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# The Securities Law Enforcement Remedies Act of 1989: Disenfranchising Shareholders in Order to Protect Them

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## The Securities Law Enforcement Remedies Act of 1989: Disenfranchising Shareholders in Order to Protect Them

Jayne W. Barnard\*

On May 2, 1988, then Chairman David S. Ruder of the Securities and Exchange Commission (SEC) announced the Commission's support for legislation which would specifically authorize federal courts, and in certain circumstances the SEC itself, to bar corporate officers and directors found to have violated the securities laws from assuming any future managerial role in a public company.<sup>1</sup> This announcement followed the recommendation of the National Commission on Fraudulent Financial Reporting (the Treadway Commission) several months earlier that "the SEC should seek explicit statutory authority to bar or suspend corporate officers and directors involved in fraudulent financial reporting from future service in that capacity in a public company."<sup>2</sup>

For some time the SEC staff had resisted this recommendation on the ground that the Commission was already empowered to seek, and in fact had successfully obtained, bar or suspension orders as ancillary relief in proceedings seeking primary injunctive relief.<sup>3</sup> In addition, the SEC had itself entered such orders in SEC administrative compliance proceedings.<sup>4</sup>

The staff's concern was that specific congressional action, such as that recommended by the Treadway Commission, might suggest to a federal district court a limitation on the SEC's ability to obtain other types of ancillary relief in litigated proceedings, such as the appointment of a receiver or the imposition of restitutional orders.<sup>5</sup> In addition, there was some concern that the Treadway Commission's recommendation did not go far enough in that its proposal would provide for bar or suspension orders only in cases involving fraudulent financial reporting, but not involving other forms of securities laws violations, such as insider trading,

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1 Statement of David S. Ruder, Chairman of the Securities and Exchange Commission Before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce Concerning the Recommendations of the National Commission on Fraudulent Financial Reporting, at 27-28 (on file at the Notre Dame Law Review).

2 Report of the National Commission on Fraudulent Financial Reporting 66 (October 1987). The Commission was headed by former SEC Commissioner James C. Treadway, who for some time has advocated that the SEC seek and exercise authority to suspend and bar executives. *See SEC Should Have Power to Bar Executives for Securities Violations, Treadway Says*, 16 Sec. Reg. & L. Rep. (BNA) 1487 (Sept. 14, 1984).

3 *See infra* notes 56-66, 69-71, 158 and accompanying text.

4 *See infra* notes 159-60 and accompanying text.

5 Statement of Chairman Ruder, *supra* note 1 at 27.



market manipulation or disregard of the proxy or tender offer rules. Moreover, argued SEC General Counsel Daniel Goelzer, seeking congressional approval of bar and suspension authority would be "controversial,"<sup>6</sup> presumably inviting the negative response of such powerful groups as the Business Roundtable, which has repeatedly opposed efforts to curb managerial autonomy.<sup>7</sup>

In ultimately embracing the recommendation of the Treadway Commission, the SEC responded to most of the staff's concerns. In his testimony, Chairman Ruder urged Congress to make clear that a specific grant of authority to seek bar or suspension orders in litigated proceedings was not exclusive, and ought not serve to preclude other types of ancillary relief. He also requested that authority to seek bar or suspension orders be extended to apply to any violation of the federal securities laws.<sup>8</sup>

On February 9, 1989, in response to the SEC's request, Representative John Dingell (D-Mich.), Chairman of the House Energy & Commerce Committee, introduced the Securities Law Enforcement Remedies Act of 1989 ("The Remedies Act") in the House of Representatives.<sup>9</sup> On March 17, 1989, Senator Christopher Dodd (D-Conn.), Chairman of the Senate Securities Subcommittee, introduced an identical bill in the Senate.<sup>10</sup>

The Remedies Act seeks to amend sections 20(b) of the Securities Act of 1933<sup>11</sup> and 21(d) of the Securities Exchange Act of 1934<sup>12</sup> (those provisions authorizing the SEC to bring civil actions against alleged wrongdoers) as follows:

In any proceeding under this subsection, the court may prohibit, conditionally or unconditionally, either permanently or for such period of time as it shall determine, any person found to have violated any provision of this title or any rule or regulation thereunder from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports pursuant to subsection (d) of Section 15 of such Act (15 U.S.C. 78o).<sup>13</sup>

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6 SEC to Ask Congress for Power to Impose Civil Monetary Fines, 20 Sec. Reg. & L. Rep. (BNA) 635 (April 29, 1988).

7 E.g., Statement of the Business Roundtable on the American Law Institute's Proposed "Principles of Corporate Governance and Structure: Restatement and Recommendations," February 1983; Pratt, The ALI Corporate Governance Project: A Radical Cure for a Healthy Patient (National Legal Center White Paper) March 1, 1989.

8 Statement of Chairman Ruder, *supra* note 1, at 27.

9 H.R. 975, 101st Cong., 1st Sess. 135 CONG. REC. H272 (1989).

10 S. 647, 101st Cong., 1st Sess., 135 CONG. REC. S3046-50 (1989).

11 15 U.S.C. § 77t(b) (1988).

12 15 U.S.C. § 78u(e) (1988).

13 H.R. 975, *supra* note 9, § 101 (amending the 1933 Act); § 202 (amending the 1934 Act). Issuers are required to register under § 12 of the Exchange Act where they are engaged in interstate commerce or their securities are traded by use of the mails or wire and where their total corporate assets are valued at \$5 million or more. 15 U.S.C. § 78l (1988) and 17 C.F.R. § 240.12g-1 (1988). They must file reports under § 15 of the Act where they have at least 300 shareholders, have had a registration statement become effective under the 1933 Act and are not subject to 15 U.S.C. § 78l. 15 U.S.C. § 78o(d) (1988).

The bill also provides that the SEC may, in an administrative compliance action under section 15(c)(4) of the Exchange Act,<sup>14</sup> enter its own bar or suspension order against “any person found to have failed to comply, or to have been a cause of the failure to comply” with sections 12, 13, 15(d) or 16(a) of the Act, where the Commission finds that such an order is “in the public interest.”<sup>15</sup> The order may be conditional or unconditional, and either permanent or “for such period of time as [the Commission] shall determine.”<sup>16</sup>

This Article explores the various suspension and bar powers embraced by The Remedies Act.<sup>17</sup> Under existing law, a corporate executive who violates one or more provisions of the federal securities laws is subject to entry of an injunction against further violations, together with attendant corrective orders.<sup>18</sup> He may be sued for civil damages by a person injured by his acts. Where his conduct has been “willful,” he may also be subject to criminal prosecution.<sup>19</sup> The Remedies Act now adds several additional options: removal from (a specific) office, suspension from office, lifetime disqualification from office, and either temporary or permanent disqualification from similar offices in any public company (the “comprehensive suspension or bar”).

The thesis of this Article is that, notwithstanding persuasive arguments against The Remedies Act, court-ordered removal and suspension from a specific office and related functions within a company for a definite term is a sound and well-established means of dealing with fiduciary misconduct. The extended-term or lifetime disqualification from a particular corporate office should be sparingly sought and imposed, but may be supported by an appropriate evidentiary foundation.

By contrast, the comprehensive bar can never be justified as a matter of evidence, is unnecessary to effective law enforcement and is a poor choice as public policy. Moreover, permitting the SEC, as opposed to the federal district courts, to compel removal or disqualification of corporate officers and directors—either in a corporation-specific context or with a comprehensive order—would grant the Commission unwarranted power and would distort its proper role in maintaining the integrity of the capital markets.

### Overview

The Article first explores the SEC’s experience in seeking judicially-imposed executive suspension or bar orders in the absence of express congressional authority, and the extent to which the doctrine of ancillary relief may permit such orders. The Article reviews the congressionally-authorized use of removal, suspension and bar orders against fiduciaries

14 15 U.S.C. 78o(c)(4) (1988).

15 H.R. 975, *supra* note 9, § 201.

16 *Id.*

17 The Remedies Act also includes an authorization for general civil penalties in both litigated and administrative proceedings and amendments to the Investment Company Act of 1940 and the Investment Advisers Act of 1940. These provisions are not discussed in this Article.

18 See *infra* notes 51-63 and accompanying text.

19 15 U.S.C. § 78ff (1988).



in contexts other than securities regulation (such as banking,<sup>20</sup> thrift management,<sup>21</sup> mutual fund management<sup>22</sup> and the management of labor unions and employee benefit plans<sup>23</sup>), demonstrating that Congress has not been reluctant to authorize removal, suspension and bar powers in situations comparable to those involving executive misconduct.

The Article then examines the desirability of court-imposed removal and suspension orders in a corporation-specific context, considering whether such orders impermissibly interfere with corporations' internal affairs and result in a taking of shareholders' rights without due process.<sup>24</sup> Assuming these problems can be overcome, we will then focus on the appropriate duration of an executive suspension order,<sup>25</sup> and a functional definition of "officer or director" which will ensure that suspension orders are neither overly broad (by prohibiting the performance of necessary managerial functions) nor overly narrow (by failing to inhibit wrongful conduct).<sup>26</sup>

Part II examines the more controversial notion of the "comprehensive bar," or disqualification from service in *any* public company (as opposed to the specific company in which misconduct has occurred). Both the SEC and the Department of Labor<sup>27</sup> have argued that an order comprehensively barring a person from serving anywhere within a broad universe of potential employers for some period of time, or perhaps in perpetuity, may be a necessary and appropriate means of aiding those agencies' law enforcement goals. However, in considering the propriety of a bar as broad as that comprehended by The Remedies Act (one which would bar access to managerial functions wholly unrelated to financial reporting and disclosure to shareholders), one must consider whether Congress really wishes to impose "merit regulation" on corporate officers and directors,<sup>28</sup> whether the comprehensive bar is unnecessarily disproportionate to the underlying misconduct and/or irretrievable to a degree which is inconsistent with due process,<sup>29</sup> and whether the bar is inconsistent with fundamental principles of corporate disclosure and shareholder suffrage.<sup>30</sup>

Part III examines the special problems presented by that portion of The Remedies Act which would empower the SEC itself to disqualify corporate executives from future executive employment. These problems include issues of adjudicatory competence, potential for abuse of discretion and the question of whether the suspension and bar power permits the SEC to "punish" individuals (which is constitutionally impermissible

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20 See *infra* notes 37-38 and accompanying text.

21 See *infra* note 39 and accompanying text.

22 See *infra* note 41 and accompanying text.

23 See *infra* note 40 and accompanying text.

24 See *infra* notes 97-103 and accompanying text.

25 See *infra* notes 127-31 and accompanying text.

26 See *infra* notes 133-35 and accompanying text.

27 See *infra* notes 164-65 and accompanying text.

28 See *infra* notes 180-87 and accompanying text.

29 See *infra* notes 199-206 and accompanying text.

30 See *infra* notes 95-96, 214-16 and accompanying text.



for a regulatory agency)<sup>31</sup> or merely to regulate their conduct. Part III focuses especially on the question of whether it is appropriate as a matter of public policy to empower the SEC to interfere with corporate governance as broadly as is contemplated in The Remedies Act.

Congress is not alone in dealing with the question of whether, and under what circumstances, it may be appropriate to suspend or bar corporate fiduciaries from the market for managerial labor. Part IV of this Article examines the experience of United Kingdom executives under the Company Directors Disqualification Act of 1986<sup>32</sup> and its predecessors, which have taken a much more intrusive approach to executive bar and suspension powers than that comprehended in The Remedies Act. Part V concludes with a proposed alternative to the bill.

### I. Corporation-Specific Removal "for Cause"

It has long been understood that corporate directors may be removed from their positions by the shareholders "for cause," and that corporate officers, like other employees, may similarly be removed by the directors "for cause."<sup>33</sup> The grounds for such dismissals have varied: malfeasance or misconduct in office, inflexible discord on major policy issues, disobedience of board directives, harassment and uncooperativeness in the transaction of corporate business, misapplication of funds, neglect or incompetency.<sup>34</sup> Other grounds may exist, such as conduct disabling the corporation from receiving licensure,<sup>35</sup> entering into a competitive business<sup>36</sup> or physical or mental incapacitation. The common denominator of "for cause" removals by shareholders is some form

31 See *infra* notes 295-70 and accompanying text.

32 See *infra* notes 291-304 and accompanying text.

33 In many states, and in corporations whose articles or bylaws so permit, removal may also be without cause. REV. MODEL BUSINESS CORP. ACT § 8.08(a) (1984) ("The shareholders may remove one or more directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause."); § 8.43(b) ("A board of directors may remove any officer at any time with or without cause.").

34 *E.g.*, NAACP of Houston Metropolitan Council v. NAACP, 460 F. Supp. 583 (S.D. Tex. 1978) (board may remove local Executive Secretary where he failed to develop organization's membership, behaved in a "dictatorial" fashion and was responsible for certain "irregular financial transactions"); Central Alaska Broadcasting, Inc. v. Bracale, 637 P.2d 711 (Alaska 1981) (board may discharge station general manager where he refused to fire an employee at the board's direction); Grace v. Grace Inst., 19 N.Y.2d 307, 226 N.E.2d 531, 279 N.Y.S.2d 721 (1967) (board may remove one of its members where he has engaged in repeated and unsuccessful litigation against the corporation); Thisted v. Tower Management Corp., 147 Mont. 1, 409 P.2d 813 (1966) (director may be removed from the board where he has threatened to sue shareholders if they interfere with his decisions to remodel corporate property and "walked out" of meetings called to permit him to explain corporate plans); Morton v. E-Z Rake, Inc., 397 N.E.2d 609 (Ind. Ct. App. 1979) (board may discharge Executive Vice-President where he failed to obey a direct order to pay certain claims); Ross v. 311 North Cent. Ave. Bldg. Corp., 130 Ill. App. 2d 336, 264 N.E.2d 406 (1970) (minority shareholders may remove officers who loaned corporate funds to another corporation controlled by them, without adequate security, rather than paying a dividend); Brown v. North Ventura Rd. Dev. Co., 216 Cal. App. 2d 227, 30 Cal. Rptr. 568 (1963) (Chairman of the Board may be removed where he has mismanaged a major project).

35 *Cf.* Cooke v. Teleprompter Corp., 334 F. Supp. 467 (S.D.N.Y. 1971) (shareholders could reasonably conclude that CEO who has been convicted of bribery in the solicitation of cable franchises should be removed, lest other communities "have some reticence in dealing with" the company or "be tempted by knowledge of the conviction to exert extortionate pressures" on the company).

36 *E.g.*, Eckhaus v. Ma, 635 F. Supp. 873 (S.D.N.Y. 1986) (discharged officer may be removed from the board for cause where he has undertaken employment with corporation's competitor); Wil-



of executive conduct injurious or potentially injurious to the sound governance of the corporation, and ultimately to its share value.

Congress has recognized the need to ensure the swift removal of corporate executives and other fiduciaries in situations comparable to the "for cause" circumstances justifying removal by shareholders, where other constituents are at risk. For example, Congress has provided that the Federal Deposit Insurance Corporation may summarily suspend from office an indicted official of a federally-insured bank if his or her continued service "may pose a threat to the interests of the bank's depositors or threatens to impair public confidence in the bank"<sup>37</sup> or an unindicted official who has engaged or participated in any unsafe or unsound practice in connection with the bank.<sup>38</sup> Congress has dealt in a similar way with directors of savings and loan associations, who may be removed from office by the Federal Home Loan Bank Board when they have engaged in a breach of fiduciary duty leading to substantial financial loss.<sup>39</sup>

Fund managers under the Employee Retirement Income Security Act (ERISA) may be removed by a federal district court where it is shown that they have violated their statutory fiduciary duties,<sup>40</sup> and mutual fund managers (and officers or directors of corporate mutual fund managers) may be removed by a federal district court where it is shown that they

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*liams v. Queen Fisheries, Inc.*, 2 Wash. App. 691, 469 P.2d 583 (1970) (president may be removed where he misappropriated Queen's equipment and employees to run a competing business).

37 12 U.S.C. § 1818(g)(1) (1988), *upheld in* *FDIC v. Mallen*, 486 U.S. 230 (1988).

38 12 U.S.C. § 1818(e)(1) (1988) ("Whenever, in the opinion of the appropriate Federal banking agency, any director or officer of an insured bank has committed any violation of law, rule, or regulation or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the bank, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the agency determines that the bank has suffered or will probably suffer substantial financial loss or other damage or that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty or that the director or officer[r] has received financial gain by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, or one which demonstrates a willful or continuing disregard for the safety or soundness of the bank, the agency may serve upon such director or officer a written notice of its intention to remove him from office.").

39 12 U.S.C. § 1464(d)(4)(A) (1988) ("Whenever, in the opinion of the Board, any director or officer of an association has committed any violation of law, rule, or regulation or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the association, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the Board determines that the association has suffered or will probably suffer substantial financial loss or other damage or that the interests of its savings account holders could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty, or that the director or officer has received financial gain by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, or a willful or continuing disregard for the safety or soundness of the association, the Board may serve upon such director or officer a written notice of its intention to remove him from office or to prohibit his further participation in any manner in the conduct of the affairs of the association.").

40 29 U.S.C. § 1109(a) (1982) (Fiduciaries may be required "to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.").



have engaged in any act or practice constituting a breach of fiduciary duty involving personal misconduct.<sup>41</sup>

Securities brokers and officers or directors of brokerage houses may be suspended or barred by the SEC where they have willfully violated any provision of the federal securities laws<sup>42</sup> or where a trustee has been appointed under the Securities Investor Protection Act.<sup>43</sup> Investment advisers and mutual fund managers may be suspended or barred by the SEC where they are found to have willfully made fraudulent public statements concerning securities.<sup>44</sup>

Even in fields not expressly regulated under federal law, executives and others may be required "to divest [themselves] of any interest, direct or indirect, in any enterprise,"<sup>45</sup> and a district court in a civil action may impose "reasonable restrictions on [their] future activities or investments"<sup>46</sup> in order to prevent violations of the Racketeer Influenced and Corrupt Organizations Act (RICO).<sup>47</sup>

A persuasive argument emerges from the foregoing enumeration of some of the situations in which Congress has explicitly authorized removal or suspension orders against managerial personnel — (1) Congress knows how to provide such authorization where it wishes to do so; (2) it is reasonable to assume that, having failed to do so with respect to corporate directors and officers in either the Securities Act of 1933<sup>48</sup> or the Securities Exchange Act of 1934,<sup>49</sup> Congress did not intend to empower the SEC to pursue such orders in court or elsewhere but rather to limit the SEC's authority to the statutorily-enumerated remedies;<sup>50</sup> and therefore (3) the SEC lacks inherent authority to seek removal or suspension orders in the absence of specific congressional authorization, such as that proposed in The Remedies Act.

#### A. *Removal and Suspension as Ancillary Relief*

The response to the strict statutory construction argument has been rooted in broad notions of equity. The SEC has long enjoyed express authority to seek an injunction where it believes that any person "is engaged or [is] about to engage in any acts or practices which constitute or will constitute a violation" of the securities acts.<sup>51</sup> With this power, the SEC has successfully sought court orders enjoining the offer and sale of

41 15 U.S.C. § 80a-35 (1988).

42 15 U.S.C. § 78o(b)(4)(D) (1988).

43 15 U.S.C. § 78jjj(b) (1988).

44 15 U.S.C. § 80b-3(e) (1988); 15 U.S.C. § 80a-9(b) (1988).

45 18 U.S.C. § 1964(a) (1988).

46 *Id.*

47 18 U.S.C. §§ 1961-68 (1988).

48 15 U.S.C. § 77a-77aa (1988).

49 15 U.S.C. § 78a-78ll (1988).

50 See *infra* note 51 and accompanying text.

51 15 U.S.C. § 77t(b) (1988) (Securities Act of 1933); 15 U.S.C. § 78u(d) (1988) (Securities Exchange Act of 1934); 15 U.S.C. § 79r(e) (1988) (Public Utility Holding Company Act of 1935); 15 U.S.C. § 80a-41(d) (1988) (Investment Company Act of 1940); 15 U.S.C. § 80b-9(d) (1988) (Investment Advisers' Act of 1940).



certain investment instruments,<sup>52</sup> the offer and sale of *any* investment instruments in violation of the law,<sup>53</sup> and *any* future violation of specified provisions of the 1933 and 1934 Acts.<sup>54</sup>

Courts of equity must have flexibility in tailoring injunctions so as to prevent and deter future unlawful conduct. It is seldom sufficient for a court merely to prohibit the precise misconduct which has led a defendant into court.<sup>55</sup> Rather, various "ancillary remedies" have developed over time which aid the court in its efforts to effectively terminate or interdict misconduct.<sup>56</sup> These remedies may supplement or replace the injunction,<sup>57</sup> and may include affirmative orders to undertake specific corrective corporate activities,<sup>58</sup> restitution or disgorgement orders,<sup>59</sup> the appointment of a receiver to oversee corporate operations,<sup>60</sup> orders freezing the defendants' assets,<sup>61</sup> and orders staying related state court litigation.<sup>62</sup> The SEC has regularly argued that an additional ancillary remedy in this arsenal is the court-ordered removal and suspension of named corporate executives from continuing service on behalf of the corporation in which misconduct occurred. (Occasionally, the SEC has

<sup>52</sup> *E.g.*, SEC v. Glenn W. Turner Ent., Inc., 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

<sup>53</sup> *E.g.*, SEC v. Carriba Air, Inc., 681 F.2d 1318 (11th Cir. 1982).

<sup>54</sup> *E.g.*, SEC v. Champion Sports Management, Inc., 599 F. Supp. 527 (S.D.N.Y. 1984); SEC v. Dimensional Entertainment Corp., 518 F. Supp. 773 (S.D.N.Y. 1981); SEC v. Kalvex, Inc., 425 F. Supp. 310, 317 (S.D.N.Y. 1975).

<sup>55</sup> *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 727 (1944) ("Of course, a mere prohibition of the precise scheme would be ineffectual to prevent [the wrong complained of]").

<sup>56</sup> *See generally* Dent, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865 (1983); Farrand, *Ancillary Remedies in SEC Civil Enforcement Actions*, 89 HARV. L. REV. 1779 (1976); Malley, *Far-Reaching Equitable Remedies Under the Securities Acts and the Growth of Federal Corporate Law*, 17 WM. & MARY L. REV. 47 (1975); Treadway, *SEC Enforcement Techniques: Expanding and Exotic Forms of Ancillary Relief*, 32 WASH. & LEE L. REV. 637 (1975); Comment, *Equitable Remedies in SEC Enforcement Actions*, 123 U. PA. L. REV. 1188 (1975); Note, *Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5*, 79 HARV. L. REV. 656 (1966).

<sup>57</sup> *See* Comment, *supra* note 56, at 1191-92 (discussing *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), in which the court awarded rescission even in the absence of an injunction).

<sup>58</sup> *E.g.*, SEC v. Waco Financial, Inc., 518 F. Supp. 651 (W.D. Mich. 1981) (defendant cannot effect any transactions in securities until it complies with Section 15(b)(7) of the Exchange Act), *aff'd* 751 F.2d 831 (6th Cir.), *cert. denied*, 474 U.S. 818 (1985); *See also* SEC v. Teleprompter Corp., SEC Lit. Rel. 6431 (S.D.N.Y. 1974) (defendant consents to adopting new financial monitoring practices); SEC v. Goldman Sachs & Co., [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,556 (S.D.N.Y. 1974) (defendant consents to substantial change in policy regarding investigation and sales of commercial paper).

<sup>59</sup> *E.g.*, SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1104 (2d Cir. 1972) (approving district court injunction requiring defendants to disgorge the proceeds received in connection with an unlawful securities offering).

<sup>60</sup> *E.g.*, *id.* at 1105 (approving appointment of a "trustee" to receive and distribute funds to plaintiff shareholders); SEC v. S & P Nat'l Corp., 360 F.2d 741, 751 (2d Cir. 1966) (approving appointment of receiver to "ascertain the true state of affairs . . . and report thereon" to the court and public shareholders and preserve the corporate assets" pending a decision on whether to liquidate the company); *Los Angeles Trust Deed & Mortg. Exch. v. SEC*, 285 F.2d 162 (9th Cir. 1960) (approving appointment of a receiver *pendente lite*), *cert. denied*, 366 U.S. 919 (1961); SEC v. Investors Sec. Corp., 415 F. Supp. 745 (W.D. Pa. 1976) (recounting the appointment of a receiver); SEC v. H.S. Simmons & Co., 190 F. Supp. 432 (S.D.N.Y. 1961) (appointing a receiver).

<sup>61</sup> *E.g.*, SEC v. Paro, 468 F. Supp. 635, 651 (N.D.N.Y. 1979) (preliminarily enjoining the transfer of assets except as necessary to the continuation of the defendants' legal business operations); *Manor Nursing Ctrs.*, 458 F.2d at 1106 (approving order temporarily freezing defendants' assets to limit waste prior to refunding public investors' money).

<sup>62</sup> SEC v. Wencke, 577 F.2d 619 (9th Cir.), *cert. denied*, 439 U.S. 964 (1978).



additionally sought the appointment of interim "independent" replacements)<sup>63</sup>

For example, in *SEC v. Florafax International, Inc.*,<sup>64</sup> the SEC sought injunctive relief against a corporation and two of its executives, claiming repeated violations of the accounting and financial reporting requirements of sections 13(a) and (b) of the Exchange Act.<sup>65</sup> The SEC sought (and ultimately secured through entry of a consent decree) an order enjoining further violations of section 13, corrected filings of past financial statements, the engagement of a special auditor, appointment of an audit committee comprised of three independent directors and the removal and suspension of the named executives for a period of three years.<sup>66</sup>

The Supreme Court, in the context of evaluating injunctive relief under the federal antitrust laws, has recognized that, in order to "eradicate the evils of a condemned scheme," lawful as well as unlawful conduct may properly be enjoined.<sup>67</sup> "The test is whether or not the required action reasonably tends to dissipate the [unlawful conduct] and prevent evasions. Doubts are to 'be resolved in favor of the Government and against the [defendants].'"<sup>68</sup> Using solely this guide, it is entirely likely that a court could fashion a decree in an SEC action seeking injunctive relief which would incorporate an order removing and suspending a miscreant executive from continuing service with the corporation in which misconduct has occurred; however, none has ever done so in a fully-litigated proceeding. Rather, the SEC has secured such orders solely in the context of negotiated consent decrees. Many of these orders require only the defendant's resignation.<sup>69</sup> "Finite suspension" orders prohibit the defendant from reassuming his position with the

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63 *E.g.*, *SEC v. Charter Securities Management Corp.*, SEC Lit. Rel. 6593 (C.D. Cal. 1974); *SEC v. Charter Diversified Services*, SEC Lit. Rel. 6507 (C.D. Cal. 1974); cases cited in Steinberg, *The Securities and Exchange Commission's Administrative, Enforcement, and Legislative Programs and Policies—Their Influence on Corporate Internal Affairs*, 58 NOTRE DAME L. REV. 173, 215 n.182 (1982). *But see* *SEC v. Falstaff Brewing Corp.*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,583 (1978) (court declines to appoint independent directors), *aff'd*, 629 F.2d 62 (D.C. Cir.), *cert. denied*, 449 U.S. 1012 (1980); *SEC v. American Realty Trust*, 429 F. Supp. 1148, 1177 (E.D. Va. 1977) (court declines to remove president and appoint trustees), *rev'd on other grounds*, 586 F.2d 1001 (4th Cir. 1978). *See generally* Note, *The SEC and Court-Appointed Directors: Time to Tailor the Director to Fit the Suit*, 60 WASH. U.L.Q. 507 (1982); Comment, *Court-Appointed Directors: Ancillary Relief in Federal Securities Law Enforcement Actions*, 64 GEO. L.J. 737 (1976). *See also* Gruenbaum & Oppenheimer, *Special Investigative Counsel: Conflicts and Roles*, 33 RUTGERS L. REV. 865 (1981).

64 Complaint No. 84-C-937-B (N.D. Okla.), filed November 27, 1984.

65 15 U.S.C. § 78m(a), (b) (1988).

66 *SEC v. Florafax International, Inc.*, SEC Lit. Rel. 10,617 (N.D. Okla. 1984).

67 *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 724 (1944).

68 *Id.* at 726.

69 *E.g.*, *SEC v. Ministers' Investment Corp. and Glen Crowe*, SEC Lit. Rel. 10,190 (W.D.Ky. 1983) (director agrees to resign from board of directors); *SEC v. Jack M. Catain, Jr. and Rusco Industries, Inc.*, SEC Lit. Rel. 9129 (C.D. Cal. 1980) (CEO/Chairman of the board agrees to resign both positions); *SEC v. Westgate-California Corp.*, SEC Lit. Rel. 6142 (S.D. Cal. 1973) (officers and directors immediately resign positions with Westgate and its subsidiaries, as well as with any other public company in which they hold a position); *SEC v. Clinton Oil Co.*, SEC Lit. Rel. 5798 and SEC Lit. Rel. 5713 (D. Kan. 1973) (all members of corporation's executive committee agree to resign as officers and directors); *SEC v. American Agronomics Corp.*, SEC Lit. Rel. No. 5667 (N.D. Ohio 1971) (defendants agree to terminate service as officers of company).



company for a stated period of time,<sup>70</sup> while “lifetime disqualification” orders prohibit the defendant from ever seeking to reassume an officer or director position in the specific company (or complex of companies) in which his misconduct occurred.<sup>71</sup>

Removing and suspending a corporate executive from the corporation within which he has personally engaged in, or through which he has orchestrated, violations of the securities laws would seem at first glance to be little more than the flip-side of appointing a post-judgment receiver for that corporation. The point of both orders is to permit the continuation of the enterprise while ensuring compliance with the law and maximizing the likelihood that misconduct will not recur.<sup>72</sup> Looked at in this way, a court’s authority to enter a removal and suspension order specific to an executive’s business ought not require express authorization from Congress, any more than the appointment of a receiver requires such authority. The court’s authority to enter either order is inherent in the court’s equitable powers.<sup>73</sup>

There are at least three reasons, however, why the forced removal and subsequent suspension or lifetime disqualification of a corporate executive may differ from the judicial appointment of a post-judgment receiver, and consequently may be inappropriate as an element of ancillary relief.

(1) A post-judgment receiver historically serves a limited function, generally to preserve corporate property or apply it to satisfy the judgment.<sup>74</sup> Typically, the receivership is of limited duration, terminated either by the winding up of the business or a return of the corporate assets to their rightful owners.<sup>75</sup> By comparison, the removal and suspension of corporate executives may last for years, if not forever, and in any event is likely to last far longer than would a properly-administered receivership. Moreover, such orders may result in quite different consequences than would a typical receivership, including an alteration in the long-range operational policies of the organization.<sup>76</sup>

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70 *E.g.*, SEC v. Florafax International, Inc., SEC Lit. Rel. 10,617 (N.D. Okla. 1984) (chairman and CEO agrees to resign both positions and refrain from serving for three years); SEC v. American Commonwealth Financial Corp., SEC Lit. Rel. 8561 (N.D. Tex. 1978) (president and director agree to resign and refrain from serving for three years). *See also* SEC v. Cloyce K. Box and OKC Corp., SEC Lit. Rel. 9183 (N.D. Tex. 1980) (chief executive officer and director agrees to resign and not reassume either position without further order of court); SEC v. Somatronics, Inc., SEC Lit. Rel. 7141 (S.D.N.Y. 1975) (executives barred from serving as officers or directors of Somatronics without Commission approval).

71 SEC v. Penn Central, SEC Lit. Rel. 8378 (E.D. Pa. 1978) (defendant agrees not to become a director, officer, employee or consultant to any of the Penn Central “complex of companies”).

72 *Cf.* Comment, *supra* note 56, at 1202 (“If present management cannot be trusted to comply with an injunction, the appointment of a receiver becomes necessary to make effective the injunctive degree and to bring a company into compliance with applicable law.”).

73 SEC v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980) (“The power of a district court to impose a receivership or grant other forms of ancillary relief does not in the first instance depend on a statutory grant of power from the securities laws. Rather, the authority derives from the inherent power of a court of equity to fashion effective relief.”). *See also* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 391 (1970) (“[W]e cannot fairly infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts’ power to grant appropriate remedies.”).

74 1 R. CLARK, LAW OF RECEIVERS § 14 (1959).

75 3 R. CLARK, LAW OF RECEIVERS § 690 (1959).

76 *See generally* Comment, *supra* note 56, at 1214.



(2) While both remedies disenfranchise shareholders, shareholders retain more control in the case of a receivership than in the case of forced removal of elected executives. Generally, receivers are not permitted to make significant operational decisions other than those specifically entrusted to them by the court.<sup>77</sup> The authority to make such decisions remains with the shareholder-selected board of directors,<sup>78</sup> just as the authority to pursue derivative claims on behalf of the corporation remains with the shareholders themselves even where the receiver objects.<sup>79</sup> With forced removal and subsequent suspension (and especially where interim directors are substituted), major corporate decisions no longer reside with the shareholder-selected board.

(3) Equity abhors a forfeiture. It may be entirely proper for a court to impose a temporary receiver to handle certain essentially ministerial corporate tasks, such as marshalling assets and making reports, and even to remove a resistant executive whose presence impedes the successful performance of the receivership, but it is quite another thing to strip a duly-selected executive of his right to seek re-employment in his former job once the receivership is terminated. Even a criminal conviction under the securities laws does not disable the defendant from seeking re-employment or re-election as a corporate director, once his period of imprisonment has been completed.<sup>80</sup>

### B. *Why Removal and Suspension Orders May Not Be Elements of Ancillary Relief*

Quite apart from noting the distinction between the appointment of a receiver and the imposition of an executive removal and suspension order, there may be other significant objections to corporation-specific

<sup>77</sup> A typical order appointing a receiver will enumerate the specific tasks which the receiver is to perform. In some SEC cases, by contrast, "the receiver may be employed not simply to perform a narrowly defined court order, but also where there has been a series of willful prior violations of the securities laws or when present management is unresponsive, to take full control of the corporation and direct its future operations in compliance with the securities laws as a whole." Farrand, *supra* note 56, at 1788.

<sup>78</sup> 3 R. CLARK, LAW OF RECEIVERS 1319, 1422 (1959) ("The ordinary equitable appointment of a receiver for the preservation of the assets of a company . . . does not necessarily destroy the corporation nor deprive the directors of their power to act as directors of officers except it does prevent the directors or officers interfering with the receiver's control and possession of the property committed to him; . . . [A] receiver under orders of the appointing court may even operate the property and exercise its rights and franchises, and yet technically speaking the power of directors may not be ousted from carrying on the internal functions of the corporation to be a corporation."). *But see* Thisted v. Tower Management Corp., 409 P.2d 813, 821 (Mont. 1966) ("the district court . . . has the power to grant authority to a receiver so that he in fact replaces the board of directors and the officers of [the company] and assumes complete control of that corporation."). Compare the role of the bankruptcy trustee, who wholly usurps the powers of corporate directors and officers. *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352-53 (1985).

<sup>79</sup> *International Controls Corp. v. Vesco*, 490 F.2d 1334, 1352 (2d Cir.) (dictum), *cert denied*, 417 U.S. 932 (1974); 16 FLETCHER, CYCLOPEDIA CORPORATIONS, § 7783.50 (1989).

<sup>80</sup> Courts may impose as a condition of probation a prohibition against working in the enterprise, or in the line of work, where the defendant's misconduct occurred. *See infra* note 263. But this disability only lasts as long as the prison sentence might have lasted. J. SCHEB & J. SCHEB II, CRIMINAL LAW & PRACTICE at 547 (1989). In the case of securities law violations, this is ten years. 15 U.S.C. § 78ff(c) (1988).



suspension orders as an element of injunctive relief in the absence of express congressional authorization:

(1) Forced removal of executives is inconsistent with the legislative history of the federal securities laws, which were specifically designed to minimize interference with matters of corporate governance. Even its patron, President Franklin D. Roosevelt, promised that the 1933 Act was intended to “protect the public with the least possible interference to honest business.”<sup>81</sup> As one commentator has noted,

Congress [did not] intend to permit federal intrusion into corporate governance once a corporation has violated the securities laws. If Congress had intended such a major exception to the general rule of noninterference in corporate governance, presumably it would have said so, as it did in other securities laws and statutes in other areas.<sup>82</sup>

The primary issue is whether removal and suspension orders premised upon federal law unduly interfere with the state-supervised “internal affairs” of corporations. The Supreme Court has cautioned against reading the federal securities laws in such a way as to “overlap and quite possibly interfere with state corporate law.”<sup>83</sup>

There has, of course, been considerable discussion of states’ rights in the area of corporate governance, both in the context of a proposed “federalization” of corporate law during the 1970’s<sup>84</sup> and more recently in the debate over the propriety of state anti-takeover legislation and the alleged preemption of such legislation by the federal Williams Act.<sup>85</sup> The Supreme Court has suggested that matters of corporate governance are better suited for regulation under state law than under federal law,<sup>86</sup> and that federal laws should be narrowly construed so as not to interfere in governance matters.<sup>87</sup> This is especially true where a broad construction of federal law would inhibit the exercise of the state-established powers of corporate directors.<sup>88</sup> (One commentator has suggested that, at least in the area of corporate governance, there is a “kind of reverse preemption” in operation,<sup>89</sup> by which courts are encouraged to prefer

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81 S. Rep. No. 47 at 7, H.R. Rep. No. 85 at 2, 73rd Cong., 1st Sess (1933). An early draft of the Act had expressly forbidden “the Commission to interfere with the management of the affairs of an issuer,” but that language was deleted as being unnecessary. Dent, *supra* note 56, at 904-05.

82 Dent, *supra* note 56, at 909.

83 Santa Fe Industries v. Green, 430 U.S. 462, 479 (1977).

84 E.g., Symposium: *Federal Chartering of Corporations*, 61 GEO. L.J. 71 (1972).

85 E.g., CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 86 (1987) (Indiana Control Share Acquisitions Act is not preempted by federal law notwithstanding fact that it will delay certain tender offers beyond the 20-business-day period permitted by the Williams Act; Court notes the “long-standing prevalence of state regulation in this area . . .”).

86 Cort v. Ash, 422 U.S. 66, 84 (1975) (“Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”).

87 Santa Fe Industries, 430 U.S. at 479.

88 Burks v. Lasker, 441 U.S. 471, 480 (1979) (state law governs the power of a corporation’s disinterested directors to terminate a derivative suit, even when the basis for suit is federal law).

89 Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 VA. L. REV. 813, 830 (1984).



state law in those areas where federal and state law potentially regulate the same conduct.<sup>90</sup>)

The primacy of state law as it relates to corporate governance is not wholly supported in the language of the securities laws.<sup>91</sup> Nor is it ensured by the rhetoric of the legislative history of those laws, which clearly contemplated that some aspects of internal policy-making would be subject to federal oversight.<sup>92</sup> All this being said, however, there is a strong argument to be made that, absent an express Congressional directive to the contrary, a federal court should only sparingly enter orders based on federal law which—as in the case of executive removal and suspension—directly interfere with matters of corporate governance. Such orders may reach results inconsistent with those intended by the state law framers<sup>93</sup> and tend to usurp the power of state courts to set their own standards in corporate law cases.<sup>94</sup>

(2) Suspension of corporate executives is inconsistent with the primary goal of the securities laws, which is full and fair disclosure to investors,<sup>95</sup> and with the existing means of promoting that goal. If a corporate executive, or one seeking election to a directoral position, has engaged in misconduct material to the job held or being sought, the regulations governing proxy solicitation already require disclosure of this information, ensuring that shareholders can exercise an informed choice. A violation of federal law aimed at the protection of shareholders is material to any executive position and has been specifically identified by the SEC as among the items which must be disclosed to the shareholders in the annual proxy statement.<sup>96</sup>

Under the existing federal statutory plan, however, shareholders are not entitled to any more than a fully-informed opportunity to select their own fiduciaries. The SEC exceeds its authority when it importunes a

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<sup>90</sup> *Id.*

<sup>91</sup> *E.g.*, 15 U.S.C. § 78bb(a) (1988) (expressly protecting only state Blue Sky laws and then only to the extent they do not “conflict with the provisions of this title or the rules and regulations thereunder”).

<sup>92</sup> *E.g.*, 15 U.S.C. § 78dd-1 (1988) (prohibiting use of mails for making “corrupt” foreign payments). *See also* Steinberg, *The Securities and Exchange Commission's Administrative, Enforcement, and Legislative Programs and Policies — Their Influence on Corporate Internal Affairs*, 58 NOTRE DAME L. REV. 173 (1982) (noting that many activities of the SEC have a substantial, though indirect, impact on corporations' internal affairs).

<sup>93</sup> For example, some states have declined to permit the removal of directors through a judicial proceeding, but have limited the format for removal exclusively to the vote of the shareholders or directors. *E.g.*, DEL. CODE ANN. tit. 8, § 141(k) (1988).

<sup>94</sup> *Cf. Codos v. National Diagnostic Corp.*, 711 F. Supp. 75, 78 (E.D.N.Y. 1989) (federal court declines to hear petition seeking dissolution of corporation, because “the exercise of federal jurisdiction ‘would in effect permit the possibility of federal dissolution actions based on [state dissolution] statutes, being commenced in a number of different districts in which a particular [state] corporation was subject to service, thereby placing an onerous burden on the corporation’”).

<sup>95</sup> *Santa Fe Industries v. Green*, 430 U.S. 462, 478 (1977) (the securities laws are, at best, tangentially concerned with fairness to the shareholders; rather their purpose is to ensure full disclosure).

<sup>96</sup> *E.g.*, Schedule 14A, incorporating by reference Regulation S-K Item 401 (requiring identification of all nominees for directorships and other executive officers and disclosure of their involvement within the past five years in enumerated legal proceedings, including injunction actions brought by the SEC. Any court finding, not subsequently reversed, that the nominee or executive officer has violated state or federal securities or commodities laws must be disclosed. Item 401(f)(5) and (6)).



court to remove and suspend an executive, rather than seeking to ensure that the executive makes appropriate disclosure in the next proxy solicitation or, at best, a special report to shareholders. Moreover, a district court which gives shareholders "more" than that to which they are entitled, in the form of a removal and suspension order, not only encourages the Commission's overreaching, but may in fact deprecate the mandatory disclosure system. Shareholders in a system which permits such orders may lose their incentive to scrutinize the disclosures related to management integrity and cease monitoring the conduct of their officers and directors.

(3) Court-ordered removal and suspension orders usurp the contractual suffrage rights of shareholders without due process *to the shareholders*.<sup>97</sup> When purchasing stock, corporate shareholders acquire various contractual rights, including the right to approve or disapprove of certain fundamental transactions,<sup>98</sup> to amend the corporate charter<sup>99</sup> and to elect and remove directors.<sup>100</sup> While these rights have been said not to constitute "vested property rights,"<sup>101</sup> they are nevertheless "property,"<sup>102</sup> and in any event are the sort of expectations which ought not be abrogated without an opportunity for the shareholders to be heard.<sup>103</sup>

(4) Forced removal of corporate executives is inconsistent with the well-established (though frequently challenged)<sup>104</sup> notion that judges are ill-suited to evaluate managerial competence. The very basis of the business judgment rule is the belief that corporate executives have particularized expertise in dealing with business risks which judges do not share.<sup>105</sup> To encourage judges, rather than shareholders, to decide when

97 See Dent, *supra* note 56, at 934-35 ("[T]he shareholders' franchise is usually eliminated without any meaningful representation of shareholders in the judicial proceeding. In theory, corporate management represents shareholder interests. In practice, the managers lose little by surrendering the shareholders' franchise, and in so doing they may placate the SEC and avoid litigation that might do the managers greater personal harm. In theory, the SEC also represents shareholder interests. Its approval of, and indeed its fond wish for, decrees eliminating shareholder rights belies the theory.").

98 *E.g.*, REV. MODEL BUSINESS CORP. ACT § 11.03 (1984) (shareholders must approve mergers or share exchanges).

99 *E.g.*, *id.* § 10.03 (shareholders must approve significant amendments to articles of incorporation).

100 *E.g.*, *id.* § 8.03 (directors are to be elected by the shareholders); *id.* § 8.08 (directors may be removed by shareholders).

101 *Id.* § 10.01(b).

102 Cf. *U.S. v. Local 560 of International Brotherhood of Teamsters*, 780 F.2d 267, 281-82 (3d Cir. 1985) (union member's right to elect the men "who will represent him in dealing with his economic security and collective bargaining where that right exists by virtue of express contract" is "property" which may be extorted in violation of the Hobbs Act), *cert. denied*, 476 U.S. 1740 (1986).

103 Cf. *Chernin v. Lyng*, 874 F.2d 501 (8th Cir. 1989) (an employee whose employer is required to fire him as a condition of the employer receiving meat inspection services is entitled to some due process before losing his job, even though his employment is at-will.).

Shareholders' rights may also be impaired in bankruptcy. In bankruptcy reorganization proceedings, however, shareholders are entitled to seek representation on a security holders' committee, 11 U.S.C. § 1102(a)(2) (1988), and frequently play an active role in the formulation of the reorganization plan. See generally Gerber, *Commentary, The Election of Directors and Chapter 11*, 53 BROOKLYN L. REV. 295 (1987).

104 Cf. Bartholet, *Application of Title VII to Jobs in High Places*, 95 HARV. L. REV. 945, 979-80 (1982).

105 D. BLOCK, N. BARTON & S. RADIN, *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS AND OFFICERS*, at 6-7 and notes 20-22 (2d. ed. 1988).



a director or officer lacks the skill or character to continue in his or her role, not only disregards the democratic nature of the corporate entity, but also places the decision in the hands of the very persons who profess incompetence to make it.

(5) In the absence of statutory authorization, the mere fact that a removal and suspension order may be an effective deterrent, or even that courts have routinely approved such orders in consensual settlements in other SEC-initiated proceedings, does not mean that it is a lawful one. Consent orders, to a greater or lesser degree, are always economically coerced.<sup>106</sup> Therefore, they cannot be relied upon to fairly reflect what the law might permit or require were a dispute to be fully litigated to its conclusion. Moreover, the mere fact that the SEC has gone unchallenged in its repeated usage of an implied remedy is not probative of that remedy's validity.<sup>107</sup>

What is really at issue is whether Congress intended that the statutory injunction power granted to the SEC in sections 20(b) of the Securities Act and 21(d) of the Exchange Act<sup>108</sup> would extend to the limits now claimed by the Commission's enforcement staff. There is ample evidence that Congress did not intend such an extension.

Express statutory authorization for courts to enter executive bar and suspension orders such as that sought in The Remedies Act would obviate some of these criticisms. Courts have upheld statutorily-authorized corporation-specific removal and suspension orders in other contexts.<sup>109</sup> However, even though expressly authorized, court-imposed removal and suspension orders against corporate executives may still reasonably be subject to criticism.

### C. *Why Congressionally-Authorized Removal and Suspension Orders May be Unwise*

There is nothing inherently "wrong" and certainly nothing unconstitutional, in the notion that a court, even in a civil case, may deprive a defendant of his means of livelihood. The constitution does not guarantee that a person can have the job of his choice, or even work in the profession of his choice. While the "right to practice one's profession is . . . precious,"<sup>110</sup> it is by no means inviolate, as may be seen in any regulated profession for which barriers to entry have been established and upheld, or in any case in which a professional's license is revoked.<sup>111</sup> All

106 Dent, *supra* note 56, at 948-49; *Cf. Chernin*, 874 F.2d at 503 (corporation felt compelled to terminate executive's employment in order to receive USDA meat inspection services, after three months of sustaining "considerable losses" due to lack of such services).

107 Compare SEC v. Sloan, 436 U.S. 103 (1978) (SEC not empowered to "tack" or serially issue 10-day trading suspensions, when statute only permits one 10-day order. This is so notwithstanding numerous prior instances of unchallenged "tacked" suspension orders).

108 See *supra* note 51 and accompanying text.

109 *Cf. United States v. Local 560 of International Brotherhood of Teamsters*, 780 F.2d 267 (3d Cir. 1985) (approving removal of union local's executive committee, in light of express authorization in 18 U.S.C. § 1964(a)), *cert denied*, 476 U.S. 1140 (1986).

110 *Yakov v. Board of Medical Examiners*, 68 Cal. 2d 67, 64 Cal. Rptr. 785, 435 P.2d 553 (1968).

111 See generally W.O. MORRIS, REVOCATION OF PROFESSIONAL LICENSES BY GOVERNMENTAL AGENCIES (1984).



that is ensured is that a person may not be barred by the government from his work for reasons that are arbitrary and capricious<sup>112</sup> and that he cannot be separated by the government from his livelihood without due process.<sup>113</sup>

There continue, however, to be some serious policy-based problems with the notion that a corporation-specific removal and suspension order is an appropriate sanction against a person found in a civil proceeding to have violated the federal securities law, even if Congress sees fit to authorize such an order. Certainly the issues discussed above—interference with corporate internal affairs, denigration of the disclosure ideal, judicial competence and the usurpation of shareholders' suffrage rights—do not disappear just because Congress authorizes the SEC to seek an additional remedy to those already authorized. In addition, one may reasonably object to the use of removal and suspension orders as a prophylactic tool, particularly where the suspension may be lengthy or indefinite in term. Such orders, even within a single corporation, are likely to be overbroad as a form of equitable relief.

Just as licensing agencies may not impose qualifications which are "unreasonable, unduly oppressive or patently beyond the necessities of the case,"<sup>114</sup> neither should courts be quick to impose injunctive restrictions on a person's ability to practice his trade which are not reasonably necessary to prevent predictable unlawful conduct. The fact that courts have routinely entered overbroad injunctions in cases in which violations of the securities laws have been found—for example, several courts have entered broadside injunctions perpetually prohibiting any and all violations of the 1933 and 1934 Acts<sup>115</sup>—is no defense to such a limitation.

For an injunction to be entered, there is supposed to be some "cognizable danger" of recurring violation or specific misconduct.<sup>116</sup> Injunctive relief is inappropriate where it is imposed solely "to prevent the possible occurrence of an event at some indefinite future time."<sup>117</sup> Rather, in SEC cases as in any injunctive case, the Commission must

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112 *FDIC v. Mallen*, 486 U.S. 230, —, 108 S. Ct. 1780, 1787 (1988) ("[a bank official's] interest in the right to continue to serve as president of the bank and to participate in the conduct of its affairs is a property right protected by the Fifth Amendment Due Process Clause. . . . [T]he FDIC cannot arbitrarily interfere with [the official's] continuing employment relationship with the bank . . .").

113 *Greene v. McElroy*, 360 U.S. 474, 492 (1959) ("...the right to hold specific private employment and to follow a chosen profession free from unreasonable governmental interference comes within the 'liberty' and 'property' concepts of the Fifth Amendment. . ."); *Chernin v. Lyng*, 874 F.2d 501, 505 (8th Cir. 1989).

114 *Gambone v. Commonwealth*, 375 Pa. 547, 551, 101 A.2d 634, 637 (1954) ("Under the guise of protecting the public interests the legislature may not arbitrarily interfere with private business or impose unusual and unnecessary restrictions upon lawful occupations.").

115 See *supra* note 54 and accompanying text. Such "obey the law" injunctions are by definition overbroad, and ought not survive appellate review or support a contempt citation. *Meyer v. Brown & Root Constr. Co.*, 661 F.2d 369, 373 (5th Cir. Nov. 1981); *Russel C. House Transfer & Storage Co. v. United States*, 189 F.2d 349, 351 (5th Cir. 1951). See also *National Labor Relations Bd. v. Express Publishing Co.*, 312 U.S. 426 (1941) (NLRB cannot use defendant's refusal to bargain as a basis for an order enjoining all unrelated unfair labor practices).

116 *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953).

117 *Janowski v. International Brotherhood of Teamsters Local 710 Pension Fund*, 673 F.2d 931, 940 (7th Cir. 1982), *vacated on other grounds*, 463 U.S. 1222 (1983) (issue of attorney's fees); see also *Connecticut v. Massachusetts*, 282 U.S. 660, 674 (1931) (An injunction "will not be granted against something merely feared as liable to occur at some indefinite time in the future.").



show that "there is a reasonable likelihood that the wrong will be repeated."<sup>118</sup> Merely showing that the defendant has violated the securities laws *in the past* is not enough to support the imposition of an injunction.<sup>119</sup> Nor, logically, should it be enough to merely show that the defendant executive will be returning to the scene of his or her prior misconduct, absent other clear indicia of likely recidivism.<sup>120</sup>

Extrapolating from these well-accepted maxims, few if any long-term or permanent injunctions would make sense, which is not an argument necessary to the point advanced here. Courts have accepted the notion that certain behavior is predictive of future misconduct.<sup>121</sup> However, it should be the rare case where a court finds sufficient evidence to support a lifetime or extended-term corporation-specific disqualification order rather than a suspension or cooling-off period of limited and finite duration.<sup>122</sup> (Such cases might include instances of repeated and clandestine misconduct such as occurred in the *Florafax* case,<sup>123</sup> especially where the defendants have a prior history of similar securities law violations in other companies.<sup>124</sup>)

Given that vacation or modification of permanent injunctions is so difficult to achieve, even where the defendant's post-order behavior has been exemplary,<sup>125</sup> and given that the impact of the permanent injunction may burden not only the defendant but also innocent shareholders and others,<sup>126</sup> an extended-term or lifetime disqualification order should

118 *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972), quoted in *Aaron v. SEC*, 446 U.S. 680, 703 (1980) (Burger, C.J., concurring). *Cf.* *United States Steel Corp. v. United Mine Workers of Am.*, 534 F.2d 1063, 1077 (3d Cir. 1976) ("Before prospective injunctive relief is ordered the district court must, we think, make specific findings based on evidence in the record as to the types of violations which have occurred in the past and limit injunctive relief to the likelihood of their recurrence, or to new and different kinds of violations which may be expected to occur in the future. The court must, moreover, relate the likelihood of recurrence or occurrence to some act, omission or responsibility of each defendant against whom such injunctive relief is ordered.").

119 *Aaron*, 446 U.S. at 701. *See generally* Steinberg, *SEC and Other Permanent Injunctions—Standards for Their Imposition, Modification, and Dissolution*, 66 CORNELL L. REV. 27, 32-39 (1980).

120 *Cf.* *Standard Brands, Inc. v. Zumpe*, 264 F. Supp. 254, 270 (E.D. La. 1967) ("'Opportunity to do wrong and a suspicion that wrong will be done is not enough to warrant action by a court to prevent such wrong.'"). *See also* Steinberg, *supra* note 119, at 33.

121 *Cf.* *Barefoot v. Estelle*, 463 U.S. 880, 899 (1983) (evidence of defendant's "future dangerousness" is admissible in support of plea for death penalty).

122 *Cf.* *Farrand*, *supra* note 56, at 1812 ("[T]he accuracy of predictions based on current and past circumstances diminishes when applied to distant future events. Indeed, when projected far enough into the future, the probability that a company currently involved in securities law violations will thereafter engage in similar transgressions or that a loss of the company's assets will be threatened is indistinguishable from the corresponding probability for any other existing company. It follows that no showing of reasonable necessity can be made for the extension of ancillary orders into the indefinite future, and that, on theoretical grounds, cut-off dates should be set for all but self-liquidating forms of relief.").

123 *See supra* notes 64-66 and accompanying text. The SEC's allegations included claims that *Florafax* systematically inflated its quarterly sales figures by shipping unordered products just before the close of the quarter and withheld material information from its accountants. SEC Lit. Rel. 10,617 (N.D. Okla. 1984).

124 Prior to the *Florafax* proceedings, defendant Hale (*Florafax*'s Chief Executive Officer) had been convicted of securities laws violations and had been enjoined in a civil proceeding in connection with another enterprise. *United States v. Hale*, SEC Lit. Rel. 10,635 (N.D. Ga. 1984); *SEC v. World-Wide Coin Inv's, Ltd.*, 567 F. Supp. 724 (N.D. Ga. 1983), *aff'd*, 774 F.2d 1172 (11th Cir. 1985).

125 *See infra* note 205 and accompanying text.

126 Steinberg, *supra* note 119, at 39.



at best be sparingly sought and imposed. (Congress in other contexts evidently has agreed that some reasonable limit on job disqualification is appropriate. For example, it has limited the job disqualification period for ERISA trustees and labor union officials who are *convicted of a felony* to no more than 13 years.<sup>127</sup> It is unlikely that a more extensive period of disqualification would be necessary or appropriate where the defendant has been found liable for a securities law violation in a civil case.)

A better approach would be to empower courts to enter corporation-specific suspension orders of finite duration, up to a congressionally-determined maximum period of time. A suggested maximum for this period is the ten year period for which a defendant may be imprisoned or subject to probation when convicted of criminal violations of the securities laws.<sup>128</sup> (Assuming the defendant were sentenced to probation rather than imprisonment, and that one of the conditions of probation was withdrawal from the firm or a promise not to work in certain jobs or industries,<sup>129</sup> the maximum length of the disability would be the maximum term of confinement.<sup>130</sup>) An alternative, but less desirable, maximum would be the one year to which the SEC is currently limited when it suspends broker/dealers.<sup>131</sup>

There is another reason why corporation-specific removal and suspension orders, even if authorized by Congress, and even if reasonable in duration, may be unwise. Such orders may deprive shareholders of necessary expertise in the governance of the companies in which they have invested. Consider the executive who is found responsible for having promulgated false financial statements for Company X. It might be reasonable for a court to prohibit that executive from continuing to have responsibility for Company X's financial reporting for some finite period of time until better financial controls can be put in place. But it may be entirely unreasonable to interdict her involvement in *any* aspect of the corporation's management. For example, the executive may have unique experience with respect to Company X's marketing strategy, product design or manufacturing processes. In this case, a court entering an order precluding her from serving in *any* managerial capacity with Company X not only would be unnecessary to protect Company X's investors, but could affirmatively harm their best interests.

Injunctions are supposed to be carefully tailored so as not to unduly inhibit the lawful activities of those enjoined.<sup>132</sup> Forcing executive resignation and prohibiting the executive thereafter from serving as an officer of a particular company—even one with no financial reporting responsibilities—may exceed the bounds of what is reasonably necessary to uphold the federal securities laws. It may also encourage subterfuge. For example, assume once again that the executive of Company X is enjoined

127 29 U.S.C. § 504 (Supp. V 1987); 29 U.S.C. § 1111 (Supp. V 1987).

128 15 U.S.C. § 78ff (1988).

129 See *infra* note 263 and accompanying text.

130 See *supra* note 80.

131 15 U.S.C. § 78o(b)(4) (1988).

132 *Genveto Jewelry Co. v. Jeff Cooper, Inc.*, 800 F.2d 256, 259 (Fed. Cir. 1986); *Society for Good Will to Retarded Children, Inc. v. Cuomo*, 737 F.2d 1239, 1251 (2d Cir. 1984).



from serving as an officer or director of that company for a period of ten years. What is to stop that executive from assuming a new job title such as "sales manager" or "shipping clerk" but continuing to exercise precisely the same responsibilities which got her into trouble in the first place? Unlike other statutes which authorize executive removal and suspension, The Remedies Act does not contemplate any prohibition other than service as a titled officer or director.<sup>133</sup>

One could argue in a contempt citation that the court should look to the substance and not to the title of the position.<sup>134</sup> One could as easily argue that contempt only extends to the specific prohibitions of the injunction.<sup>135</sup> But because it places talismanic reliance on an executive's job title, rather than on a functional evaluation of the role he or she plays within the organization, The Remedies Act encourages the entry of injunctive orders which may be overinclusive (and harmful to the shareholders) or underinclusive (and harmful to the shareholders). A better approach would be to authorize a court specifically to enjoin enumerated types of work which may facilitate renewed securities laws violations, such as: (1) assuming responsibility for a corporation's financial accounting and reporting functions, (2) assuming responsibility for communications with investors or prospective investors or (3) (most broadly) assuming responsibility for any aspect of corporate funding.

Given that courts, based on the existing authority of sections 20 of the 1933 Act and 21(d) of the Exchange Act, can already enjoin defendants from committing future violations of the securities laws,<sup>136</sup> it is difficult to see what is added by the proposed power to strip an executive of the opportunity to perform his job or related functions in a lawful manner. But enforcement officials agree that the removal and suspension power is an important tool; therefore, we will turn to the arguments

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133 Compare 12 U.S.C. § 1818(g)(1) (1988) (upon a finding that a bank director or officer has been indicted in connection with a crime involving dishonesty or breach of trust, FDIC may suspend him from office or prohibit him from "further participation in any manner in the conduct of the affairs of the bank.").

134 Courts have, in the context of Section 16(b) of the 1934 Act (which governs officers, directors and 10% beneficial owners of public companies), engaged in a functional analysis to determine that persons with non-official titles are nevertheless in fact "officers" for purposes of the securities laws. *E.g.*, *Colby v. Klune*, 178 F.2d 872 (2d Cir. 1949) ("production manager" could be treated as an officer if his duties were "of such character that he would be likely, in discharging those duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions."). See also *C.R.A. Realty Corp. v. Crotty*, 878 F.2d 562 (2d Cir. 1989) (employee's functions, not his title, are determinative); *SEC v. Aaron*, 605 F.2d 612, 617 (2d Cir. 1979), *vacated sub nom.*, *Aaron v. SEC*, 446 U.S. 680 (1980) ("To permit the manage[rs] of corporations to avoid the consequences of their supervisory responsibilities and thus to escape injunctive and other liability imposed upon them by the antifraud provisions of the federal securities laws merely because they lack corporate title, would create a peculiarly vacuous and pernicious distinction.").

135 *Cf.* *Ford v. Kammerer*, 450 F.2d 279 (3d Cir. 1971) (defendant may not be held in contempt for conduct not expressly prohibited in an injunction order, even where such conduct may have been contemplated by the enjoining judge as the sort to be prohibited); *Fujiwara v. Clark*, 477 F. Supp. 809, 818 (D. Haw. 1979) ("Defendant may not be held in contempt for actions which were not expressly written in the court order."). But see *Rosenstiel v. Rosenstiel*, 278 F. Supp. 794, 803 (S.D.N.Y. 1967) ("[A] violation of an injunction may be found even if its 'strict letter' has been complied with if, in fact, 'the spirit of the injunction' has been disregarded."); *Folk v. Standard Business Forms, Inc.*, 270 F. Supp. 147, 156 (W.D.N.C. 1967) (same).

136 See *supra* note 54 and accompanying text.



which tend to support the enactment of this portion of The Remedies Act.

D. *Policy Arguments in Favor of the Corporation-Specific Removal and Suspension Power*

Notwithstanding the strong arguments in opposition to granting federal district courts express authority to remove and suspend corporate officers and directors, three compelling arguments support enactment of The Remedies Act, insofar as it would authorize courts to remove and suspend for a finite period corporate executives found to have engaged in misconduct *within a specific company*. First, granting the SEC power to seek, in effect, removal of a corporate executive for cause will give it parity of remedies with the shareholders on whose behalf the action is taken. That is, if a shareholder were to bring a derivative action against a corporate executive for mismanagement, which includes chronic disregard of the federal securities laws, he or she (at least in some states) could elect to include a claim for removal under state law.<sup>137</sup> When the SEC, rather than a shareholder, takes action under federal law, acting, in effect *in parens patriae*, it should be able to secure the same relief as the shareholder could, where necessary to protect investors. It should not be necessary for a shareholder to bring a separate and subsequent action to achieve removal, especially in situations where the nondefendant shareholders are essentially passive investors. This is a matter of simple judicial efficiency, and is wholly consistent with the Federal Rules of Civil Procedure and their emphasis upon ease of joinder of parties and claims. Nor should it be necessary for the SEC to locate and join a token shareholder as a plaintiff in its injunctive action solely for the purpose of achieving standing on the removal claim. The SEC already has standing to seek an order requiring resolicitation of proxies<sup>138</sup> or appropriate filings of Schedule 13D<sup>139</sup> and to seek an order prohibiting controlling shareholders from transferring their securities,<sup>140</sup> where necessary to protect investors. There is nothing inappropriate about granting the SEC standing to seek removal to serve the same end.<sup>141</sup>

Second, encouraging executive removal and suspension where appropriate in a judicial forum recognizes the fact that an electoral forum is

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137 Such claims are rare in the absence of statutory authorization. Dent, *supra* note 56, at 933-34. However, many states provide such authorization in their business corporation statutes. A typical example permits judicial removal of a director where the director has "engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion, with respect to the corporation. . . ." REV. MODEL BUSINESS CORP. ACT § 8.09 (1984).

138 SEC v. American Real Estate Inv. Trust, 529 F. Supp. 1300 (C.D. Cal. 1982); SEC v. May, 134 F. Supp. 247, 258 (S.D.N.Y. 1955), *aff'd*, 229 F.2d 123 (2d Cir. 1956); SEC v. O'Hara Re-Election Comm., 28 F. Supp. 523, 525 (D. Mass. 1939).

139 SEC v. General Refractories Co., 400 F. Supp. 1248, 1261 (D.D.C. 1975).

140 *Id.*

141 It would perhaps be desirable, however, to require that notice be given to shareholders of the fact that removal is being sought, to enable them to object if they so choose. This process, similar to giving notice to shareholders of a proposed settlement of a class action, would satisfy the due process concerns discussed above. See *supra* notes 97-103 and accompanying text.



a particularly cumbersome setting for such decision making,<sup>142</sup> and that shareholders *rarely* vote against incumbent management in proxy voting, even where one of their number is willing to undertake the costs of a challenge.<sup>143</sup> If grounds for "for cause" removal are advanced, it is better that they be identified and adjudicated in a setting where due process considerations vis-a-vis the defendant can be maximized and the expenditure of investor resources minimized.

Third, removal without some additional period of suspension may not be a sufficient safeguard against the recurrence of misconduct within the very corporate culture which fostered it initially. It is entirely appropriate that removal be coupled with a finite and reasonable "cooling off period" during which both the corporate culture and the executive's frame of mind may be altered so as to preclude or inhibit future misconduct.<sup>144</sup> In aid of this notion, the court, by way of additional ancillary relief, may enter orders appointing a special auditor or special counsel to oversee and monitor the specific reconstruction of those aspects of the corporation's organization which gave rise to the initial misconduct.

The basic point of The Remedies Act is to permit and encourage federal district courts to consider and employ a broad range of options in crafting injunctive relief which is appropriate to the defendant's wrong and effective as a means of deterring future securities law violations.<sup>145</sup> The alternatives to enactment of a limited removal and suspension power are increased regulatory surveillance at a time of limited regulatory resources,<sup>146</sup> or increased use of the criminal process at a time when prosecutorial resources ought better be directed toward the eradication of drugs and guns, or at least toward high-profile securities-related crimes (such as insider trading and stock manipulation), the prosecution of which is thought to have a strong deterrent effect, as well as a salutary effect on the capital markets.

The idea of providing district courts with discretionary authority to enter a well-crafted order enjoining a corporate executive from resuming his or her job (or serving in functionally-related positions) in an environment where the evidence demonstrates a likelihood of recurring harm,

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142 *E.g.*, *Campbell v. Loew's, Inc.*, 36 Del. Ch. 563, 134 A.2d 852 (1957) (submission to shareholders of issue of "for cause" removal of a director requires "substantial safeguards" and an opportunity for the director to present his case).

143 One can count on his fingers the number of times that a shareholder-initiated proposal has passed. In 1988, shareholders of Santa Fe Southern Pacific Corp. voted to roll back the company's poison pill. During the 1989 proxy season, shareholder proposals on the same issue barely passed at Avon Products and Consolidated Freightways, while scores of other shareholder proposals, including several on poison pills and dozens on confidential proxy voting failed by wide margins. *Shareholders Score Victories Against Poison Pills, Greenmail*, V IRRRC Corporate Governance Bulletin No. 3 at 50 (May/June, 1988); *Votes on 1989 Poison Pill Shareholder Proposals* (chart), VI IRRRC Corporate Governance Bulletin No. 3 at 67 (May/June 1989).

144 The drafters of the Revised Model Business Corporation Act agree. In that Act, where a court has ordered the removal of a corporate director for cause, it may also "bar the director from reelection for a period prescribed by the court." REV. MODEL BUSINESS CORP. ACT § 8.09(b) (1984).

145 135 CONG. REC. S3045 (daily ed. March 17, 1989) (statement of Sen. Dodd) ("[The Act] is designed to . . . enable the Commission to tailor enforcement remedies more appropriate[ly] for particular facts and defendants.").

146 *E.g.*, Sontag, *'Desperate' SEC Seeks More Aid*, 11 NAT'L. L. J., May 1, 1989, at 1, col. 4; Smart & Zigas, *Watchdog Woes: Up Against it at the SEC*, BUS. WK., 120 (Oct. 10, 1988).



makes sense as a tool of law enforcement, so long as that order is narrowly drawn and of reasonable duration (or can easily be vacated upon a showing of changed circumstances).<sup>147</sup> When the SEC can demonstrate an appropriate level of likely recurrence of illegal activity—especially the type of behavior (such as false financial reporting) which is harmful to existing and continuing investors—the “cost” to shareholders of such an order (in terms of lost suffrage rights) and the arguable usurpation of states’ rights which may result are outweighed by considerations of prophylaxis and, frankly, expedience.

## II. The Comprehensive Bar to Executive Status

There are, under both federal and state law, numerous *ex ante* prohibitions against individuals serving as corporate officers or directors, premised not on personal misconduct but rather on categorical assumptions about fitness for service. The Clayton Act prohibits persons from serving on the boards of competing corporations.<sup>148</sup> The Public Utility Holding Company Act of 1935 prohibits directors or executive officers of any bank from simultaneously serving as a director or officer of a registered public utility holding company.<sup>149</sup> Certain persons affiliated with securities underwriters cannot serve as bank directors<sup>150</sup> and, where their dual service is detected, quite apart from any allegation of managerial misconduct, they may be summarily removed from office.<sup>151</sup>

There is a second type of prohibition which is based on prior misconduct, but that misconduct is or may be wholly unrelated to the contemplated employment. For example, absent a statutorily-authorized waiver, “no person shall serve as a director, officer, or employee of an insured bank who has been convicted . . . of any criminal offense involving dishonesty or a breach of trust.”<sup>152</sup> Absent a statutorily-authorized release from the disability, persons who have been convicted of enumerated felonies may not serve as officers, directors or decisionmakers in a labor organization,<sup>153</sup> or as officers, trustees or employees of any employee benefit plan<sup>154</sup> for a period of 13 years following conviction.<sup>155</sup>

147 See *infra* notes 204-06 and accompanying text.

148 15 U.S.C. § 19 (1988). The Depository Institution Management Interlocks Act, 12 U.S.C. § 3202 (1988) similarly interdicts management officials of federal depository institutions from serving in the same capacity with any other depository institution within a single metropolitan statistical area.

149 15 U.S.C. § 79q(c) (1988).

150 12 U.S.C. § 78 (1988).

151 Board of Governors of Fed. Reserve Sys. v. Agnew, 329 U.S. 441 (1947). By the same token, no registered investment company shall have a majority of its board of directors consisting of persons who are officers, directors, or employees of any one bank. 15 U.S.C. § 80a-10(c) (1988).

152 12 U.S.C. § 1829 (1988).

153 29 U.S.C. § 504 (1982 & Supp. V 1987).

154 29 U.S.C. § 1111 (1982 & Supp. V 1987).

155 In addition to direct sanctions against executives in certain industries, Congress has imposed indirect sanctions against corporations whose executives have engaged in misconduct. For example, the government may refuse food inspection services to any entity whose officer or director has been convicted of violating the pure food laws or any other law “indicating a lack of the integrity needed for the conduct of operations affecting the public health,” 21 U.S.C. § 1047 (1982) or to any establishment in which “anyone responsibly connected with” its governance has been convicted of any felony. 21 U.S.C. § 671(a) (1982 & Supp. V 1987).



Persons convicted of any felony under the securities laws cannot serve in any significant role with an investment company for 10 years.<sup>156</sup>

All of these statutory prohibitions are forms of a "comprehensive bar," in which employers are foreclosed from considering certain persons for director or officer (or other fiduciary) positions, and those persons subject to the statutory restrictions are categorically excluded from service not only with the entity with which they have had a prior relationship, but also in the entire universe of other entities subject to the bar.<sup>157</sup> In recent years, the SEC has sought to achieve a comparable comprehensive bar of certain miscreant corporate executives without reference to any statutory authorization. In a number of litigated cases, the SEC, invoking its inherent power to seek ancillary relief, has negotiated consensual comprehensive suspension and bar orders.<sup>158</sup> In addition, in at least

<sup>156</sup> 15 U.S.C. § 80a-9(a) (1988).

<sup>157</sup> There are analogies in the public sector. A person convicted of interfering with military morale is ineligible for employment by the United States, or any department or agency thereof, for five years following conviction. 18 U.S.C. § 2387 (1982). A custodian of public documents who destroys or mutilates same, or any person convicted of treason, is disqualified from holding "any office under the United States," presumably for life. 18 U.S.C. § 2071 (1982); 18 U.S.C. § 2381 (1982).

<sup>158</sup> SEC v. Charles W. Anshen, SEC Lit. Rel. 11,618 (D. Nev. 1987) (defendant is barred, for a period of five years, from holding the position of an officer or director of a public company); SEC v. Wallace C. Sparkman, et al., SEC Lit. Rel. 11,532 (S.D. Tex. 1987) (defendant barred from serving as either a director or officer of a public company for four years); SEC v. Gulf Resources, Inc., SEC Lit. Rel. 10,291 (N.D. Tex. 1984) (defendant prohibited from becoming or acting as an officer, director or control person of any public company absent Commission permission); SEC v. Frederic P. DeVeau, SEC Lit. Rel. 9842 (W.D. Tex. 1982) (defendant barred from association as an officer, director, control person or consultant to any company whose securities are publicly owned until he satisfies a disgorgement order and thereafter only upon notice to the Commission); SEC v. Jack M. Catain, SEC Lit. Rel. 9129 (C.D. Cal. 1980) (defendant is barred from serving as an officer or director of a public company absent court approval); SEC v. Sheldon L. Hart, SEC Lit. Rel. 9080 (D.D.C. 1980) (defendant is barred from being a director or, under certain circumstances, an officer, of a public company, unless that company has and maintains an Audit Committee of the board); SEC v. Starr Broadcasting Group, Inc., SEC Lit. Rel. 8667 (D.D.C. 1979) (defendant barred from seeking or accepting employment as a director or officer of a publicly-traded commission for three years); SEC v. Steven G. Weil, SEC Lit. Rel. 8719 (M.D. Fla. 1979) (defendant barred from assuming a position as an officer or director of any publicly traded issuer); SEC v. L-S-K Corp. of America, SEC Lit. Rel. 8505 (D.D.C. 1978) (defendants enjoined from serving as officers, directors or employees of any public company which has not adopted and maintained procedures to prevent violations of the federal securities laws); SEC v. American Guaranty Corp., SEC Lit. Rel. 8443 (D. Mass 1978) (defendant may not serve as officer or director of any public company for three years); SEC v. Basic Food Industries, Inc., SEC Lit. Rel. 8440 (D.D.C. 1978) (defendant enjoined from serving as an officer, director, employee or consultant of any public company for nine months); SEC v. Aminex Resources Corp., [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,458 (May 24, 1978) (defendants prohibited from serving as officers or directors of any public company without court approval); SEC v. Cosmopolitan Investors Funding Co., SEC Lit. Rel. 8419 (M.D. Pa. 1978) (defendant is prohibited from assuming a position as either an officer or director of any public company except upon approval of the court); SEC v. Continental Advisors, SEC Lit. Rel. 8257 (D.D.C. 1978) (defendant enjoined from any further association as an officer, director or employee of any public REIT); SEC v. Inflight Services, Inc., SEC Lit. Rel. 8182 (S.D.N.Y. 1977) (defendant enjoined from serving as an officer or director of any public company until July 31, 1980); SEC v. Micro-Therapeutics, Inc., SEC Lit. Rel. 8072 (D.D.C. 1977) (defendant prohibited from assuming a position as either an officer or director of any public company); SEC v. Wills, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,102 (June 22, 1977) (defendant may not serve as officer or director of any public company until he has completed a program of education of at least 40 hours relating to the legal responsibilities of corporate executives); SEC v. Timkin, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,703 (Aug. 21 1976) (defendant may not be associated as an officer or director with any public company for two years); SEC v. Emersons Ltd., SEC Lit. Rel. 7392 (D.D.C. 1976) (defendant enjoined from serving as an officer or director of any public company, absent prior consent of the Commission and leave of court); SEC v. Cosmopolitan Investors Funding Co., SEC Lit. Rel. 7366



one case, *In re GEICO*,<sup>159</sup> the SEC has issued its own comprehensive suspension order against an executive in a compliance proceeding under Section 15(c)(4) of the 1934 Act.<sup>160</sup>

The comprehensive suspension or bar such as that coveted by the SEC (call it an executive blacklist or the "Scarlet Letter" of securities law enforcement) may be characterized as an effective means of deterring misconduct short of incapacitation under the criminal law.<sup>161</sup> That is, where the evidence may not be sufficient to convict a corporate fiduciary (for example, under the securities laws, conviction requires proof of a "willful" violation<sup>162</sup>) or to support an extended jail term, it may be sufficient to support a finding of civil liability. If the court in such instances can then be persuaded to impose a comprehensive suspension or bar as an element of ancillary relief, then much of the power of a criminal sanction can be replicated at a lower cost to the government (both in terms of manpower resources and the burden of proof which the government must meet) than it would incur in the criminal context.<sup>163</sup> The costs are even lower when such orders can be entered administratively.

Other law enforcement agencies recognize the value of the comprehensive suspension or bar. Like the SEC, the Department of Labor has sought comprehensive suspension and bar orders against fiduciaries in civil proceedings in its capacity as the enforcement agency overseeing ERISA. (Unlike the SEC, the DOL has been able to secure non-consensual removal, suspension and bar orders.<sup>164</sup> In part, this may be because

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(M.D. Pa. 1976) (defendant may not assume position as an officer or director of any public company except upon approval of the court); *SEC v. Arnold Nelson*, SEC Lit. Rel. 7215 (E.D.N.Y. 1975) (defendant is barred from directly or indirectly associating with any public company); *SEC v. Techni-Culture, Inc.*, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,501 (April 2, 1974) (defendant prohibited from serving as an officer or director of any public company except upon approval of the court); *SEC v. Westgate-California Corp.*, SEC Lit. Rel. 6142 (S.D. Cal. 1973) (defendants required to resign as officers and/or directors of any public company).

159 *In re GEICO*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,750 (Oct. 27, 1976).

160 In this case, defendants agreed to refrain from accepting employment as an officer and director of any publicly-held company for a period of three years absent prior approval by the Commission staff.

161 Cf. *United States v. Lundy*, SEC Lit. Rel. 8554 (D.R.I. 1978) (as part of plea agreement in a criminal case, defendant consents to order barring him from participating in the securities business or participating as an officer or director of a public company for 10 years). See also *infra* note 263.

162 15 U.S.C. § 78ff (1988). Apparently, proof of willfulness is not all that difficult to adduce. *United States v. Chiarella*, 588 F.2d 1358, 1370-71 (2d Cir. 1978) (proof of specific intent to defraud is not required), *rev'd on other grounds*, 445 U.S. 222 (1980).

163 Note that criminal proceedings must be brought by the Department of Justice, with the assistance of the SEC, a fact which necessarily increases the cost of such actions.

164 E.g., *Katsaros v. Cody*, 744 F.2d 270, 281 (2d Cir.) (district court did not abuse its discretion when it removed trustees who had engaged in "repeated or substantial violations" of their fiduciary duties), *cert. denied*, *Cody v. Donovan*, 469 U.S. 1072 (1984); *McLaughlin v. Rowley*, 698 F. Supp. 1333 (N.D. Tex. 1988) (trustees enjoined from serving as fiduciaries of any ERISA plan for five years); *Donovan v. Bryans*, 566 F. Supp. 1258 (E.D. Pa. 1983) (defendants enjoined from serving as fiduciaries of any ERISA plan for five years); *Marshall v. Mercer*, 4 Employee Benefits Cas. (BNA) 1523, 1536 (N.D. Tex. 1983) (defendant permanently enjoined from serving as fiduciary of the plan which is the subject of litigation and from serving any other plan for a period of five years), *rev'd on other grounds*, *Donovan v. Mercer*, 747 F.2d 304 (5th Cir. 1984); *Marshall v. Carroll*, 2 Employee Benefits Cas. (BNA) 2491, 2500 (N.D. Cal. 1980); *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 644 (W.D. Wis. 1979) (defendant is enjoined from serving in any fiduciary capacity with respect to any ERISA plan).

The DOL has also succeeded in securing plan-specific injunctions. E.g., *Marshall v. Kelly*, 465 F. Supp. 341 (W.D. Okla. 1978) (defendant is removed as trustee until he has fully repaid sums



the legislative history of ERISA contemplates more expansive authority in the DOL to seek injunctive relief than does the legislative history of the securities acts.)<sup>165</sup>

The targets of the comprehensive bar are understood to be those executives, like Hale in the *Florafax* case<sup>166</sup> or Yetman in *SEC v. Timkin*,<sup>167</sup> who have had a history of other securities law violations.<sup>168</sup> These are the chronic recidivists, to whom sequential injunctions or even criminal prosecution has proven to be an inadequate deterrent. (One might well ask if they are willing to disregard injunctions against specific misconduct under the securities law then why are they more likely to honor an injunction against their serving as a corporate officer or director.<sup>169</sup> The answer is that such service will inevitably be detected in the annual reports filed by public companies with the Commission.)

In addition to the problems presented by the corporation-specific removal and suspension power—intrusion into corporate internal affairs, undermining of the mandatory disclosure system, problems of duration and nomenclature and the like—there are several additional significant issues surrounding the comprehensive suspension and bar powers proposed in The Remedies Act which merit discussion.<sup>170</sup> The first distinguishes the comprehensive bar as it applies to some regulated profession (such as the practice of law or the brokerage industry) from the comprehensive bar sought by the SEC and authorized in The Remedies Act,

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misappropriated). See also *Donovan v. Mazzola*, 716 F.2d 1226, 1237 (9th Cir. 1983) (district court did not abuse its discretion in appointing investment manager to assume control over pension fund assets for 10 years while trustees retain other functions), *cert. denied*, 464 U.S. 1040 (1984).

165 H.R. REP. NO. 533, 93d Cong., 1st Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4655; S. REP. NO. 383, 93d Cong., 1st Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4890, 4989 (the Secretary is to have the "full range of legal and equitable remedies," including injunctions to prevent future violations and removal of fiduciaries for "repeated or substantial" violations.).

166 See *supra* notes 64-66, 123-24 and accompanying text.

167 *SEC v. Timkin*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95, 703 (Aug. 21, 1976).

168 In *Timkin*, the company's controlling shareholder, Yetman, had previously been involved in a corporation whose registration statement was subject to a stop order for failure to make adequate disclosure (*In re First Dyna Ray Exploration Fund* — 1969, SEC Sec. Act. Rel. 5023 (1969)), and in a company whose trading in the over-the-counter market had been suspended. SEC Exchange Act Rel. 8565 (1969). He had been the object of an injunction requiring the filing of corrected financial statements with respect to a different company, SEC Lit. Rel. 2984 (1964) and had pled guilty to a charge of perjury before the SEC in an investigation of yet another company with which he was affiliated. SEC Lit. Rel. 2004 (1961).

169 Securities professionals barred from the brokerage industry have been known to disregard such orders. See Salwen, *SEC Tries to Keep Up One Man's Bar From Securities Industry*, Wall. St. J., July 14, 1989, at C1, col. 3 (broker barred by the SEC in 1975 found to have "blatantly shook off the agency's barring order").

170 Other issues have been disposed of. For example, a ban on employment premised upon a prior judicial finding is not a bill of attainder, nor does it violate the constitutional proscription against *ex post facto* laws. *DeVeau v. Braisted*, 363 U.S. 144, 160 (1960) (upholding the New York Waterfront Commission Act which prohibits convicted felons from collecting dues from longshoremen, effectively precluding them from serving as union officers); *Postma v. International Brotherhood of Teamsters Local 294*, 337 F.2d 609 (2d Cir. 1964) (upholding 29 U.S.C. § 504, providing for disqualification of convicted felons from holding union office). Prohibiting fiduciaries from resuming a fiduciary role following a *criminal conviction* is not an unreasonable exercise of the police power. *Presser v. Brennan*, 389 F. Supp. 808, 814 (N.D. Ohio 1975) (upholding 29 U.S.C. § 1111, providing for disqualification of persons convicted of certain crimes from serving as trustees of employee benefit plans.).



which would apply to officers and directors in all "public companies." These companies are wholly unregulated by the SEC, except insofar as they are subject to financial disclosure obligations, and, until now, the SEC has never purported to have authority to engage in "merit regulation" of the selection or retention of their corporate managers.

The second issue distinguishes the types of comprehensive bar evidenced in existing statutes, which categorically exclude all persons meeting (or failing to meet) certain standards from consideration for enumerated managerial positions, from the authority sought in The Remedies Act, which would permit but not require a court to impose a comprehensive bar on some but not all defendants found to have violated the securities laws. A related issue relates to the way in which a defendant may be released from the disability. At least one court has recognized that a lifetime ban on certain types of employment is a "radical measure,"<sup>171</sup> and that is especially so where, as in The Remedies Act, there is no articulated means of achieving redemption.

Other considerations counsel against the comprehensive bar. Certainly, the comprehensive bar impairs the suffrage rights of shareholders, as discussed above,<sup>172</sup> except that its impact encompasses not only the shareholders of the corporation in which misconduct occurred, but shareholders of all public companies. Also, the comprehensive bar is inevitably overbroad, certainly as a matter of the law of injunctions and perhaps even as a matter of constitutional law.

#### A. *Corporate Executives as an Unlicensed, Unregulated Profession*

It is well established that, in the exercise of their police powers, states may articulate minimum standards for entry into and retention within a profession, and that failure to comply with articulated standards may result in license suspension or revocation.<sup>173</sup> The federal government also has authority to "license" and therefore to suspend or revoke the licenses of, certain professionals, and the SEC, for example, has done so in many instances. Broker/dealers have been suspended or barred in SEC enforcement proceedings under Section 15(b)(4) of the Exchange Act;<sup>174</sup> investment advisers have been suspended or barred under the

171 *United States v. Rubin*, 559 F.2d 975 (5th Cir. 1977) (court declines to impose a permanent ban on criminal defendant's reacquisition of union office), *vacated*, 439 U.S. 810 (1978), *cert. denied*, 444 U.S. 864 (1979).

172 See *supra* notes 97-103 and accompanying text.

173 See generally W.O. MORRIS, *REVOCATION OF PROFESSIONAL LICENSES BY GOVERNMENTAL AGENCIES* (1984).

174 15 U.S.C. § 78o(b)(4) (1988). *E.g.*, *Svalberg v. SEC*, 7 Fed. Sec. L. Rep. (CCH) ¶ 94,458 (D.C. Cir. May 26, 1989) (brokerage firm principals permanently barred from serving as principals in any NASD member firm); *Berdahl v. SEC*, 572 F.2d 643 (8th Cir. 1978) (salesman barred from association with any broker or dealer, provided that he could reapply to the SEC for permission to become associated with a broker or dealer in a non-supervisory capacity, after nine months); *Quinn & Co. v. SEC*, 452 F.2d 943 (10th Cir. 1971) (securities salesman suspended for 20 days), *cert. denied*, 406 U.S. 957 (1972); *Vanasco v. SEC*, 395 F.2d 349 (2d Cir. 1968) ("boiler room" salesman barred from any employment in the securities field); *In re James E. Simpson*, SEC Exchange Act Rel. 26,847 (May 22, 1989) (defendant permanently barred from association with any broker, dealer, investment company, investment adviser or municipal securities dealer); *In re Michael J. Boylan*, SEC Exchange Act Rel. 18,378 (December 30, 1981) (officer of broker/dealer firm suspended for 90 days); *In re Michael Batterman*, SEC Exchange Act Rel. 12,278 (November 2, 1976) (defendant is barred from



Investment Advisers Act;<sup>175</sup> and mutual fund managers have been suspended or barred under the Investment Companies Act.<sup>176</sup> Accountants<sup>177</sup> and lawyers<sup>178</sup> who appear before the SEC have been suspended or barred administratively under SEC Rule 2(e) of the Commission's Rules of Practice.<sup>179</sup>

Unlike these professionals, however, corporate directors and officers are not subject to licensure and license revocation, either on the ground (as in the case of broker/dealers, investment advisers and mutual fund managers) that they do not comply with articulated standards for practicing their profession, or (as in the case of accountants and lawyers) that their conduct is disruptive of the ongoing operations of the SEC.

There are no articulated standards for the types of persons who may serve as the directors of public companies. Unlike lawyers, physicians, podiatrists, architects, insurance agents, accountants, pharmacists or funeral directors, all of whom may be excluded or removed from their pro-

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any association with any registered broker, dealer, investment company or investment adviser, but after two years may become so associated in a non-supervisory capacity); *In re* Carrol P. Teig, SEC Exchange Act Rel. 12,812 (September 17, 1976) (defendant barred for four months); *In re* Cotzin, Woolf & Co., SEC Exchange Act Rel. 11,769 (October 24, 1975) (partner in broker/dealer firm barred indefinitely); *In re* Goffe-Carkener-Blackford Securities Corp., SEC Exchange Act Rel. 11,690 (September 29, 1975) (president of broker/dealer barred indefinitely); *In re* Paul L. Rice, SEC Exchange Act Rel. 11,667 (September 22, 1975) (securities salesman suspended for 30 days).

175 15 U.S.C. § 80b-3(e) (1988). *E.g.*, *Marketlines, Inc. v. SEC*, 384 F.2d 264 (2d Cir. 1967) (investment adviser's registration revoked), *cert. denied*, 390 U.S. 947 (1968); *In re* The Geier Letter, Inc., [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,098 (Jan. 27, 1975) (defendant permanently barred from affiliation with an investment adviser); *In re* Shortline Reports, Inc., [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,962 (Feb. 22, 1971) (defendant suspended from association with any investment adviser for six months).

176 15 U.S.C. § 80a-9(b) (1988). *E.g.*, *In re* Vanier, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,555 (Nov. 1, 1973) (defendant barred from any employment with an investment company, but may seek relief from this order after one year); *In re* Zieg, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,109 (Nov. 16, 1972) (defendant barred from any employment with an investment company and must liquidate funds within 8 months).

177 *E.g.*, *In re* Sheldon M. Blazar, Exchange Act Release No. 26,848, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,695 (May 22, 1989) (accountant denied privilege of practicing before the commission but may perform limited work as a preparer or reviewer after one year); *In re* Richard P. Franke, Exchange Act Release No. 26,662, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,689 (March 24, 1989) (accountant permanently denied the privilege of appearing or practicing before the Commission); *In re* Edmond A. Morrison, III, Exchange Act Release No. 26,567, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,685 (Feb. 23, 1989) (accountant is denied the privilege of appearing or practicing before the Commission, but may seek "readmission" in four years); *In re* John L. VanHorn, Exchange Act Release No. 26,238, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,678 (Nov. 1, 1988) (accountant may seek "readmission" after five years); *In re* Keith Bjelajac, Exchange Act Release No. 26,124, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,670 (Sept. 28, 1988) (accountant suspended for three years); *In re* John E. Harrington, Exchange Act Release No. 22,686, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (Dec. 5, 1985) (accountant is permanently denied the privilege of appearing or practicing before the Commission).

178 *E.g.*, *In re* Paul H. Metzinger, Exchange Act Release No. 26,640 (March 17, 1989) (attorney denied privilege of appearing or practicing before the Commission for 36 months); *In re* Thomas W. Tierney, Exchange Act Release No. 23,169 (1986) (attorney permanently denied the privilege of appearing or practicing before the Commission but may seek "readmission" after three years); *In re* Robert V. Gibson, Exchange Act Release No. 18,314, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,068 (Dec. 7, 1981) (attorney suspended from appearing or practicing before the Commission for nine months); *In re* Paul H. Brumley, SEC Exchange Act Rel. 16,558 (1980) (attorney permanently disqualified from appearing or practicing before the SEC); *In re* Bernard J. Coven, SEC Exchange Act Rel. 16,448 (1979) (attorney suspended for three months); *In re* Richard D. Hodgkin, SEC Exchange Act Rel. 16,225 (1979) (attorney suspended for 12 months); *In re* Stephen R. Gilliland, SEC Exchange Act Rel. 16,046 (July 26, 1979) (attorney permanently disqualified).

179 17 C.F.R. § 201.2(e) (1988).



fession for lack of expertise or specified acts of misconduct, corporate directors and officers have no admission or performance standards save those imposed by their shareholders.

State law generally provides that standards *may* be imposed, but only on a corporation-by-corporation basis pursuant to the terms of a corporation's articles of incorporation or bylaws.<sup>180</sup> Neither the states nor the federal government has imposed on corporate executives, as they do on professionals subject to licensure, educational requirements, residence requirements, examination requirements or the posting of a bond.

Federal law does require that corporate officers and directors file periodic reports concerning their share ownership,<sup>181</sup> and requires their signatures on certain corporate documents.<sup>182</sup> Other than having to perform these essentially ministerial functions, however, and subject to generalized duties of care and loyalty, corporate officers and directors are free to conduct themselves however they please so long as they enjoy the confidence of their shareholders. Unlike in other professions where there is some consensus, for example, that physicians should not be felons (at least where their crimes bring the medical profession into disrepute<sup>183</sup>), there is no comparable consensus as to corporate executives. Thus, we find directors and officers being elected and reelected who have been found guilty of personal or corporate tax evasion,<sup>184</sup> assault, drunk driving and other "personal" crimes,<sup>185</sup> and even forgery and embezzlement from the company in question.<sup>186</sup>

In this context, it is particularly troublesome to contemplate a court determining on the basis of an executive's non-compliance with the law while managing Corporation A (or even Corporations A, B, C, D and E), that he or she is unsuitable to serve as an officer or director of Corporation X. Indeed, for some investors, the most desirable managers are

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180 See REV. MODEL BUSINESS CORP. ACT § 8.02 (1984) ("The articles of incorporation or bylaws may prescribe qualifications for directors. A director need not be a resident of this state or a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe.").

181 15 U.S.C. § 78p(a) (1988).

182 15 U.S.C. § 77f(a) (1988) (requiring officers and a majority of directors to sign registration statement); SEC Form 10-K General Instruction D(2)(a) (requiring officers and a majority of registrant's directors to sign Form 10-K).

183 *E.g.*, *Levy v. Board of Registration and Discipline in Medicine*, 378 Mass. 519, 392 N.E.2d 1036 (1979) (physician's license revoked following conviction for grand larceny and submission of false data to Rate Setting Commission). An argument can be made that *any* crime disables a physician from serving in the public interest. *E.g.*, *Raymond v. Board of Registration in Medicine*, 387 Mass. 708, 443 N.E.2d 391 (1982) (physician's license revoked following conviction for selling guns).

184 See, *e.g.*, *Furman, Albert Nipon's in Basic Black Again—Dress Company Fashions a Turnaround*, CRAIN'S NEW YORK BUSINESS, November 4, 1988, at 3 (recounting triumphant return of Albert Nipon as CEO of Albert Nipon, Inc., after a 20-month imprisonment for tax evasion); Mandell, *The Rubell Years*, *Newsday*, July 27, 1989, at 8 (recounting the successful career of Steve Rubell following his 13-month imprisonment for tax evasion. From being unable to get a credit card immediately after his release in 1981, Rubell developed and became the head of a \$180 million real estate empire).

185 See P. COLLIER & D. HOROWITZ, *THE FORDS: AN AMERICAN EPIC* at 382 (1987) (recounting the well-publicized drunk driving arrest of Henry Ford II while he was head of Ford Motor Co.).

186 See D. MCCLINTOCK, *INDECENT EXPOSURE* (1982) (recounting the story of David Begelman who was reinstated as President of Columbia Pictures, Inc. following disclosure that he had embezzled tens of thousands of dollars from the company).



those willing to take the greatest risks—including those willing to operate close to (or even over) the line of legality.

Congress could (but surely should not) set minimum standards for executive service with a public company, or empower the SEC to adopt its own standards.<sup>187</sup> One such standard might be the absence of any criminal convictions, or the absence of any prior civil finding of a violation of the federal securities laws. Other democratic bodies have limits on the types of people who may run for office,<sup>188</sup> and certainly such provisions as the Clayton Act<sup>189</sup> and the prohibition against affiliates of securities underwriters serving as bank directors,<sup>190</sup> are valid even though they limit shareholders' choices. But in the absence of such standards, it is difficult to see upon what principled basis a court would determine when a comprehensive suspension or bar against future executive service is warranted, especially where existing disclosure rules ensure that voting shareholders will have adequate notice of the prior conduct of directoral candidates before they are elected.<sup>191</sup> (A somewhat more difficult problem may exist regarding corporate officers, whose selection is not directly controlled by shareholders. But shareholders offended by the selection of an unacceptable corporate president, for example, reserve the right to vote against the board candidates responsible for the selection, or to sell their interest. In either case, if shareholder resistance is sufficient, the executive's selection will be reconsidered by those empowered to affirm or revoke it.)

The Remedies Act provides no guidance as to the standards by which executive "fitness" should be judged. Although the comprehensive bar is said to be aimed at chronic violators, the statute does not say so, as it could and does in RICO,<sup>192</sup> federal "career criminal" legislation<sup>193</sup> and in typical state recidivist statutes.<sup>194</sup> Nor does the statute contain any reference to the severity of the immediate offense (or the scienter required therefore) to guide the district court in selecting the option of a comprehensive bar. There are no behavioral standards (such as cooperation with the government in securing corrective disclosure) which might bear on the bar-or-no-bar determination.

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187 In 1977, then-director of the Enforcement Division and now federal district judge Stanley Sporkin advocated just such legislation. R. KARMEI, REGULATION BY PROSECUTION 196 (1982). It had never been imagined that, in the absence of legislation, the SEC could adopt standards of conduct on its own. See *In re Franchard*, 42 S.E.C. 164, 176 (1964) ("The [Securities] Act does not purport. . . to define federal standards of directors' responsibility in the ordinary operations of business enterprises, and nowhere empowers us to formulate administratively such regulatory standards.").

188 E.g., U.S. CONST., art. I, §§ 2, 3 (declaring minimum age and durational citizenship requirements for candidates for the House of Representatives and U.S. Senate).

189 See *supra* note 148 and accompanying text.

190 See *supra* note 150 and accompanying text.

191 See *supra* note 96 and accompanying text.

192 18 U.S.C. § 1962 (1982) ("pattern of racketeering activity" rather than isolated acts of racketeering form the basis of criminal—and civil—liability).

193 18 U.S.C. § 924(e) (1982 & Supp. V 1987) (provides for sentence enhancement for persons with three previous convictions).

194 E.g., L.A. REV. STAT. ANN. § 14:67 (West 1986) (provides for sentence enhancement for persons with two prior convictions).



Without reasonable standards, or the civil equivalent of "sentencing guidelines," courts inevitably will engage in *ad hoc* and undisciplined decision making, a process regularly and properly decried both by courts<sup>195</sup> and by Congress.<sup>196</sup>

### B. *Predictability, Proportionality and Relief from the Bar*

As noted, other federal laws specifically and categorically authorize a comprehensive bar. That is, they announce in advance that certain forms of conduct—for example, conduct leading to a criminal conviction for one or more enumerated offenses—*will result* in disqualification from future work, thereby enabling a corporate executive to make an informed *ex ante* decision governing his or her behavior. These statutes are also narrow in their focus, prohibiting work only within defined industries, such as banking, labor union management, stock brokerage or investment advisory firms. Most of the statutes authorizing a comprehensive bar set a maximum for the period of disability from work<sup>197</sup> and/or expressly provide for a means of lifting the disqualification upon some showing of rehabilitation.<sup>198</sup>

By contrast, The Remedies Act does none of these things. Because it rests wholly on the discretion of the court, the Act affords a corporate executive no certainty that a finding of civil liability will necessarily lead to a suspension or bar order, leaving the executive no means of assessing the risks of misconduct. The suspension order ultimately entered by the court need not be limited in time or (as in the case of broker/dealers and investment advisers) to a defined industry, but may apply to the entire universe of public companies, thus substantially circumscribing the defendant's employment options.<sup>199</sup> Moreover (and unlike comparable orders governing ERISA fiduciaries or labor union managers), a comprehensive order under The Remedies Act may cover many positions having nothing to do with financial reporting or other functions which are within the jurisdiction of the SEC. For example, a defendant subject to a comprehensive bar presumably could not assume a job bearing even the cosmetic title of "vice-president," such as those frequently found in banking, financial services,<sup>200</sup> sales and advertising.<sup>201</sup> Nor

195 *Furman v. Georgia*, 408 U.S. 238 (1972) (striking down Georgia's death penalty statute because it permitted the sentencing judge virtually unlimited discretion in deciding whether the death penalty was appropriate).

196 S. REP. NO. 225, 98th Cong., 2d Sess. 38, reprinted in 1984 U.S. CODE CONG. & ADMIN. NEWS 3182, 3221 ("[E]very day Federal judges mete out an unjustifiably wide range of sentences to offenders with similar histories, convicted of similar crimes, committed under similar circumstances. One offender may receive a sentence of probation, while another—convicted of the very same crime and possessing a comparable criminal history—may be sentenced to a lengthy term of imprisonment.").

197 *E.g.*, 29 U.S.C. § 504 (1982 & Supp. V 1987) (13 years); 29 U.S.C. § 1111 (1982 & Supp. V 1987) (13 years); 15 U.S.C. § 80a-9(a)(1) (Supp. V 1987) (10 years).

198 See *infra* notes 202-03 and accompanying text.

199 There are 14,620 public companies. SECURITIES AND EXCHANGE COMMISSION, DIRECTORY OF COMPANIES REQUIRED TO FILE ANNUAL REPORTS WITH THE SEC UNDER THE SECURITIES EXCHANGE ACT OF 1934, (1988).

200 See *Merrill Lynch v. Livingston*, 566 F.2d 1119 (9th Cir. 1978) (defendant, one of 48 account executives with the title "vice president," had exactly the same duties after he was awarded the title as he did before. "Livingston never attended, nor was he invited or permitted to attend, meetings of



could she become the vice-president for manufacturing, human resources, or governmental affairs of a public company. In short, a comprehensive bar, though easily establishing a bright line for law enforcement officials, may be wholly disproportionate and inappropriate to the defendant's conduct in a given case.

There is also the question of rehabilitation. Comparable statutes often expressly define the circumstances in which a comprehensive bar may be lifted. For example, a banking executive convicted of a requisite crime may petition the Federal Deposit Insurance Corporation to consent to a lifting of the statutory bar, permitting him or her to serve as an officer, director or employee of an insured bank.<sup>202</sup> A labor union official or ERISA fiduciary convicted of a requisite crime may be barred from employment with a labor union or an employee benefit plan for up to 13 years, but may during that period request the court to lift the statutory bar upon an appropriate showing of rehabilitation.<sup>203</sup>

The Remedies Act contains no specific means of lifting the bar, save the general procedures involved in seeking relief from an injunction. The Supreme Court has admonished that such relief will be granted only upon a "clear showing of grievous wrong evoked by new and unforeseen conditions,"<sup>204</sup> and as a practical matter, defendants in securities cases have seldom succeeded in meeting this standard. (The SEC counsel responsible for defending actions seeking to lift injunctions resulting from SEC-initiated lawsuits reports that the last time anyone was successful against the Commission was in 1982.<sup>205</sup>) It is not enough for a defendant to demonstrate that his life and goals have changed substantially or that he has been rehabilitated.<sup>206</sup>

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the Board of Directors or the Executive Committee. He acquired no executive or policy making duties.").

201 See *Rossini v. Ogilvy & Mather, Inc.*, 798 F.2d 590 (2d Cir. 1986) (title of "vice president" of advertising agency found to be a mere "honorarium" carrying with it no managerial responsibilities).

202 12 U.S.C. § 1829 (1988).

203 29 U.S.C. § 504 (Supp. V 1987) (bar may be lifted where sentencing court (or where conviction has been under state law, the U.S. District Court), after notice to the Department of Labor and applicable prosecutors, finds that defendant's renewed service in a labor union would "not be contrary to the purposes of this chapter"); 29 U.S.C. § 1111 (Supp. V 1987) (bar may be lifted where the sentencing court (or where conviction has been under state law, and the Justice Department so requests, the U.S. District Court), after notice to the Department of Labor and applicable prosecutors, finds that defendant's renewed service for an employee benefit plan would "not be contrary to the purposes of this subchapter.").

204 *United States v. Swift & Co.*, 286 U.S. 106, 119 (1932), cited with approval in *SEC v. Blinder, Robinson & Co.*, 855 F.2d 677 (10th Cir. 1988), cert. denied, 109 S. Ct. 1172 (1989). For a comprehensive discussion of the standards which must be met by a defendant in order to alter the terms of an outstanding injunction, particularly in the context of the securities laws, see Steinberg, *supra* note 119, at 51-58. Steinberg argues for a somewhat more flexible standard than that articulated in *Swift*. See *id.* at 59-73.

205 Telephone interview with Benjamin Greenspoon, Associate General Counsel (May 25, 1989) (citing *SEC v. Crofters, Inc.* [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,018 (S.D. Ohio 1982)). Defendants were also successful in lifting an injunction in *SEC v. Warren*, 583 F.2d 115 (3d Cir. 1978) and in modifying an injunction in *SEC v. Holben*, SEC Lit. Rel. 11952 (D. Col. 1988).

206 *E.g.*, *SEC v. Clifton*, 540 F. Supp. 848 (D.D.C. 1982) (defendant fails to secure dissolution of injunction after six years of compliance with its terms), *aff'd*, 700 F.2d 744 (D.C. Cir. 1983); *SEC v. Advance Growth Capital Corp.*, 539 F.2d 649 (7th Cir. 1976) (defendant fails to secure dissolution after 26 months of "strict compliance" with the law); *SEC v. Thermodynamics, Inc.*, 464 F.2d 457



The result of the Act as written is that a wrongdoer may prefer the "certainty" of a criminal prosecution to the "uncertainty" of a civil proceeding. In other words, even though a criminal proceeding presents the theoretical risk of a \$100,000 penalty and ten years in prison,<sup>207</sup> the government can only secure this result by proving beyond a reasonable doubt that the defendant's misconduct was "willful." By contrast, in a civil proceeding, the government need only offer proof by a preponderance of the evidence, and in many cases need not even show that the violation involved *scienter*.<sup>208</sup> But if successful, the government may effectively bar the defendant for life from seeking significant employment in any public company, notwithstanding any rehabilitation or change of values he may undergo.<sup>209</sup>

There is nothing illegal about a system in which defendants might prefer criminal prosecution to the risks of a civil action—inside traders might well prefer to serve some jail time following a criminal action than to disgorge their profits in a civil injunction proceeding—however, in crafting remedies under the securities laws, one would hope that Congress would encourage the rehabilitation of securities law violators by enabling those who have abandoned wrongful conduct to seek and secure good jobs, rather than discourage rehabilitation by authorizing a comprehensive bar which is effectively irrevocable.

An instructive case is *Schwartz v. Board of Bar Examiners*<sup>210</sup> in which a New Mexico bar examination applicant disclosed that, prior to attending law school, he had a history of using aliases, had been arrested several times and had been a member of the Communist Party. Noting that over fifteen years had passed since any of these events, and that ample evidence existed concerning his current good moral character, the Court found that New Mexico had denied the applicant's due process rights when it excluded him from the bar because of his "record."<sup>211</sup> Any statute authorizing a comprehensive bar for securities law violators ought to consider the possibility of similar life changes rather than assuming that a person with a history of financial mismanagement is incapable of change.<sup>212</sup>

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(10th Cir. 1972) (defendant fails to get injunction lifted notwithstanding five years of exemplary behavior and a "change in facts and attitude"), *cert. denied*, *Strawn v. SEC*, 410 U.S. 927 (1973); *Walling v. Harnischfeger Corp.*, 242 F.2d 712 (7th Cir. 1975) (defendant fails to secure vacation order notwithstanding 12 years of compliance with injunction's terms).

207 15 U.S.C. § 78ff(a) (1988).

208 Some securities law violations are strict liability offenses. *See, e.g.*, *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968) (top level executives effectively denied a due diligence defense in an action under § 11 of the 1933 Act).

209 Of course, the SEC reserves the right to pursue both civil and criminal sanctions for the same act. However, the civil sanctions cannot be so great as to constitute an additional "punishment" for the crime. *United States v. Halper*, 109 S. Ct. 1892, 1902 (1989) ("We . . . hold that under the Double Jeopardy Clause a defendant who already has been punished in a criminal prosecution may not be subjected to an additional civil sanction to the extent that the second sanction may not fairly be characterized as remedial, but only as a deterrent or retribution.").

210 353 U.S. 232 (1957).

211 *Id.* at 247.

212 The existence of multiple prior violations of the law may warrant a high standard of proof of rehabilitation. *See In re Application of K.B.*, 291 Md. 170, 178, 434 A.2d 541, 545 (1981) ("[T]here can be no doubt . . . that thievery of a repetitive nature, as here, is usually indicative of a serious



But under existing law, a showing comparable to that made in *Schware* would not be sufficient to require dissolution of an injunction,<sup>213</sup> leaving the defendant, at best, to make the sort of due process argument advanced in *Schware*. This kind of gauntlet is excessive as a means of enforcing the securities laws.

### C. *The Right of Shareholders to Select Directors*

Shareholders, like electors, are entitled to make bad decisions, and to choose a wrongdoer to represent them even when others might disagree with that choice.<sup>214</sup> Just as "[a] fundamental principle of our representative democracy is . . . 'that the people should choose whom they please to govern them,'"<sup>215</sup> a fundamental principle of corporate ownership (however illusory it may sometimes seem in practice)<sup>216</sup> is that shareholders should have the right to select whomever they wish as their corporate fiduciaries, except where (as in the case of bank executives convicted of certain felonies or of persons whose election would result in interlocking directorates) Congress has determined that a limited class of candidates poses a grave threat to other constituencies.

Many observers believe that the selection of directors should include "outside" candidates as a means of ensuring diversity in subject matter expertise and leadership skills, and that independence from in-house management is a value to be prized in the assembly of a corporate board.<sup>217</sup> But no law requires independence,<sup>218</sup> thus leaving the choice—as it should be left—to the shareholders.

In advocating passage of The Remedies Act, the SEC, once again, is displaying its distrust of the shareholders it was created to serve. Perhaps it has embraced the proposition that most shareholders are not capable of absorbing mandatory disclosure.<sup>219</sup> Perhaps its paternalism,

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character flaw' and that 'in such cases, the evidence of rehabilitation must be entirely convincing . . . '") (citing *In re Application of David H.*, 283 Md. 632, 640-41, 392 A.2d 83, 88 (1978)).

213 See *supra* note 206 and accompanying text.

214 Cf. *Powell v. McCormack*, 395 U.S. 486 (1969) (Congress may not refuse to seat duly elected member, notwithstanding his record of misconduct while in office).

215 *Id.* at 547.

216 Cf. E.J. EPSTEIN, *WHO OWNS THE CORPORATION* at 29 (1986) (In 1985, of 408 corporate proposals intended to restrict contests for control (shark-repellent proposals), only nineteen were voted down by the shareholders; in 1984, "out of some six thousand corporate elections of boards of directors, only eight offered shareholders the possibility of voting for an alternate board of directors, and in only three of these contests did the challenger manage to win control through proxy solicitation.") Epstein argues that shareholder suffrage is a "myth" perpetuated primarily by marketers at the New York Stock Exchange.

217 See, e.g., AMERICAN LAW INSTITUTE PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS § 303(a) (Tent. Draft No. 1, 1982) ("Corporate law should provide that at least a majority of the directors of a large publicly held corporation shall be free of any significant relationships with the corporation's senior executives. . .").

218 An exception may be the Investment Company Act, which provides that "no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company." 15 U.S.C. § 80A-10 (1988).

219 H. KRIPKE, *THE SEC AND CORPORATE DISCLOSURE — REGULATION IN SEARCH OF A PURPOSE* at 14 (1979).



thwarted in cases involving insider trading<sup>220</sup> and state anti-takeover statutes,<sup>221</sup> has reemerged in this new form.

In any event, The Remedies Act authorizes courts, at the behest of the SEC, to interfere in a very fundamental way with the right of shareholders to choose their own fiduciaries. While this may not present a first amendment issue,<sup>222</sup> it does cast the SEC into a curious and unfortunate role.

#### D. *The Inevitable Overbreadth of the Comprehensive Bar*

The most significant flaw of the comprehensive bar is that it is, by definition, overbroad as a matter of equity and even perhaps as a matter of constitutional law. Injunctions are supposed to be crafted so as to specify in reasonable detail that conduct which is prohibited.<sup>223</sup> "Although a trial court is given broad discretionary powers in shaping equitable decrees, injunctive relief should be narrowly tailored to fit specific legal violations,"<sup>224</sup> and injunctions "should be tailored to restrain no more than what is reasonably required to accomplish its ends."<sup>225</sup>

Thus, when an order is entered enjoining both lawful and unlawful activities, it must be closely scrutinized, and where found to be overbroad, recast.<sup>226</sup> This suggests that a comprehensive bar which prohibits the lawful as well as unlawful exercise of executive powers—particularly executive powers over areas of corporate activity wholly unrelated to the dissemination of financial information—is illegitimate.

With respect to the constitutional argument, it may be helpful to consider an alternative form of the SEC's proposed comprehensive bar. Assume that rather than granting unconstrained discretion to the district courts to determine when a comprehensive bar is appropriate, The Remedies Act provided that every person twice enjoined in proceedings under the securities law would in the third instance be subject to the

220 *E.g.*, *Chiarella v. United States*, 445 U.S. 222, 232 (1980) (securities laws do not ensure that some traders will not enjoy an "unfair advantage" in the marketplace).

221 *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987) (securities laws do not protect investors from interference with the free transferability of shares).

222 *Cf. Cousins v. Wigoda*, 419 U.S. 477 (1975) (right of Democratic Party members to select the delegates of their choice to the national convention is protected by the first amendment right of association).

223 *FED. R. CIV. P.* 65(d). Vague prohibitions against generalized misconduct are inappropriate. *SEC v. Savoy Industries, Inc.*, 665 F.2d 1310, 1318 (D.C. Cir. 1981) (that portion of injunction which ordered defendant not to "engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person" stricken).

224 *Gemveto Jewelry Co. v. Jeff Cooper Inc.*, 800 F.2d 256, 259 (Fed. Cir. 1986) (citations omitted).

225 *Consolidation Coal Co. v. Disabled Miners*, 442 F.2d 1261, 1267 (4th Cir.), *cert. denied*, 404 U.S. 911 (1971).

226 *E.g.*, *Spiegel v. City of Houston*, 636 F.2d 997, 1002-03 (5th Cir. Unit A 1981) (preliminary injunction which forbids good faith as well as bad faith law enforcement activities is overbroad and must be reversed); *United States Steel Corp. v. United Mine Workers of Am.*, 534 F.2d 1063 (3d Cir. 1976) (preliminary injunction which effectively prohibits any strike or work stoppage, and not just those which are similar to union's prior pattern of contract violations, must be vacated as overbroad).



comprehensive bar.<sup>227</sup> This would obviate the problems discussed above of a lack of standards for decision making and lack of predictability.<sup>228</sup> However, it would arguably create a law well beyond the limits of the government's police powers:

To justify the State in . . . interposing its authority in behalf of the public, it must appear . . . that the means are reasonably necessary for the accomplishment of the purpose, and not unduly oppressive upon individuals. The legislature may not, under the guise of protecting the public interests, arbitrarily interfere with private business, or impose unusual and unnecessary restrictions upon lawful occupations.<sup>229</sup>

This is not just hoary rhetoric reminiscent of the era of substantive due process. Laws which purport to establish qualifications for admission to a particular profession must be rationally related to the skills required for that profession.<sup>230</sup> Thus an applicant cannot be denied admission to the bar because she is a resident alien rather than a U.S. citizen,<sup>231</sup> or a nonresident of the state,<sup>232</sup> or a homosexual<sup>233</sup> or a woman.<sup>234</sup> An applicant seeking appointment to the police or fire department cannot be excluded solely because he fails to meet an arbitrary height or weight requirement, when physical strength is the real characteristic being sought.<sup>235</sup> Nor should it be appropriate for the government to bar people from a wide range of employment opportunities for noncriminal misconduct—even repeated misconduct—which is unrelated to the position being sought.

Certainly, a state or the federal government could require that corporate directors, like applicants for bar admission, demonstrate moral fitness and intellectual capacity for the job. But *Schwartz v. Board of Bar Examiners*<sup>236</sup> teaches that it is not enough for the government to look to an applicant's former arrest record to determine whether he is currently fit for work in one of the professions.<sup>237</sup> Nor should it be acceptable for the government (as opposed to the corporation itself) to cite the existence

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227 Such a statute would look like the banking statute which states "no person shall serve as a director, officer or employee of an insured bank who has been convicted [of certain types of crimes]." See *supra* note 152.

228 See *supra* notes 192-96 and accompanying text.

229 *Lawton v. Steele*, 152 U.S. 133, 137 (1894). See also *Welch v. Swasey*, 214 U.S. 91, 105 (1909) ("[I]f the statutes are arbitrary and unreasonable and beyond the necessities of the case; the courts will declare their invalidity.").

230 *Schwartz v. Board of Bar Examiners*, 353 U.S. 232, 239 ("A State can require high standards of qualification, such as good moral character or proficiency in its law, before it admits an applicant to the bar, but any qualification must have a rational connection with the applicant's fitness or capacity to practice law.").

231 *In re Griffiths*, 413 U.S. 717 (1973).

232 *Supreme Court of New Hampshire v. Piper*, 470 U.S. 274 (1985).

233 *In re Florida Bd. of Bar Examiners*, 358 So. 2d 7 (Fla. 1978).

234 *Foltz v. Hoge*, 54 Cal. 28, 35 (1879).

235 *Craig v. County of Los Angeles*, 626 F.2d 659, 667-68 (9th Cir. 1980), (employer fails to demonstrate that height restrictions were "manifestly related" to employment by the sheriff's department), *cert. denied*, 450 U.S. 919 (1981) *Horace v. City of Pontiac*, 624 F.2d 765, 767-769 (6th Cir. 1980) (there is no business necessity for a height requirement for police officers).

236 353 U.S. 232 (1957).

237 See *supra* notes 210-11 and accompanying text.



of prior securities law violations as the sole basis for excluding from consideration qualified applicants for officer or director positions.

That a federal district judge, rather than Congress, makes the bar-or-no-bar decision only makes the situation somewhat more palatable. Assume the same defendant with the same history (two prior injunctions). Assume that The Remedies Act has been enacted as introduced, and the judge, in an exercise of discretion, enters the comprehensive bar. In so doing, she prohibits the defendant—perhaps for all time—from seeking thousands of available job opportunities—most of them wholly unrelated to the defendant's initial misconduct—merely because of the title they bear. Such a result would suggest that a court under comparable legislation could bar a union organizer found to have engaged repeatedly in unfair labor practices from ever seeking a job as a bank teller; or an air traffic controller found to have abused alcohol from ever seeking a job as a meat inspector. The statute simply goes too far.

Just as criminal penalties must bear some reasonable relationship to the nature and severity of the crime,<sup>238</sup> and penalties in disciplinary proceedings brought against professionals must bear some reasonable relationship to the nature and magnitude of their misconduct,<sup>239</sup> remedies in civil proceedings—in this case the imposition of an injunction prohibiting future employment—must bear some reasonable relationship to the defendant's wrongdoing.

There is one final reason why the comprehensive bar is undesirable. A defendant who is subject to the bar is likely to seek either a nontitled position in a public company<sup>240</sup> or a titled position in a nonpublic company, where, in either case, his continuing misconduct, if it occurs, will effectively escape the scrutiny of the SEC. If the goal of The Remedies Act is to facilitate the protection of investors, driving defendants underground would not seem to be the most effective approach.

### III. Administrative Removal, Suspension and Bar

New and greater legal and policy problems are presented where the locus of decision with respect to the suspension or disqualification of a corporate executive rests not with the court but is proposed to lie with the SEC itself. The Remedies Act authorizes the SEC to seek judicially-imposed corporation-specific removal and suspension orders and comprehensive suspension or bar orders applicable to all public companies. In addition, The Remedies Act would ratify past SEC usage (i.e., *GEICO*<sup>241</sup>) by expressly authorizing the SEC, in an in-house compliance proceeding, to “prohibit, conditionally or unconditionally, either permanently or for such period of time as it shall determine, any person found

238 In criminal cases, sentences which are “significantly disproportionate” to the crime committed violate the Eighth Amendment. *Solem v. Helm*, 463 U.S. 277, 303 (1983).

239 *E.g.*, *O'Reilly v. Board of Medical Examiners*, 66 Cal. 2d 381, 426 P.2d 167, 58 Cal. Rptr. 7 (1967) (court finds 90-day suspension of osteopath excessive on facts presented), *cert. denied*, 390 U.S. 944 (1968); *Richardson v. Florida State Bd. of Dentistry*, 326 So. 2d 231 (Fla. Dist. Ct. App. 1976) (“harsh penalty” not warranted by facts).

240 *See supra* note 133 and accompanying text.

241 *See supra* notes 159-60 and accompanying text.



to have failed to comply, or to have been a cause of the failure to comply [with registration or reporting requirements], from acting as an officer or director of any [public company]."<sup>242</sup>

The SEC currently has administrative enforcement powers under section 15(c)(4) of the Exchange Act<sup>243</sup> to compel compliance with various reporting and operational provisions of the Act.<sup>244</sup> Those powers were recently expanded to permit administrative actions to be brought not only against the primary (corporate) violator but also against "any person who was the cause of [a] failure to comply" with the securities laws.<sup>245</sup> In a compliance proceeding under this section, the SEC may issue an order requiring such a person to comply with the law "upon such terms and conditions and within such time as the Commission may specify in such order."<sup>246</sup> The SEC's General Counsel has argued that this language authorizes the SEC to impose its own removal and suspension orders, and even comprehensive bar orders, against corporate executives.<sup>247</sup>

Former Commissioner Treadway has taken the contrary position, arguing that absent the sort of express authority embodied in The Remedies Act, the SEC is not empowered to enter executive suspension or bar orders.<sup>248</sup> The SEC's authority as an administrative agency is not as broad as that of a court of equity. The scope of its orders do not extend as far as inherent equity powers would permit and must be limited by its statutory empowerment.<sup>249</sup> By seeking enactment of a statute along the lines of The Remedies Act, the SEC (if not its staff) seems to have acquiesced in the notion that it currently lacks the authority to comprehensively bar executives on its own.

Assuming that The Remedies Act resolves the authority issue, the question remains whether such authority in the hands of the SEC, as distinguished from the federal courts, is well-placed. A simple answer to this question is that it would be foolish to require the SEC in every instance where removal and suspension is appropriate, to undertake the costs and delay of litigation, especially where the resources available to it are so meager.<sup>250</sup> Moreover, consigning suspension and bar decisions to the Commission, rather than to diverse district courts, would facilitate uniformity and some predictability in the entry of disqualification orders.

There are, however, other issues to be considered. There is first the question of competence. Courts are accustomed, in both criminal (sentencing, bail and "likelihood of flight" determinations) and civil (injunc-

242 H.R. 975, 101st. Cong., 1st Sess. § 201(2) (1989).

243 15 U.S.C. § 78o(c)(4) (1988).

244 See generally, McLucas & Romanowich, *SEC Enforcement Proceedings Under Section 15(c)(4) of the Securities Exchange Act of 1934*, 41 BUS. LAW. 145 (1985).

245 *Id.* at 151.

246 15 U.S.C. 78o(c)(4) (1988).

247 See Note, *The Insider Trading Sanctions Act of 1984: Does the ITSA Authorize the SEC to Issue Administrative Bars?*, 42 WASH. & LEE L. REV. 993, 997 and n.17 (1985) (quoting a 1984 speech of the SEC General Counsel to the effect that the 1984 amendment to § 15(c)(4) created authority in the SEC to bar individuals from corporate offices and boards for violations of securities laws).

248 *Id.* at n.25.

249 SEC v. Chenery Corp., 332 U.S. 194, 207 (1947).

250 See *supra* note 146.



tion) contexts, to considering whether a particular individual is more likely than not to repeat a particular type of "bad act." By contrast, one might argue that the SEC lacks this perspective. However, the SEC for years has been making judgments about the risk of recidivism in disciplinary proceedings against the accountants and lawyers who practice before it<sup>251</sup> and has frequently considered the propriety of suspension or bar orders against broker/dealers,<sup>252</sup> investment advisers,<sup>253</sup> mutual fund managers<sup>254</sup> and (particularly applicable in the instant context) corporate executives of regulated companies.<sup>255</sup> Presumably the Commission would be no less capable of exercising such judgment when considering the risks associated with other professionals accused of misconduct.<sup>256</sup>

It is true that there has been substantial criticism of the Commission's exercise of its existing bar and suspension authority, focusing on basic due process issues, the inadequacy of standards by which the "sanction or no sanction" decision is made and, in the case of disciplinary proceedings, an alleged lack of underlying statutory authority.<sup>257</sup> But the

251 See *supra* notes 177-78 and accompanying text.

252 See *supra* note 174 and accompanying text.

253 See *supra* note 175 and accompanying text.

254 See *supra* note 176 and accompanying text.

255 E.g., *Dirks v. SEC*, 802 F.2d 1468 (D.C. Cir. 1986) (court upholds six-month suspension of brokerage firm principal under the SIPA); *Hinkle Northwest, Inc. v. SEC*, 641 F.2d 1304 (9th Cir. 1981) (officer/directors of broker/dealer firm suspended for 12, 12 and three months, respectively); *A. J. White & Co. v. SEC*, 556 F.2d 619 (1st Cir. 1977) (president of broker/dealer firm permanently barred from association with any such firm), *cert. denied*, 434 U.S. 969 (1977); *In re Langheinrich & Fender, Inc.*, SEC Exchange Act Rel. 20,959 (May 14, 1984) (respondents barred from acting as a principal, owner, officer or director of any broker or dealer, for 10 years); *In re J. Daniel Bell & Co.*, SEC Exchange Act Rel. 19,867 (June 13, 1983) (respondent suspended from any association with a broker/dealer for 6 months and barred from acting as a principal, officer, director or owner of a broker or dealer for 12 months); *In re Harold Junior Morris*, SEC Exchange Act Rel. 19,805 (May 23, 1983) (respondent barred from serving as principal, officer or director of a broker or dealer for 12 months); *In re William Lee Parks*, SEC Exchange Act Rel. 18,112 (Sept. 22, 1981) (respondent barred from acting as a principal, officer, director, owner or supervisory employee of a broker or dealer for two years); *In re Denise L. Stine*, SEC Exchange Act Rel. 16,864 (June 2, 1980) (respondent barred from acting as a principal, officer, director, owner or back office employee of a broker or dealer); *In re Paul Buchbaum*, SEC Exchange Act Rel. 16,622 [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,474 (March 4, 1980) (respondent barred for 18 months); *In re Richard J. Joseph*, SEC Exchange Act Rel. 11,020 (September 23, 1974) (respondent suspended from association with any broker/dealer, investment adviser, investment company or affiliate for 90 days, and barred thereafter from any such association as an officer, director or owner).

256 As former Commissioner Treadway has stated, "[i]f one governmental remedy is to get the bad people out [of broker/dealers and investment companies], then what's the basis for the distinction between those stockholders and stockholders of industrial companies. Are stockholders of industrial companies entitled to less protection?" *SEC Should Have Power to Bar Executives for Securities Violations supra* note 2, at 1487.

257 See generally R. KARMEL, *supra* note 187, at 176-78 (arguing lack of authority for Rule 2(e), at least insofar as it applies to lawyers); Lanzarone, *Professional Discipline: Unfairness and Inefficiency in the Administrative Process*, 51 *FORDHAM L. REV.* 818 (1983) (noting "unfairness" and "risk of prejudgment" in permitting same agency to determine that reasonable grounds for censure exist and also to decide whether censure is appropriate); Best, *Shortcomings of Administrative Agency Lawyer Discipline*, 31 *EMORY L.J.* 535 (1982) (arguing that the grounds upon which the SEC may suspend lawyers practicing before it are overbroad); Note, *Disciplinary Proceedings Against Accountants: The Need for a More Ascertainable Improper Professional Conduct Standard in the SEC's Rule 2(e)*, 53 *FORDHAM L. REV.* 351 (1984) (decrying vagueness of the standard upon which SEC suspends accountants). Recent constitutional challenges to the SEC's enforcement powers over professionals have been unsuccessful. E.g., *SEC v. Blinder, Robinson & Co.*, 855 F.2d 677 (10th Cir. 1988) (civil enforcement actions by SEC do not violate separation of powers principle), *cert. denied*, 109 S. Ct. 1172 (1989); *Blinder, Robinson & Co.*



fundamental competence of the SEC to consider suspension or bar orders does not provide a serious objection to The Remedies Act.

There is a far more serious question of regulatory overreaching. The Remedies Act would authorize the SEC to select certain corporate executives and, following notice and opportunity for hearing,<sup>258</sup> to prohibit them from ever again serving in any capacity as an officer or as a director of a public company. Theoretically, at least, regulatory agencies such as the SEC are permitted to *regulate* individual conduct; they are not permitted to *punish* individual misconduct. Punishment is reserved for the criminal justice system,<sup>259</sup> and even though Congress may designate a sanction a "civil penalty" or, as here, a "remedy," the statutory scheme may not be "so punitive either in purpose or effect as to" render it a "punishment" inappropriate outside of the context and special protections of a criminal trial.<sup>260</sup>

Under the traditional test distinguishing regulation from punishment, imposition of a comprehensive bar against executive employment in any public company may well be considered a punishment. That test considers:

Whether the sanction involves an affirmative disability or restraint; whether it has historically been regarded as a punishment; whether it comes into play only on a finding of *scienter*; whether its operation will promote the traditional aims of punishment — retribution and deterrence; whether the behavior to which it applies is already a crime; whether an alternative purpose to which it may rationally be connected is assignable for it; and whether it appears excessive in relation to the alternative purpose assigned. . . .<sup>261</sup>

The comprehensive bar is an affirmative disability prohibiting persons subject to it from seeking jobs for which they are otherwise qualified. Disqualification from employment has historically been regarded as a punishment (or more precisely an alternative form of sentence) in criminal proceedings. Following a conviction for fraud (or any offense not punishable by death or life imprisonment which would include all the penal provisions of the federal securities laws), a defendant may be granted probation subject to reasonable restraints on his conduct.<sup>262</sup> Courts have frequently conditioned the grant of probation on resignation from a particular corporate office or withdrawal from an entire line of work.<sup>263</sup>

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v. SEC, 837 F.2d 1099 (D.C. Cir. 1988) (same, plus SEC administrative compliance proceedings do not violate due process clause), *cert. denied*, 109 S. Ct. 177 (1988).

258 15 U.S.C. § 78o(b)(4) (1988).

259 Kennedy v. Mendoza-Martinez, 372 U.S. 144, 167 (1963).

260 U.S. v. Ward, 448 U.S. 242, 248-49 (1980). However "only the clearest proof [may] suffice to establish the unconstitutionality of a statute on such a ground." Flemming v. Nestor, 363 U.S. 603, 617 (1960).

261 Kennedy, 372 U.S. at 168-69.

262 FED. R. CRIM. P. 32(e); 18 U.S.C. § 3651 (1982 & Supp. 1987), *repealed by* Sentencing Reform Amendments Act of 1985. New guidelines for the grant of probation may be found in the Federal Sentencing Guidelines, § 5B1.3.

263 *E.g.*, United States v. Beros, 833 F.2d 455 (3d Cir. 1987) (probation conditioned upon defendant not holding any union office or seeking union employment upheld); United States v. Brockway, 769 F.2d 263 (5th Cir. 1985) (probation conditioned upon defendant not serving as a law



Like criminal penalties, imposition of a comprehensive bar promotes the “traditional aims of punishment—retribution and deterrence.”<sup>264</sup> Unlike most criminal provisions, those sections of the Exchange Act which may form the basis for an SEC-imposed comprehensive bar, sections 12, 13, 15(d) and 16(a), do not require a showing of *scienter*.<sup>265</sup> However, the behavior for which the bar is available is a crime if shown to have been undertaken willfully.<sup>266</sup>

The final criterion for determining whether a purported civil sanction is in fact a form of punishment is whether there is some purpose other than punishment to which it is rationally connected and if so, whether the sanction appears excessive for the stated purpose. The imposition of civil fines may be a rational means of defraying the costs of law enforcement.<sup>267</sup> Suspension of a governmentally-granted license where it has been shown that the licensee has violated clearly defined standards of conduct may be a rational means of ensuring public safety.<sup>268</sup> However, as we have noted, there are no clearly defined standards of conduct for corporate executives, nor is the SEC empowered to grant or withdraw executive “licenses.” Nonetheless, the suspension or bar from *some forms* of employment of unregulated corporate executives, no less so than in the case of the suspension or bar of regulated professionals, may be said to bear some rational relationship to “the public interest.”<sup>269</sup> However, the breadth of the sanction, including as it does a prohibition against seeking all manner of jobs quite unrelated to the con-

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enforcement officer upheld); *United States v. Alexander*, 743 F.2d 472 (7th Cir. 1984) (probation conditioned upon defendant not maintaining a proprietary interest in any scale business upheld); *United States v. Tonry*, 605 F.2d 144 (5th Cir. 1979) (probation conditioned upon defendant not running for political office upheld); *United States v. Villarín Gerena*, 553 F.2d 723 (1st Cir. 1977) (resignation from police force is proper condition of probation, notwithstanding that it will cause family hardship); *United States v. Kohlberg*, 472 F.2d 1189 (9th Cir. 1973) (probation conditioned upon defendant's termination of his interest in an illegal pornographic company upheld); *United States v. Barrasso*, 372 F.2d 136 (3d Cir. 1967) (per curiam) (probation may be conditioned upon defendant's promise not to seek or accept employment by any labor union); *Whaley v. United States*, 324 F.2d 356 (9th Cir. 1963) (probation may be conditioned upon defendant refraining from engaging in the repossession business), *cert. denied*, 376 U.S. 911 (1964). *But see* *United States v. Pastore*, 537 F.2d 675 (2d Cir. 1976) (court may not condition probation on defendant's resignation from the bar where state procedural rules govern disbarment).

264 It has been noted that virtually all civil penalties would satisfy this criterion. *E.g.*, *Roach v. Nat'l Transp. Safety Bd.*, 804 F.2d 1147, 1154-55 (10th Cir. 1986), *cert. denied*, 108 S. Ct. 1732 (1988).

265 *E.g.*, *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985) (good faith is not a defense to claims of noncompliance with section 12); *SEC v. Gulf & Western Industries, Inc.*, 502 F. Supp. 343, 348 (D.D.C. 1980) (defendants cannot assert as a defense in a case brought under section 13(a) that they relied on past governmental acquiescence to certain accounting practices).

266 *See supra* note 19 and accompanying text.

267 *Gardner v. City of Columbus*, 841 F.2d 1272 (6th Cir. 1988) (imposition of civil penalties for parking violations helps pay the costs of regulating on-street parking, so it is not to be treated as a criminal punishment).

268 *E.g.*, *Roach*, 804 F.2d at 1154 (NTSB's suspension of defendant's commercial pilot's certificate is rationally related to the public safety goals of the federal aviation regulations).

269 In the case of regulated professionals, revocation of their license to practice has been found not to constitute a punishment. *E.g.*, *Blaise D'Antoni & Assoc. v. SEC*, 289 F.2d 276, 277 (5th Cir. 1961) (revocation of broker's license is “not punitive”), *cert. denied*, 368 U.S. 899 (1961). *See also* *SEC v. Advance Growth Capital Corp.*, 470 F.2d 40, 54 (7th Cir. 1972) (“The purpose of injunctive relief is, after all, not to punish but to deter future violations. . .”).



cerns of the SEC,<sup>270</sup> is clearly excessive. Taken together, these elements suggest that the administrative suspension or bar, rather than representing acceptable regulation, is an unacceptable punishment and should be substantially reduced in its scope.

Even if the allocation of the suspension or bar power to the SEC does not rise to the level of unconstitutionality, there is still the policy question of whether such an allocation invites regulatory abuse. The General Counsel of the SEC has suggested that this power, if granted by Congress, would be used sparingly and "only in the most egregious cases,"<sup>271</sup> such as those involving recidivist offenders or those who boldly disregard the law.<sup>272</sup> "[T]his isn't a tool that anybody envisions using routinely. . .," Goelzer has said.<sup>273</sup>

However, the potential for abuse of the suspension or bar power is substantial. Administrative agencies, like prosecutorial offices, have wide prosecutorial discretion.<sup>274</sup> They are empowered to select among many potential defendants, all of whom may appear to be equally subject to sanction, and target only certain of those individuals for prosecution.<sup>275</sup> Only where that selection constitutes a "patent abuse of discretion," will it be reviewable and courts have construed the "patent abuse" standard to exclude most claims invoking it.<sup>276</sup> Presumably, these guidelines would apply equally to the decision to impose a statutory suspension or bar under The Remedies Act as to the initial decision to seek compliance under section 15(c)(4)(a).<sup>277</sup> Thus, the assurance of transient officials that bar and suspension orders will not become the regulatory norm rings quite hollow.<sup>278</sup>

In addition, there is no requirement in the statute (nor is one imposed by common law)<sup>279</sup> that the SEC articulate any standards by which it will determine when it is appropriate to impose a suspension or bar order.<sup>280</sup> Under traditional notions of injunctive relief, a court in an SEC-initiated injunction action would not enter a suspension or bar or-

270 See *supra* notes 200-01 and accompanying text.

271 Interview with Daniel Goelzer, 20 Sec. Reg. & L. Rep. (BNA) 1177 (July 22, 1988).

272 In his testimony before Congress, Chairman Ruder assured his listeners that "the Commission would expect to follow its current policy of employing this remedy only in cases involving repeated violations of the securities laws or involving egregious conduct as a corporate official." Statement of Chairman Ruder, *supra* note 1, at 28.

273 Interview, *supra* note 271, at 129.

274 See generally C. KOCH, ADMINISTRATIVE LAW AND PRACTICE 358-59 (1985).

275 *Moog Industries, Inc. v. FTC*, 355 U.S. 411, 413 (1958) (per curiam).

276 *Supra* note 274, at 362-66.

277 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981) ("The fashioning of an appropriate and reasonable remedy is for the Commission, not this court, and the Commission's choice of sanction may be overturned only if it is found 'unwarranted in law or . . . without justification in fact.'").

278 Cf. *R. KARMEL*, *supra* note 187, at 88-89 (although generally an independent agency, the SEC occasionally has targeted for investigation the "political enemies" of members of Congress).

279 *SEC v. Chenery Corp.*, 332 U.S. 194, 201-02 (1947) (SEC's order against corporate managers need not be preceded by adoption of any general rule or regulation).

280 It is understood that the SEC must provide substantial justification for any suspension or bar orders which it enters. *Steadman*, 603 F.2d at 1140 ("In our view . . . permanent exclusion from the industry is 'without justification in fact' unless the Commission specifically articulates compelling reasons for such a sanction.").



der absent some showing of likelihood of recurring misconduct.<sup>281</sup> No comparable limitation burdens the SEC in The Remedies Act.<sup>282</sup>

The statute itself conditions administrative suspension and bar orders only on a finding of noncompliance with certain registration and reporting requirements<sup>283</sup> and a finding that the suspension or bar is "in the public interest." (Comparable language appears in statutes authorizing the SEC to suspend or bar brokerage firm employees<sup>284</sup> and has been upheld as against vagueness challenges.<sup>285</sup>) However, there is no additional guidance for the Commission's use in distinguishing those wrongdoers subject to the bar or suspension power and those more properly subject to other, lesser sanctions. The only discussion of the types of conduct which would support an order "in the public interest" appears in that section of The Remedies Act having to do with monetary penalties,<sup>286</sup> and does not address the question of executive bar or suspension.

Given this absence of guidelines, how would the Commission decide, for example, whether to suspend or bar corporate executives who had repeatedly overstated their company's sales and earnings, and then, when corrective disclosure was imminent, sold their shares on inside information?<sup>287</sup> Or whether to suspend or bar corporate executives who created a partnership purporting to provide "executive search" services, which then charged the corporation (of which they were CEO and CFO respectively) \$410,000 without performing any services, failing to maintain satisfactory accounting controls within the corporation itself and having made numerous false disclosures to shareholders?<sup>288</sup>

The SEC has been given broad discretion in other contexts to decide which of many available sanctions is appropriate,<sup>289</sup> but presumably that

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281 See *supra* notes 116-20 and accompanying text.

282 Just as there appears to be no requirement that the SEC find some likelihood of continuing wrongdoing before entering its suspension or bar order, there is also no assured means of lifting the disability following the passage of time. We have previously discussed the problems presented when there is no realistic opportunity for a defendant to demonstrate redemption. See *supra* notes 207-09 and accompanying text.

283 H.R. 975, 101st Cong., 1st Sess. § 201 (1989).

284 The Securities Investor Protection Act provides that bar or suspension orders may only be entered where "the Commission shall determine such bar or suspension to be in the public interest." 15 U.S.C. § 78jjj(b)(1988). The SEC may bar or suspend registered brokers or dealers only where (1) there is a finding that the action is in the public interest and (2) the broker or dealer has acted "willfully." 15 U.S.C. § 78o(b)(4)(D) (1988).

285 Cf. *Blinder Robinson & Co. v. SEC*, 837 F.2d 1099, 1110-1111 and n.12 (D.C. Cir.), *cert. denied*, 109 S. Ct. 177 (1988).

286 H.R. 975, 101st Cong., 1st Sess. § 203(c) (1989).

287 These facts come from *SEC v. Gross*, 21 Sec. Reg. & L. Rep. (BNA) 674 (May 5, 1989) (defendant executives agree to a consent injunction which includes a disgorgement order, but are not suspended or barred from their positions).

288 These facts come from *SEC v. William A. MacKay and Muncie A. Russell*, SEC Lit Rel. 11,878 (D. D.C. 1988) (defendants settle litigation by agreeing to injunction prohibiting future violations of the federal securities laws — no one is suspended or barred).

289 E.g., *O'Leary v. SEC*, 424 F.2d 908 (D.C. Cir. 1970) (court upholds order barring securities salesmen from any association with a broker or dealer, even though their wrongdoing was a first offense); *Norris & Hirshberg v. SEC*, 177 F.2d 228 (D.C. Cir. 1949) (court upholds order revoking broker/dealer's license, even though conduct did not rise to level of common law fraud); *Hughes v. SEC*, 174 F.2d 969, 974 (D.C. Cir. 1949) (court upholds order revoking broker/dealer's license even though 120 out of 175 of defendant's clients filed *amicus* brief, asserting no dissatisfaction with her work and court asserts it would do so "even if one, or none, of the particular clients here involved



is because of the Commission's special expertise as it relates to the financial services industry and the fact that that industry is within the SEC's specific jurisdiction. The Commission has no such special expertise when it comes to the governance of businesses outside of the financial services industry, and—save for reporting and filing requirements—no jurisdiction over corporate executives.

Congress has never given the SEC—or any other governmental body—direct authority to determine the competency of corporate managers. If the SEC is now to be given that power and the power to permanently bar corporate executives from any managerial capacity in public companies, at the very least Congress should specify in plain language the circumstances in which such a draconian “remedy” may be applied. Better still, Congress should reject the idea of SEC competency testing for corporate executives and instead increase the Commission's budget so that it can more effectively enforce the laws already within its jurisdiction.<sup>290</sup>

#### IV. The Company Directors Disqualification Act of 1986

While the American experience with executive suspensions and bars has been, as noted, quite haphazard, depending for the most part as it has on implied powers to seek undefined judicial remedies and the jaw-boning activities of the SEC,<sup>291</sup> the British experience has been quite different and more sharply focused. Beginning with the Companies Act of 1928, British courts have been empowered to disqualify corporate executives with both corporation-specific orders and comprehensive bars.<sup>292</sup> At first, cause for disqualification was limited to personal bankruptcy and conviction for fraud. In 1976, the Companies Act was expanded to include, as grounds for disqualification, not only fraud, but also “persistent default in satisfying the reporting requirements of the Companies Acts, and . . . proven cases of improper, reckless, or incompetent management. In addition, powers were taken to disqualify a person who had been a director of companies which successively became insolvent.”<sup>293</sup> Moreover, under the Insolvency Act, directors could be disqualified for a minimum of two-years service where their conduct was found to render them “unfit to be concerned in the management of a company.”<sup>294</sup>

In 1986, the Companies Act was again amended by the Company Directors Disqualification Act of 1986. Under the new provisions, which consolidated in one place prior provisions of the Companies Act and related provisions of the Insolvency Act,

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ha[d] been misled or ha[d] suffered injury.”). See also *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979).

<sup>290</sup> See e.g., *SEC to Ask Congress for Legislation to Permit Creation of Advisers' SROs*, 21 Sec. Reg. & L. Rep. (BNA) 871 (June 16, 1989) (noting SEC's financial inability to continue to oversee activities of investment advisers; thus requiring it to seek authority to create a member-funded self-regulatory group).

<sup>291</sup> See *supra* notes 69, 158 and accompanying text.

<sup>292</sup> Leigh, *Disqualification Orders in Company and Insolvency Law*, 7 COMPANY LAW, No. 5, 179 (1986).

<sup>293</sup> *Id.* at 179.

<sup>294</sup> *Id.* at 180.



the court may disqualify on conviction for an indictable offence 'in connection with the promotion, formation, management or liquidation of a company.' It may disqualify if a person is persistently in default in filing returns with the registrar of companies. It may disqualify if in winding up it appears that a person is guilty of fraudulent trading or of any fraud or breach of duty in relation to the company.

The court is obliged to disqualify a person who is or has been a director of a company that has become insolvent, if it finds that his conduct as director makes him "unfit to be concerned in the management of a company." There are also powers to disqualify in the public interest where an inspector's report indicates that a person is "unfit to be concerned in the management of a company," and where a person has been declared liable to contribute because of participation in wrongful trading. Finally, an undischarged bankrupt commits an offense if he takes part in management. No disqualification order is required.<sup>295</sup>

A person disqualified under the Disqualification Act is prohibited from serving as a director, liquidator, administrator, receiver or manager of a company and also from taking part, directly or indirectly, in "the promotion, formation or management of a company."<sup>296</sup> This latter provision, characterized as "devastatingly broad,"<sup>297</sup> may preclude a person from serving not only as an officer or director of a company, but also as a junior administrator, an outside consultant or even as a voting shareholder.<sup>298</sup> Acting in a manner contrary to the disqualification order is a criminal offense.<sup>299</sup>

Disqualification orders have a maximum limit of fifteen years.<sup>300</sup> A disqualified person may, at any time during the life of the order, seek relief from the court to assume a specific corporate office or perform a specific task.<sup>301</sup>

Considerable ambiguity has arisen concerning the application of the Disqualification Act. There is no consensus, for example, on the standard of proof applicable to the issue of "unfitness,"<sup>302</sup> nor on the sorts of conduct which constitute "unfitness."<sup>303</sup> There appears, however, to be consensus on the propriety of disregarding the private model of corporate governance and granting instead sweeping judicial powers to interfere with management selection and retention. At least one commentator has noted:

[g]iven that disqualification orders have a prophylactic purpose, there seems little reason not to disqualify for long periods persons who are glaringly incompetent in the management of their companies. We

295 Hicks, *Making and Resisting Disqualification Orders*, 8 COMPANY LAW. No. 6, 243 (1987).

296 *Id.*

297 *Id.* at 244.

298 *Id.* at 245.

299 *Id.* at 243.

300 *Id.* at 245.

301 *Id.* at 246.

302 *E.g.*, Dine, *Disqualification Orders*, 9 COMPANY LAW. No. 4, 97, 98 (1988).

303 *Id.* at 98-100.



have long since abandoned the position that these are matters for the shareholders alone.<sup>304</sup>

It is interesting to note that even in a system which frankly adopts the proposition that the government has a regulatory interest in the quality of corporate management, disqualification can only be decreed by a court, after a full trial, whereas The Remedies Act proposes to give that power to the SEC without any meaningful standards (even so little as "incompetence" or "unfit[ness] to be concerned in the management of a company") with which to make a decision as intrusive as the comprehensive bar.

#### IV. The Better View of the Remedies Act

The Securities Law Enforcement Remedies Act of 1989 would more reasonably serve its intended goal of ridding the markets of persons inclined to disregard their fundamental disclosure obligations, if it focused on entity-by-entity enforcement, rather than a comprehensive reordering of the market for managerial labor.

A simple, but preferable alternative to the bill as written would provide as follows:

Section 20(b) of the Securities Act of 1933 (15 U.S.C. 77t(b)) [and subsection (d) of section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d))] is amended by inserting after the first sentence thereof the following:

In any proceeding under this paragraph, the court may prohibit, conditionally or unconditionally, singly or cumulatively, and for such period of time as it shall determine necessary up to a maximum of ten years, any person (1) who has previously been found guilty of a violation of [the securities laws] or who has previously been subject to an injunction prohibiting violation of any provision of [the securities laws] and (2) who is found in a separate and subsequent proceeding to have wilfully violated any provision of this title or any rule or regulation thereunder:

- (a) from continuing to serve in the job in which he served at the time of the violation, or in any functionally similar job;
- (b) from seeking rehire in the job in which he served at the time of the violation, or in any functionally similar job;
- (c) from continuing in the employment of his current employer in any capacity involving supervision over or substantial responsibility for the employer's financial accounting or preparation of reports for investors; or
- (d) from seeking employment with his current employer in any capacity involving supervision over or substantial responsibility for the employer's financial accounting or preparation of reports for investors.

Any person subject to an order prohibiting conduct under this section shall be entitled at any time following 180 days after entry of the order, to seek dissolution or modification of the order and the court shall grant such dissolution or modification if it finds that such an order would not be contrary to the purposes of [the securities laws].

304 Leigh, *supra* note 292, at 183.



## V. Conclusion

A cynic might suggest that what the SEC is seeking in The Remedies Act is to render the criminal justice system (or perhaps, more pointedly, the office of the Attorney General of the United States) irrelevant to the process of enforcing the securities laws, and to usurp for courts in *civil*, rather than criminal cases, and ultimately for itself, the power to compel a corporate executive to step down, or out of his or her profession.

While limited use of this power by a federal district court (in the context of a corporation-specific removal and suspension order of finite duration) may reflect sound public policy, unlimited exercise of the power (such as the entry of any comprehensive suspension or bar order) does not. Moreover, reallocating this power to the Securities and Exchange Commission and away from the courts would be unwise, and create an undue power in the Commission which historically has regulated the disclosure, but not the behavior, of corporate executives.

The Securities Law Enforcement Remedies Act of 1989 is properly intended to facilitate the enforcement of complex laws in a simple way. However, it is more simplistic than simple, and its passage would ultimately disserve its proponents at the SEC.