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A REGULATOR RESPONDS

by
Stanley Sporkin
Director of the Division of Enforcement
U.S. Securities and Exchange Commission
December 18, 1978



[Introductory note: Stanley Sporkin, Director of the Division of Enforcement of the Securities and Exchange Commission, joined the SEC in October 1961 as an attorney working on the Special Study of the Securities Markets. In March 1963, after completion of his assignments with that study, he was named to the Commission's then Division of Trading and Markets, where in December 1963 he was appointed Branch Chief, Branch of Enforcement; in July 1966, Chief Enforcement Attorney, Office of Enforcement; in January 1967, Assistant Director (Enforcement); in January 1968, Associate Director, and in 1974, Director.

Mr. Sporkin received a Special Achievement Award from the National Civil Service League in 1976; the SEC's Distinguished Service Award in 1971; and the Supervisory Excellence Award in 1969. In addition, he was named a winner of a 1978 Rockefeller Public Service Award, which is generally considered the most prestigious awards presented to citizens working in the public service. Five of these awards of \$10,000 each are given annually in several different categories. Mr. Sporkin was selected under the category of "administering justice and reducing crime"; he was the only Federal government employee selected for a 1978 award.

He received his B.A. degree in 1953 from Pennsylvania State University, where he was elected to Phi Beta Kappa. He earned his LL.B. degree from Yale Law School in 1957 and was admitted to the Pennsylvania and Delaware Bars in 1963. He is also a Certified Public Accountant, a member of the American Bar Association, Delaware Bar Association, Federal Bar Association, Phi Beta Kappa, Phi Kappa Phi, Phi Delta Phi, and the American Institute of CPAs.]

As we approach the ninth decade of the twentieth century, one can sense a definite climate or mood in the nation. A moment's reflection will confirm that we experience these moods or movements from time to time -- civil rights, ecology and environmental issues, consumerism, the women's rights movement. Yet, this one is quite unlike those of the sixties and early seventies.

Earlier moods generally expressed popular support for increased attention by the government to the rights of the underprivileged or interests which had been too long neglected. The current mood is different. In the current mood the government is perceived not as an instrument of the people, but their apparent adversary. The people have manifested their mood by resisting increased taxation and additional governmental regulation. They have turned their backs on the less fortunate of our society and opposed social welfare programs.

Various factors have been advanced as causes of this confrontation between citizen and government. The issues involved are complex and the solutions are hardly clear or easy. It has been suggested that a reduction in the size of government, significant curtailment of government expenditures and elimination of a number of regulatory controls would ameliorate the ill-feeling. But such actions are more easily

suggested than accomplished. I would also suggest that the effects of implementing such measures may well prove that the cure is worse than the disease.

I do not propose to address these issues directly tonight. I would, however, caution that we be on our guard not to permit opportunists, in the guise of supporting or furthering certain seemingly popular causes, to promote their own specific interests in derogation of those of the citizenry.

I believe that one of the causes of the present confrontation stems from the absence of a meaningful and constructive dialogue between citizen and government with respect to these issues. Most exchanges of this sort have taken place in connection with political contests. The rhetoric of the political forum, however, is generally not well-suited to the type of discussion I envision. A forum more conducive to objective appraisal is required. Also needed are government officials willing and able to participate in debate, prepared to explain their actions and to account to the public for their stewardship of the public trust. I submit that an important step in resolving the present conflict would be to open the channels of communication between citizen and government. I propose to stimulate that process tonight by setting forth and explaining certain information about the Enforcement program of the U.S. Securities and Exchange Commission. It is a program that I have been involved with for over 15 years -- the last five of which were under my direction, subject to the overall control of the five member Commission.

In establishing the proper setting for this discussion certain general observations are in order. Myths about the government and its officials abound. Usually their currency is heightened because there is some truth to at least part of the myth. One proverbial saying is that Government officials are overpaid, underworked and they preside over programs that are overstaffed and overfunded.

Whatever the merits of these perceptions in general, I can tell you that the SEC's Enforcement program does not operate with an over-abundance of resources. Indeed, the budget and staffing of the entire Commission has been extremely lean. The Commission's budget for fiscal 1979 is less than 64.7 million dollars. Some 2,125 staff positions are funded by this budget. About 5.5 million dollars and 660 staff positions have been allocated to the Commission's Enforcement program. Two hundred seven of these positions are stationed in Washington, the remaining positions are distributed among the Commission's nine regional and eight branch offices throughout the United States.

The dimensions of the Commission's enforcement task, I think all would agree, are enormous. The Commission oversees the disclosures and filings of thousands of entities. There are approximately 11,000 reporting corporations, 2,600 registered broker-dealers, 4,000 investment advisers, 1,470 investment companies, 13 Stock Exchanges and the National Association of Securities Dealers.

When we first observed the tremendous task before us, it seemed that it would be virtually impossible to effectively discharge our responsibilities with the available resources. Traditionally, when resources appear insufficient to the task, there are generally two ways of dealing with the problem. One, which is all too prevalent in our society, is that we can perform a limited or basic role commensurate with the resources available. This, of course, means that a good portion of the task at hand will not be done. The other response is to analyze carefully the programs needing priority attention and try to develop a strategy that will maximize the return for the resources available. I have always subscribed to the latter approach and, with respect to the Commission's enforcement program, set upon a course to effectuate it. This was not an easy task to accomplish.

The Market Access Strategy

To discharge our obligations we developed the so-called "market access strategy," which today is a main element of the Commission's enforcement program. This strategy is premised on the theory that a dishonest promotion, to be successful in the regulatory environment of the securities industry, must have access to the marketplace. Such access, in most instances, requires the active participation of the various industry professionals-brokers, accountants and, in some instances, lawyers. For example, a

stock promotion in order to reach the marketplace normally will require underwriters and brokers to package the offering and sell it to the public, an accountant to review the financial statements of the enterprise, and a lawyer to prepare certain of the offering documents and provide opinions on the legality of certain aspects of the offering. We concluded that if the various groups or entities who provide access to the market were encouraged to discharge their responsibilities with care and diligence, the Commission could thereby perform a large part of its market oversight function and, in turn, the risks that dishonest promotions would be offered to the unsuspecting public would be greatly diminished.

To effectuate its market access strategy, the Commission has made it abundantly clear by actions it has taken that it will hold these professionals in the securities industry responsible where they have not discharged their responsibilities in accordance with the law. The various professions have responded positively and created a new mechanism, unique to the consumer protection field; namely, the compliance official. Today virtually every major brokerage organization has a full-time compliance organization, employing a number of persons whose tasks are solely devoted to assuring that their employer complies strictly with the federal securities laws.

The benefits that such a system provides to the public are substantial. First, it places the cost for these protections directly on the persons involved. Second, these initiatives are specifically designed by the private sector and tailored to meet the needs of the particular firm and its clients, unencumbered by bureaucratic gloss and overlay. Notwithstanding that at times brokerage firms and their compliance departments have been slow to react to a changing consumer environment, particularly recently with respect to the sale of options, I am confident that the brokerage industry ultimately will respond affirmatively and take the necessary corrective measures to eliminate emerging abuses.

Although most widely employed by the brokerage community, the compliance concept is starting to take hold in other areas of the securities industry. Investment companies and large investment advisory services have also initiated compliance programs. Moreover, each of the major accounting firms in the United States has persons in the organization performing the functions of a compliance official.

With the compliance concept approaching its maturity, we have witnessed a reduction in the number of enforcement actions brought against brokerage firms. Largely because of the effectiveness of the compliance program, the Commission has been able to employ its limited enforcement resources in other important areas. For example, it has permitted the Commission to assume a larger role in its oversight of the filings of corporate issuers of securities.

I submit that, on the whole, the system functions well and that the compliance concept has tremendous potential in other areas of consumer needs.

The Consent Decree

Another of the important facets of the Commission's enforcement program has been the use of the so-called "consent decree," I would like to spend the balance of my time with you this evening discussing that subject.

Under the federal securities laws, Congress has given the Commission a broad range of remedies it may invoke when it believes that the laws it administers have been violated. The Commission may authorize its staff to bring a civil action seeking to have a federal court enjoin further violations of the federal securities laws. The Commission also has the authority to hold administrative hearings with respect to persons subject to its jurisdiction -- such as broker-dealers, investment advisers or affiliates of investment companies -- to determine if they have violated the securities laws; and if so, whether they should be allowed to continue in business, or what, if any, restrictions should be placed on their activities. The Commission is also empowered to consider what, if any, action should be taken with respect to commission filings that may be false or misleading. In addition, the Commission has the

authority to refer violations of the Acts it administers to the Department of Justice for criminal prosecution.

When a civil or administrative action is authorized by the Commission, the case is either litigated to conclusion before a Federal District Court Judge or an Administrative Law Judge, depending upon the forum in which the case is brought, or settled by agreement between the parties. Like other enforcement or prosecutorial agencies, the Commission is able to settle a large number of the cases it brings. In most instances this is because the Commission's staff has conducted a thorough investigation and can prove the pertinent facts necessary to establish that the federal securities laws have been violated.

The settlement, when it involves an injunctive action, usually takes the form of a consented-to decree entered by the U.S. District court providing for the relief sought by the Commission in its complaint. These decrees are commonly referred to as "consent decrees." While technically that term covers only decrees entered in U.S. District Courts, the term has also been used in connection with the settlement of administrative proceedings.

For reasons that are largely not articulated, there has been certain criticism of the Commission's use of consent decrees as a means of resolving cases in which enforcement action has been authorized. For example, a *Business Week* article several years ago, criticized the Commission for obtaining 22 consent decrees in the foreign bribery area without having litigated a single one of those cases. Let me quote from that article:

"Indeed, settlements still form the basis for the SEC's reputation. In the area of corporate bribes and payoffs, where ... the SEC have been winning laurels from the press lately, the agency has not litigated a single corporate case and thus not won a single conviction. All 22 companies sued by the SEC have settled."

I believe much of the criticism of the consent decree process is unfounded. By and large the consent decree provides the Commission with everything it seeks for the protection of the public and, indeed the relief it would be entitled to obtain by litigation.

The *Business Week* article also questioned that aspect of the consent decree process which permits a person to enter into a settlement without admitting or denying the allegations of the complaint or the administrative order for proceedings. Again I quote:

"It has not always been so. 'In the old days,' says Louis Loss, a Harvard Law professor and prominent authority on securities regulation who was with the SEC in the 1940s, 'we used to make [defendants] say 'uncle.' They had to admit their guilt normally. That's the way we did it."

Although I recognize the seeming allure of requiring that a settling party admit wrongdoing each time, I don't think that the Commission could justify either the manpower or the resources it takes or the utilization of precious court time to litigate every case just to meet that criticism.

I submit that the consent decree process has vindicated the rights of the public in a most direct, efficient and effective way. Where we find that a publicly held company is controlled by persons or entities who are defrauding the public or misusing corporate assets, we have attempted through the consent decree to correct the abuses while preserving the corporate form and maintaining the company's business. In various consent decrees, the Commission has consistently attempted to provide relief that is not only necessary to prevent the recurrence of the problem, but also, by utilizing the full equitable powers of the court and the administrative process, to assure that all necessary corrective action has been provided for and implemented.

Those persons who have been critical of the consent decree process should carefully examine the decrees to determine whether they have achieved the desired objective and not simply express some

knee-jerk reaction unfounded and completely unsubstantiated. I would welcome such a review perhaps by one of our preeminent law schools. I submit that this analysis would demonstrate that in many instances the settlements embodied in the consent decree more effectively benefitted the public's interest in a timely fashion than if the cases had been litigated to their conclusion. I think a few examples of what has been accomplished in certain of our cases will illustrate how effective these decrees have been.

In one case, the defendants were charged with selling investments in orange groves, using high pressure sales tactics, to many persons for whom such an investment was unsuitable. They allegedly used various false statements and even collected money for investments in groves that were never planted. Others purchased on the recommendation of their financial advisers apparently without knowing that the company was paying the advisers for making these recommendations.

As part of the consent decree, the Commission set up a mechanism designed to correct the harm done and prevent the possibility of a recurrence. The two principal individual defendants agreed to establish a fund of about five million dollars from which, based upon a report of certified public accountants, a court-appointed special counsel would compensate all those for whom the investment was determined to be unsuitable or who had made payments on groves that were never planted. In addition, the board of directors was restructured to include at least 40% independent directors and an audit committee was established.

In a case involving a number of stock exchange listed companies, the president and members of his family allegedly used \$1.7 million dollars in company funds for their personal purposes. The consent settlement provided for an immediate payment of \$600,000 and, among other things, the establishment of a special audit committee which, in conjunction with attorneys specially appointed for this purpose, reviewed company records. The committee subsequently determined that the defendants were to repay an additional \$1.1 million to the company. In addition, a number of changes were made in company policies and procedures with respect to the maintenance of records to be used to account for corporate assets.

In another case the alleged violations involved trading on inside information, a series of tender offers and false statements in Commission filings, all centering around the existence and non-disclosure of favorable reports relating to the worth of a company's coal reserves. The consent decree obtained by the Commission ordered that the insiders offer back to the company, at a reduced price, a number of shares sufficient to reduce the insiders' control to the level at which it stood prior to their alleged violations. The company's coal reserves were ultimately sold and public shareholders realized an additional \$7.5 million, or over \$6.50 per share more than they otherwise would have, as a result of the Commission's action.

Another unusual case involves an insurance company whose assets were allegedly stolen by certain members of management. As part of a settlement decree the Commission obtained the appointment of a receiver who, in conjunction with state regulators, was able to work out a comprehensive plan reorganizing the operations of the company. The company received an immediate \$1 million and a hearing procedure was established in which it was later determined that former management would have to pay back an additional \$3 million.

In an administrative proceeding we alleged that a mutual fund's prospectus had represented that the fund was being professionally managed when, in fact, the fund's investment adviser had allowed inexperienced and incompetent people to make significant decisions for the fund. These persons had committed \$21 million of fund assets to the purchase of speculative, unseasoned, thinly traded stocks, based upon the recommendations of one salesman. These persons were also charged with incurring high brokerage commissions which they could have eliminated by going directly to market makers.

The offer of settlement accepted by the Commission obligated the respondents to offer to the mutual funds they advised \$2.5 million in settlement of claims based upon the activities described in the order

for proceedings, and to employ a special compliance officer who would review the respondents procedures for managing mutual funds, prepare a report and comprehensive manual of procedures and monitor compliance with the procedures established. In addition, the respondents were to refrain from any new business for six months.

These are only a few examples from the hundreds of cases that the Commission becomes involved in each year.

The consent decree mechanism has enabled the Commission to fashion the relief obtained to the needs of the particular case. In other past cases the Commission has, at various times, made use of one or more of the following in the relief it has obtained through consent decrees:

1. Appointment of an equity receiver to marshal and distribute assets;
2. Restitution or disgorgement of gains from those who may have profited by their violation of the law;
3. Appointment of special officers to investigate and pursue claims against erring managements and others on behalf of the corporation and its shareholders.
4. Placing persons independent of management and not previously associated with the company on the board of directors;
5. Appointment of special review or audit committees;
6. Recision offers to those who were defrauded;
7. An accounting for monies improperly received;
8. Filing of additional disclosure documents with respect to financial information or securities transactions.

I don't want to create the impression that the Commission settles all of its cases. The Commission is now litigating certain cases and stands ready to litigate whenever the need arises. Like any party involved in complex civil litigation, most cases are settled. The test of how good the settlement is with respect to an SEC case, is how well it effectuates the public's objectives. By and large, the consent decree has enabled the SEC to put an immediate stop to countless numbers of unlawful activities, obtain implementation of necessary corrective measures and, over the years, enabled the investing public to recover hundreds of millions of dollars wrongfully taken from them.

Not only have we obtained impressive forms of relief by virtue of the consent decree in particular cases, but these decrees have also performed an important prophylactic function. Other persons have studied and analyzed various consent decrees that have been entered and taken corrective measures to prevent their activities from falling within the subject areas of various actions the Commission has taken. This is vividly demonstrated by the improper payments cases where, to date, over 600 firms have voluntarily disclosed the making of illicit foreign payments in order to, in large part, lessen the likelihood of Commission action against them.

I think it is most important to bear in mind that without voluntary compliance, whether it be in the area of securities regulation or in other endeavors, society could not function effectively. The Commission's success in obtaining voluntary compliance is a record it can justly be proud of.

It should be clear by now that the consent decree process has had impressive results. It is true that those charged with violations of the law have not been required to admit their wrongdoing, they are nevertheless subject to the court's contempt power not to engage in further illegal activity. In this

manner, Defendants are constrained to conduct their business in accordance with the federal securities laws, but without the expense or diversion of protracted legal proceedings. Nothing in the consent decree precludes the Commission from making its investigative files available to the Department of Justice, either of its own accord or upon request, to determine whether criminal proceedings should be brought. In addition, the filing of the Commission's complaint, may make share-holders and the public aware of information about the company which may previously have been withheld from them. Moreover, the consent decree does not preclude any shareholder from pursuing private lawsuits where the shareholder believes that the consent decree has not fully vindicated his or her rights.

Because the Commission is a government agency and does not engage in public relations campaigns to promote its own image, it's unfortunate that the public sometimes does not have the information necessary to understand fully the breadth of the Commission's activities. I hope that in my presentation this evening you have been able to obtain a broader perspective with respect to the enforcement activities of our agency. Although we are a relatively small agency, I think objective observers would agree that the Commission has compiled an impressive record in protecting public shareholder rights.

Many of the critics of government agencies state that after an agency has been in existence for a number of years it loses its vitality and should be dismantled. Sometimes there are accusations that the agency has become dominated by those it was intended to regulate. There has been little, if any, suggestion that this is the case with the S.E.C.

The S.E.C., which will shortly enter into its 45th year, has continued to be an active and a vital agency. It has not lost its ability to perform because it has not lost sight of its basic objectives and goals.

The SEC is an agency with a rich legacy. Its former staff members and Commissioners hold important leadership roles in both the business and legal communities. Its current staff continues to enjoy the same outstanding reputation today as it has in the past. Its present leadership is devoted to discharging the agency's responsibilities in the same manner as in the early years following Commission's creation. I am not trying to say that the Commission is deserving of great plaudits for carrying out its statutory' functions. I believe the public is entitled to expect and receive such performance from its public officials and institutions. If all governmental agencies discharged their obligations in such a fashion, the public's interest will have been properly served.

In closing, I would submit that the citizenry must accept the responsibility of evaluating the performance of its officials to assure that each agency is fulfilling the agency's objectives and meeting the citizens' needs. Although the citizenry sometimes finds its attempts to make government more responsive to its needs often frustrated, resorting to a Proposition 13 kind of remedy is not the answer. This form of solution is overly broad and does not perform the necessary selective function that is in the best interests of the public at large. It is only through careful analysis of government performance that the public can determine whether a particular agency of government has been performing in its best interest. If we broadly condemn all of government because certain of its parts may not be functioning properly, a great disservice will be done to those in need of the services of agencies that are carrying out their mission. The ultimate harm to the public is incalculable and could be irreversible. I would therefore urge, as I have suggested here this evening, that the process of reforming our government be painstakingly done by a careful analysis and evaluation of its various components.

QUESTIONS AND ANSWERS

Question:

Being statistically inclined, I'd like to ask you, Mr. Sporkin, in a given year, how many cases do you handle as far as consent decrees. In other words, how many consent decrees do you engage in, and how many cases are referred to the Justice Department for criminal prosecution, and of the number referred for criminal prosecution, how many are taken up by the Justice Department?

Answer:

Let me answer the first question. I would say that our consent decree, accounts for about 85% of our cases. This means that we litigate about 15%, possibly 20% of our cases. Referral to the Department of Justice, I think last year was about 55 cases out of a total of about 300 or 400 brought. How many are actually prosecuted? I would say that our rate is pretty high in that, 85 or 90%. It's fairly high, the rate that they'll take the case, because largely now the files are sent over at the request of the Department; so they have an interest right at the beginning, you see.

Question:

Mr. Sporkin, I understand that one of the things that you like about consent decrees is the degree of flexibility that it gives you and yet, on the other hand, what we get, at least reported second hand from the SEC, is pressure for uniformity, a great deal of it, particularly on accountants. I wonder if you would comment on that; and then later perhaps you'd comment on whether the golden age of the SEC wasn't when there were out-of-work brokers running the place.

Answer:

That's probably so. You know, I think we're mixing apples and oranges. In accounting you certainly need uniformity. In other words, the public is trying to evaluate the reports of a company and it can only do this if they have some sort of objective standard. In other words, if an investor wants to invest, has the choice of investing in two securities, he wants to be able to know that the bottom line of one can be compared with the bottom line of another company. Therefore he hopes that the way you get to the bottom line is through an application of consistent principles. Otherwise it would be impossible to make that kind of analysis. With respect to the flexibility in consent decrees, I look at an erring company as a doctor would look to a patient who is sick. There you can't say, "well, we'll give you the same dose of medicine we gave to Mr. A or Mr. B," if Mr. A or Mr. B didn't have the same malady. And really, that is what we're doing, in a number of these cases; you've really got to look at what has happened in the case. What was the cause of the problem? Was it because the company didn't have outside directors? Was it because the company was overreached, and therefore they need a compliance official? You know, you've got to look to see what the cause of the problem was; and then try to prescribe the medicine to take care of that problem. That's why it's got to be, pretty much, on a patient-by-patient or company-by--company basis.

Question:

Mr. Sporkin, I want to take up the question of flexibility and the uniformity in accounting treatment, and the thrust of the SEC is comparability between different corporations, particularly corporations within the same industry field. Yet it is a management decision, as to whether, for example, a corporation should borrow part of its capital or get its capital in the form of equity funds. It is a management decision, again, whether it should be labor or capital intensive, and doesn't that destroy the comparability of the bottom line?

Answer:

I'm sure there obviously are instances where the individual management decisions can certainly have an impact, but it seems to me, there's got to be an accommodation for that, somewhere along the line, perhaps through some form of disclosure to indicate exactly what the company is doing. There's nothing that the SEC does, as far as I know, that precludes a company from setting forth exactly what it's doing; that indicates it is engaged in a program of debt versus equity capital. I don't think there's anything which would preclude that, but I don't think you can have an accounting system in which each company can set forth its own accounting standards. That would be chaos, I don't think it could work, and I think you couldn't police a system such as that, actually.

Question:

Stan, I won't now enter into a debate with you with respect to the uniformity implications of accounting, but you'll find my views in the proceedings of, I believe it was the sixteenth Saxe Lecture, under the title, "Let Many Flowers Grow." Stan, you know, over the past fifteen years or so, how deeply I am

indebted to you for what it is you have done for our government and the securities industry. I testified under oath before the Moss Committee over two years ago, that the Securities and Exchange Commission is undoubtedly the very best agency that exists, especially in this particular context. Having said all of that, I nevertheless considered the concept of the consent decree to be something of a pejorative, because for me, all you're compelling the defendants to say is that "we won't commit the same kind of mayhem in the same way, the same place, with the same consenting party." Change any one of those variables and they can just go ahead and play the game in whatever way they might choose. In short, you're not doing anything more than getting them to say, "henceforth, they're going to comply with the law, which is something that I would expect someone to do even absent their name to a consent decree. Now you took specifics, and I applaud your specifics, but let me give you three cases that have me climbing the wall right now. They're of very recent vintage. You just got one involving Poultry Homes and my good friend Saul Steinberg. He was giving tips to his friends, including his secretary, who I assume knew how to type, to buy a particular stock. At the very same time that he was selling that stock in Poultry Homes he was a director. And who is it that signed up as counsel saying he reviewed this in accordance with form, an attorney who happens to be a principal member of the audit committee, independent audit committee of his complex of corporations. But more important, a person who is thus involved, and who in *Feit versus Leasco*, was described for the shenanigans in prospectuses, nevertheless sits to manage over a billion dollars of other people's monies in an insurance company. Now Bert Lance and William Miner were not permitted to do that until they exposed their credentials in public, and Bert Lance was not able to do it thereafter. Why should an individual who manifests this character quirk be permitted to sit in this position of power, and then for the attorney, the same one that signed up, the one on the audit committee, said, "well, we had to avoid the expense of litigation; we're not admitting anything." I'll take a second case, Sharon Steel. After describing the ways in which they spelled steel, s-t-e-e-l, nevertheless, the same group of management sits in control. Yes, you did insist upon an audit committee, and I congratulate you on that. But most importantly, or most recently I should say, not most importantly, in the middle of October you got a consent decree from L.T.V., and Jones & Loughlin. They were playing games with LIFO, shenanigans. They had a whole game plan. They had a committee to play the game very meticulously, chapter and verse. They had all the positions in place, and yet you got them to sign a consent decree including, not only the corporation, but a James Paulos, a certified public accountant, the chief financial executive. They signed a consent decree saying that they'll behave, and then that same corporation that engaged in those shenanigans, the SEC permitted to go ahead and acquire yet another corporation, Lykes and their steel company, Youngstown Steel. And who is it that was the signatory to the SL for the takeover, the same James Paulos. What I am saying is, Stan, there's only one way in which you are going to make this effective. Clip the wings of power of those who have perpetrated this evil. That's the only way in which they're going to pay the price. Forget criminal aspects, forget about putting them in jail, that's not the answer. We don't have enough jails for the white collar criminals. Clip their power. Yes, and I mean that literally, you've got those six hundred corporations, each one confessed to criminality; at least those six hundred, and I don't know how many persons were involved. Take away their power, this is what it is that they want, it's the size of the tent. The consent decree does nothing more; well I take that back because it does give me a frame of reference for writing. It does little more than give to the defendant the opportunity of a press release saying, and I believe this is exactly what Peat Marwick said in 173, "you can't keep fighting mother all the time; so we went ahead, yes there was Penn Central, there was National Student Marketing, Tally Industries, Republic National, Stirling Homex, none of those, mind you, we didn't admit that we did anything wrong, but you can't keep fighting mother all the time." And then, after the consent decree, mind you, as Judge Pool pointed out in that accounting firm, after the consent decree, went along with the game plan of Sharon's LIFO. Clip the wings of power!

Answer:

How do you get Abe to Washington to pass the laws that we need? Now I think, Abe, what you're saying, and I might agree with some of it, but I think you've got to understand that it's not the consent decree that you're arguing with because if you read our statute, all it says is that the Commission may bring a case where somebody has violated the law to obtain an injunction against future violations. That's what the act says, and it's not because people do it by consenting, because even if we litigated the

entire case, and spent years at litigation, we would still come up with the same bottom line and I think that, to me, is very important. Sure, you give me a new law that says we can disqualify these people from continuing on as executives of insurance companies; you give me a law that says that, and we will enforce that law, but we do not have the authority to do that. So we try to do it as best we can, as hard as we can, attempting to give some semblance of protection; and indeed as you mentioned, the one very important aspect of these cases is the fact that we lay it out. You could not be here criticizing me today without the facts that we give you to criticize us. Now, compare that with other government agencies, that do nothing, I mean never bring any case. I don't see Abe, and I say this in a very nice way, since Abe is a good friend of mine, I don't see Abe coming up here and saying "Hey, FTC or hey, FPC, or hey FCC, why aren't you doing A or why aren't you doing B," because the reason you can't do it is not enough actions have been taken. Sure, we can be criticized, and we should be criticized but the fact remains that each and every one of you knows exactly what we found in these cases, knows the facts that we found, and hopefully that will be a deterrent in the future, because you only get so many bites at the apple. Hopefully the second time around, or the third time around, we can do something more. But we're dealing with an authority which is quite limited Abe and I think you appreciate that we've gone as far as we can with that authority.

Question:

Mr. Sporkin, audit committees have figured in many of the consent decrees that you have obtained, and my questions concern steps which might be taken to enhance the audit committee's potential for improving corporate governance. The first step is obviously linked with the overall effort to improve the quality of non-management directors. You have suggested there should be schools for directors, but rather than having profit-making schools for directors, provide guidance and thereby creating perhaps another oversight area for the SEC, couldn't the SEC take some direct action? Specifically, I have three questions regarding such action. (1) Is the SEC considering a safe harbor rule for outside directors, not so safe as to excuse negligence, but enough to allay some fears of liability exposure and increase peoples' willingness to serve as directors and accept audit committee assignments? (2) Is the SEC considering the promulgation of minimum standards for audit committees? (3) I understand the SEC and IIA are currently trying to develop guidelines for the relationship between the audit committee and the internal audit department, and for the status of the internal audit department within the corporate organizational structures. What is the SEC's time frame for issuing such guidelines, and can you tell us something about what is being considered?

Answer:

As you know, we've done quite a bit on the audit committees, indeed we originally suggested to the New York Stock Exchange that they impose such a requirement, thinking there being that the New York Stock Exchange has the largest companies and therefore the costs would not be that much of an important factor. As with respect to the safe harbor rule for directors, the answer is, as far as I know, no, and I probably would be against it, quite frankly, because, I don't know what you mean by a safe harbor rule, that audit directors should have less of a responsibility than somebody else? We sometimes in our cases have limited what a director can be held responsible for, for example, our ICC case. There we had a situation where we had just gotten rid of Vesco, and appointed a court appointed board, and we thought it would be appropriate in that case to set forth certain standards for which the directors would be held accountable. This was because the board was directly under the control of the court itself, but as a general proposition, I don't think I would probably be in favor of that. With respect to minimum standards for audit committees, as you know, the Commission has had difficulty in establishing guidelines in a number of areas. I think that this will evolve, but I don't think its going to be by a Commission pronouncement as such. It will evolve by imposition in a number of cases; it will evolve because of certain voluntary actions that will be taken by various companies, it will evolve by certain actions taken by perhaps certain of the self-regulatory bodies, like the New York Stock Exchange. With respect to the audit committee and the internal auditor, it's awfully important that there be access between the two. The internal audit programs in the various companies that I have seen have been woefully deficient. You know, how could you have had the kind of findings that have come out in the past three or four years if you had an internal audit program that was actively working. I think that the

internal auditors probably have been more lax than in any other part of the surveillance mechanism. In other words, I think that they're probably more culpable than the outside auditory, probably even more so than some of the outside directors. I think there's got to be a total reshaping of the internal audit concept, and one part of it has to be responsibility of the internal audit function to report to the audit committee. I have come up with a proposal that I think is extremely important in this area. It's called the Business Practices Officer, the BPO. This Business Practices Officer would be a person who is on a par with the chief executive officer of a company. He would be a person who would report directly to the audit committee. He would be a person who would operate by virtue of an ironclad contract that would insure his independence. He would be a person that would be not unlike the inspector general in some of our government agencies. To me, that is a first step that is absolutely essential. The internal audit function will be strengthened by having a good BPO operating, who could then be in a position to have, working for him, and have perform under him, some of the functions of internal audit. There are some functions of internal audit that have nothing to do with what we're talking about, such as, a determination of whether the price, the quality control, things of that nature are proper. But with respect to wrongdoing, that should all be funneled through the BPO who would bypass the chief executive officer, who in a number of instances has himself been responsible for the misconduct. How can you expect an internal auditor who is on his way through an organization, who reports to the controller, to be able to turn that controller in? That's really where the problem is in the internal audit process and it gives me concern.

