. In the first decade after the passage of the Remedies Act, the agency, and more important the courts, had typically felt constrained by the actual statutory limits. But the agency changed its tune in the early 2000s as a result of the accounting fraud scandals that were coming to light around that time and began emphasizing the "per violation" formulation and how it could be used to expand the

164. News Release, Sec. & Exch. Comm'n, Remarks of Philip R. Lochner, Jr. Comm'r, "The SEC's New Powers Under the Securities Enforcement Remedies and Penny Stock Reform Act of 1990" 20 (Oct. 4, 1990), <http://www.sec.gov/news/speech/1990/100490lochner.pdf> [<https://perma.cc/67MV-GN74>].

165. *Id.*

166. William R. McLucas, Stephen M. DeTore & Arian Colachis, *SEC Enforcement: A Look at the Current Program and Some Thoughts about the 1990s*, 46 J. BUS. L. 797, 836 (1990).

167. Ralph C. Ferrara, Thomas A. Ferrigno & David S. Darland, *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 J. BUS. L. 33, 44-45 (1991) ("The Remedies Act provides a maximum penalty for each violation. The Act, however, does not define the term "violation," and the legislative history does not discuss whether a course of conduct prohibited by the securities statutes shall constitute a single violation or whether each illegal act or transaction will constitute a separate violation. . . . Thus, characterizing a course of conduct as multiple violations of multiple provisions could increase dramatically the number of violations for which a penalty may be imposed.").

amount of penalties the agency could obtain.¹⁶⁸ Using the expansive view of what constitutes a “violation,” the upper limit is almost non-existent.

In a litigated context, some judges have struggled with the proper standard to be applied with respect to penalties.¹⁶⁹ The SEC has typically argued for the most expansive view possible of how to count the number of violations, and some judges have agreed that the SEC methodology is appropriate, even if it is difficult to apply in practice.¹⁷⁰ There have also been occasional criticisms of the SEC’s approach, even by the SEC’s own in-house judges.¹⁷¹ But with settled actions things are quite different. In a settlement context, and particularly with regard to settlements that are done in the administrative forum, that is in-house, and are never reviewed by a federal judge or even by an in-house Administrative Law Judge (ALJ), the agency is largely unconstrained with respect to penalties. In practice, when it comes to determining the amount of the fine in the case of a public company in a settled action, the statutory framework is for all intents and purposes irrelevant: the amount of the fine is entirely discretionary and subject to negotiation.

As discussed further below, the extraordinary leeway that exists with respect to penalties provides the agency considerable power as well as considerable flexibility. The lack of a meaningful cap gives the agency the ability to extract settlements by threatening exorbitant penalties. At the same time, it gives the agency enormous discretion in fashioning settlements. Because penalties can always be adjusted up or down, they can be manipulated almost endlessly. And this means that penalties can be used as a bargaining tool as part of an overall negotiated resolution, a process that works both ways: the penalty amount can always be adjusted in relation to the charges. Instinctively, the two should go hand-in-hand, with the most

168. Then-Director of Enforcement Stephen Cutler made this point in a speech in 2002 right about the time that the agency began to push for more, and higher, penalties. *See* Stephen M. Cutler, Speech by SEC Staff: Remarks at the University of Michigan Law School (Nov. 1, 2002) (stating that courts had traditionally imposed low penalties because they looked to the precise statutory limits, but noting that the statute actually allows for higher fines because the statutory limit is per violation).

169. *Compare* *In re Gerasimowicz*, Initial Dec. No. 496 (July 22, 2013) (imposing penalty based on number of investors) *with* *In re Reliance Financial Advisors, LLC, et al.*, Initial Dec. No. 941 (Jan. 11, 2016) (imposing penalty based on number of misrepresentations).

170. *See, e.g.*, *SEC v. Haligiannis*, 470 F Supp. 2d 373, 386 (S.D.N.Y. 2007) (finding that each quarterly statement sent to each investor is a materially false statement that constitutes a separate violation, but ordering penalty in the amount of the defendant’s ill-gotten gains because of difficulty in calculating total number of violations).

171. *See, e.g.*, *In re Total Wealth Management, Inc., et al.*, Initial Dec. No. 860 (Aug. 17, 2015) (SEC judge considered the SEC’s method for calculating the number of violations to be arbitrary).

serious charges giving rise to the most serious penalties. In practice, they are often set in opposition: a lower penalty may be agreed to in exchange for a more serious charge, or a higher penalty might be agreed to in exchange for a lesser charge. The evidence gathered from the Dataset, and in particular the large number of instances where significant penalties were imposed in non-scienter-based fraud cases, suggests that the Commission may have been willing to bargain down charges in exchange for higher penalties; the evidence equally suggests that public companies have been willing to pay higher penalties in exchange for lesser charges.

2. Lack of Transparency and Consistency

In addition to lacking clear standards, and closely related thereto, the SEC never explains how it arrives at a penalty amount or what factors it considered, other than to sometimes note that the company cooperated. The lack of transparency that surrounds the process makes it difficult to evaluate the fairness and effectiveness of civil penalties against public companies.¹⁷² It also plays into an overall narrative that the agency is acting in an unprincipled, and sometimes arbitrary, manner.¹⁷³ As noted above, there have been various calls to develop clear guidelines for the calculation of penalty amounts or, as one former Commissioner put it, run the “grave risk of acting unfairly and arbitrarily.”¹⁷⁴ The Commission, however, has never developed an *ex ante* framework, similar to the sentencing guidelines, and has continued to proceed with a case-by-case approach. Unfortunately, the Commission never even gives an *ex post* explanation for the penalty, which makes it difficult, if not impossible to assess whether the agency is acting in

172. See William R. Baker & Dane A. Holbrook, *SEC Statement Clarifies Corporate Penalties—a Bit*, Nat’l Law J., Mar. 13, 2006 (noting that, despite the Penalty Statement, the SEC’s system for calculating corporate penalties remains a black box).

173. There have been occasional challenges to SEC penalties on the ground they are arbitrary and capricious. See, e.g., *Collins v. Sec. & Exch. Comm’n* (D.C. Cir. Nov. 26, 2013) (noting that consideration of whether a sanction is arbitrary and capricious involves “consideration of whether the sanction is out of line with the agency’s decisions in other cases,” but rejecting challenge).

174. News Release, Sec. & Exch. Comm’n, Remarks of Philip R. Lochner, Jr. Comm’r, “The SEC’s New Powers Under the Securities Enforcement Remedies and Penny Stock Reform Act of 1990” (Oct. 4, 1990), <http://www.sec.gov/news/speech/1990/100490lochner.pdf> [<https://perma.cc/67MV-GN74>] (“Another area of concern is how we will utilize our fining authority. Although the tiering of fines provided for by Congress gives us some guidance, the Commission must develop some articulable guidelines to be used in determining the level of fines. Otherwise, we run the risk of inconsistent treatment of similar securities law violations. Perfect consistency is not obtainable, but without having publicly defensible rules, we run a grave risk of acting unfairly and arbitrarily.”).

a principled and consistent manner.

The SEC will often state why it did *not* obtain a civil penalty in a particular matter, typically because the entity or individual paid a penalty in a parallel criminal case,¹⁷⁵ or because of extraordinary cooperation or remediation,¹⁷⁶ and in some cases because of the company's financial condition.¹⁷⁷ But in settled actions the SEC almost never says why it *did* obtain a penalty, all of which reinforces the notion that penalties are the expectation and the norm and need no explanation, whereas departures from the norm must be explained to the public. More important, in settled actions the SEC never explains how the penalty was calculated or what the basis for a particular penalty calculation is.¹⁷⁸ This is all the more troubling given that the penalties often bear little relation to the statutory framework. As previously noted, the statute allows for penalties to be assessed up to certain defined limits, depending on the type and severity of the misconduct, but the limit is for *each* violation; the SEC has long taken the position that every repetition of a misstatement can constitute an independent violation.¹⁷⁹

175. See, e.g., JP Morgan Chase & Co., Exchange Act Release No. 79,335 (Nov. 17, 2016) (acknowledging that Commission was not imposing a civil penalty based upon the imposition of a criminal fine).

176. See Press Release, Sec. & Exch. Comm'n, SEC Charges Biopharmaceutical Company with Failing to Properly Disclose Perks for Executives (Dec. 12, 2017), <https://www.sec.gov/news/press-release/2017-229> [<https://perma.cc/9VWE-XHPK>] ("The SEC's settlement with Provectus – which does not include any penalty – takes into account the proactive remediation and cooperation by the company's new leadership"); Press Release, Sec. & Exch. Comm'n, SEC Charges Salix Pharmaceuticals and Former CFO With Lying About Distribution Channel (Sept. 28, 2018), <https://www.sec.gov/news/press-release/2018-221> [<https://perma.cc/ZNA9-8K7D>] (finding that settlement with company, which did not include a penalty, "reflects the company's self-report to the Commission and its significant cooperation with the investigation"). The SEC also has the statutory authority to take into account a defendant or respondent's demonstrated inability to pay in considering whether to impose a penalty, see 17 C.F.R. § 201.630 (2004), and in those cases the SEC typically makes clear in the order or consent decree that a penalty is not being imposed for that reason. See, e.g., Final Judgment of Defendant Innospec Inc., Sec. & Exch. Comm'n v. Innospec Inc., No. 10-cv-00448 (D.D.C. Mar. 26, 2010) (noting that based on defendant's sworn financial statements, court is not ordering civil penalty and waiving part of disgorgement).

177. See, e.g., Immunocellular Therapeutics, Ltd., Securities Act Release No. 33-10,338 (Apr. 10, 2017) at 5 ("[I]n determining whether to impose a penalty, the Commission took into consideration the fact that Respondent's Form 10-K . . . included a going concern opinion from its independent auditor").

178. In litigated actions, judges, including ALJs do go through a statutory analysis to explain their penalty calculations. See, e.g., Retirement Surety LLC, Initial Dec. No. 1,250 (Apr. 18, 2018) at 13–18 (analyzing record and concluding that only first tier penalties are appropriate and maximum penalties at that tier are not warranted).

179. See Eisenberg *supra* note 159 (describing the conditions and calculations for damages under the SEC penalty framework).

Looking at the cases in the Dataset, it is almost impossible to discern any pattern that would reveal why a particular penalty amount was imposed in any particular case. In a few instances, the penalty is clearly tied to the disgorgement figure: in those cases the penalty is typically equal to the disgorgement amount, although in a few cases, it is a multiple (and sometimes a fraction) of the disgorgement amount.¹⁸⁰ But in many of the cases in the sample set there is no disgorgement at all to tie the penalty amount to.

The most obvious basis for the size of the penalty would be the extent of the misconduct, including the duration and the repeated or isolated nature of the violation, the amount of investor harm that was caused, and the degree of willfulness or carelessness involved. With respect to the last point, it would seem that the largest penalties would be imposed in those cases involving intentional misconduct, which should be reflected in the charges that are brought: scienter-based charges are more serious than non-scienter-based charges, because they reflect an intent to deceive or defraud rather than mere negligent conduct. Yet, as discussed above, a look at the cases in the Dataset reveals no such connection, and more troubling still reveals something of the opposite: some of the largest fines are imposed in cases involving non-scienter-based fraud. This is particularly true when the defendant or respondent is a financial institution. Moreover, these are typically cases that the agency chooses to highlight in press releases that headline the size of the monetary payments.

There are numerous examples of this in the Dataset, including in the most recent years. For example, just in FY 2018 the SEC imposed a fine of \$42 million on Merrill Lynch while charging violations of Securities Act Sections 17(a)(2) & (3). The press release headlined “Merrill Lynch Admits to Misleading Customers about Trading Venues – Will Pay \$42 Million Penalty to Settle Charges.”¹⁸¹ The SEC also imposed a \$22.2 million fine on Deutsche Bank while charging violations of Securities Act Section 17(a)(3); the press release headlined “Deutsche Bank to Pay Nearly \$75 Million for Improper Handling of ADRs,” a figure that included disgorgement and interest.¹⁸² Four units of Transamerica were ordered to pay a total of \$97 million, which included a \$36.3 million penalty; the charges were non-

180. *See supra* notes 148–149.

181. Press Release, Sec. & Exch. Comm’n, Merrill Lynch Admits to Misleading Customers about Trading Venues – Will Pay \$42 Million Penalty to Settle Charges (June 19, 2018), <https://www.sec.gov/news/press-release/2018-108> [<https://perma.cc/BC6W-BDDH>].

182. Press Release, Sec. & Exch. Comm’n, Deutsche Bank to Pay Nearly \$75 Million for Improper Handling of ADRs (July 20, 2018), <https://www.sec.gov/news/press-release/2018-138> [<https://perma.cc/H8NS-S4ST>].

scienter-based violations of Section 17(a)(2) of the Securities Act and Sections 206(2) and 206(4) of the Advisers Act.¹⁸³ Citigroup and an affiliate were ordered to pay \$7.5 million in penalties; the charges were once again non-scienter-based violations of Securities Act Section 17(a)(2).¹⁸⁴ Credit Suisse was ordered to pay a \$5 million penalty to the SEC, along with another \$5 million to the NY Attorney General. The press release headlined “Credit Suisse Agrees to Pay \$10 Million to Settle Charges Related to Handling of Retail Customer Orders.” The press release even specified that “Credit Suisse negligently violated Section 17(a)(2) of the Securities Act.”¹⁸⁵ The trend of big money penalties accompanied by non-scienter-based charges is evident in prior fiscal years as well.¹⁸⁶

To be clear, many of these cases involved situations where *customers* of the financial services companies were harmed, rather than the company’s shareholders. Indeed, in these cases there typically was a benefit to the company—and by implication to the company’s shareholders—so they reflect situations where a corporate penalty is most appropriate. The only point is that the charges may not be reflective of the misconduct or the amount of penalty assessed.

The disconnect between the severity of the charges and the size of the penalty is problematic for a number of reasons. First, the statutory

183. Press Release, Sec. & Exch. Comm’n, Transamerica Entities to Pay \$97 Million to Investors Relating to Errors in Quantitative Investment Models (Aug. 27, 2018), <https://www.sec.gov/news/press-release/2018-167> [<https://perma.cc/L79L-ETPC>].

184. Press Release, Sec. & Exch. Comm’n, SEC Charges Citigroup for Dark Pool Misrepresentations – Citigroup and Affiliate Ordered to Pay More Than \$12 Million in Disgorgement and Penalties (Sept. 14, 2018), <https://www.sec.gov/news/press-release/2018-193> [<https://perma.cc/A32V-E5UY>].

185. Press Release, Sec. & Exch. Comm’n, Credit Suisse Agrees to Pay \$10 Million to Settle Charges Related to Handling of Retail Customer Orders (Sept. 28, 2018), <https://www.sec.gov/news/press-release/2018-224> [<https://perma.cc/QF6C-GTZV>].

186. *See, e.g.*, Press Release, Sec. & Exch. Comm’n, Citigroup Paying \$18 Million for Overbilling Clients (Jan. 26, 2017), <https://www.sec.gov/news/pressrelease/2017-35.html> [<https://perma.cc/BK83-WTAH>] (imposing a \$14.3 million penalty; charges included violations of Sections 206(2) and 206(4) of the Advisers Act, which require simple negligence); Press Release, Sec. & Exch. Comm’n, Morgan Stanley Paying \$13 Million Penalty for Overbilling Clients and Violating Custody Rules (Jan. 13, 2017), <https://www.sec.gov/news/pressrelease/2017-12.html> [<https://perma.cc/754M-SA3Y>] (finding violation of Section 206(2) of the Advisers Act which requires simple negligence rather than scienter); Press Release, Sec. & Exch. Comm’n, Deutsche Bank Settles Charges of Misleading Clients About Order Router (Dec. 16, 2016), <https://www.sec.gov/news/pressrelease/2016-264.html> [<https://perma.cc/LU69-X4VV>] (imposing penalty of \$18.5 million and charges of violating Securities Act Section 17(a)(2)); Press Release, Sec. & Exch. Comm’n, Barclays, Credit Suisse Charged With Dark Pool Violations – Firms Collectively Paying More Than \$150 Million to Settle Cases (Jan. 31, 2016), <https://www.sec.gov/news/pressrelease/2016-16.html> [<https://perma.cc/EPX4-ED5P>] (involving charges of violating Securities Act Section 17(a)(2)).

framework is predicated on a laddering of misconduct, with the severest penalties reserved for the most egregious acts: maximum tier one penalties are low and are available in non-fraud cases; maximum tier two penalties are higher by a factor of ten, but require a showing of fraud; maximum tier three penalties are the highest and require not only a showing of fraud, but also a showing that the misconduct resulted either in substantial losses, or created a significant risk of substantial losses to other persons, or in the case of a cease-and-desist proceeding resulted in substantial pecuniary gain to the person who committed the violation.¹⁸⁷ When the SEC brings a settled administrative action, it never explains how the penalties fit within these categories, or how the misconduct satisfies the test for tier three. Of course, given the infinite malleability of the per violation calculus, it may well be that even the largest penalties could be derived using the tier two formula, but it does seem harder to justify. As discussed more fully below, the fact that the SEC does not have to justify its penalty calculation in administrative proceedings but must make at least some attempt to fit the penalty within the statutory framework when it brings an action in federal court helps explain why the SEC has moved even settlements in-house.

Second, the disconnect is jarring at a more basic intuitive level: a large penalty screams egregious misconduct, but a lesser charge, one based on negligence rather than intentional fraud, simultaneously says that things are not so bad. The opposite is true as well: a charge of scienter-based fraud is an indication of egregious conduct, while a small penalty seems to minimize the conduct.¹⁸⁸ In the end, there may be good reasons why the overall settlement makes sense in any particular case: settlements are all about compromise, there are often significant issues of proof in a case, and a split-the-baby resolution may well be preferable to litigation. But the lack of transparency with respect to penalty calculations can also lead to a generalized sense that the penalty number is wholly arbitrary and disconnected from the actual misconduct, which in turn leads to cynicism about the process and concerns that the penalty is being used to deflect harsher sanctions. This is particularly problematic in the case of public companies, where management may be more concerned with the collateral consequences that accompany certain charges and with avoiding personal

187. See Exchange Act § 21(d)(3)(B)(iii) (concerning federal court actions); Exchange Act § 21B(b)(3) (regarding cease-and-desist proceedings).

188. This was one of the elements in Judge Rakoff's critique of the SEC's proposed settlement in the Citigroup case. The described conduct looked like scienter-based conduct, yet the SEC was allowing a settlement that involved only negligence-based charges. See *Sec. & Exch. Comm'n v. Citigroup Glob. Mkts., Inc.*, 827 F. Supp. 2d 328, 330–34 (S.D.N.Y. 2011) (involving behavior that looks like scienter, but only charged with negligence).

liability, than with spending shareholder money to resolve a matter.

The lack of clear standards makes it almost inevitable that there will be some inconsistencies in the treatment of seemingly similar cases. Of course, there may be good reasons for disparate treatment—differences in the evidentiary record, for example, which might contribute to litigation risk—but the lack of transparency in the process makes it almost impossible to discern what those reasons may be.

B. Settlements

1. The Administrative Turn

In recent years, the SEC has increasingly brought enforcement actions as administrative proceedings, rather than as federal district court actions.¹⁸⁹ This trend is clear with respect to public company enforcement actions. In the first four years in the Dataset, seventy-three of the 169 actions were brought administratively (43.1%), while ninety-six were brought as federal district court actions. In the last five years in the Dataset, 318 of the 360 actions were brought administratively (88.3%), while only forty-two were brought as federal district court actions.

The administrative turn has led to much criticism and complaints, namely that the SEC administrative process is stacked against defendants, and to accusations that the SEC is using its “home court advantage” to unfairly game the system when it pursues alleged securities law violators.¹⁹⁰ Much of the criticism has focused on procedural differences between administrative proceedings and federal court actions:¹⁹¹ there is less discovery in the administrative forum particularly with respect to taking depositions, the proceedings happen much more quickly leaving less time to prepare, the rules of evidence are more relaxed with hearsay being more

189. See Stephen J. Choi & A.C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment*, 34 YALE J. ON REG. 1 (2017) (illustrating the trend toward SEC administrative proceedings and away from federal district court actions).

190. See, e.g., Megan Leonhart, *Republicans Question Fairness of SEC In-House Judgments*, WEALTHMANAGEMENT.COM (Mar. 19, 2015), <https://www.wealthmanagement.com/legal/republicans-question-fairness-sec-house-judgments> [<https://perma.cc/6H7S-ZB3N>] (questioning whether internal administrative court can maintain due process and objectivity); Gretchen Morgenson, *Crying Foul on Plans to Expand the SEC's In-House Court System*, N.Y. TIMES, June 26, 2015, at 5 (noting the increased use of internal tribunals in lieu of federal court actions); William F. Johnson & Amelia R. Medina, *SEC's Administrative Enforcement Intensifies Fairness Debate; Corporate Crime*, N.Y. L.J. (Nov. 6, 2014) (explaining the procedural differences between internal tribunals and federal district courts).

191. See, e.g., Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1 (2015) (detailing attacks on the SEC's internal enforcement mechanism).

readily considered, there is no right to a jury trial, and the ALJs, although nominally independent, are SEC employees who do not enjoy all the protections afforded Article III judges.¹⁹² Moreover, an appeal from an adverse ALJ decision is heard by the Commission, the very body that had to authorize the proceeding in the first place; the Commission's decision can itself be appealed to a Federal Appellate court, but the standard of factual review is very deferential.¹⁹³ The administrative turn has raised serious concerns among practitioners, academics, and even one federal judge,¹⁹⁴ and has led to several challenges on constitutional grounds,¹⁹⁵ including last year's successful challenge to the method of appointment of SEC ALJs.¹⁹⁶ Many of these criticisms are well taken, even if the SEC's actual success rate in litigated actions before ALJs may not in fact be that much better than in federal court actions.¹⁹⁷

But a focus on the outcome of litigated actions may obscure a deeper point: the SEC's administrative turn is even more prominent with respect to settled actions than it is with respect to litigated ones.¹⁹⁸ Nowhere is this more apparent than with respect to public company cases: as more fully discussed above, the overwhelming majority of actions against public companies in the Dataset were filed as settled actions, and at least since 2014 the overwhelming majority of those settled actions have been in administrative proceedings rather than federal court actions. For the five

192. See, e.g., Urska Velikonja, *Are the SEC's Administrative Law Judges Biased: An Empirical Investigation*, 92 WASH. L. REV. 315, 324–27 (2017) (describing procedural differences between federal court actions and administrative proceedings).

193. See, e.g., Ryan Jones, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 S.M.U. L. REV. 507, 523–26 (2015) (arguing that the lack of regulating guidelines for internal proceedings deprives litigants of due process).

194. Judge Jed S. Rakoff, Keynote Address at the PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law unto Itself? (Nov. 5, 2014) (transcript available at <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf>) [<https://perma.cc/64UK-QZR9>].

195. See Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. PA. J. CONST. L. 45, 72–116 (2016) (discussing various constitutional challenges to SEC administrative proceedings).

196. *Lucia v. Sec. & Exch. Comm'n*, 138 S. Ct. 2044 (2018).

197. See Urska Velikonja, *Are the SEC's Administrative Law Judges Biased? An Empirical Investigation*, 92 WASH. L. REV. 315, 348–49 (2017) (finding that the SEC prevailed after trial in about 83% of cases in federal court compared with 89% of cases decided by an ALJ).

198. See Urska Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J.F. 124, 126 (2016) (“[The] shift to administrative settlement is both larger and more significant than the shift in litigation. Before Dodd-Frank, 40% of settlements were filed in administrative proceedings; in fiscal year 2015, over 80% were.”).

fiscal years from 2014 to 2018, the SEC brought a total of 360 actions involving one or more public companies; 346, or 96.1%, of these were brought as settled actions, and 315 or 91% of the settled actions were brought as administrative proceedings. Overall, a total of 318 of the 360 matters in this time frame were brought as administrative proceedings and all but 3 of those were brought as settled actions.¹⁹⁹

In FYs 2017 and 2018, the last years for which data is available, the SEC brought 136 cases against public companies; 133 or 97.79% were brought as settled actions, and 118 of the 133 (or 88.72%) were brought as administrative proceedings.

There may be some litigation strategy in the decision to go administrative: the perception, however accurate it may be, that the SEC has a distinct advantage in the administrative forum may push persons to settle by the mere threat to proceed administratively.²⁰⁰ But there is undoubtedly something else as well: a settlement in an administrative proceeding need only be approved by the Commission, whereas a settlement in a federal court action is subject to approval by the court. As will be discussed in greater detail below, the decision to go administrative even with respect to settled cases may be driven by a desire to maintain control and discretion over the process, with all the potential benefits—and pitfalls—that may entail.

The SEC's administrative turn was made possible by the passage of Dodd-Frank which gave the SEC the authority to obtain penalties—roughly equivalent to the penalties that can be obtained in federal court actions—against any person in cease-and-desist proceedings. Prior to Dodd-Frank, the SEC had no choice but to bring a federal court action if it wanted to obtain civil penalties against non-registered persons. With respect to public companies, some are registered as brokers or investment advisers, so penalties could have been obtained in administrative proceedings, at least with respect to certain violations. But other cases had to be brought in federal court. With the passage of Dodd-Frank, the agency has the option to go administrative or bring a federal court action in almost every case.

But while Dodd-Frank made the administrative turn possible, the

199. The three administrative proceedings that were brought as contested actions were all subsequently settled.

200. In 2014, the then-Director of Enforcement, Andrew Ceresney, reportedly told a bar association gathering that the mere threat of bringing a case in the administrative forum had led to a number of settlements. See Alan Lieberman, *Fast-Track Justice: Is the SEC Exercising 'Unchecked and Unbalanced Power'?*, WESTLAW J. SEC. LITIG. & REG., Sept. 18, 2014, at 1 (“After pronouncing administrative proceedings ‘fair,’ Ceresney said ‘a number of cases in recent months . . . settled’ when the Enforcement Division ‘threatened’ to bring them as administrative proceedings. Not surprisingly, this remark did little to assuage his audience.”).

impetus, particularly as it regards settled actions, lies elsewhere and can be traced directly to judicial (and public) criticism of SEC settlements in the wake of the financial crisis of 2008. At that time, the SEC brought a number of settled enforcement actions against large financial institutions, some of which were thought, rightly or wrongly, to have played a role in the near collapse of the financial markets. As a result, the cases garnered a great deal of public attention, which in turn led to heightened judicial scrutiny. The most prominent of these cases involved Bank of America's acquisition of Merrill Lynch at the height of the financial crisis.²⁰¹ The SEC brought a settled action against Bank of America alleging violations of the anti-fraud provisions of the federal proxy rules and imposing a \$33 million penalty.²⁰²

Judge Rakoff of the Southern District of NY refused to approve the settlement which he considered weak and collusive.²⁰³ Judge Rakoff also expressed his indignation that Bank of America was allowed to settle the case with admitting wrongdoing—and thus not getting at the “truth”—and set the case for trial.²⁰⁴ The SEC and Bank of America subsequently resettled the case, with a higher monetary penalty and a consent judgment that included a detailed recitation of facts.²⁰⁵ Judge Rakoff reluctantly approved the new settlement although he termed it “half-baked justice at best.”²⁰⁶

Judge Rakoff's stand garnered much public support and led several other federal judges to start carefully scrutinizing SEC settlements, sometimes demanding additional factual support before approving a consent decree.²⁰⁷ Then, in 2011, Judge Rakoff again rejected an SEC settlement.²⁰⁸ The SEC had reached an agreement with Citigroup to settle, on a no-

201. Sec. & Exch. Comm'n v. Bank of Amer. Corp., 653 F. Supp. 2d 507 (S.D.N.Y. 2009).

202. *Id.* Full disclosure: I worked on this matter as a lawyer for the SEC.

203. *Id.*

204. *Id.* at 512.

205. Final Consent Judgment as to Defendant Bank of Am. Corp., Sec. & Exch. Comm'n v. Bank of Am. Corp., 09-CV-6829, 10-CV-0215 (ECF) 7, 14 (S.D.N.Y. Feb. 1, 2010).

206. Sec. & Exch. Comm'n 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).

207. See, e.g., Sec. & Exch. Comm'n v. Hohol, No. 14-C-41, 2014 WL 461217, at *4 (E.D. Wis. Feb. 5, 2014) (declining to enter proposed judgment as presented and requiring the SEC to supplement its filings); Sec. & Exch. Comm'n v. CR Intrinsic Inv'r's, LLC, 939 F. Supp. 2d 431, 435–36 (S.D.N.Y. 2013) (approving settlement while questioning no-admit/no-deny basis); Michael C. Macchiarola, “*Hallowed by History, But Not By Reason*”: Judge Rakoff's Critique of the Securities and Exchange Commission's Consent Judgment Practice, 16 CUNY L. REV. 51, 90–92 (2012) (discussing copycat effect of Judge Rakoff's refusal to approve settlement); cf. Sec. & Exch. Comm'n v. Hohol, 14-C-41, 2014 WL 1330299, at *4 (E.D. Wis. Mar. 31, 2014) (granting SEC's revised proposed judgment with added information).

208. Sec. & Exch. Comm'n v. Citigroup Glob. Mkts., Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

admit/no-deny basis, a case involving fraudulent conduct with respect to a fund of mortgage-backed securities.²⁰⁹ The settlement included the payment of a civil monetary penalty of \$285 million.²¹⁰ Judge Rakoff refused to approve the consent decree calling the penalty “pocket change to any entity as large as Citigroup.”²¹¹ Judge Rakoff also criticized the fact that the settlement did not include “any proven or admitted facts upon which to exercise even a modest degree of independent judgment,”²¹² and concluded that without such an established factual predicate, deploying the injunctive power of the judiciary “serves no lawful or moral purpose and is simply an engine of oppression.”²¹³ Judge Rakoff set the case for trial, but this time the SEC appealed that decision, which was ultimately overturned by the Second Circuit.²¹⁴

In the interim, however, the SEC started to move more and more of its enforcement proceedings to the administrative forum. In late 2013, then-Director of Enforcement Andrew Ceresney acknowledged the trend and noted that because of Dodd-Frank, the agency would increasingly be proceeding administratively: “Our expectation is that we will be bringing more administrative proceedings given the recent statutory changes.”²¹⁵

Judicial and public criticism of what were perceived to be weak SEC settlements also propelled the agency to revise its long standing no-admit/no-deny policy and to require defendants and respondents to sometimes make admissions when settling a case with the SEC.²¹⁶ The new admissions policy—which has now been largely abandoned²¹⁷—was driven by Judge Rakoff’s criticism of the agency for allowing no-admit settlements and was motivated, at least in part, by a fear of a judicial takeover of the SEC

209. *Id.* at 334.

210. *Id.*

211. *Id.*

212. *Id.* at 330.

213. *Id.* at 335.

214. Sec. & Exch. Comm’n v. Citigroup Glob. Mrkts., 752 F.3d 285, 289 (2d Cir. 2014).

215. Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES, Oct. 6, 2013, at BU1.

216. David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution That Wasn’t*, 103 IOWA L. REV. 113, at 123 (2017).

217. See Dave Michaels, *SEC Signals Pullback from Prosecutorial Approach to Enforcement*, WALL ST. J. (Oct. 26, 2017), <https://www.wsj.com/articles/sec-signals-pullback-from-prosecutorial-approach-to-enforcement-1509055200> [<https://perma.cc/M9S9-DCCB>] (describing shift in SEC’s strategy away from requiring admission of wrongdoing in settlements); Russell G. Ryan, *How SEC Enforcement is Getting Back to Basics*, COMPLIANCE & ENFORCEMENT (Feb. 14, 2019) https://wp.nyu.edu/compliance_enforcement/2019/02/14/how-sec-enforcement-is-getting-back-to-basics [<https://perma.cc/WL5F-MVTY>] (“[T]he agency’s experiment with [the admissions] practice appears to have largely run its course.”).

settlement process.²¹⁸ As then-SEC Chair Mary Jo White noted when she announced the admissions policy, “[t]hese decisions are for [the SEC] to make within our discretion, not decisions for a court to make.”²¹⁹

In June 2014, the Second Circuit handed down its decision in the *Citigroup* case, overruling Judge Rakoff’s rejection of the SEC settlement.²²⁰ The court held that a district court reviewing an agency consent decree must determine “whether [it] is fair and reasonable, with the additional requirement that the ‘public interest would not be disserved,’ in the event that the consent decree includes injunctive relief.”²²¹ The court concluded that “[a]bsent a substantial basis in the record for concluding that the proposed consent decree does not meet these requirements, the district court is required to enter the order.”²²²

Although the standard established by the Second Circuit is highly deferential in many respects—the court made clear, for example, that whether the “consent decree best serves the public interest . . . rests squarely with the S.E.C., and its decision merits significant deference,”²²³—it is not altogether toothless. The court set forth a four-part test that should be undertaken in reviewing a proposed consent decree “for fairness and reasonableness”:

A court . . . should, at a minimum, assess (1) the basic legality of the decree; (2) whether the terms of the decree, including its enforcement mechanism, are clear; (3) whether the consent decree reflects a resolution of the actual claims in the complaint; and (4) whether the consent decree is tainted by improper collusion or corruption of some kind.²²⁴

The court insisted that the focus of the inquiry is whether the “decree is procedurally proper,” while “taking care not to infringe on the S.E.C.’s discretionary authority to settle on a particular set of terms.”²²⁵

The Second Circuit also made clear that it was an abuse of discretion for a court to require the SEC to establish the “truth” of the allegations, noting that “[t]rials are primarily about the truth. Consent decrees are

218. See Jean Eaglesham & Chad Bray, *Citi Ruling Could Chill SEC, Street Legal Pacts*, WALL ST. J., Nov. 29, 2011, at C.1 (discussing possibility of losing control of the settlement process).

219. Mary Jo White, Chair, Sec. & Exch. Comm’n, Speech at the Council of Institutional Investors Fall Conference: Deploying the Full Enforcement Arsenal (Sept. 26, 2013).

220. Sec. & Exch. Comm’n v. *Citigroup Glob. Mkts.*, 752 F.3d 285, 289 (2d Cir. 2014).

221. *Id.* at 294 (citation omitted).

222. *Id.*

223. *Id.* at 296.

224. *Id.* at 294–95 (citations omitted).

225. *Id.* at 295.

primarily about pragmatism.”²²⁶ Nonetheless, the court made clear that as “[a]s part of its review, the district court will necessarily establish that a factual basis exists for the proposed decree.”²²⁷ Although in many instances this might involve a minimal review of the pleadings, the court noted that some cases “may require more of a showing, for example, if the district court’s initial review of the record raises a suspicion that the consent decree was entered into as a result of improper collusion between the S.E.C. and the settling party.”²²⁸

Despite the victory in the *Citigroup* case and the largely deferential standard it set forth, the agency was not mollified. Fearing perhaps that judges might be too quick to find a whiff of collusion, the SEC continued to steer settlements away from the federal courts. In November 2014, then-Director of Enforcement Andrew Ceresney acknowledged that the agency was increasingly using the administrative forum for settlements and defended the practice on efficiency grounds:

For settled matters, we often, but not always, choose to file in an administrative forum, largely because of efficiency. The filing quickly ends the matter on a settled basis, among parties that have agreed to a settlement, and there is no need to have implementation of the parties’ agreement subject to the competing demands of busy district court dockets.²²⁹

Ceresney also stressed that the SEC’s ability to use in-house mechanisms to resolve enforcement matters “was recently endorsed by the Second Circuit Court of Appeals in the *Citi* decision, where the court noted that the Commission ‘is free . . . to employ its own arsenal of remedies’ rather than bring settlements to district court.”²³⁰

In the end, the ultimate irony of the judicial criticism of supposedly “collusive” SEC settlements is that it drove those settlements in-house, where they can escape any oversight at all.²³¹ Settlements in SEC administrative proceedings do not even go through an ALJ: the orders issue directly from the Commission. And naturally there is no appeal. As

226. *Id.*

227. *Id.*

228. *Id.* at 295–96.

229. Andrew Ceresney, Director, Sec. & Exch. Comm’n Div. of Enf’t, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014).

230. *Id.*

231. Velikonja, *supra* note 197, at 132–33. Not surprisingly, Judge Rakoff has been critical of the administrative turn. See Judge Jed S. Rakoff, PLI Securities Regulation Institute Keynote Address: Is the S.E.C. Becoming a Law unto Itself? (Nov. 5, 2014) (transcript available at <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf>) [<https://perma.cc/64UK-QZR9>].

Professor Velikonja has aptly put it, these are “[s]ettlements in the [s]hadows.”²³²

2. Charges and Collateral Consequences

As described above, there has been a notable shift in SEC enforcement actions involving public companies towards settlements that include a civil penalty and non-scienter-based fraud charges.²³³ This undoubtedly reflects what public companies care most about when agreeing to a settlement with the SEC: the monetary sanction, even where it is considerable, is unlikely to be material or to affect the company’s bottom line.²³⁴ On the other hand, companies care deeply about the charges largely because of the collateral consequences that can accompany scienter-based fraud.

First, scienter-based fraud charges are very likely to lead to class action lawsuits. Even where the settlement is done on a no-admit/no-deny basis, the simple fact that a public company has consented to the entry of a judgment or order that includes scienter-based fraud charges will often lead to private lawsuits, and the facts detailed in the Commission’s complaint or order instituting proceedings will typically be sufficiently specific for the private plaintiffs to use in their own complaint and survive a motion to dismiss under the PSLRA. But non-scienter-based fraud charges are different because there is no private right of action for most negligence-based fraud (and there is no private right of action under Sections 17(a)(2) & (3) of the Securities Act or Sections 206(2) or 206(4) of the Advisers Act, the statutory provisions most often at issue here); as a result, the facts detailed in the Commission’s complaint or order—while sufficient to establish negligence—may not be sufficient for the plaintiffs to use in their own complaint and survive a motion to dismiss in an action alleging scienter-based fraud.²³⁵

Second, there are a number of “bad boy” provisions under the federal

232. Velikonja, *supra* note 197, at 124.

233. *See supra* Section III B.

234. In the Citigroup case, Judge Rakoff called the \$285 million fine “pocket change.” *Sec. & Exch. Comm’n v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2d 328, 334 (S.D.N.Y. 2011).

235. Most class action lawsuits are brought pursuant to Section 10(b) of the Exchange Act and Rule 10b-5 thereunder which require a showing of scienter. There is no private right of action under Section 17(a) of the Securities Act. There are private rights of action that are based on negligence (and even strict liability) in cases involving fraud in connection with securities offerings (*see* Sections 11 and 12(a)(2) of the Securities Act), but if the SEC brought an action for a violation of Section 5 of the Securities Act (the public analog for those private actions), any recovery in a private action would likely be duplicative.

securities laws that are triggered by fraud charges. For example, in 2005, the SEC significantly loosened the registration and offering rules for the largest and most widely followed issuers of securities, referred to as “Well Known Seasoned Issuers” (“WKSI”).²³⁶ The new rules include “bad boy” provisions that make issuers ineligible for WKSI status if they have violated the antifraud provisions of the federal securities laws within a specified period of time.²³⁷ However, the Commission can grant waivers from ineligible status upon a showing of good cause. The Commission’s Division of Corporation Finance, which has been delegated authority to grant these waivers, has made clear that the decision whether to do so hinges principally on whether the conduct involved scienter-based fraud rather than non-scienter-based conduct.²³⁸

Similarly, Rule 506 of Regulation D exempts certain offers and sales of securities from the registration provisions of the Securities Act, provided the issuer meets certain specified conditions.²³⁹ However, an issuer that has been the subject of a Commission cease-and-desist order involving scienter-based fraud within the last five years, is deemed a “bad actor” under the rules and cannot avail themselves of this exemption.²⁴⁰

Third, there are reputational concerns that accompany scienter-based fraud. Scienter-based fraud is generally considered more serious than non-scienter-based fraud; because it involves intentional misconduct, it can harm a firm’s reputation in ways that a charge of negligence might not.

236. 17 C.F.R. § 230.405 (2016). *See* Securities Offering Reform, 70 Fed. Reg. 44,722, 44,727 (Aug. 3, 2005) (defining a WKSI as an issuer that has at least \$700 million in market capitalization, or that has at least \$1 billion in debt, and has timely filed all its periodic reports). WKSI can register their offerings on shelf registration statements that become effective automatically upon filing—rather than having to wait for the SEC to declare the registration statement effective before making sales—and therefore can proceed much more quickly to market. They can also make unrestricted written and oral offers prior to filing a registration statement. *Id.* Qualifying as a WKSI can therefore be very important to an issuer of securities.

237. 17 C.F.R. § 230.405 (2016).

238. *See* Sec. & Exch. Comm’n, Div. of Corp. Fin., *Revised Statement on Well-Known Seasoned Issuer Waivers*, SEC. & EXCHANGE COMMISSION (2014), <https://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp-031214.htm> [https://perma.cc/82UE-8G69] (deciding whether good cause exists depends in part on “whether the conduct involved a criminal conviction or scienter-based violation, as opposed to a civil or administrative non-scienter-based violation.”); Sec. & Exch. Comm’n, Div. of Corp. Fin., *Statement on Well-Known Seasoned Issuer Waivers*, SEC. & EXCHANGE COMMISSION (July 8, 2011), <https://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp.htm> [https://perma.cc/WA6S-3C2U] (writing that scienter-based fraud should be considered in the decision to give a good cause waiver).

239. 17 C.F.R. § 230.506 (2016).

240. 17 C.F.R. § 230.506(d)(1)(v)(A).

While these settlements are an expression of what companies care most about, they also likely reflect the agency's perceived interests. The move towards non-scienter-based fraud charges accompanied by civil penalties appears to be a compromise: it allows the agency to assert violations of the antifraud provisions in its charging documents and trumpet a big figure fine in its press release—which sends a message to the public of a tough enforcement program—while at the same time allowing the defendants to escape the more onerous collateral consequences, sanctions, and reputational harms, that accompany scienter-based charges.

3. Individuals

Another noticeable aspect of the public company cases is the relative lack of individuals charged, particularly when it comes to the financial services industry and senior officials. Overall, individuals were charged in just under a quarter of the cases in the Dataset (122 of 529), but in only 12.7% of the financial services industry cases (33 of 259). The relative lack of individual charges is another reflection of what companies care most about when settling cases with the SEC: safeguarding senior management.

The dearth of individual charges is problematic because companies obviously can only act by and through real people. Yet over and over again, the SEC has brought fraud charges against entities but somehow no real person has been implicated. The SEC's failure to charge individuals has been the subject of much criticism over the years. Agency officials have repeatedly stated their willingness and desire to go after individuals, yet in practice it rarely happens.

When the Remedies Act was being debated, Senator Heinz specifically queried about individual charges in connection with the agency's new penalty authority. He asked: "Doesn't the imposition of a fine against a publicly traded company penalize the shareholders?" and went on to ask whether the agency should not be going after individuals instead.²⁴¹ Chairman Breeden replied that the agency goes after both entities and individuals, although he noted that in cases where an entire organization had engaged in wrongdoing, it might not be practical to go after every individual miscreant.²⁴²

Successive SEC Commissioners and enforcement officials have expressed the importance of going after individuals and have frequently

241. *The Securities Law Enforcement Remedies Act of 1989; Hearing on S. 647 Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 101st Cong. 85 (1990) (statement of Richard C. Breeden).

242. *Id.*

touted the agency's success in doing so.²⁴³ In 2013, then Chair Mary Jo White stated that a "core principle of any strong enforcement program is to pursue responsible individuals wherever possible" and after noting that companies only act through individuals insisted that "[r]edress for wrongdoing must never be seen as 'a cost of doing business' made good by cutting a corporate check."²⁴⁴ Chair White frequently returned to the same theme: "A company, after all, can only act through its employees, and to have a strong deterrent effect on market participants, it is absolutely critical that responsible individuals be charged and that we pursue the evidence as high as it can take us."²⁴⁵

More recently, Co-Director of Enforcement Stephanie Avakian stated: "We have also continued to focus on individual accountability by pursuing charges against individuals for misconduct in the securities markets."²⁴⁶ In a speech in May 2018, the other Co-Director of Enforcement, Steven Peikin, echoed the need to charge individuals, noting: "One of the primary ways we [advance the goal of deterrence] is with a focus on identifying and charging culpable individuals. . . . I view individual accountability as perhaps the most effective general deterrent tool in our arsenal."²⁴⁷

Peikin went to assert that "[o]ver the past year, the Commission has charged individuals in almost 80 percent of the Enforcement actions it has brought."²⁴⁸ That may well be correct with respect to enforcement actions overall, but it is not reflective of the public company actions in the Dataset: during FY 2017 individuals were charged in nine of the sixty-four public company actions (14%) and in none of the twenty-six financial services public company actions; in FY 2018 individuals were charged in sixteen of the seventy-two public company actions (22.2%), and in only two of the

243. See, e.g., Mary L. Schapiro, Chair, Sec. & Exch. Comm'n, Remarks at the Practising Law Institute's SEC Speaks, Address Before the Practising Law Institute (Feb. 24, 2012) (saying "[i]n the area of financial crisis-related cases, we filed charges against nearly 100 individuals and entities – actions against Goldman Sachs, Citigroup, J.P. Morgan and top executives at Countrywide, Fannie Mae and Freddie Mac. And more than half of the individuals charged were CEOs, CFOs or other senior officers").

244. Mary Jo White, Chair, Sec. & Exch. Comm'n, Deploying the Full Enforcement Arsenal, Address Before the Council of Institutional Investors (Sept. 26, 2013).

245. Mary Jo White, Chair, Sec. & Exch. Comm'n, A New Model for SEC Enforcement: Producing Bold and Unrelenting Results, Address Before the New York School of Law Program on Corporate Compliance and Enforcement (Nov. 18, 2016).

246. Stephanie Avakian, Co-Dir., Div. of Enf't, Sec. & Exch. Comm'n, Measuring the Impact of the SEC's Enforcement Program, Address Before the Government Enforcement Institute (Sept. 20, 2018).

247. Steven Peikin, Co-Dir., Div. of Enf't, Sec. & Exch. Comm'n, Keynote Address to the UJA Federation (May 15, 2018).

248. *Id.*

thirty-seven financial services public company cases.

There are obviously numerous factors that go into a decision to charge an individual, including the quality of the evidence implicating the particular person. In addition, in large organizations there are often numerous parties who have a small role in the misconduct but may not have known or been aware of the overall scheme. As a result, it is not always feasible to charge individuals even where it is apparent that there is chargeable misconduct at the organizational level. But the dearth of individual charges in the public company cases, and particularly in the financial services cases, once again suggests a compromise approach to settlements: payment of a fine, but no personal liability.

C. Deterrence

Deterrence is the principal stated rationale for imposing civil penalties, including civil penalties against public companies. The idea is that managers, boards of directors, and shareholders will all want to avoid the imposition of civil penalties in order to avoid the real effect that penalties can have on the company's bottom line and the more intangible effects, like reputational harm, that can accompany them, and that each of these constituencies will be motivated to take action to avoid penalties. Managers, who may themselves own stock or options in the company, or whose compensation may be tied to certain financial performance metrics, will seek to avoid penalties because managers may indirectly bear some of their costs. Managers will also be concerned that, notwithstanding the absence of SEC charges against them, they will be held accountable by the board, which could remove them from their positions. The board, in turn, will seek to rein in managers whose illicit conduct causes the company to incur a penalty, or whose lax supervision allows others to engage in misconduct. Finally, the shareholders, who may suffer the brunt of the cost of the penalty, can—at least in theory—hold the board accountable, by voting them out of office (although this is very difficult to do in practice). The desire to avoid penalties should therefore lead to greater and better oversight and compliance, and a reduction in actionable misconduct. The firm's managers will be incentivized to avoid penalties, even if they are not the one's paying them directly.

Measuring and evaluating deterrence, of course, is notoriously difficult. We do not, and cannot, know what illicit actions were *not* undertaken as a result of the fear of being penalized, and it is entirely possible that the SEC's penalty regime has been successful in deterring a great deal of misconduct, even if there is much that remains.

But one way to assess how effective civil penalties are in deterring misconduct is by looking at recidivism. Deterrence, after all, can be both general and specific: general in the sense that it is aimed at all market participants, including those who have never engaged in any misconduct, and seeks to ensure they never do so in the first place; specific in the sense that it is aimed at particular persons and entities who have engaged in misconduct, and seeks to ensure they never do it again.

The Dataset includes a fair number of actions against repeat offenders, primarily entities—including related entities—in the financial services industry, which is not in itself surprising given the size and scope of some of these financial institutions and the fact that financial services is the core area of SEC regulatory oversight. But the numbers are nonetheless jarring: Bank of America and its related entities (including Merrill Lynch) have been defendants or respondents in seventeen actions; UBS (and related entities) have been defendants or respondents in fourteen actions; Morgan Stanley (and related entities), JP Morgan (and related entities), and Citigroup (and related entities) have each been defendants or respondents in eleven actions; Credit Suisse (and related entities) have been defendants or respondents in ten actions; Goldman Sachs (and related entities) and Wells Fargo (and related entities) have each been defendants or respondents in seven actions; and Deutsche Bank (and related entities) have been defendants or respondents in six actions. Together, these nine financial services firms account for about 17.7% of the actions in the Dataset (94 of 529). At least with respect to these firms, it is fair to say that the SEC enforcement actions, and the civil penalties that have accompanied them, have had little if any deterrent effect, either general or specific.

Moreover, in each of these enforcement actions, the relief ordered includes either an injunction (in a federal district court action) or a cease-and-desist (C&D) order (if the action is brought administratively). The orders are worded to prohibit violations, and future violations, of specified provisions of the federal securities laws. Because the charges are frequently the same, the orders in these cases often prohibit the entities from violating provisions that they have already been ordered not to violate. And while many of the entities discussed in the previous paragraph are legally distinct, even if related, that is not always the case. For example, in the relevant time period covered herein, JP Morgan Securities LLC (and its predecessor in interest JP Morgan Securities Inc.) was enjoined, or ordered to cease-and-desist, from violating Section 17(a)(2) of the Securities Act on no fewer than

five occasions.²⁴⁹ So too was Citigroup Global Markets Inc.²⁵⁰

D. Harm to Shareholders

The most common and consistent critique of penalties for public companies is that they harm the shareholders who had nothing to do with the misconduct at issue, and indeed may have already been victimized by it, either directly through the conduct itself or through a drop in the company's share price when the misconduct is revealed. While it is true that the fines, even when they are large sums, are frequently immaterial to a company's bottom line, it is still money that comes out of the pockets of shareholders. Moreover, some of the fines at issue are large enough to matter, and sometimes they come on the heels of misconduct that itself led to considerable shareholder borne losses.

A good example, and one that goes beyond the SEC, involved the so-called "London Whale," a trader at JP Morgan who made a series of very risky derivative transactions that ended up costing the bank some \$6.2 billion in losses.²⁵¹ Various regulatory and criminal authorities in both the US and the UK investigated the trading, and in the end JP Morgan paid approximately \$920 million in fines to resolve the charges, including \$200

249. J.P. Morgan Sec., Inc., Securities Act Release No. 9,078, Exchange Act Release No. 60,928 (Nov. 4, 2009); Press Release, Sec. & Exch. Comm'n, J.P. Morgan to Pay \$153.6 Million to Settle SEC Charges of Misleading Investors in CDO Tied to U.S. Housing Market (June 21, 2011), <https://www.sec.gov/news/press/2011/2011-131.htm> [<https://perma.cc/9K8M-HNLD>]; Press Release, Sec. & Exch. Comm'n, SEC Charges J.P. Morgan Securities LLC with Misleading Investors in RMBS Offerings (Nov. 16, 2012), <https://www.sec.gov/news/press-release/2012-2012-233.htm> [<https://perma.cc/8D6M-JDWS>]; J.P. Morgan Securities LLC, Securities Act Release No. 9,827, Exchange Act Release No. 75,221 (June 18, 2015) (sanctions and cease-and-desist order); J.P. Morgan Sec., LLC., Securities Act Release No. 10,001, Exchange Act Release No. 76,839 (Jan. 6, 2016) (sanctions and cease-and-desist order).

250. Press Release, Sec. & Exch. Comm'n, Citigroup to Pay \$285 Million to Settle SEC Charges for Misleading Investors About CDO Tied to Housing Market (Oct. 19, 2011), <https://www.sec.gov/news/press/2011/2011-214.htm> [<https://perma.cc/7B6K-D83A>]; Citigroup Global Markets Inc., Securities Act Release No. 9,819, Exchange Act Release No. 75,213 (June 8, 2015) (sanctions and cease-and-desist order); Citigroup Alternative Investments LLC, Securities Act Release No. 9,893, Exchange Act Release No. 75,710 (Aug. 17, 2015) (sanctions and cease-and-desist order); Citigroup Global Markets Inc., Securities Act Release No. 10,288 (Jan. 24, 2017) (sanctions and cease-and-desist order); Citigroup Global Markets Inc., Securities Act Release No. 10,545, Exchange Act Release No. 84,124, (Sep. 14, 2018) (sanctions and cease-and-desist order).

251. Dominic Rusche, *London Whale Scandal to Cost JP Morgan \$920m in Penalties*, THE GUARDIAN (Sep. 19, 2013, 14:22 EDT) <https://www.theguardian.com/business/2013/sep/19/jp-morgan-920m-fine-london-whale> [<https://perma.cc/Z6M4-XTRE>].

million to the SEC.²⁵² The cost of those fines was ultimately borne by the shareholders, who had previously been saddled with the huge losses from the trading at issue. The conduct in that case may well have been egregious and may have created systemic risk that needed to be addressed, but making the shareholders pay for conduct that harmed them (and that obviously they had nothing to do with), is at the very least problematic. As Professor John Coffee put it: “The victims of this enormous loss were the shareholders of JP Morgan and the remedy is for those shareholders to pay \$900m-plus in fines. It’s not just adding insult to injury, it’s adding injury to injury.”²⁵³

V. THE NAME OF THE GAME

A. Summary

When the SEC first obtained penalty authority, there were concerns expressed about imposing penalties on public companies because the cost of the penalty is ultimately borne by the shareholders who were not responsible for the misconduct and may have been harmed thereby. As a result, even penalty advocates insisted that penalties should not become routine for public companies, but rather should be reserved for a limited class of cases, primarily those where it could be shown that the company—and by extension the shareholders—had somehow benefitted from the misconduct. But starting around the time of the big accounting scandals at the turn of the millennium, the paradigm began to shift toward the normalization of public company penalties. Although the shift was itself controversial and produced a backlash, the penalty regime now seems firmly in place.

Our review of nine years of data shows that penalties have become almost the norm in SEC enforcement actions against public companies. The data also shows that the penalties are increasingly being imposed through the entry of consensual administrative orders—orders that emanate from the Commission and are unreviewable. The data further shows that with respect to actions involving fraudulent conduct, the settlements increasingly include non-scienter-based charges, rather than charges evidencing intentional misconduct. Finally, the data shows a dearth—though by no means a complete lack—of individual charges connected to the entity misconduct.

252. *Id.* The bank also paid \$300 million to the Comptroller of the Currency, \$200 million to the Federal Reserve, and about \$220 million to the UK’s financial authorities.

253. *Id.* In the same article Prof. Coffee noted that no senior bank officials had been charged in connection with the misconduct: “Ideally the regulators should fine actual individuals who are responsible. But time and again the SEC settles for large penalties and gives virtual immunity to some officers.”

This package—a settled administrative proceeding with non-scienter-based charges, the payment of a civil penalty, and no individual charges—is particularly pronounced with respect to entities in the financial services industry. While many of these cases do involve situations where the misconduct led to a benefit to the company—and thus where a penalty is most appropriate—that is not always true and, in any event, the penalty (which is still borne by the shareholders) is never tied to the benefit in any formal, or decipherable, way.

B. The Data for the First Half of FY2019

Data for the first half of FY 2019 is now available and in several important respects—but with one notable exception—the data confirms the trends identified herein. In the first half of FY 2019, the Commission brought a total of fifty-two new actions against public companies and their subsidiaries. However, just under half of these actions (twenty-four) came about as a result of a special one-time initiative—the Share Class Selection Disclosure Initiative (the Initiative)—which stands apart and, for the most part, should be treated separately to avoid skewing the results.

Overall, a few things stand out. First and foremost, every single one of the fifty-two actions were brought as a settled administrative proceeding: none of the actions were litigated, and none were filed in federal district court even as a settled matter. This continues and cements the agency’s administrative turn even in the settlement context, and with it the lack of any independent oversight.

Second, of the twenty-seven matters unconnected to the Initiative, penalties were imposed in twenty-one cases (77.7%).²⁵⁴ In only six cases

254. Citibank, N.A., Securities Act Release No. 10,571, 2018 WL 5818280, at *8 (Nov. 7, 2018); ITG Inc., Securities Act Release No. 10,572, 2018 WL 5818281, at *10 (Nov. 7, 2018); Fifth Street Mgmt., LLC, Securities Act Release No. 10,581, Exchange Act Release No. 84,713, Investment Company Act Release No. 33,312, 2018 WL 6304195, at *9 (Dec. 3, 2018); Agria Corp., Exchange Act Release No. 84,763, 2018 WL 6445196, at *9 (Dec. 10, 2018); MUFG Sec. Americas Inc., Exchange Act Release No. 84,758, 2018 WL 6445193 at *4 (Dec. 10, 2018); Am. Modern Green Senior (Houston) LLC, Securities Act Release No. 10,584, 2018 WL 6523104, at *4 (Dec. 12, 2018); Santander Consumer USA Holdings Inc., Exchange Act Release No. 84,829, 2018 WL 6600988, at *4 (Dec. 17, 2018); Bank of New York Mellon, Securities Act Release No. 10,586, 2018 WL 6600986, at *8 (Dec. 17, 2018); UBS Fin. Serv. Inc., Exchange Act Release No. 84,828, 2018 WL 6600987, at *7 (Dec. 17, 2018); ADT Inc., Exchange Act Release No. 84,956, 2018 WL 6804040, at *2 (Dec. 26, 2018); Centrais Electricas Brasileiras S.A., Exchange Act Release No. 84,973, 2018 WL 6804091, at *4 (Dec. 26, 2018); JPMorgan Chase Bank, N.A., Securities Act Release No. 10,600, 2018 WL 6804087, at *8 (Dec. 26, 2018); Polycom, Inc, Exchange Act Release No.

was a penalty not imposed; in two of those cases, the order specified that a penalty was not being imposed because of the imposition of a criminal fine in a parallel action,²⁵⁵ meaning that in over eighty-five percent of the actions, the public company paid a fine either to the SEC or the DOJ. In only four cases, all involving books-and-records violations was there no penalty;²⁵⁶ interestingly in two of those cases the order specifically noted that a penalty was not being imposed because of cooperation,²⁵⁷ and in a third case the Commission noted that in accepting the settlement the agency took account of the company's cooperation and remediation,²⁵⁸ which may be a sign that the agency intends to reward cooperators in a meaningful way going forward.

Third, ten of the twenty-seven non-Initiative cases included fraud charges, but only two of those involved scienter-based fraud,²⁵⁹ while eight involved non-scienter-based fraud charges,²⁶⁰ typically violations of Section

84,978, 2018 WL 6804090, at *5 (Dec. 26, 2018); Hertz Glob. Holdings, Inc., Securities Act Release No. 10,601, Exchange Act Release No. 84,979, 2018 WL 6839631, at *10 (Dec. 31, 2018); Digital Turbine Inc., Exchange Act Release No. 84,998, 2019 WL 364619, at*2 (Jan. 29, 2019); Grupo Simec S.A.B. de C.V., Exchange Act Release No. 84,996, 2019 WL 364618, at *4 (Jan. 29, 2019); Lifeway Foods, Inc., Exchange Act Release No. 84,995, 2019 WL 364617, at *3 (Jan 29, 2019); Cognizant Tech. Sol. Corp., Exchange Act Release No. 85,149, 2019 WL 653711, at *6 (Feb. 15, 2019); BB&T Sec, LLC, Exchange Act Release No. 85,249, 2019 WL 1036153, at *6 (Mar. 5, 2019); Mobile TeleSystems PJSC, Exchange Act Release No. 85,261, 2019 WL 1074540, at *14 (Mar. 6, 2019); Merrill Lynch, Pierce, Fenner & Smith Inc., Exchange Act Release No. 85,395, 2019 WL 1314892, at *7 (Mar. 22, 2019).

255. Lumber Liquidators Holdings, Inc., Exchange Act Release No. 85,291, 2019 WL 1124071, at *5 (Mar. 12, 2019); Fresenius Med. Care AG & Co. KGaA, Exchange Act Release No. 85,468, 2019 WL 1424366, at *15 (Mar. 29, 2019).

256. Pyxus Int'l, Inc., Exchange Act Release No. 84,562, 2018 WL 5881781, at *4-5 (Nov. 9, 2018); Vantage Drilling Int'l, Exchange Act Release No. 84,617, 2018 WL 6040668, at *6-7 (Nov. 19, 2018); KCAP Fin., Inc., Exchange Act Release No. 84,718, Investment Company Act Release No. 33,314, 2018 WL 6322406, at *7-8 (Dec. 4, 2018); Hain Celestial Grp., Inc., Exchange Act Release No. 84,781, 2018 WL 6499907, at *5-6 (Dec. 11, 2018).

257. Vantage Drilling Int'l, 2018 WL 6040668, at *7 (the order also noted the company's financial condition as a reason for not imposing a penalty); Hain Celestial Grp., Inc., 2018 WL 6499907, at *6.

258. Pyxus Int'l, Inc., 2018 WL 5881781, at *4.

259. Agria Corp., 2018 WL 6445196, at *8; Lumber Liquidators Holdings, Inc., 2019 WL 1124071, at *5.

260. Citibank, N.A., Securities Act Release No. 10,571, 2018 WL 5818280, at *2 (Nov. 7, 2018); ITG Inc., Securities Act Release No. 10,572, 2018 WL 5818281, at *10 (Nov. 7, 2018); Fifth Street Mgmt., LLC, Securities Act Release No. 10,581, Exchange Act Release No. 84,713, Investment Company Act Release No. 33,312, 2018 WL 6304195, at *7 (Dec. 3, 2018); Am. Modern Green Senior (Houston) LLC, Securities Act Release No. 10,584, 2018 WL 6523104, at * 2 (Dec. 12, 2018); Bank of New York Mellon, Securities Act Release No. 10,586, 2018 WL 6600986, at *2 (Dec. 17, 2018); JPMorgan Chase Bank, N.A., Securities Act Release No. 10,600, 2018 WL 6804087, at *2 (Dec. 26, 2018); Hertz Glob. Holdings,

17(a)(2) or (3) of the Securities Act.²⁶¹ Interestingly, in one of those cases the order includes a paragraph specifying that the charges were not scienter-based, but only required a showing of negligence.²⁶² The inclusion of this paragraph, no doubt at the insistence of company counsel, reflects the degree to which public companies care about the distinction between scienter-based and non-scienter-based fraud, as well as how much they care to communicate that distinction to the public (and to class-action lawyers).

Finally, individuals were charged in, or in connection with, only two of the twenty-seven non-Initiative actions,²⁶³ and in none of the Initiative actions. Although the co-directors of Enforcement have both emphasized the need to hold individuals accountable, and the Division of Enforcement's latest Annual Report²⁶⁴ stresses the importance of individual accountability, in practice, at least when it comes to public company actions, individuals are still not being charged very often.

The Initiative, on the other hand, stands apart in at least one important respect. Although, as already noted, the Initiative is reflective of the overall trend in that it involved settled administrative actions and the cases lacked individual charges, and is also reflective in terms of involving non-scienter-based fraud charges that are largely devoid of collateral consequences, the companies that settled pursuant to the Initiative paid disgorgement and pre-judgment interest, but no civil penalties.

The Initiative was aimed at investment advisers who failed to adequately disclose conflicts of interest related to the sale of certain higher cost mutual fund shares to their clients, when lower cost shares were available.²⁶⁵ Pursuant to the Initiative, investment advisers that self-reported

Inc., Securities Act Release No. 10,601, Exchange Act Release No. 84,979, 2018 WL 6839631, at *9 (Dec. 31, 2018); BB&T Sec, LLC, Exchange Act Release No. 85,249, 2019 WL 1036153, at *6 (Mar. 5, 2019).

261. One case also involved non-scienter-based charges under 206(2) and (4) of the Advisers Act (Fifth Street Mgmt., LLC, 2018 WL 6304195, at *7), and one case involved only non-scienter-based charges under 206(2) of the Advisers Act (BB&T Sec, LLC, 2019 WL 1036153, at *6).

262. Hertz Glob. Holdings, Inc., 2018 WL 6839631, at *9.

263. Press Release, Sec. & Exch. Comm'n, SEC Charges Agria Corporation and Executive Chairman with Fraud (Dec. 10, 2018), <https://www.sec.gov/news/press-release/2018-276> [<https://perma.cc/NR6G-X2EB>]; Press Release, Sec. & Exch. Comm'n, SEC Charges Cognizant and Two Former Executives with FCPA Violations (Feb. 15, 2019), <https://www.sec.gov/litigation/litreleases/2019/lr24402.html> [<https://perma.cc/8X2H-UQN8>]. In the Cognizant case, the SEC sued two former executives of the company in an unsettled federal district court action.

264. U.S. SEC. & EXCH. COMM'N DIV. OF ENF'T, ANNUAL REPORT 12 (2018).

265. See Press Release, Sec. & Exch. Comm'n, SEC Share Class Initiative Returning More

misconduct were allowed to settle with the imposition of a cease-and-desist order finding violations of Section 206(2) of the Advisers Act,²⁶⁶ which is non-scienter-based, with no civil penalty so long as the adviser paid disgorgement and prejudgment interest and took steps to return the funds to injured investors.²⁶⁷ A total of seventy-nine investment advisers, including twenty six public companies or subsidiaries (in twenty-five actions) entered into settlements pursuant to the Initiative on March 11, 2019. The Initiative was a one-shot deal, although it follows on the MCDC initiative which also involved self-reporting.²⁶⁸ This time, however, there were no civil penalties. Whether that reflects less culpable conduct or a greater desire to reward cooperation is an open question. More to the point, whether the Initiative was a unique approach taken in light of unusual facts, or whether it marks a shift away from an almost automatic penalty regime also remains to be seen.

C. Conclusion

Civil penalties have now become a routine aspect of settling SEC enforcement actions against public companies. Penalties are imposed in most cases, without any regard to whether the misconduct benefitted the company or whether it already harmed shareholders. Instead penalties have become the norm. Proponents of penalties argue that they are necessary to deter misconduct, and it is entirely possible that penalties have had some effect, although it is almost impossible to know how much. The number of recidivist violators in the financial services industry suggests that, at least when it comes to specific deterrence, the effect of civil penalties has been minimal at best. Indeed, as civil penalties have become routinized, they lose some of their stigma and much of their sting: when almost every public company that settles an SEC enforcement action pays a penalty, the penalties do not seem so bad, and can easily be rationalized as a cost of doing business, even if the cost is actually borne by the shareholders.

Treating almost all forms of misconduct as warranting a penalty also

Than \$125 Million to Investors (Mar. 11, 2019), <https://www.sec.gov/news/press-release/2019-28> [<https://perma.cc/D5WE-SGAL>] (“The initiative incentivized investment advisers to self-report violations of the Advisers Act resulting from undisclosed conflicts of interest. . . . The SEC’s orders found that the investment advisers failed to adequately disclose conflicts of interest related to the sale of higher-cost mutual fund share classes when a lower-cost share class was available.”).

266. Advisers Act § 206(2) (2018).

267. *Share Class Selection Disclosure Initiative*, SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/enforce/announcement/scsd-initiative> [<https://perma.cc/5UR9-694T>] (last updated May 1, 2018).

268. *Supra* note 110.

makes little sense; indeed, it has the perverse effect of diminishing egregious scienter-based misconduct by treating it similarly to the merely negligent. And taxing innocent shareholders in every instance for the misconduct of company employees—without regard to whether the shareholders ultimately benefitted or were harmed by the misconduct—seems doubly unfair given that the offending employees are themselves rarely held to account.

The SEC's penalty regime is all the more troubling given the complete lack of standards for calculating penalties and the utter lack of transparency that envelops the process. Settlements that are concluded in the "shadows" without any explanation of the basis for the penalty or how it was calculated, can easily appear arbitrary or even collusive.

Going forward, it is important for the SEC to articulate some new guidelines for the imposition of civil penalties against public companies, guidelines that take account in a meaningful way of the obvious problem of shareholder harm. Rather than treating all cases the same, these guidelines should make meaningful distinctions concerning the type, extent, and egregiousness of the misconduct, the extent of cooperation and remediation, as well as the degree of benefit or harm to the company's shareholders from both the misconduct and the effect of the penalty. The guidelines should also try to address in some objective way the deterrent effect of penalties. The Penalty Statement was an attempt to provide some guidance in this area, but it has fallen away and never been replaced by anything else.

In addition, the SEC needs to articulate some standards for calculating the amount of civil monetary penalties and provide some explanation for how the penalties were calculated in any given case. The statutory guidelines are almost infinitely malleable, which gives the agency extraordinary power and flexibility. Flexibility, and some measure of discretion, is of course vitally important for the agency to be able to settle cases: settlements are all about compromise, and every case is a little different with respect to the facts and the evidence. Some element of discretion is absolutely necessary for the agency to be able to reach negotiated resolutions. Too much rigidity in the formula for calculating penalties could lead to an increase in wasteful and costly litigation, and at least as presently constituted, the SEC is not set up or equipped to be a litigating agency. But too much discretion in how the penalties are calculated, and a complete lack of transparency in the process, can easily veer towards arbitrariness.

Perhaps the most important thing going forward is to hold individuals accountable. Agency officials have repeatedly stressed the need to do so, but in practice individuals have been charged in only a minority of the public company cases. There are, of course, often difficulties in proving individual culpability, particularly when it comes to establishing the requisite state of

mind. But the agency has shown a willingness to bring non-scienter-based charges with respect to entities and could expand its use of negligence charges in the case of individuals. Moreover, the SEC has tools it rarely deploys that could be used to establish individual liability, including control person liability²⁶⁹ and aiding-and-abetting liability.²⁷⁰ Holding individual wrongdoers accountable in the public company context is not only a fairer resolution than imposing a fine on shareholders, but also a more efficient one: individuals are far more likely to be deterred from misconduct if they pay the price than if the cost is borne by someone else.

The current penalty regime with respect to public companies makes little sense conceptually or practically. Penalties are routinely imposed without regard to shareholder impact. The lack of standards for the calculation of penalties, and the lack of explanation with respect to the those that are imposed, make the penalties appear somewhat arbitrary. To the cynic, the penalty regime appears to be a studied compromise, in which public companies are allowed to settle SEC enforcement actions with reduced charges and no individual liability in exchange for a payment. This allows the SEC to trumpet a strong enforcement program by pointing to a big monetary fine. It also allows public companies and their executives to avoid more serious and onerous sanctions, along with the collateral consequences thereof, by paying a fine using other people's money.

269. Section 20(a) of the Exchange Act imposes liability upon any person who controls another person liable under the securities laws to the same extent as such controlled person, unless the controlling person acted in good faith and did not directly or indirectly induce the violation. Exchange Act § 20(a), 15 U.S.C. § 78t (2012). Control person liability can be used to establish liability against those who facilitate misconduct. However, in practice, the SEC has rarely used the provision to go after individuals. See Marc I. Steinberg and Forrest Roberts, *Laxity at the Gates: The SEC's Neglect to Enforce Control Person Liability*, 11 VA. L. & BUS. REV. 201, 230 (2017) ("Although the SEC clearly has the power to bring actions premised on control person and failure to supervise liability, these actions, when instituted at all, have frequently been brought against top level personnel of relatively small enterprises, not the 'big fish' associated with the financial crisis and misconduct perpetrated thereafter.").

270. The SEC has specific authority to prosecute "any person that knowingly or recklessly provides substantial assistance to another person in violation" of the securities laws. Exchange Act § 20(e).