REMARKS BEFORE THE

TWENTY-THIRD ANNUAL
ROCKY MOUNTAIN
STATE-FEDERAL-PROVINCIAL SECURITIES CONFERENCE

COMMISSIONER MARY L. SCHAPIRO*

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

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

I. *Introduction*

I am delighted to be in Denver today and to have the opportunity to speak with you. This is my first trip to Denver, and I am particularly happy to have the opportunity to meet personally with so many members of the Denver Regional and Salt Lake Branch Office staffs.

Despite the geographical distance separating Denver from Washington, Bob Davenport, his staff and I have developed a strong relationship. For many years Bob Davenport has done an extraordinary job leading the Denver Regional Office. He and his staff recognized the abuses in the penny stock market long before it was in fashion to focus on the losses of the thousands of small investors who are defrauded by unscrupulous penny stock promoters. The Denver Regional Office staff helped lead the Commission into launching the campaign, announced two years ago here in Denver, to clean up the penny stock market. The Denver and Salt Lake Offices of the Commission, the NASD regional office, and state agencies in the Rocky Mountain region have played pivotal roles in the effort to shine the bright sunlight of full, honest disclosure in the shadowy, unregulated reaches where penny stock fraudsters ensnare their victims. By working together, I believe we have achieved some real success in increasing investor protection.

The importance of accessible, active, efficient and fair capital markets for companies and investors in the Rocky Mountain region is underscored by recent

events in the Middle East. Events there have pushed oil prices to record high levels, with some analysts predicting prices of $50 per barrel if there is an early, cold winter in the United States. With these developments, the Rocky Mountain states may be on the verge of a renewed period of high profile oil and gas exploration and development. Raising the new capital required for increased energy exploration and development will undoubtedly lead to more securities underwritings as well as increased trading activities throughout the Rocky Mountain region.

II. *Establishment of the Task Force on the Administrative Process*

During the coming months, the Commission also faces the prospect of increased activity and new opportunities in several important areas. One area which will experience fundamental changes is the Enforcement program. As a result of passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 -- widely known simply as the Remedies Bill or the Remedies Act -- the Commission will be able to impose or seek a flexible, sweeping array of new sanctions, ranging from bare administrative cease and desist orders to complex court orders allowing for ancillary, affirmative relief and the assessment of very substantial monetary penalties.

Last March, in anticipation of receiving new authority to impose new administrative sanctions, I suggested that the Commission should examine its administrative process in order to determine, what, if any, additional steps we could take to assure that administrative hearings are conducted in the most expeditious and efficient manner possible. In mid-July Chairman Breeden announced the creation of a Commission Task Force on Administrative Proceedings, which he asked me to chair. I would like to take this opportunity to report to you on some of our activities.

I want to preface my comments about the work of the Task Force with the observation that to date we have reached no conclusions, either in our analysis of which aspects of the administrative process should be changed in light of evolving practice and the passage of the Remedies Bill, or as to the solutions we might favor. A commitment by Task Force members to approach our review of the administrative process without preconceived ideas about "appropriate changes" has been key to the frank and searching discussions taking place in the Task Force. I believe that a willingness to make a fresh in-depth analysis of the problems, and a willingness to consider diverse proposals contributes greatly to the chances of ultimately achieving fair and useful improvements in this difficult area of practice.

The agenda set for the Task Force is ambitious: to ensure that the Commission is meeting the highest standards in the fair and efficient administration of justice. Our first broad task is to review existing rules and procedures to determine whether, and

where, we currently experience undue delay and then, how best to speed our process. Justice delayed, is unquestionably justice denied. Undue delay works against the government because it prevents the imposition of sanctions which are necessary to protect the public. Undue delay also works against respondents who wish to resolve charges against them, and get on with their lives.

As a part of our consideration of existing rules, we are also examining ways to ensure that the rules continue to provide substantive fairness and adequate information about our processes. A central criticism raised by members of the bar is the claim that the Commission's rules are deficient because they fail to reflect informal procedures which may have developed as a regular part of many administrative proceedings. The rules may also benefit, in some cases, from better organization or drafting.

Our second broad task is to prepare new rules that will be necessary when the Remedies Bill becomes law. Both Houses of Congress have passed the Bill and it has been forwarded to the President. My understanding when I left Washington yesterday was that it could be signed at any time.

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The Task Force consists of representatives from the Office of the Administrative Law Judges, the Office of the General Counsel, the Division of Enforcement, the Regional Offices and the Office of the Secretary. The offices of the other Commissioners and each of the Commission's other principal operating Divisions have sent a liaison to Task Force meetings.

I am gratified that members of the bar, individually, and on an organized basis through the ABA, have taken a cooperative and active role in sharing their views with the Task Force. Jim Cheek, Chairman of the ABA Committee on Federal Regulation of Securities Law, has been in contact with me, and Richard Phillips, Secretary of the ABA Section of Business Law, organized a group consisting of a number of distinguished SEC practitioners to present their views to the Task Force.

I hope our report will be concluded in the first half of 1991. Our ability to conclude our work is, like so much else, closely tied to the ongoing budgetary chaos in Washington and other projects at the Commission. Priority for the staff members working on the Task Force must be pending matters, including litigation and critical investigations.

III. *Work of the Task Force: Some Interim Issues*

During the latter half of July, Task Force members prepared brief reports identifying major issues of concern in promoting the fair and efficient administration of justice by the Commission in our own administrative proceedings. The full Task Force met during the first week in August. At that meeting I established four working groups to further develop an analysis of our administrative process. The groups were asked to address issues from three perspectives: the development of rules and regulations, establishment of internal guidelines or normative standards and implementation of reporting or management systems that would facilitate more efficient or timely allocation of resources whether or not there were also new rules or normative guidelines.

One group is examining the existing rules and procedures at the stage from entry of an order instituting proceedings through the initial decision of an ALJ. The second group is examining existing rules from the point an initial decision is appealed through the entry of a final order by the Commission. This review encompasses appeals from decisions rendered by the NASD and other SROs.

A third group is drafting proposed rules for the conduct of cease and desist proceedings and other new proceedings authorized in the Remedies Bill. The fourth group has undertaken a detailed statistical examination of every litigated administrative

proceeding in which an initial decision has been issued from January 1, 1982 to the present. Through this examination, we are learning how much time is spent at each phase of the administrative process. Obviously, matters still pending before the Commission are rigorously excluded from any deliberations by me, the Task Force as a whole or the working groups.

Over the past months, I have met regularly with the working groups, often several times a week. The four working groups will be reporting back to the entire Task Force at the end of October, at which time we will begin to assemble our report on whether, and where we can take steps to improve the existing process and to adopt fair and efficient procedures to govern our new powers under the Remedies Bill.

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The work of the fourth group, which is examining our track record in processing administrative proceedings is logically precedent to the other groups. Without an understanding of the current process, we could not improve it. The data gathered is interesting. It has surprised many people to learn that there are only approximately 10 initial decisions per year issued by the Commission's Administrative Law Judges: over the eight and three quarters years since January 1, 1982, there have been a total of approximately 90 initial decisions, including decisions on remand. Many cases are not

appealed; during the same time period there have only been approximately 40 appellate decisions issued by the Commission.

Because of the small number of cases one must exercise substantial care in drawing broad conclusions about the length of time at each stage, or the reasons for the amount of time spent at each stage. For example, the composition of the Commission itself changes. Delay may arise, therefore, from a lack of a quorum, or a period of time during which a new commissioner is reviewing an existing record. By contrast, in the court system, changes in the membership of a court, particularly at the appellate level, are less likely to affect disposition of particular cases.

Nonetheless, one preliminary thesis would be that if the administrative system is working as we would hope, an appeal to the Commission should take less time, on average, than the trial and initial decision before the Administrative Law Judge. Based on selective, and still very preliminary data,[1] it appears that the Commission is not meeting this goal. Over the entire eight year period of our study, it took, on average, approximately thirteen months from institution of proceedings until an ALJ handed down an initial decision. By contrast, during the same time period, the Commission, on average, took approximately 17 months to render a decision following the appeal of an initial decision.

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[1] Certain cases have not been included in our preliminary analysis, because of either a lack of complete data or the anomalous character of the proceeding, e.g., In the Matter Bacardi Corporation (File Number 3-7019, Initial decision issued Feb. 15, 1990)(only proceeding under Exchange Act Section 12(g)(4)).

Even more disturbing are the trends over the eight year period studied. Prior to October 1, 1985 proceedings before ALJs took just under 12 months, and appeals to the Commission took only 14 months, approximately. Since October 1, 1985 proceedings before ALJs took 16 months, approximately - a 33 per cent increase. Appeals to the Commission took approximately 20 months -- a 40 per cent increase.

Clearly more analysis is necessary. We do not have complete statistics on the time taken to complete appeals from SRO proceedings. Also, median times, and standard deviations are more powerful statistical representations than simple averages. But in this case, the simple average reveals thought-provoking information.

While the trends are not in the direction we would like, the data shows some positive developments, unexpected by some observers of the Commission. For example, excluding Rule 2(e) cases, which present certain unique features, ALJ's appear to be quite prompt in handing down initial decisions -- taking approximately 90 days from submission of final briefs to the issuance of opinions. This means that on average, over the past eight years, administrative trials were generally concluded about ten months after orders instituting proceedings are filed. We are continuing to gather data on the time spent by ALJs actually in trial and on the time taken for Rule 2(e) proceedings.

Obviously, however, allowing defense counsel time to familiarize themselves with the staff's investigative files, and conducting a full trial with reasonable accommodation for schedules imposed by other proceedings, the location of witnesses, etc. is going to take time. Accordingly, we already suspect that the effort to improve the efficiency of the administrative process should focus more on the appellate process than the trial process.

While ALJs must accommodate the schedule of counsel and witnesses, Commissioners can read the record and briefs on their own timetable, and without the delays inherent in a live proceeding where objections must be entertained, and other strategic moves played out. This is not to suggest, however, that the ALJs do not have some distinct advantages in moving their case load. The ALJs are professional, full-time judges, whose performance is assessed by fellow judges and members of the bar by how well they fulfill their judicial function.

By contrast, Commissioners are not full-time judges. A commissioner is often faced with a demanding schedule of public Commission meetings, closed or enforcement related meetings and engagements to meet, speak with, or exchange views with foreign regulators, regulated entities, professionals practicing before the Commission, Congress and others. This burden is even greater on the Chairman, who is frequently called to testify by Congress, who has duties in organizations such as IOSCO and who is responsible for the Commission's budget and management.

Commissioners' performance is not evaluated, either by the securities bar or the general public by their efficiency or skill in fulfilling their quasi-judicial role. Because of subtle changes in the culture and organization of the Commission, the Commission, as an institution, may not elevate the Commissioner's quasi-judicial role to the importance which that role demands and merits.

When I became a Commissioner little, if anything, was said in briefings about the Commission's administrative litigation process. Nor, during my initial months as a Commissioner, was I able to plug into the appellate process the way I was able to, or even forced to, deal with weekly enforcement calendars and open meeting rule-making items.

Another advantage an ALJ may have in controlling and moving his caseload is the ability to act alone. The Commission acts as an appellate body, in which at least two of three, and usually three of five individuals must come together to render a decision. On first blush it appears to be a remarkable aspect of our administrative process that five officials, appointed by the President and confirmed by the Senate will decide an administrative case. Unless an appellate court is sitting en banc, Federal cases of the most far reaching importance are entrusted to only three Presidential rank officials. Only the smallest fraction of cases receive scrutiny from the nine justices of the Supreme Court.

Naturally, one suggestion being investigated by the working group on the appellate process is whether the Commission could handle appeals more expeditiously with panels consisting of three Commissioners. Our discussion on this matter is not concluded, but I will share with you some of the points made to date. If case disposition is being held back by inefficiencies in coordinating the work of five member panels, three member panels would offer the prospect of fewer meetings to thrash out differences and therefore quicker decisions. Also, members of an identified three person panel might feel greater personal obligation, and greater freedom to move their cases.

On the other hand, a panel process might be largely subverted as a device aimed at speeding case resolution if appeals were allowed en banc. It would also be necessary to assign panels by a wheel or other random method, in order to prevent opportunities for forum shopping by litigants, or commissioners, who might arrange to participate only in particular types of cases.

More fundamentally, there is some reason to question whether the fact that panels have five members instead of three is actually a cause of delay. My own suspicion is that they are not. The Commission meets almost every week for an enforcement calendar, so scheduling meetings to address appellate issues need not be an issue. On most cases, there are not divided panels or separate opinions.

We will examine data for periods when the Commission had fewer than five members on a panel, and see if those decisions were rendered more quickly than otherwise. Whether we have a enough data to draw any conclusions, I would predict that our report will raise this issue as one of many for public comment.

Controlling the Commission's docket is not inherently complex. The Commission must have the ability to schedule oral arguments, to thereafter call meetings to debate cases, and then to draft decisions, or have access to staff to draft opinions for editing and final approval. As many of you recognize it would not be wise to attempt to compel these activities by rules or a timetable which create substantive rights for respondents. For example, a rule requiring oral argument within a fixed period after submission of briefs to the Commission would have to have a provision to delay argument when no quorum is available, if the Congress requires testimony that conflicts with an oral argument, or for innumerable other valid reasons.

If the Commission has the will to make its quasi-judicial function a greater priority, no rule imposed deadlines would be necessary. Without that will, the deadlines will not be effective. The most important suggestions of the Task Force for reducing delay in the existing process may relate to subtle changes in institutional organization, internal management, case tracking and normative standards as much as the requisitioning of additional staff resources or the imposition of new

requirements. This view is one which at least some members of the bar have expressed, and it is one which we are taking seriously in our deliberations.

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One of the first things I did when the idea of a Task Force on Administrative Proceedings was under consideration was to ask senior staff members about prior efforts to address perceived problems with the Commission's administrative proceedings process. That exercise, as in most efforts to gain historical context, proved to be very illuminating about the pitfalls of embarking on changes to a system that may be imperfect, but is far from broken.

As many of you may be aware, in 1979 the ABA appointed a Task Force on SEC Adjudicative Proceedings to examine the SEC's Rules of Practice, the decisional process and the appellate process. From mid-1983 through mid-1984 the Commission staff, under the leadership of the General Counsel's Office, conducted its own detailed review of the Commission's Rules of Practice. I have unearthed and read the notes of the General Counsel's review group, which included notes of meetings with various ABA members. In 1986 the ABA was again planning a Task Force on the SEC's Administrative Process, and wrote to Commission staff members about topics for consideration. In 1979, in 1983 and again in 1986 these topics included:

- Revision of the rules to reflect actual practice with regard to discovery of the staff's investigatory files;

- Additional avenues for discovery;

- Summary judgment or other procedures to terminate a hearing prior to issuance of an initial decision;

- Providing time limits at various stages in the administrative process;

- Providing additional resources in the Office of the Administrative Law Judge; and,

- The need to publish and better circulate decisions by the ALJs.

All these issues were raised again last month by the delegation from the ABA, as well as in July by SEC staff preparing for the first meeting of the Task Force. These issues -- among others --are being considered by the working groups. Obviously, they have been the subject of much study for many years by very able and very experienced people. Yet, with all the study, there have been few changes. Perhaps the issues studied were obvious and necessary ones to investigate, but not ones sufficient to actually effect a change. Perhaps no material changes in existing procedures are attainable now, either.

However, I believe that passage of the remedies legislation has given us a special opportunity to examine existing rules and to improve our process, if needed, at least in some modest ways. I can promise that we are reviewing these and other matters afresh, and with a new urgency pressed upon us by the growing demands of our markets, the competing demands for time placed upon Commissioners, and the

significant grant of authority in the Remedies Bill to impose disgorgement and civil money penalties.

IV. *The Remedies Legislation*

Before concluding, let me turn for a few moments to the new remedies legislation.

The Congress joined the Commission's proposed Securities Law Enforcement Remedies Act with the Penny Stock Reform Act into a single bill. The name of that bill -- its "short title" in the ironic parlance of Congress -- is the Securities Enforcement Remedies and Penny Stock Reform Act, which has the unfortunate acronym of SERPSRA.

Titles I through IV of the Act were derived from the Commission's proposed Securities Law Enforcement Remedies Act. Title V of the Act is derived from the Penny Stock Reform Act.

The key provisions of Titles I through IV are well known. Unlike Section 15(c)(4) which limits proceedings to violations of specified Exchange Act provisions, the Act authorizes the Commission to bring administrative cease and desist proceedings against any person who is violating, has violated or is about to violate

any section of the Securities Act, Exchange Act, Advisers Act or Investment Company Act. Proceedings could also be brought against any other person, who is, was, or would be a cause of the violation.

In addition to a cease and desist order, the Commission could order an accounting and disgorgement, and/or assess civil penalties. Much has been said about the need for guidelines for the assessment of penalties. I am inclined at this time, in advance of any actual cases being presented to the Commission, to feel that guidelines cannot be written in the abstract. But there are a host of practical issues which can be addressed. For example, should the Commission seek to require a bond or some other security for an assessed penalty pending appeal.

While a great deal of attention has been focussed on the penalty provisions of the remedies bill, there is some reason to think that the real action may lie elsewhere. Most insider trading cases settle, even when penalties are sought. The same may prove true, at least initially, in the administrative forum. For example, in cases involving serious, massive frauds I would predict that this Commission and the current senior staff in the Division of Enforcement will tend strongly towards bringing proceedings in court. In those proceedings handled administratively there may not be opportunity or cause to seek penalties that would lead to fully litigated proceedings -- either because of the nature of the violation, the financial condition of the respondent, or the existence of a court ordered penalty.

Bigger battles may emerge over the power of the Commission to shape ancillary relief. In unambiguous language, Congress has stated that cease and desist orders may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for limited periods of time. Under this language I expect that in appropriate cases, the Commission will be asked by the staff to impose ancillary, affirmative relief, such as hiring an outside law firm to do a special review of chinese wall procedures in a broker-dealer case where inadequate chinese wall procedures played a central role in violations by the broker. I think we must await actual cases, and an opportunity to study briefs from all sides, for decisions as to the showing required for such relief, and the limitations on such relief. However, this is clearly a tool at least as powerful as the authority to fine.

Most C&D proceedings will seek permanent relief. However, in a controversial provision, the Commission is also empowered, under certain circumstances, to seek a temporary c&d order, analogous to a temporary restraining order. The application of this provision was limited by Congress to regulated entities such as broker-dealers, investment advisers and their associated persons. An even more controversial provision of the Act permits temporary c&d orders to be issued on an ex parte basis under certain situations. I expect that the Task Force will recommend for comment rules delineating the circumstances and procedures under which the staff would be permitted to proceed on an ex parte basis.

One other particularly controversial provision of the Commission's proposed bill was not included in the final version adopted by Congress. This provision would have permitted a more liberal standard for criminal prosecutors to share with the Commission staff grand jury materials.

In summary, the new remedy provisions will provide the Commission with significant new powers, first to seek administrative orders restraining ongoing or future violations and second, to seek or impose disgorgement and penalties in both administrative and court proceedings. The Commission has needed greater flexibility in pursuing remedies against securities violators, and I welcome the passage of this legislation.

I recognize that there are very significant issues about how this legislation is going to be implemented by the Commission. Resolution of some of these issues, is likely to take some time. In some areas the Commission is likely to issue rules. For example, the legislation explicitly leaves to the Commission authority to adopt rules concerning pre-judgment interest and other matters related to accounting and disgorgement orders. In other areas, such as the criteria used by the Commission for determining the choice of forum, and the nature of civil penalties sought when authorizing enforcement actions, the Commission's practice is likely to evolve on a case by case basis.

V. *CONCLUSION*

It is a challenging opportunity to head the Commission's Administrative Proceedings Task Force. I look forward to the continuing work of the Task Force, and the opportunity to meet with you again in the future to discuss our report and the reaction to it. I encourage you, in advance of a formal release to let me know your thoughts, and certainly to comment formally when the Task Force report is released. Thank you.