COMMENT

EQUITABLE REMEDIES IN SEC ENFORCEMENT ACTIONS

I. INTRODUCTION

A. The Power to Fashion Equitable Remedies

Section 21(e) of the Securities Exchange Act of 1934 authorizes the Securities and Exchange Commission (SEC) to bring an action to enjoin any person who "is engaged or about to engage in any acts or practices which constitute or will constitute a violation of [these] provisions . . . ."1 Section 27 of this Act confers exclusive jurisdiction on the federal courts to hear "all suits in equity . . . brought to enforce any liability or duty created by [the Act.]"2 Pursuant to the equitable power conferred by these sections and analogous provisions of the Securities Act of 1933,3 the courts, at the behest of the SEC, have fashioned a broad range of remedies, often ancillary to the issuance of an injunction, to aid in rectifying fraud and to protect against future violations. Remedies imposed in enforcement actions have become increasingly varied,4 falling basically into three categories: (a) the remedying of past abuses through the grant of monetary relief;5 (b) the prevention of future fraud by requiring the adoption of special corporate procedures;6 and (c) the temporary appointment of special agents in cases of gross mismanagement requiring unusual control or wholesale replacement of existing management.7

The power of the courts to grant SEC requests for relief beyond a simple injunction against further wrongdoing appears

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4 For an extensive review of various types of ancillary relief, see Mathews, SEC Civil Injunctive Actions—II, 5 Rev. Sec. Reg. 949 (1972).
5 Text accompanying notes 40-50 infra. The Commission is not empowered to seek relief on behalf of private parties. In the context of this Comment, monetary relief refers to remedies which require defendants to give up money which they have obtained unlawfully; compensation to individual private parties is incidental to the thrust of the enforcement action.
6 Text accompanying notes 51-65 infra.
7 Text accompanying notes 66-146 infra.
well-established. The statutory grant of equitable power to the
courts includes all power necessary to make effective the decree
rendered by the court.

The SEC has no express statutory authority to seek re-
session, restitution, or other forms of equitable monetary
relief. The Commission, however, may institute an
action for injunctive relief and, once the equity jurisdic-
tion of the district court has been properly invoked, the
court has power to grant all equitable relief necessary
under the circumstances. . . . Ancillary relief contributes
to effective enforcement of the securities laws by depriv-
ing defendants of gains made through violations, by
deterring future violations, and by increasing the over-
all efficiency of Rule 10b-5 and similar actions.8

The power to effectuate the equitable decree is part of the
court's ancillary jurisdiction9 and exists in all cases absent a
specific statutory denial.10 It is the necessary means to protect
the authority of the court by assuring that its decrees are
meaningful.11 To the extent that the remedies requested by the
SEC serve specifically to effectuate the terms of the injunction,
that is, to prevent future wrongdoing, they are surely well within
the ancillary power of the court.

A somewhat broader basis for the exercise of judicial power
has emerged in the wake of the successful imposition of the
disgorgement-of-profits remedy in SEC v. Texas Gulf Sulphur
Co.12 Initially there was some doubt whether a remedy which was
not truly ancillary to the injunction could be imposed in an en-
forcement action.13 Thus, in Texas Gulf Sulphur the relief re-
quested was purely compensatory and remedial and could not,
in a formal sense, be considered necessary to effectuate the pro-
visions of the injunction, which was directed at the abatement of
future wrongdoing. The court there nonetheless refused to read

8 Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 390-91 (2d Cir.), cert.
9 See 1 J. Pomeroy, Equity Jurisprudence § 171(1) (5th ed. 1941).
11 Id. (power to order expungement of an arrest record properly ancillary to the
court's power to declare the innocence of a defendant in a criminal case).
12 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971).
13 See, e.g., Note, Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5, 79 Harv. L. Rev. 656 (1966); Comment, SEC Enforcement of the Rule 10b-5 Duty To Disclose
Material Information—Remedies and the Texas Gulf Sulphur Case, 65 Mich. L. Rev. 944
(1967); cf. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir.), cert. denied, 404
the Act to exclude this remedy. Relying on Supreme Court cases dealing with governmental enforcement in other regulatory areas and the recent decisions under the securities acts clarifying the scope of remedies in favor of private litigants, the court held "that the SEC may seek other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief . . . ." Power to impose the disgorgement-of-profits remedy, which is not strictly ancillary to the issuance of an injunction, derives from the general power of the federal courts to fashion federal common law in order to effectuate legislative programs. Congress necessarily legislates for the broad range of cases, leaving the effective implementation of its scheme to the courts and regulatory agencies. Enforcement of a legislative scheme may simply involve statutory construction, but it often includes the creation and implication of remedies going beyond the specific mandates of an act and involving, essentially, judicial lawmaking. Congress has enacted a comprehensive regulatory scheme in the securities field to "insure the maintenance of fair

14 446 F.2d at 1307-08.  
17 446 F.2d at 1308 (emphasis added).  
19 See Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388, 402-03 n.4 (1971) (Harlan, J., concurring): The Bovak case is an especially clear example of the exercise of federal judicial power to accord damages as an appropriate remedy in the absence of any express statutory authorization of a federal cause of action. There we "implied"—from what can only be characterized as an "exclusively procedural provision" affording access to a federal forum . . . —a private cause of action for damages for violation of § 14(a) of the Securities Exchange Act of 1934 . . . . We did so in an area where federal regulation has been singularly comprehensive and elaborate administrative enforcement machinery had been provided. The exercise of judicial power involved in Bovak simply cannot be justified in terms of statutory construction . . . . The notion of "implying" a remedy, therefore, as applied to cases like Bovak, can only refer to a process whereby the federal judiciary exercises a choice among traditionally available judicial remedies accord-
and honest markets"\textsuperscript{20} and to provide "full and fair disclosure of the character of securities sold . . . and to prevent frauds in the sale thereof . . . ."\textsuperscript{21} The power to implement these policies has been given to the SEC and to the courts and it is necessary that these institutions have the flexibility to enforce the securities acts in ways that are particularly suited to the case at hand.

Competence [in the judiciary to make law] is essential to the effective implementation of the legislative powers committed to the national government by the Constitution. . . . At the very least, effective Constitutionalism requires recognition of power in the federal courts to declare, as a matter of common law or "judicial legislation," rules which may be necessary to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress. In other words, it must mean recognition of federal judicial competence to declare the governing law in an area comprising issues substantially related to an established program of government operation.\textsuperscript{22}

Recognition of this broad basis for the exercise of judicial power provides a rationale for the imposition of a wide range of relief as long as it promotes the statutory purpose. Additionally, the federal common law rationale provides a basis for the award of relief \textit{irrespective} of the grant of injunctive relief.\textsuperscript{23} Thus, in \textit{Chris-Craft Industries, Inc. v. Piper Aircraft Corp.},\textsuperscript{24} the court awarded rescission against one of the defendants, Bangor Punta Corporation, which had sold stock in an exchange offer on the basis of a materially misleading registration statement. This remedy was imposed despite the court's refusal to issue an injunctive ordering to reasons related to the substantive social policy embodied in an act of positive law.

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\item \textsuperscript{21} Securities Act of 1933, ch. 38, Preamble, 48 Stat. 74.
\item \textsuperscript{22} Mishkin, \textit{supra} note 18, at 799-800.
\item \textsuperscript{23} Imposition of an injunction against a defendant has important consequences beyond the immediate effect of placing him in contempt should he violate the law in the future. These consequences include disqualification from serving in various capacities in connection with the management of an investment company, the unavailability of a "Reg. A" exemption (a shorter procedure available for the registration of certain public offerings of securities), and, for professionals practicing before the SEC, the possible temporary or permanent disqualification under rule 2(e) of the Commission's Rules of Practice, 17 C.F.R. § 201.2(e) (1974). See generally Mathews, \textit{SEC Civil Injunctive Actions}, 5 Rev. Sec. Reg. 969, 970-71 (1972).
\item \textsuperscript{24} 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973).
\end{itemize}
tion, though one was sought. Such an award is not without precedent. In *United States v. Moore*, the Supreme Court granted restitution for rental payments made in violation of similarly worded rent control provisions of the Housing and Rent Act of 1947 although no injunction could issue in that situation because the property in question had been decontrolled.

It is clear that both the courts and the SEC are becoming increasingly aware of this "quasi-legislative" power to impose flexible and creative remedies to fit the violation charged. As a practical matter, however, in some cases this power has developed with little formal judicial check on the SEC's discretion, because a number of these newer remedies have emerged as a result of negotiated consent decrees.

B. The Consent Decree Process

Consent decrees as a method of concluding litigation are viewed as a necessity for the Commission, which has neither the time nor the resources to litigate each case. They are also a speedy and efficient means by which to secure the immediate cessation of illegal conduct and to impose the desired relief. For the targets of the proceeding, there are many reasons to agree to a settlement. Early settlements limit the extent of adverse publicity, avoid more detailed elaboration of the proof underlying the charge (which would be presented, for example, in support of a preliminary injunction), may provide the opportunity to negotiate who is named in the injunctive decree, and preclude any possible collateral estoppel effects of the proceeding in future private actions. Additionally, because an unsuccessful defense is not reimbursable from corporate funds, the targets have an incentive to avoid costly litigation.

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25 *Id.* at 392. Similarly, in SEC v. Manor Nursing Centers, Inc., 340 F. Supp. 913 (S.D.N.Y. 1971), *modified*, 438 F.2d 1082 (2d Cir. 1972), certain defendants were ordered to return proceeds made in a fraudulent public offering of stock although no injunction was granted against them. *Id.* at 936.


27 Ch. 163, § 206(b), 61 Stat. 193. The provision under which the Administrator was suing provided, "Whenever . . . any person has engaged in or is about to engage in any act or practice which constitutes or will constitute a violation of subsection (a) of this section, [the Administrator] may make application . . . for an order enjoining such act . . . or for an order enforcing compliance with such subsection . . . ."


31 Mathews, *supra* note 4, at 955.

Although the decision to enter into a consent decree is an administrative act, the entry of the decree itself is an exercise of judicial power. "By approving the consent judgment, the court is adjudicating the plaintiff's right to relief and its extent, both of which are essential elements of any judgment." The court must be satisfied that the decree is equitable, that it affords relief in the public interest, and that the violation will, in fact, be remedied. Once there is consent to a decree, it can be attacked on appeal only on the grounds of fraud, lack of actual consent, or lack of subject matter jurisdiction in the court entering the decree. That a remedy could not be imposed if the case were litigated is not ground for appeal. Finally, it is extremely difficult for the defendant to secure modification of the decree once it is entered.

Out of this process recently have come several new remedies which are largely the creations of the SEC. Among these are model corporate procedures, the appointment of special counsel, and the appointment of interim directors. Although it is clear that these new remedies are within the power of the SEC to

an injunction and appointment of a receiver not reimbursible out of the receivership estate).

37 See, e.g., Swift & Co. v. United States, 276 U.S. 311, 324 (1928); SEC v. Dennett, 429 F.2d 1303 (10th Cir. 1970).
38 In Walling v. Miller, 138 F.2d 629 (8th Cir. 1943), cert. denied, 321 U.S. 784 (1944), an action brought by the Administrator of the Wages and Hours Division, the court refused to vacate a consent decree ordering restitution for back wages in an action under the Fair Labor Standards Act of 1938, 29 U.S.C. § 201 (1970), even though this remedy had not been established as one which the administrator was empowered to bring.

Assuming, but not deciding, that the administrator is not authorized in the first place to maintain a suit for restitution and that only the employees may do so, the inclusion of the order for restitution in the consent decree did not go to the jurisdiction or power of the court but to the merits only.

Id. at 631. Compare Communication Workers v. NLRB, 362 U.S. 479 (1960) (per curiam), modifying 266 F.2d 823 (6th Cir. 1959), with NLRB v. Brandman Iron Co., 368 U.S. 399 (1962), rev'd 281 F.2d 797 (6th Cir. 1960). In the former, a litigated case, the Court modified, as too broad, the injunction which had issued. In the latter case, equivalent language was reinstated by the Court when the injunction had issued as a result of a consent decree. Cf. Flynn, Consent Decrees in Antitrust Enforcement: Some Thoughts and Proposals, 53 IOWA L. REV. 983, 985 (1968): "[P]rovisions of the decree based upon erroneous factual or legal conclusions, provisions which enjoin intrastate activities, provisions which are vague and general, and provisions which go beyond the scope of the antitrust laws are barred from attack on appeal because of the defendant's consent to the decree." But cf. Cascade Natural Gas Corp. v. El Paso Natural Gas Co., 386 U.S. 129 (1967); Orth v. Transit Inv. Corp., 132 F.2d 938 (3d Cir. 1942).
negotiate and the courts to approve, they nonetheless present problems which should be examined.

The appointment of interim directors is a drastic remedy in that, like the equity receivership, it temporarily suspends the power of a company's shareholders to choose its managers. It is very different from that traditional remedy in that such directors, unlike equity receivers, have broad power to manage the firm—power that appears to be coextensive with that of elected directors; this increased power, however, seems to be subject to substantially less supervision by the court entering the decree authorizing appointed management. Moreover, provisions in consent decrees themselves seem to give the SEC a voice in the internal management of the company, as well as in the selection of these appointed managers. Although it is clear that the SEC as presently composed is one of the most effective and trusted federal agencies, it is equally clear that this may not always be the case. It seems a wise precaution to establish proper standards for the imposition of extensive new forms of relief before the failure to have articulated standards leads to abuses of power.

The finality of the consent judgment, the private nature of the negotiation process, and the lack of discussion by courts imposing many of the SEC's newer remedies combine to create relationships among shareholders, appointed management, the SEC, and the courts that need to be fully described and analyzed.

II. Remedies That Do Not Displace Elected Management

A. Monetary Relief

Since Texas Gulf Sulphur, disgorgement of profits derived from illegal insider trading has become a "regular" in the arsenal of enforcement remedies.40 (A recent variation of this remedy, requested in SEC v. Penn Central Co.,41 seeks disgorgement of profits, unrelated to insider trading, made through improper diversion of corporate funds and improper corporate agreements.)42 The rationale for the imposition of this remedy is that it promotes the statutory goals of the securities acts by en-

42 Cf. the recent consent decrees in the illegal political contribution cases wherein the targets agreed to reimburse the company for illegal payments which they caused the company to make. Notes 60-62 infra & accompanying text.
suring integrity in securities transactions and, in some instances, by encouraging disclosure as well. If an insider wishes to trade he must disclose all material inside information.) Additionally, this remedy is important both for its deterrent effect on future misconduct, by guaranteeing that no one may profit by wrongdoing, and because it makes provision for compensation to the victims of fraud through the appointment of agents to receive the money and administer it to defrauded claimants.

There are other monetary remedies which similarly promote the statutory purposes by encouraging disclosure, ensuring integrity, deterring future misconduct, and compensating victims. In SEC v. Manor Nursing Centers, Inc. the district court ordered rescission and restitution of proceeds for the benefit of purchasers in a faulty public offering. Similarly, requests for restitution and an accounting against an investment company were approved in SEC v. Quing N. Wong.

The remedies employed to grant monetary relief are basically the historical ones of restitution and rescission. The power to impose these remedies has been fully litigated, and, generally, the courts have attempted to articulate the functions which they are intended to serve; it is clear that they are well within the traditional power of equity to grant restorative relief. The principal problems in this area are now those of detail, such as problems of administration of the money collected or the extent of the relief to be granted. Other remedies, however, have

43 See Comment, supra note 13, at 956.
44 See, e.g., SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir.), cert denied, 404 U.S. 1005 (1971); SEC v. Golconda Mining Co., 327 F. Supp. 257, 259 (S.D.N.Y. 1971) (Weinfeld, J.) ("The injunction against future violations, while of some deterrent force, is only a partial remedy since it does not correct the consequences of past conduct.")
48 See 3 J. POMEROY, supra note 9, § 910.
50 See, e.g., SEC v. Manor Nursing Centers, Inc., 340 F. Supp. 913 (S.D.N.Y. 1971), modified, 458 F.2d 1082 (2d Cir. 1972) (trial court ordered that income and profits derived from the proceeds of the public offering be disgorged as well as the proceeds themselves; appellate court struck down this part of the order as punitive. 458 F.2d at 1104-05). See also SEC v. Shapiro, 494 F.2d 1301, 1309 (2d Cir. 1974) (affirming the trial court's method of determining the amount of illegal profits).
been imposed without hearing or opinion, and thus have no articulated basis for the exercise of judicial power.

B. Model Corporate Procedures

The most interesting of the newer remedies which the SEC has been imposing by way of consent decree is the mandating of special corporate procedures specifically designed to prevent recurrence of the violation charged. Under this type of decree, a company agrees under court order to set up special committees or to implement statements of policy which, if complied with, are expected to internalize various safeguards which will effectuate the provisions of the injunction that has issued.51

Several recent cases present good examples of this type of remedy. In SEC v. Goldman Sachs & Co.,52 the company was charged with selling Penn Central commercial paper to the public without adequately disclosing the financial condition of the company or the risks involved in the purchase of the securities. In the consent decree, Goldman Sachs agreed to implement a statement of policy with regard to its dealings in commercial paper and agreed that this statement would not be altered without securing Commission approval. This statement included commitments that (a) before dealing in any commercial paper, Goldman Sachs would conduct an investigation to ascertain that the security was validly issued and that it complied with applicable registration requirements; (b) before recommending the security, the company would have reasonable grounds to believe that the issuer would have the ability to redeem the paper at maturity; and (c) Goldman Sachs would receive copies of all reports filed by the issuer with the SEC or reasonably comparable information if no filings were required.53 This policy was calculated to assure compliance with the fiduciary obligation of rendering sound investment advice which the Commission seeks

51 In a related context, the Commission has been requiring the adoption of special internal controls in the settlement of proceedings under rule 2(e) of the Commission's Rules of Practice, 17 C.F.R. § 201.2(e) (1974). In Touche Ross & Co., 4 CCH Fed. Sec. L. Rep. ¶ 72,175 (Feb. 25, 1974), the settlement order provided that Touche Ross set up procedures designed to determine "management's direct or indirect involvement in material transactions which are included in the financial statements," and to ensure that periodic review of the quality of audits was conducted at least every two years. See also In re Jo M. Ferguson, SEC Securities Act Release No. 5523 (Aug. 21, 1974), and the action against Benjamin Botwinick & Co., an accounting firm, wherein the target company agreed that over the next 5 years, each of its partners would attend 40 hours annually of courses and seminars in subjects related to the accounting profession. Wall St. J., Jan. 15, 1975, at 19, col. 2.
53 Id.
to enforce against brokerage firms and was specifically tailored to protect the public in its dealings with Goldman Sachs.

The SEC has not hesitated to mandate special procedures for companies other than broker-dealers. Teleprompter Corporation, an operator of cable television systems, recently consented to an injunction against issuing false and misleading press releases and annual reports. Apparently satisfied that the company's failure to disclose that it was reducing its construction program was caused by inadequate "internal financial controls and procedures," rather than by intentional fraud, the SEC accepted new financial monitoring and reporting techniques as part of the consent decree. These new procedures required the preparation of operating and capital budget forecasts on a reasonably current basis; they also included the safeguard of furnishing the SEC with an affidavit describing the procedures accompanied by a letter from the auditor confirming that such procedures had in fact been implemented. This settlement was clearly aimed at the specific problem of identifying anticipated cutbacks in capital expansion programs at an early stage and assuring full disclosure to the public. This specific failure to disclose was the precise problem for which Teleprompter had been cited.

The consent decree in SEC v. Lums, Inc. went one step further than the Teleprompter order, in that it actually mandated the disclosures which had to be made in any subsequent registration or proxy statement issued in connection with the future acquisition of any gambling casino. Included among the required disclosures were who controlled the acquired business and the material consideration, in addition to the purchase price, to be paid for the acquired business. These disclosures were supplemented by a proscription against the inclusion of unaudited financials of the acquired company unless assurances of their fairness were received from independent auditors. This order was an attempt to assure the accuracy of proxy and registration statements issued by Lums in connection with future acquisitions.

59 Id.
Companies that have filed false financial reports to cover up their illegal campaign contributions may become targets of enforcement actions in the future. In the first such campaign contribution case, the Commission negotiated a consent decree with American Ship Building Company in which the corporation agreed to disclose the illegality and to set up a special review committee made up of two independent directors and a chairman, unaffiliated with the company, to study the company's books to determine the extent of misused corporate funds, and to remedy these violations. The expectation of the Commission is that this special committee will remedy past improprieties and set up a system to prevent recurrence of such illegality. Further, the SEC has indicated that corporations that have failed to disclose illegal campaign contributions may adopt the procedures mandated in the American Ship Building Company court order and thereby SEC action against them.

The provisions mandated by each of these consent decrees are attempts by the Commission to establish ongoing procedures which will ensure corporate compliance with federally created obligations. That enforcement of the securities laws is creating a federal law of substantive corporate duties and responsibilities which supplements and often exceeds the requirements of state law is well-documented. Mandating special corporate procedures by court order contributes to this already substantial body of federal law in several ways. The immediate effect of this kind of remedy is to restructure certain aspects of corporate procedure on pain of contempt. The larger result is that the SEC is building up a body of approved model corporate procedures (including special committees to oversee various aspects of the

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61 Id. In addition, the company chairman agreed to repay any illegally contributed funds.
62 See Wall St. J., Feb. 3, 1975, at 4, col. 1, reporting a consent decree negotiated with the Minnesota Mining & Manufacturing Company enjoining the company, its chairman, and two former officers from using corporate funds for illegal campaign purposes, from filing false reports with the SEC, and from establishing secret funds. The company agreed to the appointment of a special agent, approved by the Commission, to "investigate and report on any other instances in which the company disguised the real use of corporate funds."
63 The order . . . spells out the actions other illegal corporate contributors should take if they want to avoid SEC action. SEC officials have said that any company convicted of making illegal gifts should disclose the wrongdoing, set up procedures to make sure it doesn't happen again and require the repayment of any corporate funds.
business, approved statements of policy, and approved items for inclusion in proxy or registration statements) which can be taken as guides to all companies in their efforts to meet federal law.

The SEC has not gone uncriticized for having fostered the creation of an unreasonably high level of corporate responsibility. Mandating model procedures is a creative way for the SEC to show that these expectations are not unrealistic. These "approved" procedures could have the effect of shifting the burden of proof in subsequent private actions against target companies that had failed to comply with the court orders against them. Alternatively, the institution of and compliance with these model procedures in a non-target company might provide evidence of having complied with the duty of due care.

The remedies discussed in this section are well within the statutory grant of authority to the SEC and the courts "to enforce any liability or duty" created by the securities acts. The special procedures have been specifically designed to remedy the precise violation charged. If the SEC has the power to request injunctions against future violations, surely its ancillary power should include the ability to mandate procedures to ensure future compliance. Management that has failed to set up procedures which successfully ensure compliance with the law may appropriately be ordered to implement changes which will protect the public in dealing with its securities.

III. Remedies That Displace Elected Management

Another type of remedy which the SEC has successfully requested is the appointment of a variety of special agents endowed with power to redress past violations, to bring the company into compliance with applicable law, and to prevent future wrongdoing. In this category are receivers, and, it will be argued, what are essentially variations of this remedy—special counsel and interim directors.

The appointment of a receiver is a traditional tool of equity courts. The Commission staff maintains that its success in obtaining equity receiverships in appropriate cases indicates that its power must extend as well to less extreme forms of relief, namely the appointment of special counsel and interim directors. In imposing remedies short of receivership, the

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65 For a discussion of the major criticisms in this area, see id. 1172-73.
67 Sporkin, supra note 28, at 123.
Commission hopes to preserve the corporate entity as a viable business by avoiding the inflexibility and adverse public reaction which invariably accompany the institution of a receivership while preserving the protections which inhere in that remedy.

A. Receivers

A receiver is an officer of the court who stands neutral among all parties and whose primary function is the protection of the property within his control from waste or mismanagement.\(^{68}\) The institution of a receivership is a drastic remedy, to be imposed only as a last resort.\(^{69}\) Requisite to its imposition are findings by the court of fraud, mismanagement, and imminent danger of waste should existing management remain in control.\(^{70}\) It is primarily a holding measure, the purpose of which normally is the marshaling and preservation of assets pending some ultimate action such as liquidation or reorganization.\(^{71}\) Often in SEC enforcement cases, however, no such ultimate action is contemplated, and a receiver is appointed simply to bring a company into compliance with all applicable law, as by causing a full audit to be made and by making all required disclosures.\(^{72}\)

As an officer of the court,\(^{73}\) the receiver is a fiduciary and is held to the highest standard of undivided loyalty.\(^{74}\) However, the receiver may assure himself of protection in the exercise of his duties by applying to the court which appointed him for direction.\(^{75}\) Indeed, he is dutybound to receive direction from

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\(^{68}\) J. Pomeroy, supra note 9, § 1330.

\(^{69}\) See, e.g., Ferguson v. Tabah, 288 F.2d 665, 674 (2d Cir. 1961).


\(^{71}\) See, e.g., SEC v. Diversified Brokers Co., 305 F. Supp. 950, 952-53 (E.D. Mo. 1969): "This SEC receivership is designed and intended as a holding action, conserving and collecting assets pending the proper final disposition. Since the passage of time works against the conservation of, and against the ability to collect assets, immediate action is necessitated."

\(^{72}\) See, e.g., SEC v. S & P Nat'l Corp., 360 F.2d 741, 750-51 (2d Cir. 1966): "[The purpose of this receivership is] to install a responsible officer of the court who could bring the companies into compliance with the law, 'ascertain the true state of affairs... and report thereon' to the court and public shareholders and preserve the corporate assets."


\(^{74}\) Phelan v. Middle States Oil Corp., 154 F.2d 978, 991 (2d Cir. 1946): "A receiver, as 'an officer or arm of the court,' is a trustee with the highest kind of fiduciary obligations. He owes a duty of strict impartiality, of 'undivided loyalty,' to all persons interested in the receivership estate, and must not 'dilute' that loyalty." See 16 W. Fletcher, Cyclopedia of the Law of Private Corporations § 7811 (rev. ed. 1962).

\(^{75}\) See Pioche Mines Consol., Inc. v. Dolman, 333 F.2d 257, 276 (9th Cir. 1964), cert. denied, 380 U.S. 956 (1965); 16 W. Fletcher, supra note 74, § 7864.
the court prior to taking any action on an important matter.\textsuperscript{76} To attack the conduct of a receiver is to attack the integrity of the court itself.\textsuperscript{77} In all cases, a receiver for a corporation is bound by applicable state law.\textsuperscript{78}

Because a receivership is primarily a measure designed to preserve the status quo, it is ill-adapted to the continuation of an ongoing business.\textsuperscript{79} The receiver, bound to represent the interests of all parties in the receivership estate,\textsuperscript{80} is not normally authorized to carry on a business in a speculative way.\textsuperscript{81}

The ability of the Commission to obtain equity receivers in appropriate cases is well-established.\textsuperscript{82} Although the remedy was initially confined to cases of insolvent broker-dealers,\textsuperscript{83} the courts have been willing to apply it to other kinds of companies,\textsuperscript{84} irrespective of solvency.\textsuperscript{85}

Although the Supreme Court has not directly faced the power of courts to impose equity receiverships as an enforcement remedy, the power to obtain receivers has been sustained with respect to a private litigant suing under the Securities Act of 1933.\textsuperscript{86} In a suit seeking an injunction, rescission, and the appointment of a receiver on the ground that the defendant was guilty of fraudulent misrepresentation in the advertisement and sale of securities, the Court stated:

\begin{quote}
[T]he Act as a whole indicates an intention to establish a statutory right which the litigant may enforce in designated courts by such legal or equitable actions or procedures as would normally be available to him. . . . [I]n
\end{quote}

\textsuperscript{76} See 4 J. Pomeroy, \textit{supra} note 9, § 1336.
\textsuperscript{77} Phelan v. Middle States Oil Corp., 154 F.2d 978, 1000 (2d Cir. 1946).
\textsuperscript{78} See 16 W. Fletcher, \textit{supra} note 74, § 7813.
\textsuperscript{79} See, e.g., United States v. Johnson, 98 F.2d 462, 466 (8th Cir. 1938):

In the absence of special authority, a receiver has no power to continue to carry on a private business of which he is appointed receiver . . . . The court, in its discretion, may permit a receiver to continue the conduct of a business temporarily, when the interests of the parties seem to require it, but it is said that the court should move "with great caution in conferring such authority and exposing the property to the hazards of business;" and such action is justified only when clearly necessary for the preservation of the rights of the parties.
\textsuperscript{80} 4 J. Pomeroy, \textit{supra} note 9, § 1331.
\textsuperscript{81} Northwest Marine Works v. United States, 307 F.2d 537, 542 (9th Cir. 1962).
\textsuperscript{82} See, e.g., SEC v. Bowlar, 427 F.2d 190 (4th Cir. 1970); SEC v. S & P Nat'l. Corp., 360 F.2d 741 (2d Cir. 1966); Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960).
\textsuperscript{83} See 3 L. Loss, \textit{Securities Regulation} 1508-14 (2d ed. 1961).
\textsuperscript{84} See, e.g., SEC v. Bowlar, 427 F.2d 190 (4th Cir. 1970) (a small loan business).
\textsuperscript{85} See, e.g., Bailey v. Proctor, 160 F.2d 78, 82 (1st Cir.), cert. denied, 331 U.S. 834 (1947).
\textsuperscript{86} Deckert v. Independence Shares Corp., 311 U.S. 282 (1940).
section 22(a) . . . specified courts are given jurisdiction "of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter." The power to enforce implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.\textsuperscript{87}

The cited language is equally applicable to actions instituted by the Commission "to enforce any liability or duty created" by the Securities Acts. If present management cannot be trusted to comply with an injunction, the appointment of a receiver becomes necessary to make effective the injunctive decree and to bring a company into compliance with applicable law. In such a case the SEC may appropriately request the remedy and the court has the power and discretion to grant it.

Despite its well-established power to obtain receiverships in appropriate cases, the Commission is often reluctant to enforce this remedy.\textsuperscript{88} One reason, mentioned above as a consequence of the requirement, that he represent all interests in the receivership estate, is the inability of the receiver to operate the company aggressively. The principal drawback of this remedy, however, is the negative public reaction consequent to its institution. The appointment of a receiver is often a sharp blow to customer and investor confidence. Courts are not unmindful of the public-relations impact of this remedy. In \textit{Los Angeles Trust Deed & Mortgage Exchange v. SEC},\textsuperscript{89} in which a receiver was appointed at the request of the SEC, the court said: "It is appreciated that the conservator type of receivership which we have insisted upon is not well adapted to a business the very essence of which is promotion and, apparently, depends on a constant inflow of new business."\textsuperscript{90} Again, in \textit{SEC v. Bowler},\textsuperscript{91} the court conceded:

We do not question the strength of defendants' arguments that some plan of reorganization of the corporate defendants is probably preferable to the appointment of a receiver. The latter carries connotations which may be ruinous in an industry where ready access

\footnotesize{\textsuperscript{87} Id. at 287-88 (emphasis in original). \textsuperscript{88} See generally Sporkin, supra note 28. \textsuperscript{89} 285 F.2d 162 (9th Cir. 1960), cert. denied, 366 U.S. 919 (1961). \textsuperscript{90} Id. at 182. \textsuperscript{91} 427 F.2d 190 (4th Cir. 1970).}
to borrowed funds is a condition precedent to profitable operation and where prompt payment of receivables is essential.\textsuperscript{92}

The effect of this remedy on creditors, alluded to in \textit{Bowler}, may be even more direct. A provision found in many loan agreements provides that the appointment of a receiver will constitute a condition of default and thus cause the loan to fall due.\textsuperscript{93} Such a triggering of any substantial loan may, of course, be ruinous to a business.

Courts have struggled with this problem in private actions, attempting to structure relief to accomplish the goals of protection of investors or creditors from further wasting of assets without totally destroying the ongoing business in the process. In \textit{Adelman v. CGS Scientific Corp.},\textsuperscript{94} an action for rescission of a sale of one corporation to another which was alleged to have been fraudulently induced, the court appointed a "custodian" who was authorized to hold the assets of the company for fifty-nine days; this avoided a condition in a loan agreement which provided that the appointment of a receiver for sixty consecutive days would be a ground for acceleration of the loan.\textsuperscript{95} And in \textit{Roach v. Margulies},\textsuperscript{96} the trial court appointed a fiscal agent "with full power and authority to check the propriety of all disbursements to be made or proposed to be made or proposed to be made by the corporation."\textsuperscript{97} If the agent questioned any disbursement he was to report to the parties who could then apply to the court for relief. The appellate court sustained this remedy as an ingenious device "contrived to avoid more stringent measures" and thus "to avoid injuring the business in its relations with the public and its large number of subscribers."\textsuperscript{98}

Thus, courts have long been willing to mold their decrees in private actions to minimize the possibility of harm when the goals of protection could be adequately served through means less drastic than the appointment of a receiver. Recently, in enforcement actions, the SEC has been attempting to construct

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\textsuperscript{92} Id. at 196.
\textsuperscript{93} See generally Sporkin, \textit{supra} note 28.
\textsuperscript{95} Id. at 151-52.
\textsuperscript{97} Id. at 245, 126 A.2d at 46.
\textsuperscript{98} Id. at 246, 126 A.2d at 47. Cf. \textit{SEC v. Koenig}, 469 F.2d 198 (2d Cir. 1972) (appointing a "limited receiver" \textit{inter alia} to supervise public disclosures, to investigate and make a public report on certain secret securities transactions, and to make preparation for and hold a shareholders' meeting to elect new directors).
\end{flushleft}
remedies which avoid the inflexibility and adverse connotations which are inherent in the traditional remedy of receivership.

B. Directors Appointed or Approved by the Court

1. Use of the Remedy in Practice

Recent consent decrees in enforcement actions have included, in various forms, the appointment of independent directors who are satisfactory to the SEC and approved by the court. This remedy, like the receivership, temporarily suspends the traditional power of the stockholders (at least with respect to these directors) to choose the management of their company.

SEC v. Mattel, Inc. is one example of the way in which this remedy has been imposed. On August 5, 1974, Mattel consented to an order permanently enjoining it from securities fraud violations. As part of this order, it agreed to add to its board two court-approved directors, unaffiliated with Mattel and satisfactory to the Commission, and to set up two special committees composed in part of these new directors to review accounting procedures, to supervise the accuracy of financial disclosures and reports issued from the company, and to study the possibility of legal action against past or present officers of the company. On November 26, 1974, the court, at the behest of the SEC, amended the order to require that Mattel name a majority of independent, SEC-approved directors to its board; these additional directors were ordered to appoint a special counsel satisfactory to the SEC, and approved by the court. The amendment was prompted by additional disclosures to the SEC indicating that overstatement of profits and understatement of losses had occurred at least since 1971 (rather than for only the 1973 fiscal year, as originally thought), and that the company might be vulnerable to private class action litigation already instituted alleging fraud in the sale of securities. It was the opinion of the SEC, and the court agreed, that Mattel should be controlled by new, independent management.

The Mattel case is an excellent example of the flexibility of this new remedy, which allows the courts to institute a specific

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100 Id.
101 Civil No. 74-2958 (C.D. Cal., Nov. 26, 1974). The case was transferred from the District of Columbia to the Central District of California after the entry of an amended order on October 2, 1974, which embodied essentially the same relief as the order of November 26. Wall St. J., Oct. 3, 1974, at 4, cols. 2-4.
type of control—tailored to the offense charged—which may be altered as circumstances change. The original order was issued on the assumption that publication of incorrect financial figures would not be repeated because all disclosures and accounting and control procedures would thereafter be reviewed by independent outsiders. When additional information made it appear that the false financials were the result of fraud, the agency requested that the role of existing management be curtailed and that control be given to independent outsiders whom the court and the SEC deemed to be acceptable.\textsuperscript{103}

The court appointment of interim directors who are satisfactory to the Commission has been mandated by several other recent consent decrees.\textsuperscript{104} This appointment has been coupled with the mandatory resignation of existing management, as in \textit{SEC v. Vesco},\textsuperscript{105} or has been imposed although existing management was allowed to remain, as in \textit{SEC v. Coastal States Gas Corp.}\textsuperscript{106} In the latter case the order provided simply that a majority of the board be court-appointed. Although the decrees vary somewhat, they basically provide that the board of the enjoined company be composed partly or entirely of members independent of the company.\textsuperscript{107} This board is to have "full power under applicable corporate law to conduct the affairs" of the company.\textsuperscript{108} They are to serve

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until further order of this Court upon the application of plaintiff Commission and until the shareholders . . . have elected a new board of directors . . . . No individual director appointed pursuant to this provision shall be discharged or replaced or any additional directors be appointed or elected except upon application to
\end{quote}

\textsuperscript{103}Id.


\textsuperscript{105}72 Civ. 5001 (S.D. N.Y., Mar. 16, 1973).


\textsuperscript{107}See, e.g., \textit{Memorandum of Terms of Settlement \textsection \ 4(b), SEC v. Clinton Oil Co.}, Civil No. W-5020 (D. Kan., Mar. 8, 1973).

\textsuperscript{108}See, e.g., \textit{Final Judgment of Permanent Injunction and Appointment of Special Counsel and Directors \textsection \ 4, SEC v. Vesco}, 72 Civ. 5001 (S.D. N.Y., Mar. 16, 1973).
this Court by plaintiff Commission in accordance with the provisions of this paragraph.\textsuperscript{109}

Additionally, each such director "shall not be liable for any action taken or omitted to be taken by him or for any error in judgment made in good faith by him in his capacity as interim Director unless it shall be proved that he was grossly negligent in connection with such action, omission or judgment ..."\textsuperscript{110}

Thus, by court order and at the Commission's request, a board of directors that cannot be voted out or removed by normal shareholder action is installed, and is accountable only for actions which are grossly negligent. Initially, it seems anomalous that the Commission, which has had as a major goal the expansion of shareholder democracy\textsuperscript{111} and the creation of a higher standard of accountability for corporate management,\textsuperscript{112} should have sponsored the creation of this remedy which appears to be at odds with those policies. The anomaly is, however, more apparent than real.

An analysis of this remedy shows that these provisions are the result of efforts to modify the equity receivership remedy to preserve its virtues while eliminating its drawbacks of inflexibility and adverse public and creditor reaction. Appointment of independent agents called "directors," who will serve for a time without standing for election and who need not worry about personal liability for actions short of gross negligence, is an attempt to provide the freedom from liability and the full control of a receiver while at the same time providing for a measure of flexibility not available under that more traditional remedy. A comparison of the receivership remedy with the appointment of interim directors will highlight the reasons for these provisions.

2. Comparison of Remedies

The orders consenting to the appointment of interim directors provide that they shall have full power to conduct the affairs of the company "under applicable corporate law." Rather than being agents of the court with carefully delineated powers, as are equity receivers,\textsuperscript{113} these directors operate as traditional agents and managers of the company. They may take risks, sell or ac-

\textsuperscript{109} Id.\textsuperscript{110} Id. \S 4(ii).
\textsuperscript{111} Cf. Proposals of security holders, 17 C.F.R. \S 240.14a-8 (1974).
\textsuperscript{112} Cf. Address by Commissioner Sommer, American Bar Association, in 267 BNA SEC. REG. & L. REP. G-1-5 (Aug. 28, 1974).
\textsuperscript{113} Text accompanying note 68 supra.
quire assets, negotiate with creditors, and, in short, do what is necessary to manage the "business and affairs" of the company. They may do all this, presumably, without applying to the court for direction. To substitute for the cloak of protection which court approval provides for the receiver, the order prescribes a "gross negligence" standard of care to which these directors will be held accountable. Because there is continuing jurisdiction in the court to oversee various provisions of the decree, and because it has been held, in connection with a receivership proceeding, that the SEC remains a party and may apply to the court to enforce compliance with the decree or to bring evidence of misbehavior to the court's attention, the shareholder will still be protected. What has changed, of course, is that given the gross negligence standard, effective protection now lies in the court or the SEC rather than in the shareholder's own private legal action.

The result, then, of the institution of interim directorships is that, as in a receivership, the existing management is ousted or effectively precluded from further control; there is continuing surveillance by the SEC and the court of the operation of the business; and the company continues to function, vis-à-vis the public, subject to the provisions of applicable law. Unlike a receivership, however, the interim board has broad and flexible powers to manage the company without going to the court for approval.

C. Special Counsel

Another agent, whose appointment the SEC has been securing with some regularity, is special counsel. His designation

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115 Text accompanying notes 75-78 supra.
116 See, e.g., Memorandum of Terms of Settlement ¶ 18, SEC v. Clinton Oil Co., Civil No. W-5020 (D. Kan., Mar. 8, 1973); "[T]he Court shall retain jurisdiction with respect to all matters relating to the implementation, accomplishment and enforcement of the acts to be done pursuant to the terms of the settlement agreement and to make such orders as may be necessary and appropriate in connection therewith . . . ."
117 East v. Crowdus, 302 F.2d 645, 647 (8th Cir. 1962).
119 See, e.g., SEC v. Holiday Magic, Inc., Civil No. C 73 1095 (N.D. Cal., Apr. 2, 1974);
often accompanies the court appointment of interim directors, and his role in reordering the enterprise is essentially to investigate the financial affairs of the company, to oversee a full accounting of all the transactions, and to take any legal actions warranted by the results of these investigations.

Special counsel appointed for the International Controls Corporation (ICC) has brought one such action pursuant to his mandate in SEC v. Vesco. ICC is part of the beleaguered financial enterprise of the now-famous Robert Vesco. Special counsel brought suit against forty-two individual and corporate defendants who had allegedly aided Vesco in his scheme to defraud a number of Vesco-controlled companies, including ICC, resulting in the defendants' control of "over $200 million deposited in banks located in countries ranging geographically from Luxembourg to Costa Rica." In that suit, ICC secured a preliminary injunction against the disposition of certain assets claimed by ICC—including a pleasure yacht used exclusively by Vesco and his family, an astonishingly well-equipped Boeing 707 aircraft, and over 800,000 shares of ICC stock transferred by Vesco and his family to an alter ego, Vesco and Co.

The incredible complexity of the fraud alleged in the Vesco case, and the obvious need for rapid action to protect ICC and the public from further diversion of corporate assets beyond the borders of this country, provide an excellent example of the need for a special agent to investigate the company's affairs and to take quick legal action. Indeed, the International Controls Corp. v. Vesco suit was instituted within three months of ICC's consent to the injunction and appointment of special counsel.

This power to bring suit on behalf of a corporation for fraud or waste is normally vested in the board of directors of the company itself, or, if the board will not act, in the stockholders by way of a derivative suit. Empowering a special agent to bring

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120 Final Judgment of Permanent Injunction and Appointment of Special Counsel and Directors ¶ 3(a), SEC v. Vesco, 72 Civ. 5001 (S.D.N.Y., Mar. 16, 1973).


122 Id. at ¶ 10(b).


124 Id. at 1338-39.

125 Id. at 1338.

126 Entry of the injunction was March 16, 1973, and the subsequent suit was instituted June 7, 1973, id. at 1340.
such suits represents a significant departure from the traditional scheme created by state law. The orders appointing these agents give them full power to institute all legal proceedings subject only to notification of or consultation with the board of directors with respect to their intentions, or in one case, subject to a prior demand on directors.

In essence, this power is no different from the power often given to equity receivers in enforcement actions to aid them in the marshaling and preservation of assets. To the extent that special counsel acts as a receiver under the court's supervision, the remedy is simply a modified form of an equity receivership. There is, however, an extremely important way in which this remedy differs from a receivership order.

Although the board of directors has relatively little power to prevent special counsel from prosecuting claims, the SEC has significant power in this regard. The court order in SEC v. Vesco provides that special counsel "shall neither decline to pursue any claim . . . , nor settle any claims, against the recommendation of plaintiff Commission and without the approval of this Court . . . ." The order appointing special counsel in SEC v. Holiday Magic, Inc. provides that "[t]he Commission retains the right to oppose the pursuit of any claim where it believes investors' interests would not be served by the pursuance of such claim." These provisions give the SEC broad power to control the deci-

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128 Consent Judgment of Permanent Injunction and Appointment of Special Counsel ¶ III-B, SEC v. Holiday Magic, Inc., Civil No. C 73 1095 (N.D. Cal., Apr. 2, 1974). Special Counsel shall, after consulting with corporate counsel of the Corporate Defendants, request the board of directors of the appropriate companies to authorize and direct management to institute the suit. If the board of directors fails to honor the Special Counsel's request within 15 days of the request or if management or its counsel fails to institute the suit expeditiously, the Special Counsel shall be authorized to institute and pursue the suit on behalf of the company.
129 See text accompanying note 136 infra.
130 It should be noted that special counsel has been given the same immunity from liability, except for actions which are grossly negligent, as that discussed in connection with the appointment of interim directors. Text accompanying notes 110-117 supra. In the case of special counsel, however, the need for flexibility and freedom from court supervision is not as compelling as in the case of temporary directors, and this provision seems to be an unnecessary dilution of accountability. Realistically, it is likely that in both cases the provision is included as an inducement to get well-qualified people to serve in often difficult situations.
sions made with respect to the prosecution and settlement of claims against the target company and its officers. This kind of substantive control over the business decisions of the company is probably an unwarranted and presently unjustified extension of the SEC's power over corporations.

Another provision in the order in Holiday Magic presents a similar problem. That order provides: "The Corporate Defendants shall not expand their operations to a new product line or business not now in existence without approval of the Special Counsel."\textsuperscript{133} It is very difficult to understand why special counsel needs to be given this approval power as ancillary to an injunctive decree that enjoins defendants from selling securities in connection with a pyramiding scheme "unless the products or services of the corporate defendants are rendered in substantial degree to consumers . . . ."\textsuperscript{134} Nor is it clear that such power effectuates the statutory purposes of the securities acts, which seek to regulate securities sold by business and not the business itself.

D. Why Establish These New Remedies?

There seem to be two basic reasons for the efforts to find substitutes for the equity receiver. The first has to do with the much greater efficiency of an appointed board of directors in rapidly taking the steps necessary to put a defendant company in order. Frequently, firms that have been the subject of fraudulent and manipulative management are on the brink of insolvency. A traditional receiver appointed by a court would be restrained in his attempts to salvage the situation both by his duty to represent all interested parties in a neutral manner, and by the necessity of obtaining court approval for all but the most routine decisions. An appointed board of directors would be free to negotiate loans, sales of assets, and other organic changes in the structure of the business necessary to salvage all or a part of it as an ongoing enterprise.

This degree of flexibility may be an appropriate and necessary ingredient of any remedy which is designed to keep a company viable while providing a means for ascertaining the current state of affairs and for bringing the company into compliance with applicable law. It is not at all clear, however, that this purpose could not be achieved by means of a receivership which was subject to less supervision by the court, but which also had less

\textsuperscript{133} Id. \textsuperscript{1} VI-C.

\textsuperscript{134} Id. \textsuperscript{1} 1-D.
power to change the corporate structure in fundamental ways. For example, the receiver in *SEC v. Arkansas Loan & Thrift Corp.*\(^{135}\) was authorized *inter alia*:

> to continue, manage and operate the business of the defendants, until the further order of this court, with full authority to carry on, manage and operate the said business, to buy and sell merchandise, supplies or stock in trade for cash or on credit, and as may be deemed advisable by such receiver . . . to employ such managers, agents, employees, servants, accountants, and attorneys as may in his judgment be advisable or necessary in the management, conduct, control or custody of the affairs of the defendants . . . to make such payments and disbursements as may be needful and proper for the preservation of the properties of the defendants . . . to receive and collect any and all sums of money due or owing to the defendants . . . to institute, prosecute and defend, compromise, adjust, intervene in or become party to [court] actions . . . as may in his opinion be necessary or proper for the protection, maintenance and preservation of the assets of the defendants . . .\(^{136}\)

This receivership order would seem to encompass most actions that a director would want to take in the exercise of his duties. What a receiver is precluded from under such an order is wholesale reorganization of the business. He probably could not sell off a substantial part of the assets or change a line of business. These are actions which the interim board presumably could take and which could be accomplished without the normal requirements of accountability and direction that are provided by shareholder election of management and by the threat of shareholder derivative suits.

The efficiency argument mentioned above may justify the greater power vested in appointed directors to manage the company, depending upon the severity of the situation and the need for quick action, but it also illustrates that such appointments are possibly an even more drastic remedy to seek and impose than the equity receivership.

What seems to be at the heart of these new remedies, however, is the desire to cause minimal disruption to the ongoing

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\(^{136}\) *Id.* at 1237.
operation of a company. It is apparently felt that the imposition of something called a receivership will cause creditors and investors far more alarm than the appointment of agents with more familiar names—temporary directors and special counsel.

There are, in fact, many kinds of receivers.137 A receiver may be appointed to preserve property during the course of litigation or in aid of a final decree. He may be directed to take charge of some of the assets of a corporation or of the corporation itself. A receiver may be directed to liquidate a company or to preserve assets pending some future action, and, perhaps most significant in the present context, a receiver may be appointed pursuant to a statute or by the inherent equity power of the court.

Very often the appointment of receivers pursuant to a statutory procedure may either herald the initiation of a federal bankruptcy proceeding wherein debts will be canceled or an arrangement confirmed,138 or indicate that a dissolution procedure has been initiated under state law.139 The appointment of a receiver in these cases is often dependent on some showing of insolvency. It usually indicates to the creditor that his property is going to be dealt with in a way that is beyond his control and to the investing public that the corporate entity may be on the verge of bankruptcy or liquidation. The appointment of an equity receiver in an SEC enforcement action, however, does not necessarily signal the need for or institution of a bankruptcy proceeding.

It is precisely this failure to distinguish among the various types of receivers in the covenants of loan agreements that has forced the SEC to seek similar remedies with new names.140 The intent of the covenants is usually to call loans only when the company is nearing insolvency. A receivership, requested by the SEC and imposed by the courts, is traditionally available only in cases of massive fraud, where allowing existing management to remain would be highly detrimental to the investors and creditors alike. It is instituted to protect the public and often to put

137 See generally 16 W. Fletcher, supra note 74, § 7666.
140 Confusion surrounds the definition of “receiver” in other areas as well. In re Blair & Co., 471 F.2d 178 (2d Cir. 1972), vacated, 414 U.S. 212 (1973), dismissed as moot, 495 F.2d 299 (2d Cir. 1974), concerned whether a liquidator appointed pursuant to New York Stock Exchange rules was a receiver within the contemplation of the Bankruptcy Act (11 U.S.C. § 21(a)(5) (1970)), which deems an act of bankruptcy the appointment of a receiver of an insolvent’s property.
the company back in a position of viability. It would seem untenable for a creditor to argue that he is in a worse position after the imposition of this remedy than before, assuming that no other conditions of default have occurred.

In Ferguson v. Tabah, a derivative suit in which massive fraud, waste, and mismanagement were alleged, the court sustained the appointment of a receiver, saying:

[T]he factors usually militating against the appointment of a receiver are not so strong in this case. [Defendant's] credit position has been severely jolted over the last decade by the apparent repeated raids by its management . . . . [I]t is not unreasonable to hope for even a comparatively favorable response from financial and credit institutions because of the appointment of the receiver. A realistic approach to the needs of the company and a specific molding of the decree appointing a receiver to fit those needs are far more important than the label "receiver."

As has been argued, the imposition of an interim board or the appointment of special counsel may be an unwarranted interference with the power of shareholders to determine the direction of the corporation, vesting it solely, if temporarily, in the SEC and the federal courts. Shareholder elections are suspended and any attack on the imposition of these remedies is subject to being enjoined by the federal court as an attack on its judgment. Although a receivership also has this effect, it is established in the minds of the public and the courts as a drastic remedy. The grounds for its institution and its duration are established by settled legal traditions.

It is the SEC staff's position that the imposition of interim directors and special counsel is an alternative to a receivership and will be requested most often in cases where there are grounds for the appointment of a receiver. However, the failure to identify these remedies adequately as modified forms of receivership (for fear that the label will invoke a procession of

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141 288 F.2d 665 (2d Cir. 1961).
142 Id. at 674-75.
143 In those cases in which the SEC has obtained receivers, mismanagement and fraud have been so extensive that other covenants of outstanding loan agreements probably have already been breached.
144 Text accompanying note 109 supra.
horribles) gives them the appearance of normalcy which is precisely the appearance the Commission and often the defendant corporation are seeking. But this failure obscures the facts that flexible alternatives to the receivership should be instituted only in extreme cases where management has effectively forfeited its right to control the corporation, and that they are unusual and temporary measures designed only to bring the corporation back into compliance with applicable law, to ascertain the current state of affairs, and to make required disclosures.

If they serve any further purpose, such as allowing the SEC or the courts to influence the policies of the business or the substantive nature or character of the organization itself, these remedies are inappropriate for the Commission to request and the courts to grant. The restructuring of companies so that substantive business decisions, placed by state law in the hands of shareholders and their managers, become subject to scrutiny by the SEC is not properly ancillary to the Commission's power to obtain injunctions to enforce compliance with the securities laws, nor does it seem to be a traditional and appropriate way to further the statutory purposes.

IV. CONCLUSION

The imposition of an equity receivership, though a drastic remedy which temporarily alters the basically state-created power relationship between stockholders and management, is a traditional remedy which is imposed only as a last resort, in accordance with established standards when compliance with federal law can be assured through no less drastic means. The grounds for the imposition of special counsel and interim directors, however, have not been articulated, the nature of the remedies themselves is not clear, and the reasons for increased oversight by the Commission of substantive business decisions have not been explained.

Responsibility for the exploration and ultimate resolution of these concerns rests with the courts because their powers are invoked to give force to the consent decrees which incorporate these remedies. Following the model of the recently enacted Antitrust Procedures and Penalties Act, which encourages increased judicial scrutiny of antitrust consent decrees, courts in the SEC enforcement area should determine that a consent de-

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cree judgment is in the public interest, considering such factors as:

(1) the . . . impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or [sic] relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment;

(2) the impact of entry of such judgment upon the public generally . . . including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.\textsuperscript{148}

The courts should specifically consider the impact of the remedy on the stockholders and creditors and should address the possibility of alternative remedies. For example, if it is determined that corporate management must be replaced to assure future compliance with federal law, a court is faced with the alternatives of (a) holding an election of directors under court supervision, if necessary, and requiring that all candidates be independent of existing management;\textsuperscript{149} (b) instituting some modified form of receivership, such as the appointment of a fiscal agent, special counsel, or interim directors; (c) institution of an equity receivership; or (d) some form of a statutory bankruptcy proceeding. In evaluating these alternatives the court should make clear the differences among them, and, most importantly, in cases where the remedy is not defined through the statutes or through the traditions of common law, articulate the nature of the remedy itself.

Further, if one of the drastic forms of relief is to be imposed, the court should explicitly set out the standards by which the particular form of relief was selected, the period during which the shareholders' right to choose who will manage the company will be suspended, and why lesser remedies are not

\textsuperscript{148} \textit{Id.} § 2. This Act also provides for a period of public comment on any proposed settlement. Such a provision does not seem necessary for the proposed remedies discussed in this Comment. Such a procedure, however, would ensure that those who find the consent decrees too lenient would be heard. \textit{Cf.} Gapay, supra note 29.

\textsuperscript{149} \textit{Cf.} Orth v. Transit Inv. Corp., 132 F.2d 938, 945 (3d Cir. 1942). This case also presents an interesting question, beyond the scope of this Comment, as to whether existing management violates its fiduciary responsibility when it consents to the appointment of interim directors in an enforcement action, thus binding the stockholders to a situation wherein their power has been severely limited. \textit{Id.}
sufficient to bring the corporation back into compliance with federal law. The court entering the judgment should require that notice of the imposition of any form of receivership or modified receivership be sent to shareholders, and, in proper cases, should provide a period during which shareholders may suggest ways in which the consent decree may be modified to reduce the impact on shareholder rights without hindering the law-enforcement goals of the SEC.

Finally, much of the discussion in this Comment concerning the powers and duties of court-appointed directors has been tentative. This is because there has been little judicial discussion, in either a decree-entering or adversary context, of the limits to appointed directors' powers. Under the terms of negotiated decrees, such appointed agents appear to have power to manage the firm equal to that of elected directors. Courts would do well, in the consideration of future consent decrees, to define precisely the power to be vested in appointed directors. Just as restricted receivers have been appointed with powers limited to those necessary to correct a specific situation, restricted directors could be appointed with their power limited, for example, to the routine decisionmaking necessary to manage the company on a day-to-day basis.

The power to create and enforce remedies beyond a simple injunction is an important ingredient of a meaningful regulatory scheme. The SEC has requested a variety of remedies which are either formally ancillary to the issuance of an injunction (as in the case of mandated corporate procedures) or appropriate to promote the statutory goals (such as the award of monetary relief). The appointment of special agents to ensure compliance with an injunction may appropriately be an ancillary form of relief. Greater judicial oversight and articulation of the precise nature and goal of these remedies is needed, however, if the federal courts are to respect their traditionally limited jurisdiction by the specific molding of the remedy to the nature of the violation to be corrected. The federal securities laws are at best a limited federal corporation law, and the SEC and federal courts are bound to respect the limits which are inherent in a statutory scheme aimed at ensuring disclosure in the sale of securities and not at the substantive regulation of business itself.