NONACQUIESCENCE BY THE SECURITIES AND EXCHANGE COMMISSION: ITS RELEVANCE TO THE NONACQUIESCENCE DEBATE

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INTRODUCTION

The twentieth century has witnessed the creation in the United States of large and powerful federal administrative agencies that perform both adjudicative and interpretive functions under the control and direction of the Executive. The growth of these agencies has led to a corresponding increase in conflicts between judicial and administrative interpretations of federal law. These conflicts have resulted in numerous, and at times bitter, clashes between the judiciary and the various agencies. One tactic taken by the agencies, as part of their effort to restrict the power of federal courts to shape federal law, and thereby restrict or direct administrative activities, is to refuse to follow precedents set by various circuit courts of appeals. This action is referred to as nonacquiescence.

Administrative agency nonacquiescence is defined in its broadest sense as "an administrative agency's refusal to follow judicial precedent when the agency handles cases that involve similar issues."¹ Nonacquiescence is divided into two categories: inter-circuit or intracircuit. Intercircuit nonacquiescence is the refusal of an agency to follow the ruling of a circuit court of appeals in cases arising in a different circuit. This type of nonacquiescence is a generally accepted and noncontroversial form of agency behavior that is typically pursued for the purpose of producing circuit conflicts and eventual Supreme Court review.

This Comment is concerned primarily with intracircuit nonacquiescence, the refusal of an agency to follow the precedent of a circuit court of appeals in subsequent cases arising in the same circuit. Intracircuit nonacquiescence is a very controversial practice, which has spurred a sharp debate in recent years.² Nonacquies-

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¹ Deborah Maranville, *Nonacquiescence: Outlaw Agencies, Imperial Courts and the Perils Of Pluralism*, 39 VAND. L. REV. 471, 475 (1986) (footnote omitted).

² See Matthew Diller & Nancy Morawetz, *Intracircuit Nonacquiescence and the*

cence is classified as either formal or informal. Formal nonacquiescence is exemplified by "an explicit public statement that the agency intends to disregard a particular judicial decision."³ Informal nonacquiescence is exemplified by agency disregard of judicial precedents or attempts to identify factual distinctions while giving the appearance of compliance with precedent.⁴ This Comment will demonstrate that formal and informal nonacquiescence is practiced by the Securities and Exchange Commission (SEC or Commission) and will explore its implications for the nonacquiescence debate.

As Professor Deborah Maranville noted in her leading article on the subject, agency nonacquiescence is not a new phenomenon and has been practiced regularly by the Internal Revenue Service (IRS) and the National Labor Relations Board (NLRB) for decades.⁵ Prior to the 1980s, these two agencies were the focus of most if not all of the attention directed at the issue of nonacquiescence.⁶ In recent years, however, the controversial nonacquiescence policy of the Social Security Administration (SSA) has come to dominate the debate.⁷

This Comment seeks to expand the boundaries of the study of nonacquiescence by focusing on the SEC, an agency commonly ignored in nonacquiescence scholarship. As the controversy surrounding intracircuit nonacquiescence continues, it is important

Breakdown of the Rule of Law: A Response to Estreicher and Revesz, 99 YALE L.J. 801 (1990); Samuel Estreicher & Richard L. Revesz, *The Uneasy Case Against Intracircuit Nonacquiescence: A Reply*, 99 YALE L.J. 831 (1990) [hereinafter Estreicher & Revesz, *The Uneasy Case*]; Samuel Estreicher & Richard L. Revesz, *Nonacquiescence by Federal Administrative Agencies*, 98 YALE L.J. 679 (1989) [hereinafter Estreicher & Revesz, *Nonacquiescence*]; Austin J. Murphy, *When the Government Ignores the Law*, JUDGE'S J., Summer 1990, at 2.

³ Maranville, *supra* note 1, at 476-77.

⁴ See *id.* at 480.

⁵ See *id.* at 473.

⁶ See Lynn P. Mattson, *The United States Circuit Courts and the NLRB: 'Stare Decisis' Only Applies if the Agency Wins*, 53 OKLA. B.J. 2561 (1982); Gary L. Rodgers, *The Commissioner "Does Not Acquiesce,"* 59 NEB. L. REV. 1001 (1980); Don A. Zimmerman & David Dunn, *Relations Between the NLRB and the Courts of Appeals: A Tale of Acrimony and Accommodation*, 8 EMP. REL. L.J. 4 (1982); Comment, *The Commissioner's Nonacquiescence*, 40 S. CAL. L. REV. 550 (1967); Edward F. Zwick, Comment, *Treasury Department's Practice of Non-acquiescence to Court Decisions*, 28 ALB. L. REV. 274 (1964).

⁷ See Gerald W. Heaney, *Why the High Rate of Reversals in Social Security Disability Cases?*, 7 HAMLINE L. REV. 1 (1984); James R. Williams, *The Social Security Administration's Policy of Nonacquiescence*, 12 N. KY. L. REV. 253 (1985); Ann Ruben, Note, *Social Security Administration in Crisis: Nonacquiescence and Social Insecurity*, 52 BROOK. L. REV. 89 (1986); Christopher C. Taintor, Note, *Federal Agency Nonacquiescence: Defining and Enforcing Constitutional Limitations on Bad Faith Agency Adjudication*, 38 ME. L. REV. 185 (1986).

that any discussion of policy include the effects of nonacquiescence on a variety of governmental agencies. The following analysis shows that SEC nonacquiescence diverges markedly from the behavior of the three agencies traditionally studied. The Comment concludes that generalizations concerning nonacquiescence by all federal agencies are unjustified. The approaches and prescriptions of recent scholarship based on such generalizations concerning nonacquiescence are therefore flawed.

I. CURRENT APPROACHES TO NONACQUIESCENCE

A. *The Social Security Administration's Nonacquiescence Campaign*

The current debate surrounding agency intracircuit nonacquiescence is profoundly influenced by memories of the SSA's stubborn nonacquiescence during the 1980s. The SSA revoked the social security disability benefits of hundreds of thousands of individuals through the use of a judicially-rejected interpretation of the Social Security Act and the standard of proof it imposes upon individuals attempting to retain their benefits.⁸ The history of SSA policy illustrates why intracircuit nonacquiescence is so controversial.

In 1980, Congress authorized a program of continuing disability investigations (CDIs) to combat cheating by recipients.⁹ When the Reagan administration came to office, the SSA vigorously conducted CDI investigations, resulting in the termination of benefits of almost 500,000 people.¹⁰ The SSA placed the burden of proof upon disability beneficiaries, who had to show in review hearings that they were still disabled to avoid termination of their benefits.¹¹ The SSA continued this policy despite repeated rulings by various federal courts of appeals that the Social Security Act required the agency to show that the recipient's medical condition had improved before terminating benefits.¹² Vast numbers of SSA orders

⁸ See Ruben, *supra* note 7, at 91.

⁹ See *id.* at 95.

¹⁰ See *id.* at 89.

¹¹ See *id.* at 99-100.

¹² See *De Leon v. Secretary of Health and Human Servs.*, 734 F.2d 930 (2d Cir. 1984); *Buckley v. Heckler*, 739 F.2d 1047 (5th Cir. 1984); *Harmon v. Secretary of Health and Human Servs.*, 749 F.2d 357 (6th Cir. 1984); *Rush v. Secretary of Health and Human Servs.*, 738 F.2d 909 (8th Cir. 1984); *Byron v. Heckler*, 742 F.2d 1232 (10th Cir. 1984); *Dotson v. Schweiker*, 719 F.2d 80 (4th Cir. 1983); *Kuzmin v. Schweiker*, 714 F.2d 1233 (3d Cir. 1983); *Patti v. Schweiker*, 669 F.2d 582 (9th Cir. 1982); *Simpson v. Schweiker*, 691 F.2d 966 (11th Cir. 1982); *Cassiday v. Schweiker*,

denying benefits were never appealed by the mostly poor, physically and mentally ill, uneducated, and uncounseled beneficiaries, despite the high likelihood that their appeals would have been successful.¹³ Most of these individuals lacked the resources to pursue litigation. Even if they had sufficient resources, relief would have been years away, due to the sudden flood of social security claims upon already crowded court dockets.¹⁴

To avoid adverse Supreme Court precedents, the SSA did not seek certiorari in the cases in which it was defeated. Thus, vigorous and defiant nonacquiescence enabled the SSA to maintain its policy of denying claims even in the face of repeated court defeats. The SSA nonacquiescence policy provoked bitter criticism from all quarters: Congress, the press, state governments,¹⁵ and the bench. One judge compared SSA nonacquiescence with the "repudiated pre-Civil War doctrine of nullification."¹⁶

In the end, extreme judicial measures were brought to bear against the SSA nonacquiescence policy. In the case of *Lopez v. Heckler*,¹⁷ a class action was filed joining all Ninth Circuit SSA claimants. The class of plaintiffs sought to enjoin continued SSA nonacquiescence to Ninth Circuit precedent as a denial of due process and a violation of the separation of powers doctrine.¹⁸ The district court issued a preliminary injunction forbidding the SSA from ignoring Ninth Circuit precedent.¹⁹ Although the Ninth Circuit affirmed the preliminary injunction, the Supreme Court eventually vacated it because of congressional amendments to the Social Security Act.²⁰

663 F.2d 745 (7th Cir. 1981).

¹³ See Ruben, *supra* note 7, at 101 n.57 (noting that close to half of the people who had their benefits terminated successfully appealed (citing 130 CONG. REC. S11,464 (daily ed. Sept. 19, 1984) (statement of Sen. Heinz))).

¹⁴ See *id.* at 90 n.4 (stating that 50,000 SSA appeals were pending in federal court at one time (citing 130 CONG. REC. S11,460 (daily ed. Sept. 19, 1984) (statement of Sen. Sasser))).

¹⁵ See *id.* at 100-01 nn.56-57.

¹⁶ *Lopez v. Heckler*, 713 F.2d 1432, 1441 (9th Cir. 1983) (Pregerson, J., concurring).

¹⁷ 572 F. Supp. 26 (C.D. Cal.), *stay den.*, 713 F.2d 1432 (9th Cir.), *stay granted*, 463 U.S. 1328 (1983), *vacated*, 469 U.S. 1082 (1984).

¹⁸ See *id.* at 28.

¹⁹ See *id.* at 30.

²⁰ See *Heckler v. Lopez*, 469 U.S. 1082 (1984); see also Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 701.

In *Stieberger v. Heckler*²¹, and *Schisler v. Heckler*²² a district court and a circuit court panel, both within the Second Circuit, enjoined the SSA from continuing to nonacquiesce in that Circuit. The district court in *Stieberger* held that SSA nonacquiescence "was inconsistent with the constitutionally required separation of powers."²³ The injunction in *Schisler* merely required the SSA to publish in its relevant publications its acquiescence to the Second Circuit ruling for the purpose of informing its employees that they were required to follow this decision.²⁴ The court limited injunctive relief to this publication order.

The judicial measures taken by the Ninth and Second Circuits, combined with public outrage and congressional action,²⁵ finally curbed the SSA nonacquiescence. The present debate takes place in the shadow of SSA nonacquiescence and the hardship it imposed upon hundreds of thousands of impoverished Americans who lacked the resources to vindicate their legal rights.²⁶ This Comment seeks to expand the debate over nonacquiescence by exploring its implications upon other agencies whose purposes and tactics may be much different than the SSA's.

B. *The Current Debate*

In her article, Professor Maranville provides a general description of the various forms of nonacquiescence. Maranville identifies four doctrines by which courts and commentators have sought to limit agency nonacquiescence: stare decisis, issue preclusion or collateral estoppel, due process, and separation of powers.²⁷ Criticizing each doctrinal approach, Maranville finds that none provides a satisfactory rationale for limiting or barring agency nonacquiescence, whether intercircuit or intracircuit.²⁸ She

²¹ 615 F. Supp. 1315 (S.D.N.Y. 1985), *vacated sub nom.* *Stieberger v. Bowen*, 801 F.2d 29 (2d Cir. 1986).

²² 787 F.2d 76 (2d Cir. 1986).

²³ *Stieberger*, 615 F. Supp. at 1367.

²⁴ *See Schisler*, 787 F.2d at 84.

²⁵ *See* Social Security Disability Benefits Reform Act of 1984, Pub. L. No. 98-460, 98 Stat. 1794 (1984) (codified at 42 U.S.C. § 423(f) (1988)) (codifying the requirement that the administration prove medical improvement before revoking benefits).

²⁶ *Cf.* Note, *Collateral Estoppel and Nonacquiescence: Precluding Government Relitigation in Pursuit of Litigant Equality*, 99 HARV. L. REV. 847 (1986) (stating that agencies have obtained a procedural advantage by being able to pursue a strategy of nonacquiescence).

²⁷ *See* Maranville, *supra* note 1, at 499.

²⁸ *See id.* at 499-527.

concludes that because a doctrinal resolution is not possible, a determination of the proper limits of agency nonacquiescence depends upon a prior value judgement:

The question whether nonacquiescence is legitimate or desirable can be resolved at a theoretical level only by reference to a prior choice between conflicting values. The decisionmaker must choose between the perspective of the agency and that of the courts, between rule of law values and bureaucratic values. . . . [V]alue conflict pervades administrative law [I]t is unlikely to be resolved generally or permanently in the context of nonacquiescence.²⁹

Other commentators take issue with Maranville's skepticism about the existence of a principled basis for defining the legitimate extent of agency nonacquiescence. In their recent article, *Nonacquiescence by Federal Administrative Agencies*,³⁰ Samuel Estreicher and Richard L. Revesz expressly reject Maranville's conclusion, stating that "rather than an open-ended choice between conflicting values, the proper treatment of nonacquiescence flows, we believe, from an understanding of the respective functions of agencies and courts in our administrative lawmaking system."³¹ Focusing on the SSA and NLRB, the authors describe nonacquiescence in essentially the same terms as Maranville. After presenting their rejection of constitutional challenges to nonacquiescence,³² Estreicher and Revesz then present an analysis of the costs and benefits of nonacquiescence. They conclude that intercircuit nonacquiescence and nonacquiescence in cases in which the agency does not know which circuit will be reviewing its decision³³ are essential to the proper functioning of the agencies and judiciary, and therefore should not be limited. This conclusion is not controversial.

Turning to the more controversial issue of intracircuit agency nonacquiescence, Estreicher and Revesz adopt a strong stance in favor of allowing agencies to nonacquiesce under given circumstances. They conclude that intracircuit nonacquiescence is justified and should be allowed "when it is employed as an interim measure that allows the agency to maintain a uniform administration of its

²⁹ *Id.* at 528-29.

³⁰ Estreicher & Revesz, *Nonacquiescence*, *supra* note 2.

³¹ *Id.* at 682 n.14.

³² *See id.* at 718-35.

³³ These cases are referred to as "nonacquiescence in the face of venue choice." *Id.* at 683.

governing statute while it makes reasonable attempts to persuade the courts to validate its preferred policy."³⁴ To give substance to this standard, Estreicher and Revesz propose that agency nonacquiescence be allowed if a three part test can be satisfied. The test requires (1) "that the agency have national policymaking authority over the point in dispute,"³⁵ (2) that the agency have "a 'justifiable basis' for [the] belief that the agency's position falls within its policymaking discretion,"³⁶ and (3) "that the agency be reasonably seeking to vindicate its position in the courts of appeals and before the Supreme Court."³⁷ Estreicher and Revesz believe that if this test is satisfied agency intracircuit nonacquiescence is justified. They propose that justified agency nonacquiescence be protected from the types of judicial remedies employed against the SSA in *Lopez v Heckler*,³⁸ *Stieberger v. Heckler*,³⁹ and related litigation.⁴⁰

As justification for their proposal, Estreicher and Revesz offer an analysis of the costs and benefits associated with intracircuit nonacquiescence. They argue that intracircuit nonacquiescence is beneficial because it allows a circuit court to benefit from and participate in ongoing intercourt dialogue by reconsidering its previous disposition of an issue.⁴¹ Estreicher and Revesz also argue that intracircuit nonacquiescence helps agencies avoid the need for different administration of the law in different circuits,⁴² and thus advances the goal of achieving uniform outcomes in enforcement proceedings⁴³ brought by agencies throughout the country.⁴⁴ According to Estreicher and Revesz, the primary costs of intracircuit nonacquiescence are the undesirable distributional effects, as poor plaintiffs are unable to vindicate their rights due to lack of resources for litigation.⁴⁵ The authors also note that

³⁴ *Id.* at 753.

³⁵ *Id.* at 754.

³⁶ *Id.*

³⁷ *Id.* at 755.

³⁸ 572 F. Supp. 26 (C.D. Cal.), *stay den.*, 713 F.2d 1432 (9th Cir.), *stay granted*, 463 U.S. 1328 (1983), *vacated*, 469 U.S. 1082 (1984).

³⁹ 615 F. Supp. 1315 (S.D.N.Y. 1985), *vacated sub nom. Stieberger v. Bowen*, 801 F.2d 29 (2d Cir. 1986).

⁴⁰ See *supra* notes 12 & 17-24 and accompanying text.

⁴¹ See Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 743-47.

⁴² See *id.* at 748-49.

⁴³ These same arguments also apply to the goal of equal benefit distribution in different circuits.

⁴⁴ See Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 747.

⁴⁵ See *id.* at 749-50.

relitigation leads to an increased workload for federal courts.⁴⁶

The position taken by Estreicher and Revesz has been sharply criticized. Matthew Diller and Nancy Morawetz, two veterans of the SSA nonacquiescence litigation,⁴⁷ reject the Estreicher and Revesz analysis as grossly understating the costs and greatly overstating the benefits of intracircuit nonacquiescence.⁴⁸ Diller and Morawetz claim that intracircuit nonacquiescence makes little or no contribution to intercourt dialogue because "circuit court rules [are] designed to achieve stability of precedent,"⁴⁹ and "these rules require panels to follow prior panels within their circuits."⁵⁰ As a result, they conclude that most intercourt dialogue results from conflicting decisions in different circuits, not from the same circuit. Diller and Morawetz also dispute Estreicher and Revesz's claim that intracircuit nonacquiescence increases uniformity of treatment of claimants and uniformity of administration.⁵¹ Diller and Morawetz point out that intracircuit nonacquiescence actually exacerbates these two problems by creating disuniformity between the way wealthy and poor litigants are treated.⁵² The crux of Diller and Morawetz's critique is that Estreicher and Revesz ignore the devastating consequences that intracircuit nonacquiescence has upon individual claimants or litigants who are denied the benefits of judicial standards.⁵³

Diller and Morawetz also attack the proposals of Estreicher and Revesz on the grounds that they (1) disregard the importance of circuit court precedent in establishing a coherent body of laws in the United States,⁵⁴ (2) baselessly advance the notion that agencies are entitled to deference in their decisions not to acquiesce based on congressional authorization of the agency as an interpreter of its basic statute,⁵⁵ and (3) ignore the threat intracircuit nonacquiescence poses to due process, equal protection, and separation of powers.⁵⁶ The relevance of the Diller and Morawetz analysis of nonacquiescence to incidents of SEC nonacquiescence will be called

⁴⁶ See *id.* at 750.

⁴⁷ See Diller & Morawetz, *supra* note 2, at 801 n.††.

⁴⁸ See *id.* at 812.

⁴⁹ *Id.* at 812.

⁵⁰ *Id.* at 805.

⁵¹ See *id.* at 814-15.

⁵² See *id.* at 815.

⁵³ See *id.*

⁵⁴ See *id.* at 804-05.

⁵⁵ See *id.* at 818-21.

⁵⁶ See *id.* at 821-25.

into question by the following discussion.

II. OVERVIEW OF THE SECURITIES AND EXCHANGE COMMISSION

The SEC was created by Congress through the Securities Exchange Act of 1934⁵⁷ (1934 Act) to provide federal regulation of the securities industry. The need for regulation of the industry arose in response to widespread abusive and fraudulent practices in the selling of securities to the public and the trading of securities, both of which contributed to the 1929 stock market crash.⁵⁸

The SEC is empowered to enforce a variety of statutes that govern the securities industry and the capital markets.⁵⁹ The most significant sections of the securities laws are its anti-fraud provisions, such as section 10-b of the 1934 Act and related provisions in other statutes.⁶⁰ The securities laws mandate full disclosure of all material facts regarding the sale of securities, whether to the public or in private transactions, and they make fraud in selling or trading of securities a predicate for civil and criminal liability under federal law.⁶¹

The SEC attempts to prevent securities fraud by requiring registration of all publicly sold securities and their issuers,⁶² and by imposing continuing disclosure obligations.⁶³ Broker-dealers, securities exchanges, investment companies, and investment advisors must register with the Commission.⁶⁴ The SEC also

⁵⁷ Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78j (1988)).

⁵⁸ See THOMAS L. HAZEN, *THE LAW OF SECURITIES REGULATION* 7 (2d student ed. 1990).

⁵⁹ The most significant of these statutes are: the Securities Act of 1933, 15 U.S.C. § 77 (1988) (regulating the distribution of domestic and foreign securities); the Securities Exchange Act of 1934, 15 U.S.C. § 78 (1988) (regulating all aspects of public trading of securities and also establishing the SEC); the Investment Company Act of 1940, 15 U.S.C. § 80a-1 to -64 (1988) (regulating investment companies, including their fiduciary duties, fees, and registration and disclosure requirements); and the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to -21 (1988) (regulating non-broker-dealers who render investment advice).

⁶⁰ One such anti-fraud provision is § 17 of the Securities Act of 1933, which proscribes the use of any instrumentality of interstate commerce to engage in fraudulent sales or offerings. See 15 U.S.C. § 77q (1988).

⁶¹ See Securities Exchange Act of 1934, §§ 18, 32, 15 U.S.C. §§ 78r, 78ff (1988).

⁶² See Securities Act of 1933, § 5, 15 U.S.C. § 77e (1988).

⁶³ See Securities Exchange Act of 1934, § 13, 15 U.S.C. § 78m (1988).

⁶⁴ See *id.* §§ 5, 6, 15, 15 U.S.C. §§ 78e, 78f, 78o; Investment Company Act of 1940, § 8, 15 U.S.C. 80a-8 (1988); Investment Advisers Act of 1940, § 203, 15 U.S.C. § 80b-3 (1988).

promulgates and enforces prohibitions on abusive and fraudulent tactics in the marketplace, such as insider trading. Augmenting the SEC's regulatory framework are the self-regulating organizations (SROs). These organizations, which write their own rules, include the various stock exchanges, such as the New York Stock Exchange (NYSE), and the institutions that facilitate trading over the counter, such as the National Association of Securities Dealers (NASD).⁶⁵ The SEC retains the right to suspend or revoke an SRO's registration if the SRO fails to comply with the 1934 Act.⁶⁶

To enforce the securities laws the Commission is empowered to hold enforcement hearings, or administrative trials, to determine if violations have occurred. Upon finding a violation, the Commission is empowered to impose sanctions on the individual, partnership, or corporation charged. Since all broker-dealers, investment advisors, and investment companies are required to register with the Commission to do business lawfully, the Commission commonly sanctions violations by revoking or suspending these registrations. SEC final orders are directly reviewable by the circuit courts of appeals.

Other enforcement powers of the SEC include the right to refuse to register securities,⁶⁷ which prevents their sale, and the right to issue stop-orders, which require the cessation of sales already taking place.⁶⁸ If a security is already issued and being traded, the Commission has the power to suspend trading in that security for up to ten days.⁶⁹

The Commission also has the right to investigate possible violations. Formal SEC investigations, which must be publicly announced, can only be undertaken with the express approval of the Commission.⁷⁰ Once the SEC staff receives an order to investigate, it is further authorized to issue subpoenas to compel testimony and the production of documents. Although there is no financial or procedural penalty should a subpoena recipient refuse to com-

⁶⁵ The rules governing these two institutions are found in 2 NEW YORK STOCK EXCHANGE GUIDE (CCH) (1984) and NASD SECURITIES DEALERS MANUAL (CCH) (1990). Other SROs include the Municipal Securities Rulemaking Board and the Chicago Board Options Exchange (CBOE).

⁶⁶ See Securities Exchange Act of 1934, § 19(d)(1), 15 U.S.C. § 78s(h)(1) (1988).

⁶⁷ See Securities Act of 1933, § 8(b), 15 U.S.C. § 77h(b) (1988).

⁶⁸ See *id.* § 8(d), 15 U.S.C. § 77h(d).

⁶⁹ See Securities Exchange Act of 1934, § 12(k), 15 U.S.C. § 78l(k) (1988).

⁷⁰ See RICHARD W. JENNINGS & HAROLD MARSH, JR., *SECURITIES REGULATION* 1526-27 (6th ed. 1987).

ply,⁷¹ the subpoena can be enforced through court order.⁷²

Perhaps the most potentially damaging weapon in the SEC arsenal is its right to bring lawsuits in federal court seeking injunctions against possible violations. The issuance of an injunction against an individual or corporation can provide grounds for the Commission to permanently bar such individual or organization from the securities industry.⁷³ In the context of tender offers and proxy solicitations, the issuance of a preliminary injunction can block an enjoined party's transaction.⁷⁴ Under section 21(a) of the Exchange Act, the Commission is authorized to publish, at its discretion, the findings of its investigations in releases.⁷⁵ These findings may include an implicit threat of enforcement action. Thus, even without formal disciplinary sanctions, the SEC can express its disapproval of certain activities.

III. FORMAL PUBLIC SEC NONACQUIESCENCE: THE UNUSUAL CASES

A search of SEC releases since 1944 uncovers only two instances of publicly announced or published statements by the SEC in which it flatly stated that it would refuse to comply with a recent court ruling because it regarded that ruling as wrongly decided. The rarity of this practice illustrates how the conduct of the SEC differs from that of the IRS or SSA, both of which routinely proclaim that they will disregard judicial decisions.⁷⁶ Judging from the lack of commentary concerning the SEC in this area, most writers have apparently interpreted the reticence of the Commission as proof that it does not regularly engage in nonacquiescence.

The striking aspect of these two formal public statements of nonacquiescence is that neither one of the contested court decisions directly overruled a Commission order or attempted to change

⁷¹ Noncompliance with an SEC investigation is hardly a recommended course of action. Jennings and Marsh note that "[s]uch contumacy is rarely advisable, since it will infuriate the SEC staff, and they are likely to make life as unpleasant as possible to the person involved during the subsequent course of the proceeding." *Id.* at 1527.

⁷² See Securities Exchange Act of 1934, § 21(c), 15 U.S.C. § 78u(c) (1988).

⁷³ In *SEC v. Milken*, Litig. Release No. 12454, [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,200 (Apr. 24, 1990), the SEC used a prior court injunction as a basis for permanently barring the defendant from the securities industry.

⁷⁴ See LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 491-97, 531-32 (1988).

⁷⁵ See Securities Exchange Act of 1934, § 21(a), 15 U.S.C. § 78u (1988).

⁷⁶ See Maranville, *supra* note 1, at 477-78 & nn.14-17 (discussing nonacquiescence by the IRS, SSA, NLRB, and Tax Court).

internal SEC practices. Courts have done just that in other cases, and have drawn much more measured responses from the Commission. Both rulings at issue did constitute a threat to the SEC, however. They threatened to curtail sharply the SEC's efforts to regulate important sectors of the financial markets. In the first instance, *Grayson-Robinson Stores, Inc. v. SEC*,⁷⁷ SEC influence over bankruptcy reorganizations was threatened. Similarly, in *Greenfield v. Heublein, Inc.*,⁷⁸ SEC-mandated standards for disclosure of pending corporate control transactions were seriously challenged.

A. *The Commission Does Not Acquiesce:*
Grayson-Robinson Stores, Inc. v. SEC

In the *Grayson* case, the Second Circuit rejected an attempt by the SEC to force Grayson-Robinson, the debtor in possession in a Chapter XI bankruptcy case, to refile under Chapter X.⁷⁹ Under Chapter X, an independent trustee would have been put in charge of the corporation, whereas under Chapter XI the debtor corporation's management often stays in place.⁸⁰ The SEC attempted to force the case into Chapter X by motion in the district court,⁸¹ and appealed when this motion was rejected. As the court of appeals noted, Congress created this SEC right of action through amendments to the Bankruptcy Code in 1952:

In 1952 Congress altered Chapter XI in two respects relevant here. It added § 328, providing that "The judge may, *upon application of the Securities and Exchange Commission* or any party in interest, . . . if he finds that the proceedings should have been brought under chapter X of this Act, enter an order dismissing the proceedings under this chapter," unless the debtor amends its petition to seek Chapter X relief⁸²

⁷⁷ 320 F.2d 940 (2d Cir. 1963).

⁷⁸ 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

⁷⁹ *Grayson*, 320 F.2d at 941-42.

⁸⁰ This case was litigated under the Bankruptcy Act of 1898 as amended. *See* Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (as amended) (repealed 1978). Very different procedures are now in force pursuant to the Bankruptcy Act of 1978. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended in 11 U.S.C.). In this particular case the original Grayson management was still in place during the bankruptcy. *See Grayson*, 320 F.2d at 944-46.

⁸¹ *See In re Grayson-Robinson Stores*, 215 F. Supp. 921, 922 (S.D.N.Y.), *aff'd*, 320 F.2d 940 (2d Cir. 1963).

⁸² *Grayson*, 320 F.2d at 947.

The court stated that the congressional intent behind this amendment to the Bankruptcy Code was to establish a means by which the SEC could intervene in bankruptcies involving widely disbursed security holders to ensure that public and private interests were adequately protected⁸³. This greater protection of security holders was achieved in Chapter X through the appointment of a disinterested trustee to run the corporation and through SEC oversight of the reorganization.⁸⁴

The court of appeals upheld the district court's order denying the Commission's motion to cause the bankruptcy to be refiled in Chapter X. The Second Circuit held that the district judge properly balanced various factors allowing for the conclusion that a Chapter X refiling was unnecessary to protect the investing public. Writing for the court of appeals, Judge Friendly stated:

This is a case where no publicly held securities are being readjusted, the creditors have had vigorous independent representation, stockholder interests have offered substantial contributions, and rights to pursue claims for dereliction remain unaffected. In such circumstances a court can hardly ignore a substantially uncontradicted factual showing that Chapter XI affords some hope of paying off creditors whereas Chapter X offers none.⁸⁵

The court of appeals emphasized that the district court properly considered the financial burden upon the debtor and its creditors in exercising its discretion not to grant the motion. Discussing the delicate balancing involved, the court of appeals noted that "[h]owever we might decide the case if the record contained no more than this, we do not feel warranted in upsetting the judge's exercise of discretion when there is added to the scales the evidence as to the drastic financial consequences of transfer to Chapter X."⁸⁶

The circuit court's decision was controversial for two reasons. First, the decision appeared to accord great weight to the financial interests of the debtor and its creditors in determining whether a

⁸³ See *id.* at 948 (citing *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 456 (1940)).

⁸⁴ See Bankruptcy Act of 1898, Chapter X, § 156 (as amended June 23, 1938) (repealed 1978) (providing for the appointment of an independent trustee); *id.* § 172 (providing for SEC review of reorganization plans and issuance by SEC of advisory report).

⁸⁵ *Grayson*, 320 F.2d at 950.

⁸⁶ *Id.* at 949.

case should be placed under Chapter X and whether a disinterested trustee should be appointed. Second, the decision invested the trial judge with broad discretion in making that determination.

In a strongly worded dissent from the denial of a rehearing en banc, Judge Charles E. Clark argued that the *Grayson* decision conflicted with Supreme Court precedent and would severely hamper SEC efforts to fulfill its enforcement mandate. Clark argued that the standards set out in previous Supreme Court cases required that *Grayson* be reorganized under Chapter X.

[W]e have here all the criteria emphasized by the Supreme Court⁸⁷ . . . as requiring reorganization under SEC supervision in Chapter X proceedings, rather than an unsupervised arrangement under Chapter XI. The debtor's commercial empire is indeed expansive, including . . . [a] nationwide chain of . . . shops [T]he debtor . . . was the largest retail seller of photographic and audio equipment and supplies in the United States. *Grayson's* common stock is listed on the New York Stock Exchange and is held by approximately 3,470 investors. . . . Thus the public nature of the debtor would seem beyond debate.

Furthermore, the possibility that new management is sorely needed is suggested from the fact that until . . . present management gained control of *Grayson*, the debtor had enjoyed many consecutive years of profitable operation. . . .

The "Plan of Arrangement" . . . would appear to require SEC expertise for its proper evaluation. . . . [I]ndependent appraisal of whether *Grayson* got the better end of the bargain would seem imperative.⁸⁸

Judge Clark outlined five factors weighing in favor of requiring a Chapter X filing: (1) the large size of the debtor enterprise, (2) the presence of public security holders, (3) the questionable capability of present management, (4) the sophisticated nature of the plan of arrangement, and (5) the questionable fairness of the plan. He then derided the interests weighing against granting the SEC motion for a Chapter X petition, namely the desires of the debtor and creditors to avoid the financial risks of a Chapter X trusteeship:

The only countervailing reasons for excluding the government

⁸⁷ Judge Clark was here referring to the leading Supreme Court precedents of *General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956), and *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940).

⁸⁸ *Grayson*, 320 F.2d at 950-51 (Clark, J., dissenting from denial of rehearing en banc).

agency charged with representing the public from considering a situation so requiring its study is that the creditors for the most part seem to be approving and that there is a need for haste lest the business be disrupted. These would seem rarely controlling to furnish overriding objections to a case which the SEC . . . believes should be the subject of further agency supervision.⁸⁹

Judge Clark concluded by stating that the Court's decision would have severe adverse effects upon SEC enforcement capabilities:

The decision itself, . . . which appears to be contrary to decisions of this court and of the Supreme Court . . . puts in jeopardy practically all attempts by the SEC to execute its statutory responsibility to investigate and supervise the reorganization of large corporations in this circuit, since the denial of such power in a case with the complexity of corporate relations here shown presages a potential battle in practically all such cases in the future.⁹⁰

The SEC responded quite rapidly to the adverse decision by asking the Solicitor General of the United States to seek certiorari to the United States Supreme Court. The Solicitor General refused to do so. On October 22, 1963 the Commission released its extraordinary "Statement of Nonacquiescence,"⁹¹ which recounted its efforts to obtain certiorari and stated its hostility to the Second Circuit ruling:

The Commission has been advised by the Solicitor General that he has decided not to file a petition with the United States Supreme Court for a writ of certiorari to review . . . *Grayson-Robinson Stores v. S.E.C.* The Solicitor General does not believe that the case presents a proper question for consideration by the Supreme Court at this time.

The decision not to seek Supreme Court review in this case, however, should not be construed as acquiescence by the Commission in the decision of the Court of Appeals or concurrence with the views expressed in the opinion.⁹²

After the release, the SEC embarked upon a course of litigation, both inside and outside of the Second Circuit, in which it attempted

⁸⁹ *Id.* at 952.

⁹⁰ *Id.* at 950.

⁹¹ Statement of Nonacquiescence by Securities and Exchange Commission in *Grayson-Robinson Stores, Inc. v. Securities and Exchange Commission*, 320 F.2d 940, SEC Corporate Reorganization Act Release No. 208, 1963 SEC LEXIS 1165 (October 22, 1963).

⁹² *Id.*

to reassert its authority to force Chapter XI bankruptcies to refile under Chapter X. This relitigation involved not only intercircuit, but also, and more significantly, intracircuit nonacquiescence.

The Second Circuit based its decision in *Grayson* upon a balancing test which accorded great weight to the financial interests of the debtors and creditors involved in the petition. In a subsequent SEC attempt to obtain conversion from Chapter XI to Chapter X, *SEC v. Canandaigua Enterprises Corp.*,⁹³ the Second Circuit altered the balancing test. In *Canandaigua*, Judge Friendly, the author of the *Grayson* opinion, wrote a decision ordering that an SEC motion for conversion of a Chapter XI bankruptcy to Chapter X be granted. The SEC motion was granted despite the overwhelming opposition of the creditors and debtors involved and credible claims that a Chapter X filing could destroy the business.⁹⁴ The court spoke of its displeasure "at having to insist on a course which scarcely a creditor or stockholder has sought and which may lead to disaster."⁹⁵ Judge Friendly distinguished this case from *Grayson* on the basis that *Canandaigua's* reorganization involved adjustment of publicly held debt, while *Grayson-Robinson's* reorganization involved adjustment of only trade debt.

Public investors are far more likely than trade creditors to be ill-informed . . . and they lack the trade creditors' opportunity for advantage from profitable dealings with a management well disposed to them. . . . The case of trade or other private creditors with whom we dealt in *Grayson-Robinson* is radically different.⁹⁶

Although Judge Friendly maintained that the *Canandaigua* case was "radically different" from *Grayson*, there are some striking similarities between them: (1) both reorganizations involved the issuance of debt securities which were exempt from SEC registration;⁹⁷ (2) in the opinion of the respective courts, both managements required investigation;⁹⁸ (3) both reorganizations were of

⁹³ 339 F.2d 14 (2d Cir. 1964).

⁹⁴ *Canandaigua Enterprises's* sole operation was a horse racing track in upstate New York. See *id.* at 15. The court noted the judgment of the district court that there was "grave danger that the entire venture will be jeopardized if the matter is changed to a Chapter X proceeding." *Id.* at 17.

⁹⁵ *Id.* at 21.

⁹⁶ *Id.* at 20.

⁹⁷ See *Canandaigua*, 339 F.2d at 20 (stating that the debt securities were exempt from registration under § 264 and § 393 of the Bankruptcy Act); *Grayson*, 320 F.2d at 948 (stating that the general debentures, though eligible for trade, were exempt from registration under § 393(a)(2) of the Bankruptcy Act).

⁹⁸ See *Canandaigua*, 339 F.2d at 18; *Grayson*, 320 F.2d at 948.

questionable fairness,⁹⁹ and most importantly, (4) in both cases, Chapter X held great financial risks for the creditors and debtors involved. Despite these similarities, Judge Friendly made the adjustment of publicly held debt in *Canandaigua* the overriding factor in the decision. Judge Friendly went so far as to argue that the readjustment of publicly held debt in a corporate bankruptcy creates a presumption that a Chapter X filing is required: "[W]e do not read [*General Stores Corp. v. Shlensky*] as precluding a court of appeals from ruling that the need for a readjustment of publicly held debt creates a presumption in favor of Chapter X"¹⁰⁰ While this opinion does not directly overrule *Grayson*,¹⁰¹ the *Canandaigua* decision represents an important departure from the multi-factored balancing test mandated by *Grayson*, which accorded great deference to debtor and creditor interests.

The SEC program of relitigating the issue ruled upon by the Second Circuit in *Grayson* was obviously more acceptable to the courts than the SSA relitigation of the 1980s. The SEC did not and could not openly flout and ignore circuit court precedent (since enforcement action consisted of motions in district court). Because it did not raise the ire of judges or litigants, the intracircuit nonacquiescence practiced in *Canandaigua* may seem insignificant. Nevertheless, SEC relitigation in the Second Circuit resulted in a substantial alteration of the test to be applied by judges deciding whether to grant SEC motions for a Chapter X refiling.

The SEC also challenged the *Grayson* decision in other circuits. In *SEC v. Crumpton Builders, Inc.*,¹⁰² a Fifth Circuit case, the SEC pressed aggressively for the adoption of what the court called "an ironclad rule that transfer must be required when some of the unsecured debt is held by the investing public in the form of debentures rather than in the form of trade debt."¹⁰³ The Fifth Circuit panel refused to create such a rule, but it did hold that the district court had overstepped its discretion in denying the SEC

⁹⁹ See *Canandaigua*, 339 F.2d at 21; *Grayson*, 320 F.2d at 948-49 & n.13.

¹⁰⁰ *Canandaigua*, 339 F.2d at 19.

¹⁰¹ The Supreme Court recognized the conflicting nature of *Grayson* and *Canandaigua* in *SEC v. American Trailer Rentals Co.*, 379 U.S. 594 (1963). Justice Goldberg cited *Canandaigua* in support of the holding that public debt readjustment requires Chapter X filing, and he cited *Grayson* as a contrary authority. See *id.* at 613 n.12.

¹⁰² 337 F.2d 907 (5th Cir. 1964).

¹⁰³ *Id.* at 911.

motion.¹⁰⁴ In his opinion in *Canandaigua*, Judge Friendly compared and contrasted "the more flexible criteria suggested in Judge Wisdom's thoughtful opinion in [*Crumpton*]"¹⁰⁵ with the presumption he was creating for the Second Circuit.

The entire issue was finally reviewed by the Supreme Court in *SEC v. American Trailer Rentals Co.*¹⁰⁶ *American Trailer* presented an especially compelling situation for Chapter X trusteeship. The company was committing massive fraud on investors by selling rights in trailers that were never constructed, while large amounts of funds simply disappeared. The company was forced into bankruptcy because the SEC halted its illegal securities sales, thereby cutting off the company's source of funds.¹⁰⁷ The facts heavily supported the SEC's position, and the circuit court decision, which denied the Chapter X trusteeship,¹⁰⁸ was a clear error.

The Supreme Court rejected the SEC's contentions "that, as an absolute rule, all proceedings for the financial rehabilitation of a corporate debtor which would alter the rights of public investor creditors must be in Chapter X,"¹⁰⁹ but it did adopt a balancing test that would usually lead to this conclusion:

[There are only] narrow limits within which there are exceptions to this general rule that the rights of public investor creditors are to be adjusted only under Chapter X. "Simple" compositions are still to be effected under Chapter XI. Such a situation, even where public debt is directly affected may exist, for example, where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor¹¹⁰

Commenting on the scope of discretion allowed the trial judge in deciding whether a bankruptcy must be refiled under Chapter X, Justice Goldberg cited the *Canandaigua* holding as support for the proposition that the trial judge cannot make the determination simply based on what he thinks is best for the debtor.¹¹¹

¹⁰⁴ See *id.* at 907-08.

¹⁰⁵ *Canandaigua*, 339 F.2d at 21 n.7 (citing *Crumpton*, 337 F.2d at 911).

¹⁰⁶ 379 U.S. 594 (1965).

¹⁰⁷ See *id.* at 599.

¹⁰⁸ See *In re American Trailer Rentals Co.*, 325 F.2d 47 (10th Cir. 1963), *rev'd*, 379 U.S. 594 (1965).

¹⁰⁹ *American Trailer*, 379 U.S. at 607.

¹¹⁰ *Id.* at 614.

¹¹¹ See *id.* at 619-20 (citing *Canandaigua*, 339 F.2d at 19, for the proposition that

The SEC's refusal to acquiesce to *Grayson* illustrates some of the benefits that Estreicher and Revesz claim intracircuit nonacquiescence can have on intercourt dialogue and the "percolation" of issues in preparation for Supreme Court review.¹¹² In *Canandaigua*, the SEC relitigation of the issues presented in *Grayson* allowed the Second Circuit, and Judge Friendly himself, to revisit the issues and consider them in light of other circuit court rulings, especially the Fifth Circuit's decision in *Crumpton*. When the issues were finally addressed by the Supreme Court in *American Trailer*, the Court considered them with the benefit of Judge Friendly's analysis in *Canandaigua*.

The relitigation engaged in by the SEC, however, does not satisfy all three prongs of the test Estreicher and Revesz believe should be met before allowing an agency to nonacquiesce. The first prong of the test requires "that the agency have national policy-making authority over the point in dispute."¹¹³ In this case the dispute between the court of appeals and the SEC was over the proper interpretation of the Bankruptcy Code, not the securities laws. According to Estreicher and Revesz, a necessary condition for legitimate intracircuit nonacquiescence is that the dispute between the agency and the courts concerns the interpretation of the agency's organic statute.¹¹⁴ Yet, the SEC's nonacquiescence to *Grayson* appears to be a paradigmatic example of nonacquiescence that these theorists find beneficial. *Grayson* illustrates one of the contradictions that emerge when the Estreicher and Revesz approach is applied to agencies other than those for which it is designed.

The concerns of Diller and Morawetz,¹¹⁵ that nonacquiescence harms vulnerable individual plaintiffs, are irrelevant to this particular episode of SEC nonacquiescence. The SEC enforcement action here involved well-counseled corporations rather than individuals, so no due process or equal protection problems were evident. Since the *Grayson* nonacquiescence consisted of simple relitigation, a challenge to the authority of the judiciary raised no separation of powers concerns either. Despite the fact that SEC

excessive discretion would leave decisions to turn on the "particular experience and predilections" of the judge).

¹¹² See Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 743-47.

¹¹³ *Id.* at 754.

¹¹⁴ See *id.*

¹¹⁵ See *supra* notes 47-56 and accompanying text.

nonacquiescence to *Grayson* did not threaten harm to individual litigants, the primary evil of nonacquiescence according to Diller and Morawetz, their approach, which is completely hostile to intracircuit nonacquiescence, would require its prohibition.¹¹⁶

B. *SEC Nonacquiescence to Third Circuit Efforts to Narrow
Corporate Disclosure Obligations in Takeovers:
Greenfield v. Heublein, Inc.*

The SEC has publicly rejected and planned to disregard only one other circuit court decision—the Third Circuit's ruling in *Greenfield v. Heublein, Inc.*¹¹⁷ That case involved a class action brought by a Heublein stockholder who sold his stock after corporate officials issued a statement that they knew of no reason why the trading volume of their stock had increased eight-fold in one day.¹¹⁸ In fact, the Heublein officials were engaged in private preliminary merger negotiations with the R.J. Reynolds Company and were aware that the surge in trading activity was probably caused by individuals trading with knowledge of this potential transaction.¹¹⁹ The plaintiff and other stockholders sold their stock after this announcement for approximately \$45.00 per share.¹²⁰ Two weeks after its announcement, Heublein agreed to merge with R.J. Reynolds at a price of \$60.00 per share.¹²¹

The plaintiffs brought suit on the grounds that Heublein's false statements constituted an "untrue statement of a material fact" made "in connection with the purchase or sale of any security" and therefore violated section 10(b)¹²² and Rule 10b-5 of the Securities Exchange Act of 1934.¹²³ The plaintiffs also argued that

¹¹⁶ See Diller & Morawetz, *supra* note 2, at 808 ("If the decisions of the circuits were not accorded precedential weight, but were constantly open to question, these courts would be easily overwhelmed by parties raising issues addressed in earlier rulings by the same court. The system simply could not function if precedent were so unstable.")

¹¹⁷ 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

¹¹⁸ See *id.* at 754.

¹¹⁹ See *id.*

¹²⁰ See *id.* at 754-55.

¹²¹ See *id.*

¹²² Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1988).

¹²³ Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983). This rule provides:

It shall be unlawful for any person . . .

. . . .

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light

Heublein's failure to disclose the ongoing merger negotiations and to correct its prior denial was an omission to state a material fact necessary to prevent its prior statements from being "misleading."¹²⁴ The plaintiffs sought damages for their lost trading profits, but the district court gave summary judgment to the defendants.¹²⁵

On appeal, the Third Circuit concluded that since the Heublein management had not been aware of any leaks of their ongoing merger talks, and since it was only through a leak that the merger negotiations could have caused a surge in trading volume, Heublein did not make a false statement when it said that it "was aware of no reason that would explain the activity in its stock trading on the NYSE."¹²⁶ The court found a lack of awareness notwithstanding that Heublein trading volume surged from an average of 32,500 shares per day to 242,500 in one day during the negotiations.¹²⁷ Since, according to the appellate court, Heublein's statement was not false, the district court's entry of summary judgment was affirmed.

As for the second charge, the appellate court agreed that if the existence of the preliminary negotiations had been a material fact, Heublein, by virtue of its earlier statement, would have had a duty to disclose them to make its earlier statement "not misleading." The court held, however, that, as a matter of law, preliminary merger negotiations do not become material until an "agreement in principle" is reached.¹²⁸ The court then defined "agreement in principle" as agreement upon both price and structure of the merger.¹²⁹ Since Heublein and R.J. Reynolds did not agree on these items until the night before the merger, after the name plaintiff and almost all members of the plaintiff class had sold their stock, none of the plaintiffs had a valid claim for their trading losses.¹³⁰

of the circumstances under which they were made, not misleading . . .

. . . .

in connection with the purchase or sale of any security.

Id.

¹²⁴ See *Heublein*, 742 F.2d at 755 & n.4.

¹²⁵ See *id.* at 755.

¹²⁶ *Id.* at 754.

¹²⁷ See *id.* at 754 n.1. The price per share also rose \$2.75 on that day.

¹²⁸ *Id.* at 756 (quoting *Staffin v. Greenberg*, 672 F.2d 1196, 1207 (3d Cir. 1982)).

¹²⁹ See *id.* at 756-57.

¹³⁰ See *id.* at 757.

Although not a party to this litigation, the SEC was clearly displeased with the result. The SEC took the position that a statement by an issuer to the effect that merger discussions are not occurring when in fact they are constitutes a false and misleading material statement and therefore a violation of section 10-b and Rule 10b-5 of the Exchange Act. The SEC expressed its disapproval of the *Heublein* decision through a so-called 21(a) letter.¹³¹ The Commission bluntly stated: "The Commission believes that *Heublein* was wrongly decided."¹³² The Commission then put corporate management on notice that if they chose to measure their disclosure responsibilities by the judicial standard and failed to adhere to the standard announced by the SEC when engaged in merger negotiations, they could expect trouble:

Issuers that make public statements are required under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder to speak truthfully and to include all material facts necessary to make the statements made, in light of the circumstances . . . not materially misleading. *This requirement applies to issuers engaged in preliminary acquisition discussions. The Commission will take appropriate enforcement action against issuers which fail to comply with these requirements.*¹³³

The SEC decided that the standard of materiality for mergers would be the same as for ordinary corporate developments.¹³⁴

This example of SEC nonacquiescence presents a unique problem in terms of judicial control over such behavior. The SEC has not yet taken any enforcement action that the courts can overturn. It has simply threatened that in the future it will take enforcement action against issuers who fail to conform to the Commission's disclosure requirement, as opposed to that of the Third Circuit.

An issuer would incur huge risks if it were to challenge the SEC's interpretation of the disclosure law. Even in the face of

¹³¹ Under § 21(a) of the Securities Exchange Act of 1934, the SEC has the power to publish the results of its investigations. See 15 U.S.C. § 78u (1988). Ostensibly, the SEC was publishing the results of its investigation into the Carnation-Nestle merger when it released its statement of nonacquiescence to *Heublein*.

¹³² *In re Carnation Co.*, Exchange Act Release No. 22,214, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.8 (July 8, 1985).

¹³³ *Id.* at 87,597 (emphasis added).

¹³⁴ This standard was declared in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (1968) (stating that materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event")

eventual repudiation in court, many types of SEC enforcement actions, ranging from investigation to the obtaining of a preliminary injunction, could severely damage or even ruin a planned corporate control transaction. The mere threat of being forced to defend a suit by the SEC on charges of securities fraud can compel a party to adhere to the SEC's interpretation.

The SEC release sparked considerable debate over the propriety of such a statement,¹³⁵ with the SEC vigorously defending its right to state its position publicly.¹³⁶ One commentator opined that issuers were lucky that the SEC had bothered to state its position at all before seeking to enforce it:

The § 21(a) report simply placed issuers on notice about the Commission's interpretation of *Heublein*. The less satisfactory alternative would be for the Commission to articulate its view through the medium of an enforcement action, an alternative particularly unpalatable to the subjects of the investigation. The *Carnation* release at least provided advance warning, allowing issuers to modify their actions in a way that will avoid conflict with the Commission's interpretation and a possible enforcement action.¹³⁷

Viewed from this perspective, there is little doubt that the publication of the *Carnation* release was intended as an enforcement act by the Commission, designed to further its standard requiring disclosure. The use of this method of nonacquiescence by the SEC can probably be attributed to the effectiveness with which the threat of SEC action tends to intimidate issuers and other entities regulated by the Commission.¹³⁸

Since the issue presented in *Heublein* is one normally raised in private suits for damages caused by alleged securities fraud, the SEC

¹³⁵ See, e.g., Douglas M. Branson, *SEC Nonacquiescence in Judicial Decisionmaking: Target Company Disclosure of Acquisition Negotiations*, 46 MD. L. REV. 1001 (1987) (discussing the disclosure policy that should be implemented with regard to acquisitions, not, as the title suggests, SEC nonacquiescence); J. Robert Brown, Jr., *Corporate Secrecy, the Federal Securities Laws, and the Disclosure of Ongoing Negotiations*, 36 CATH. U. L. REV. 93, 160-61 nn. 246-47 (1986) (listing and discussing various commentary critical of the release); *Uncertainty Over Merger Disclosure is Costly, Grundfest Tells ABA Group*, 18 Sec. Reg. & L. Rep. (BNA) No. 15, at 521 (Apr. 11, 1986) [hereinafter *Remarks of SEC Commissioner*] (pointing out different views relating to the importance of the SEC release).

¹³⁶ See *Remarks of SEC Commissioner*, *supra* note 135, at 521.

¹³⁷ Brown, *supra* note 135, at 161 n.247.

¹³⁸ See Monroe H. Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280, 282 (1974) (arguing that the SEC "depends upon intimidation of individuals, business firms, and attorneys though aggressive abuse of its power").

did not have an opportunity to litigate it. The Commission did, however, press its position in amici briefs. When the issue was finally laid to rest in *Basic Inc. v. Levinson*,¹³⁹ *Heublein* was overruled and the SEC's standard of materiality of merger negotiations was adopted.¹⁴⁰

This type of SEC nonacquiescence to a court of appeals decision is significant because it is free from judicial interference. The SEC's decision to issue a statement of its opinion was not reviewable by any court, yet that simple act may have effectively secured compliance with the SEC's interpretation of the law. Considering that the SEC can easily bring suit against any issuer in almost any jurisdiction, an SEC threat is real.¹⁴¹ Therefore, the SEC could effectively nullify *Heublein* and deny its benefits to issuers located and doing business solely within the Third Circuit's jurisdiction.

The SEC's nonacquiescence to *Heublein* also raises the issue of what notice, if any, litigants are entitled to when an agency decides it will ignore circuit court precedent. It would appear that a little-publicized agency decision to pursue enforcement proceedings based upon a statutory interpretation rejected by the relevant reviewing court deprives a defendant of necessary notice. Such lack of notice could constitute a denial of due process.

Estreicher and Revesz would clearly approve of the type of nonacquiescence practiced by the SEC in response to *Heublein*. The dispute involved the "organic statute" of the SEC, which had a reasonable argument for its interpretation, and which sought to obtain review by the Supreme Court. Diller and Morawetz, however, would likely oppose this SEC action on due process and separation of powers grounds. The SEC threat to take enforcement action against issuers, presumably even if eventual circuit court review would overturn such action, is the type of behavior of which Diller and Morawetz are critical. Such agency action threatens to convert the administrative process from a good faith effort to resolve the issues into a series of hurdles which a litigant must overcome before obtaining judicial review.¹⁴² Diller and Morawetz probably would find the SEC assertion that it, and not the

¹³⁹ 485 U.S. 224 (1988).

¹⁴⁰ See *id.* at 236.

¹⁴¹ See Securities Exchange Act of 1934, § 27, 15 U.S.C. § 78aa (1988); HAZEN, *supra* note 58, at 807-08.

¹⁴² See Diller & Morawetz, *supra* note 2, at 826 ("[T]he administrative process becomes a series of obstacles yielding decisions that are predictably subject to reversal by reviewing courts.").

circuit court, is the proper interpreter of the relevant statutes to be unacceptable and a violation of the separation of powers doctrine.¹⁴³

The concerns for individual rights, distributional fairness, and separation of powers that motivate the Diller and Morawetz critique of nonacquiescence are, however, irrelevant in this instance. Hence, the prohibitive approach to nonacquiescence advocated by them is overinclusive. The Commission's nonacquiescence affected well-counseled corporate litigants, not impoverished social security recipients. Perhaps more importantly, the SEC's position was adopted in rather short order by the Supreme Court. The SEC was not trying to deadlock the courts. Rather, the SEC prevented the adoption of a mistaken approach until its view was vindicated. It is difficult, if not impossible, to identify any legitimate interests that were damaged by this example of SEC nonacquiescence.

IV. THE SEC AS A COURT: THE STANDARD OF PROOF CONTROVERSY

The reaction of the SEC to *Collins Securities Corp. v. SEC*,¹⁴⁴ a decision of the Court of Appeals for the D.C. Circuit that raised the standard of proof required in Commission enforcement proceedings, presents an excellent example of the difficulties involved in assessing the extent of SEC nonacquiescence, its utility, and the effects of attempting to increase statutory or judicial checks upon it. *Collins* reversed the imposition of SEC sanctions against a broker-dealer and its individual proprietor for alleged stock manipulation on the grounds that the Commission was required to judge the charges against the broker by a standard of "clear and convincing evidence," instead of the usual Commission standard of "preponderance of the evidence."¹⁴⁵

The court's opinion began by noting that while preponderance of the evidence is the traditional standard for administrative proceedings, the Supreme Court had created exceptions to this rule in cases where the sanction to be imposed is quite severe, such as deportation.¹⁴⁶ *Collins* and his firm were accused of securities fraud, and the sanctions imposed by the SEC were severe. The company's registration was revoked, effectively putting it out of

¹⁴³ See *id.* at 824-25.

¹⁴⁴ 562 F.2d 820 (D.C. Cir. 1977).

¹⁴⁵ See *id.* at 826.

¹⁴⁶ See *id.* at 823 (citing *Woodby v. INS*, 385 U.S. 276, 286 (1966)).

business. In addition, Collins himself was barred from the securities industry for a two-year period, depriving him of his profession.¹⁴⁷

The evidence against Collins and his firm was largely circumstantial, as it often is in fraud cases.¹⁴⁸ The court reasoned that in cases such as this, involving difficult-to-prove charges and heavy sanctions, a higher standard was necessary to protect defendants:

Two elements appear relevant to the standard we should impose here: (1) the type [of] case (fraud); (2) the heavy sanction (deprivation of livelihood). Given those elements, typical of many S.E.C. cases, and given the type of circumstantial proof on which the SEC must often rely, it appears to us that the "clear and convincing evidence" standard is the proper standard here¹⁴⁹

Thus, although the charges that the SEC had filed against Collins involved securities fraud rather than common law fraud, the court decided that the "clear and convincing" standard was suitable in the securities context.¹⁵⁰

Although the SEC did not publicly state its opposition to the *Collins* ruling, the analysis below demonstrates that the SEC nonacquiesced in *Collins*, both formally and informally. The informal aspect of the SEC resistance to *Collins* is what makes its extent difficult to evaluate.¹⁵¹ *Collins* required the Commission to adopt a new higher standard of proof in determining, during its enforcement hearings, whether or not persons before the Commission had committed violations of the anti-fraud provisions of the securities laws and regulations that would warrant sanctions.¹⁵² Decisions of the Commission are directly reviewable by the circuit courts of appeals, including the Court of Appeals for the D.C. Circuit, to which the litigant always has the option of appealing.¹⁵³ SEC venue provisions are extremely broad, creating great uncertainty as to which circuit will exercise appellate review of an

¹⁴⁷ See *id.* at 821.

¹⁴⁸ See *id.* at 824.

¹⁴⁹ *Id.*

¹⁵⁰ See *id.* at 825-26.

¹⁵¹ See Maranville, *supra* note 1, at 480-81 ("[I]nformal nonacquiescence is more difficult to identify than formal nonacquiescence. Only by exhaustively tracing the history of individual cases can one identify instances of agency failure to follow judicial precedent.").

¹⁵² These regulations include not only the rules promulgated by the Commission, but also the rules promulgated by the Exchanges, NYSE, AMEX, and NASD, as well as other SROs.

¹⁵³ See Securities Exchange Act of 1934, § 25, 15 U.S.C. § 78y (1988).

SEC enforcement order. Thus, SEC nonacquiescence in such cases cannot be neatly characterized as intracircuit or intercircuit.

A. SEC Enforcement Orders

An analysis of SEC releases ordering or declining to order disciplinary action against broker-dealers and other persons during the period when *Collins* was good law appears to indicate substantial SEC compliance with the *Collins* ruling. In several disciplinary opinions the Commission claimed that it had applied a clear and convincing standard of proof in weighing the sufficiency of the evidence. This claim was expressed by the SEC in a variety of ways, however. In some opinions the Commission simply mentioned that it had applied a clear and convincing evidence standard, as it did in the *Dirks* case, for example: "Applying these general rules to the facts at hand, we find the evidence clear and convincing, as did the administrative law judge, that Dirks willfully disseminated material facts" ¹⁵⁴ In another case, the Commission apparently applied the standard stringently in overturning an administrative law judge's (ALJ) finding of liability, holding that, "on the basis of our review of the record, we are unable to conclude that the fraud allegations against Bertoli have been sustained by clear and convincing evidence." ¹⁵⁵

More commonly, Commission decisions stated that *Collins* might not be applicable, but that the issue was not properly before them since violations were found under the "clear and convincing" standard. The SEC often used this language in orders reviewing the disciplinary actions of the exchanges on appeal. The issue arose in this context because the exchanges often continued to apply the preponderance of the evidence standard in their disciplinary actions. A typical example of this language is found in the *Schloss* release:

Citing *Collins Securities Corp. v. S.E.C.*, Schloss also contends that the Exchange was required to dismiss the charges against him unless they were supported by clear and convincing evidence. However, although the NYSE rejected the *Collins* standard, it stated that its conclusion would have been the same even if it had applied that standard. . . . *In any event we also find the evidence against Schloss clear and convincing.* ¹⁵⁶

¹⁵⁴ *In re Dirks*, Exchange Act Release No. 17,480, 47 S.E.C. 434, 442 (1981).

¹⁵⁵ *In re Bertoli*, Exchange Act Release No. 17,438, 47 S.E.C. 430, 432 n.6 (1981).

¹⁵⁶ *In re Schloss*, Exchange Act Release No. 16,934, 47 S.E.C. 317, 323 n.24 (1980).

In several other cases the Commission recited that it made its findings based on the clear and convincing standard while expressing doubt as to its applicability: "whether or not we must apply the higher standard of proof . . . is of no consequence here. We have again reviewed the record and we find the evidence . . . clear and convincing."¹⁵⁷ Even where the Commission assumed the validity of *Collins* but found that it was not applicable in that particular case, the Commission still made its findings based on clear and convincing evidence:

[The defendant] also claims that the evidence against him must be clear and convincing. . . . [T]he clear and convincing standard is only applicable to cases of fraud. This appeal does not involve any findings of fraud. *Thus, Collins is clearly inapposite.* In any event, we find the evidence with respect to [the defendant's] violations clear and convincing.¹⁵⁸

Although a quick overview of SEC disciplinary opinions seems to indicate a broad SEC policy of acquiescing to the *Collins* decision even where such deference is not legally required, a closer look at the record shows that despite SEC claims of deference, the Commission was informally nonacquiescing to *Collins* in these disciplinary cases. That study first requires a discussion of formal SEC nonacquiescence to *Collins*.

B. Formal SEC Nonacquiescence to *Collins*

The SEC's formal nonacquiescence to *Collins* is strong evidence that the Commission was also nonacquiescing informally. In a select number of cases, the Commission mounted facial challenges to the *Collins* ruling. Unfortunately for a broker named Decker, his case was chosen by the SEC to test the validity of *Collins*.¹⁵⁹

Decker was charged with willfully aiding and abetting a violation of § 17(e)(1) of the Investment Company Act of 1940.¹⁶⁰ Fraud

(emphasis added) (citations omitted).

¹⁵⁷ *In re Chatham*, Exchange Act Release No. 14,594, 46 S.E.C. 1181, 1182 (1978). Similar language finding the applicable standard of proof to be an open question is found in an SEC disciplinary opinion, *In re DMR Securities, Inc.*, Exchange Act Release No. 16,990, 47 S.E.C. 350, 353 n.15 (1980).

¹⁵⁸ *In re Seaton*, Exchange Act Release No. 16,207, 47 S.E.C. 131, 132 n.6 (1979) (emphasis added) (citations omitted).

¹⁵⁹ See *Decker v. SEC*, 631 F.2d 1380 (10th Cir. 1980).

¹⁶⁰ See Investment Company Act of 1940, § 17(e)(1), 15 U.S.C. § 80a-17 (1988). This statute prohibits self-dealing transactions by managers of investment companies. It is in essence a codification of the old common law rule prohibiting self-interested

was not an element of the charge, which is similar to a common law claim for breach of fiduciary duty. In exonerating Decker, the ALJ applied the clear and convincing standard. The Commission overruled the ALJ without discussing the applicable standard, then found that Decker had "willfully aided and abetted a violation of §17(e)(1)."¹⁶¹ The Commission imposed the sanction of censure, and Decker then appealed the Commission's order.

On appeal to the Tenth Circuit, the Commission, though it could have sought to distinguish Decker's case from *Collins* on the ground that fraud was not part of the charges, mounted a facial challenge: "Although [it is] of the view that it makes no difference in this case, the Commission urges on appeal that this standard [of clear and convincing evidence] is inappropriate in civil actions under the securities laws."¹⁶² The court of appeals held that in "[Decker's] case involving aiding and abetting a violation of §17(e)(1) . . . the proper standard . . . is preponderance of the evidence."¹⁶³ In so doing, however, the court took notice of a D.C. Circuit decision emphasizing that *Collins* only applies to cases of fraud¹⁶⁴ and decided in favor of the SEC on the narrow ground that the charges did not amount to fraud. The court implicitly rejected the SEC's challenge to *Collins*.

It appears that the SEC nonacquiescence strategy was adapted to deal with the problem of the broad venue provisions under the securities laws. Decker was censured pursuant to the Investment Company Act of 1940. Section 43 of the act calls for judicial "review of such order[s] in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia."¹⁶⁵ These broad provisions effectively prevent the SEC from knowing with certainty where an appeal will be filed at the time it issues its enforcement order. The court stated that the Commission overruled the ALJ without discussing the applicable standard, and waited until the appeal was filed to argue for the reversal of *Collins*.¹⁶⁶ While it is impossible to prove whether such delay was intentional, it is clearly significant that by

transactions by corporate directors.

¹⁶¹ *Decker*, 631 F.2d at 1383.

¹⁶² *Id.*

¹⁶³ *Id.* at 1384.

¹⁶⁴ See *Investors Research Corp. v. SEC*, 628 F.2d 168, 175 n.41 (D.C. Cir. 1980).

¹⁶⁵ Investment Company Act of 1940, §43, 15 U.S.C. § 80a-42 (1988).

¹⁶⁶ See *Decker*, 631 F.2d at 1383.

waiting until the appeal was filed before it explicitly challenged the validity of *Collins*, the SEC insured that it would not be brought before a D.C. Circuit panel to defend its "respectful disagreement" with the established precedent of that circuit. Thus the SEC avoided having its attempt at *intercircuit* nonacquiescence converted by the petitioners choice of forum into *intracircuit* nonacquiescence. Also, had the SEC opinion explicitly challenged the *Collins* rule, it is quite possible that Decker's counsel would have seen this as an opportunity for his client to defeat the SEC by seeking D.C. Circuit review.

C. Informal SEC Nonacquiescence

Standing alone, the SEC challenge to the *Collins* standard in *Decker* raises doubts as to the SEC's acceptance and compliance with the standard. The case of *Whitney v. SEC*¹⁶⁷ indicates that the SEC was not applying the *Collins* standard even in enforcement proceedings where it claimed to be doing so.

Whitney was a broker-dealer and insurance salesman who was disciplined by the SEC for alleged violations of the anti-fraud provisions of the Securities and Exchange Act, section 10-b and SEC Rule 10b-5.¹⁶⁸ The underlying transaction involved the placement, due to the efforts of Whitney, of half of the Town of Stratford's municipal pension funds in the management of Connecticut General Life Insurance Company (CG).¹⁶⁹

Whitney sought a commission for his efforts from either the pension funds or CG, but was rebuffed.¹⁷⁰ Whitney claimed to have reached a private agreement with John Elliott, an executive of CG, that CG would attempt to compensate him for his efforts by giving him the brokerage commission for liquidating the securities

¹⁶⁷ 604 F.2d 676 (D.C. Cir. 1979).

¹⁶⁸ Securities Exchange Act of 1934, §10(b), 15 U.S.C. § 78j(b). This section provides:

It shall be unlawful for any person, directly or indirectly . . .

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe

Id.

¹⁶⁹ See *Whitney*, 604 F.2d at 677.

¹⁷⁰ See *id.* at 677-78.

of the pension fund. Elliott died shortly thereafter and his successor refused to compensate Whitney as described.¹⁷¹

Thereafter, Whitney, at the request of the Town, picked up the securities "for conveyance to CG" and, accompanied by the Town's pension board chairman, took them to the New York offices of Thomson, McKinnon, Auchincloss, Kohlmeyer, Inc. (TM).¹⁷² An account was opened in the name of the pension fund "for the courtesy of CNA,"¹⁷³ a broker-dealer company owned by Whitney. Whitney told the TM employee that he need not send a confirmation to the pension board or CG.¹⁷⁴

At this point, the SEC claimed, Whitney continued unsuccessfully to try to persuade the Town to use his services for the liquidation.¹⁷⁵ When the Town sought to close its account at TM, however, it was informed that if it did so it would be charged \$5,000 for services already performed in opening the account.¹⁷⁶ The Town then had TM liquidate the account and TM paid Whitney \$3,500 out of the brokerage commissions earned from the sale.¹⁷⁷

The SEC concluded that through this conduct Whitney violated section 10-b of the Act and Rule 10b-5 by "deliberately deceiv[ing]" CG and the Town pension board [in order] 'to obtain compensation by arranging to have those securities sold through an agent of his own choosing.'¹⁷⁸ The Commission, pursuant to section 15(b) of the Exchange Act, sanctioned Whitney by revoking his broker-dealer registration for nine months.¹⁷⁹ The D.C. Circuit disagreed, reversing and remanding the case. The court held that "[t]he evidence . . . is so contradictory and ambiguous that we think no reasonable person would find it clear and convincing."¹⁸⁰

Just as it did in the several opinions listed previously, the Commission stated in *Whitney* that "[w]hether or not such a standard is required is of no consequence here. We find the evidence of Whitney's fraudulent conduct clear and convinc-

¹⁷¹ *See id.*

¹⁷² *Id.* at 678. Thomson, McKinnon, Auchincloss, Kohlmeyer, Inc. was a NYSE member firm and a broker-dealer.

¹⁷³ *Id.*

¹⁷⁴ *See id.*

¹⁷⁵ *See id.*

¹⁷⁶ *See id.*

¹⁷⁷ *See id.* at 678-79.

¹⁷⁸ *Id.* at 680 (quoting *In re Whitney*, Exchange Act Release No. 14,468, 46 S.E.C. 1159, 1164-65 (1978)).

¹⁷⁹ *See id.* at 681.

¹⁸⁰ *Id.* at 684.

ing."¹⁸¹ The court, however, rejected the SEC's contention that it had faithfully applied the correct standard, especially in light of the SEC position on appeal: "[T]he Commission recited in a footnote that it found the evidence of . . . fraud 'clear and convincing.' . . . It recalled [the holding of] *Collins*. . . . Evidently, however, the Commission is of the view that *Collins* is either wrong or inapposite. We disagree. *Collins* which we reaffirm today, plainly governs this case."¹⁸²

The court ridiculed the Commission's attempts to distinguish *Whitney's* case from *Collins* on the basis that *Whitney* was merely suspended and the evidence direct:

These supposed distinctions do not matter. Even were we for some reason inclined to choose the standard of proof under section 15(b) on a case-by-case basis, a practice which would not have occurred to us, we would not depart from the "clear and convincing" standard in this case.¹⁸³

The importance of *Whitney* is the doubt it casts over the sincerity of the Commission in the cases just reviewed, where it claims to have applied the clear and convincing standard of proof mandated by the court. On its face, the Commission opinion in *Whitney* is exactly like those issued in all the other cases recited above. Yet, on appeal, the Commission challenged the applicability of the very standard it claimed to have applied. The D.C. Circuit apparently believed that the Commission had given mere lip service to the required standard of proof.

The SEC continued to challenge *Collins* outside of the D.C. Circuit. In the Fifth Circuit, the Commission finally secured a decision which directly conflicted with *Collins*, *Steadman v. SEC*.¹⁸⁴ In that case, the SEC applied the preponderance of the evidence standard during an enforcement hearing and found the defendant guilty of various securities fraud counts.¹⁸⁵ The Commission then barred *Steadman* from the securities industry.¹⁸⁶ Thus, both elements of the *Collins* decision were present—charges of fraud and a severe sanction. *Steadman* appealed the Commission decision, claiming that the Commission should have applied the higher

¹⁸¹ *In re Whitney*, 46 S.E.C. at 1164 n.5.

¹⁸² *Whitney*, 604 F.2d at 680 (emphasis added) (footnotes omitted).

¹⁸³ *Id.* at 681.

¹⁸⁴ 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).

¹⁸⁵ *See id.* at 1137.

¹⁸⁶ *See id.* at 1128.

standard of proof under *Collins*.¹⁸⁷ The Fifth Circuit did not agree: "We are reluctant to say, however, that in all disciplinary proceedings under the securities anti-fraud provisions the Commission must prove its case by clear and convincing evidence. . . . [W]e cannot say here . . . that 'the possible injury to the individual is significantly greater than any possible harm to the state.'"¹⁸⁸

The Supreme Court granted certiorari and affirmed the SEC position, primarily through reliance on the Administrative Procedure Act, which it concluded, "was intended to establish a standard of proof and that the standard adopted is the traditional preponderance-of-the-evidence standard."¹⁸⁹ In this case, informal SEC nonacquiescence was apparently pursued while both intercourt dialogue and Supreme Court review were obtained.

Thus, the SEC resisted *Collins* through both formal intercourt nonacquiescence and informal nonacquiescence that was both inter- and intracircuit. The formal intercourt nonacquiescence is exemplified by the *Steadman* case, where the SEC facially challenged the *Collins* standard in the Fifth Circuit. At the same time, the SEC may well have been informally nonacquiescing, by reciting its deference to *Collins* instead of actually applying it. In *Whitney*, the Commission's claims of applying the clear and convincing standard, in addition to its attempts to distinguish the case from *Collins*, constituted informal intracircuit nonacquiescence.¹⁹⁰

While neither Estreicher and Revesz nor Diller and Morawetz would have any objection to the formal intercourt nonacquiescence practiced by the SEC in resisting *Collins*,¹⁹¹ both commentators probably would object seriously to the SEC's informal intracircuit nonacquiescence. Estreicher and Revesz disapprove of informal nonacquiescence because, by concealing its behavior from the courts, the agency does not allow courts to contribute to intercourt dialogue, which is the primary benefit of intracircuit nonacquiescence. Informal nonacquiescence is also inconsistent with reasonable efforts to obtain Supreme Court review of the issue, according

¹⁸⁷ See *id.* at 1137.

¹⁸⁸ *Id.* at 1139 (quoting *Addington v. Texas*, 441 U.S. 418, 427 (1979)).

¹⁸⁹ *Steadman v. SEC*, 450 U.S. 91, 102 (1981).

¹⁹⁰ See *Whitney v. SEC*, 604 F.2d 676 (D.C. Cir. 1979).

¹⁹¹ See Diller & Morawetz, *supra* note 2, at 802 n.8 (describing intercourt nonacquiescence as "not . . . very controversial"); Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 735-36 ("[I]ntercircuit nonacquiescence should not be constrained.").

to Estreicher and Revesz.¹⁹²

Diller and Morawetz would object to the SEC's informal nonacquiescence because it deprives the defendants in SEC enforcement actions, who are sometimes individuals, of the benefits of court standards if they lack the resources to appeal an adverse Commission ruling.¹⁹³ Also, Diller and Morawetz would likely view efforts by the SEC covertly to circumvent the law as a great threat to court control over the formation and declaration of the law.¹⁹⁴

CONCLUSION

The three cases of clashes between the SEC and the circuit courts of appeals illustrate how approaches advocated to deal with nonacquiescence in the context of the Social Security Administration are of limited relevance and applicability to other agencies. The three part test developed by Estreicher and Revesz states that an agency can only legitimately engage in intracircuit nonacquiescence when the dispute involves the agency's organic statute. *Grayson* shows how this requirement could sharply limit SEC ability to nonacquiesce in court interpretations of statutes that have a profound impact on the SEC's ability to regulate the securities industry effectively. The case also illustrates how small a role the concerns for individual rights and due process, as voiced by Diller and Morawetz, should play in judging nonacquiescence when the litigants opposing an agency are large, well-counseled corporations.

Heublein shows how effectively an agency can nonacquiesce through means beyond the reach of the courts and probably Congress. Many agency nonacquiescence practices are simply beyond legal regulation through any traditional doctrine and are left to the discretion of the agency. Finally, *Collins* shows how nonacquiescence is frequently difficult to detect, let alone effectively regulate, while also casting doubt upon the assertion that informal nonacquiescence retards the process by which the judiciary clarifies legal rules.

Another point to be drawn from this Comment is that at least some agency nonacquiescence is quite beneficial in terms of

¹⁹² See Estreicher & Revesz, *Nonacquiescence*, *supra* note 2, at 755.

¹⁹³ See Diller & Morawetz, *supra* note 2, at 815.

¹⁹⁴ See *id.* at 803-04 ("Continuity between legal standards as expressed in judicial decisions and legal standards as observed outside the courts is a central aspect of the rule of law.").

reaching correct results. In all three of the discussed cases, the SEC position was at least partially, if not totally, affirmed by the Supreme Court. The possibility of such results seems to have been ignored by most commentators, except Estreicher and Revesz. Before any general policies are implemented in the area of agency intracircuit nonacquiescence, much greater attention will have to be paid to the impact such policies will have upon agencies such as the SEC, which thus far have been neglected in the discussions of the subject.

The generalized approaches forwarded in recent articles by Estreicher and Revesz and by Diller and Morawetz do not reach their intended results when they are applied outside of the settings for which they were designed: repeated, formal, and open non-acquiescence by the SSA, NLRB, and IRS. More importantly, perhaps these scholars have focused on the wrong problem; if the SEC is indicative of other agencies, subtle, informal, and hidden nonacquiescence is more pervasive, and harder to identify.