

# Reporting Agency Performance: Behind the SEC's Enforcement Statistics

Urska Velikonja

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# REPORTING AGENCY PERFORMANCE: BEHIND THE SEC'S ENFORCEMENT STATISTICS

Urska Velikonja\*

*Every October, after the end of its fiscal year, the Securities and Exchange Commission releases its annual enforcement report, detailing its activity for the year. The report boasts record enforcement activity, often showing significant increases over the prior fiscal year in the number of enforcement actions brought and monetary penalties ordered. The numbers suggest that the SEC is ever tougher on securities violators. The SEC includes these statistics in its budget requests; the figures are repeated in congressional testimony, scholarship, policy proposals, and the business press.*

*Yet the SEC's metrics are deeply flawed. This Article, a pilot study, reviews fifteen years of enforcement actions and demonstrates that the widely-circulated statistics are invalid because they do not measure what they purport to measure, and unreliable because they are inconsistent and can be manipulated all too easily. The SEC double and triple counts many of the enforcement actions it brings and overstates the fines it orders. Once these measures are adjusted, they reveal that enforcement remained steady between 2002 and 2014, and shifted towards easier-to-prosecute strict-liability violations.*

*The SEC is not alone in using statistics that have a propensity to mislead to report its output. Multiple reporting statutes authorize Congress to cut agencies' budgets for failing to meet performance targets. In response, agencies report flawed statistics to protect their ability to continue enforcing the law. This Article suggests that Congress should not threaten to reduce an agency's budget because of year-to-year fluctuations in enforcement. In addition, to make reported numbers more reliable, nonfinancial performance measures should not be developed by the agency. Instead, the selection*

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and development of performance indicators should be outsourced and possibly standardized across agencies, much like financial reporting has already been standardized. Doing so would depoliticize reporting, as well as facilitate comparisons among agencies, both domestically and internationally.

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INTRODUCTION

The year 2014 was a “bumper year” for financial enforcement agencies;<sup>1</sup> the Department of Justice (DOJ),<sup>2</sup> the Com-

<sup>1</sup> Madison Marriage, *2014 Was a Bumper Year for Regulators*, FIN. TIMES (May 10, 2015, 6:48 AM), <http://www.ft.com/cms/s/0/be5231bc-f59d-11e4-bc6d-00144feab7de.html#axzz3al0FRVD9> [<http://perma.cc/RZL4-EQUW>].

<sup>2</sup> See U.S. Dep’t of Just., *Justice Department Recovers Nearly \$6 Billion from False Claims Act Cases in Fiscal Year 2014* (Nov. 20, 2014), <http://>

modity Futures Trading Commission (CFTC),<sup>3</sup> and the Securities and Exchange Commission (SEC or Commission) all reported record numbers in enforcement. Specifically, the SEC reported that it brought 755 enforcement actions and secured \$4.16 billion in monetary penalties in the fiscal year 2014,<sup>4</sup> setting all-time records for the SEC and posting significant increases over the prior fiscal years.<sup>5</sup> Various news outlets have reported prominently both figures as evidence of a more “severe” stance towards wrongdoing in the market.<sup>6</sup> The SEC itself celebrated 2014 as a “very strong year for enforcement,” highlighting the aggregate numbers of enforcement actions filed and monetary penalties ordered.<sup>7</sup>

But, was it? Through a close study of SEC enforcement over a fifteen-year period this Article reveals that the statistics the SEC most commonly uses to assess and report its enforcement performance are flawed.<sup>8</sup> The term “enforcement action” includes all legal proceedings that the SEC brings, including

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[www.justice.gov/opa/pr/justice-department-recovers-nearly-6-billion-false-claims-act-cases-fiscal-year-2014](http://www.justice.gov/opa/pr/justice-department-recovers-nearly-6-billion-false-claims-act-cases-fiscal-year-2014) [<http://perma.cc/8PJS-2D5C>] (reporting that the year set a “record” due to “unprecedented \$3.1 billion from banks and other financial institutions” for mortgage fraud).

<sup>3</sup> See U.S. COMMODITY FUTURES TRADING COMM’N, FY 2014 ANNUAL PERFORMANCE REPORT, FY 2016 ANNUAL PERFORMANCE PLAN 86 (2015), <http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2014apr.pdf> [<http://perma.cc/FK4H-E67V>] (reporting that “[t]he CFTC obtained a record \$3.27 billion in monetary sanctions” in fiscal 2014).

<sup>4</sup> See U.S. SEC. & EXCH. COMM’N, AGENCY FINANCIAL REPORT: FISCAL YEAR 2014, at 19 (2014), <http://www.sec.gov/about/secpar/secapr2014.pdf> [<https://perma.cc/JTM5-WGDJ>]. The SEC’s fiscal year starts on October first of the earlier calendar year and ends on September thirtieth of that calendar year. The 2014 fiscal year runs from October 1, 2013, to September 30, 2014.

<sup>5</sup> *Id.* at 2.

<sup>6</sup> Marriage, *supra* note 1; see also Jean Eaglesham & Michael Rapoport, *SEC Gets Busy With Accounting Investigations*, WALL ST. J. (Jan. 20, 2015, 6:51 PM), <http://www.wsj.com/articles/sec-gets-busy-with-accounting-investigations-1421797895> [<http://perma.cc/V26P-FMD5>] (describing the SEC’s “push to step up its policing of accounting fraud”); Aruna Viswanatha, *SEC Shifts Focus to Ratings Firms, Fund Valuations as Crisis-Era Cases Fade*, WALL ST. J. (Mar. 18, 2015, 4:34 PM), <http://blogs.wsj.com/moneybeat/2015/03/18/sec-shifts-focus-to-ratings-firms-fund-valuations-as-crisis-era-cases-fade/> [<http://perma.cc/ND5Z-KNF7>] (noting that the SEC’s broken window policing has led to “a record 755 cases from the SEC” in FY 2014).

<sup>7</sup> SEC’s FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases, U.S. SEC. & EXCHANGE COMMISSION (Oct. 16, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660> [<http://perma.cc/XM85-C7HU>].

<sup>8</sup> See Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J.L. & PUB. POL’Y 639, 639 (2010) (“[T]he SEC’s performance is measured by Congress and in the court of public opinion on the simplistic basis of how many cases it brings and on the size of the fines it collects.”).

primary enforcement actions, as well as suspensions, bars, and license revocations that are usually the second or third proceedings against the same defendant for the same misconduct. In fact, during the study period, the share of second and third proceedings increased from 23% to 34% of all SEC enforcement actions filed.<sup>9</sup> Once the SEC's measures are adjusted,<sup>10</sup> they show that core SEC enforcement did not increase between 2002 and 2014—contrary to what reported statistics suggest. The statistic “monetary penalties ordered” also overstates the actual figure: it includes disgorgement orders offset by restitution ordered in a parallel criminal prosecution, civil fines imposed by and paid to FINRA or the exchanges, and penalties ordered but waived due to defendant's financial inability to pay.<sup>11</sup>

These are only two examples of the Commission's problematic reporting. As this Article demonstrates in more detail, the two other enforcement statistics that the SEC highlights, defendant count and subject-matter categorization, are also distorted.<sup>12</sup> In addition to overstating its enforcement effort, the SEC's reported statistics suggest the presence of bogus trends and obscure actual trends; they reveal nonproblems and disguise real problems.<sup>13</sup> Reported statistics conceal whether and where SEC enforcement might be lacking, and encourage the agency to bring easy-to-prosecute strict-liability offenses instead of pursuing more serious violations.<sup>14</sup>

The SEC is not the only agency that reports flawed enforcement statistics. Other agencies also report figures that are neither useful nor do they accurately reflect the agencies' true activities. The Environmental Protection Agency's (EPA) reporting suffers from “[w]idespread and persistent data inaccuracy.”<sup>15</sup> The Federal Trade Commission's (FTC) annual reports have become less useful in recent years.<sup>16</sup> The enforcement

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<sup>9</sup> See *infra* section III.A.1. The distortion in the defendant count is smaller though still large: between 9% (in 2008) and 23% (in 2003) of defendants have already been counted once in the SEC's statistics. See *id.*

<sup>10</sup> See *infra* Part V.

<sup>11</sup> See *infra* section IV.A.

<sup>12</sup> See *infra* sections III.A.3, B.2.

<sup>13</sup> See *infra* sections IV.A–D.

<sup>14</sup> See *infra* sections IV.E, F.

<sup>15</sup> David L. Markell & Robert L. Glicksman, *A Holistic Look at Agency Enforcement*, 93 N.C. L. REV. 1, 47 (2014).

<sup>16</sup> Annual reports until 2013 reported the FTC's success rates in enforcement actions. Subsequent reports omit that measure, but report “consumer savings compared to the amount of FTC resources allocated to consumer protection law enforcement.” U.S. FED. TRADE COMM'N, FISCAL YEAR 2014 PERFORMANCE REPORT AND

statistics they do report are internally inconsistent<sup>17</sup> and confusing.<sup>18</sup> Despite a considerable effort to add bite to its enforcement, the CFTC reports very little. The metrics that it does report do not measure what they purport to measure.<sup>19</sup> Even if they did, they would be pretty useless because they are so limited. If anything, the SEC's reporting on enforcement is more transparent than reporting by other agencies, making the analysis offered in this Article possible.

Fuzzy reporting is problematic. In part, the reporting challenges that this Article identifies may be insurmountable because reported figures, in particular enforcement statistics, are used for a variety of conflicting purposes. Statistics used to measure how the agency communicates its priorities should be different from statistics used to measure how agency priorities are put into action, which, in turn, should be different from statistics that are used to evaluate the deterrent effects of various enforcement initiatives. Yet the same numbers are used to do it all.<sup>20</sup>

But in part, fuzzy reporting can be improved. That reporting issues have not been resolved is a problem at several different levels. First, federal agencies are particularly well situated to collect and organize vast amounts of data by virtue of being regulators and enforcers of important statutes. Reporting data

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ANNUAL PERFORMANCE PLAN FOR FISCAL YEARS 2015 AND 2016, at 48, 63 (2015). The document does not explain how the measure was generated.

<sup>17</sup> Whereas the 2014 annual report reports that the FTC returned \$38.58 million to consumers, the 2014 Annual Highlights featured prominently on the website report \$65.2 million, a considerably higher figure. See *id.* at 63; *Stats & Data 2014*, FED. TRADE COMMISSION, <https://www.ftc.gov/annual-highlights-2014/stats-data-2014> [<http://perma.cc/WD3K-6SVZ>].

<sup>18</sup> For example, in the 2014 annual report, the FTC measures the “[a]mount of money the FTC returned to consumers *and* forwarded to the U.S. Treasury.” U.S. FED. TRADE COMM'N, *supra* note 16, at 63 (emphasis added). Only a close reading of the methodology section reveals that the reported figure (\$66.9 million) combines monies paid to consumers as compensation (\$38.58 million) and amounts that were not distributed to consumers but were remitted to the U.S. Treasury (\$28.27 million). See *id.*

<sup>19</sup> The CFTC reports only two metrics regarding enforcement. The first metric measures what share of investigations is closed within twelve months of opening. It shows declining performance in recent years and will be changed in the next year to measure investigations closed within eighteen months of opening. The second metric shows that the CFTC cooperates with criminal prosecutors and other agencies in 100% of investigations, well above target. But a close reading of the methodology reveals that the CFTC excluded from the denominator all cases that were not referred. By definition, all other cases were in fact referred, thus showing the CFTC's 100% success. See U.S. COMMODITY FUTURES TRADING COMM'N, *supra* note 3, at 52–53.

<sup>20</sup> Developing better measures for recording enforcement output is beyond the scope of this Article.

in formats and categories that are not meaningful is a waste of resources and of opportunities to learn and improve both enforcement and rulemaking. Second, and of more immediate interest to legislators, agencies report their activities to Congress during budget appropriation season and repeat them during testimony before congressional oversight committees.<sup>21</sup> In fact, federal agencies are required to report their performance under a series of federal statutes introduced to improve agency reporting and the efficiency of federal programs.<sup>22</sup> The appropriations process, coupled with unreasonable congressional expectations, reward agencies that report ever-increasing figures.<sup>23</sup> That agencies massage their numbers reveals that excessive oversight can be counterproductive. Finally, the 2008 financial crisis prompted greater collaboration among financial and securities regulators both domestically and internationally. As part of the effort, international organizations have spearheaded efforts to develop best practices. Fuzzy numbers make comparisons between one agency's performance with that of its peers impossible.<sup>24</sup>

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<sup>21</sup> See, e.g., *Examining the SEC's Agenda, Operations, and FY Budget Request: Hearing Before the H. Comm. on Fin. Servs.*, 114th Cong. (2015) (statement of Mary Jo White, Chair, Securities and Exchange Commission), <http://financialservices.house.gov/uploadedfiles/114-10.pdf> [<https://perma.cc/NW6R-3XMF>] (mentioning the SEC's enforcement numbers for 2014 to justify a budget increase for fiscal 2016); *Oversight of the SEC's Agenda, Operations, and FY 2015 Budget Request: Hearing Before the H. Comm. on Fin. Servs.*, 113th Cong. (2014) (statement of Mary Jo White, Chair, Securities and Exchange Commission), <http://financialservices.house.gov/uploadedfiles/113-75.pdf> [<https://perma.cc/79DL-KSU4>] (noting the SEC's enforcement statistics in fiscal 2013 to justify a budget increase in fiscal 2015).

<sup>22</sup> See discussion *infra* section I.B.

<sup>23</sup> See Jonathan G. Katz, *Reviewing the SEC, Reinventing the SEC*, 71 U. PITT. L. REV. 489, 506 (2010) ("Because people strive to achieve the results that are measured, the choice of measures strongly determines what people try to do. When an agency uses faulty measures to evaluate its staff, it rewards the wrong people for the wrong actions.").

<sup>24</sup> The SEC is an active member of the International Organization of Securities Commissions (IOSCO). To demonstrate compliance with international standards, the SEC is required to report to IOSCO. In its report, the SEC must outline its enforcement activities in the various areas of its supervision, including financial reporting, market manipulation, insider trading, and securities offering fraud. See IMF, *Detailed Assessment of Implementation: IOSCO Objectives and Principles of Securities Regulation*, Country Report: United States 21–30 (Mar. 2015). The SEC reports its aggregate enforcement figures, which this Article shows to be misleading. The reported figures overstate enforcement activity, sometimes by nearly 50%, and show false trends. See *id.* at 94. While the report stated that the SEC brought 144 enforcement actions related to securities offering violations in FY 2010, my research revealed that sixty-nine of those were follow-on cases. See *infra* Tables 3A & 3C; see also John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 269 (2007) (comparing SEC enforcement

The study reported in this Article thus contributes to two important debates in law and public policy: the debate about the tools and methods of agency accountability and the debate about the relationship among legal rules, their enforcement, and economic growth. Rulemaking and congressional, presidential, and judicial oversight of rulemaking have attracted a disproportionate share of theoretical and empirical scholarship on agency accountability.<sup>25</sup> By contrast, enforcement remains understudied.<sup>26</sup> While enforcement theory is quite rich,<sup>27</sup> empirical studies of both agency performance in enforcement and of deterrent effects of enforcement remain a rare breed,<sup>28</sup> with

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actions with similar enforcement actions in the U.K. without adjusting the U.S. figures).

<sup>25</sup> See, e.g., Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 824 (2003) (presenting an empirical study of White House review of agency rulemaking); Nestor M. Davidson & Ethan J. Leib, *Regleprudence—At OIRA and Beyond*, 103 GEO. L.J. 259, 264 (2015) (analyzing agency lawmaking); Daniel A. Farber & Anne Joseph O’Connell, *The Lost World of Administrative Law*, 92 TEX. L. REV. 1137, 1140–41 (2014) (describing modern administrative rulemaking); Abbe R. Gluck & Lisa Schultz Bressman, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I*, 65 STAN. L. REV. 901, 906–08 (2013) (studying the impact the canons of statutory interpretation have on members of Congress in drafting legislation); Jennifer Nou, *Agency Self-Insulation Under Presidential Review*, 126 HARV. L. REV. 1755, 1757–58, 1784 (2013) (studying presidential review of agency rulemaking); Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 7 (1995) (evaluating President Clinton’s efforts to reform the regulatory state).

<sup>26</sup> This was true in 1990, when Cass Sunstein complained that “even the most prominent evaluations of the performance of the regulatory state . . . [are] conspicuously silent on the question” of the real-world consequences of agency activities, and remains true today. Cass R. Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407, 408 (1990).

<sup>27</sup> See James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CALIF. L. REV. 115, 118 (2012) (suggesting that studies of securities enforcement have relied “heavily on economic theories of enforcement” without much empirical grounding); see also Kate Andrias, *The President’s Enforcement Power*, 88 N.Y.U. L. REV. 1031, 1033–34 (2013) (discussing the President’s formal and informal influence over agency enforcement); Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 692 (1997) (discussing enforcement and efficiency goals of corporate liability); Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 207–09 (1968) (developing law and economics model of criminal sanctioning); Louis Kaplow & Steven Shavell, *Optimal Law Enforcement with Self-Reporting of Behavior*, 102 J. POL. ECON. 583, 601–02 (1994) (same).

<sup>28</sup> See, e.g., Catherine L. Fisk & Deborah C. Malamud, *The NLRB in Administrative Law Exile: Problems With Its Structure and Function and Suggestions for Reform*, 58 DUKE L.J. 2013, 2028–33 (2009) (studying NLRB’s enforcement over a decade-long period); Richard A. Posner, *The Behavior of Administrative Agencies*, 1 J. LEGAL STUD. 305, 305 (1972) (studying agency enforcement choices).



the exception of a handful of recent papers that have studied small slices of agency enforcement.<sup>29</sup>

But enforcement is at least as important as the rules that agencies adopt to further their goals. Unlike rulemaking, which happens episodically,<sup>30</sup> enforcement is continuous. The business press closely follows and reports on enforcement, in particular securities enforcement.<sup>31</sup> Enforcement is also politically significant.<sup>32</sup> The SEC, the focus of this study, is regu-

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<sup>29</sup> See, e.g., Stephen J. Choi, Anat Carmy Wiechman & A. C. Pritchard, *Scandal Enforcement at the SEC: The Arc of the Option Backdating Investigations*, 15 AM. L. & ECON. REV. 542, 547–52 (2013) (studying the options backdating scandals); James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 763–77 (2003) (studying concurrent SEC and private enforcement of accounting fraud); Stavros Gadinis, *The SEC and the Financial Industry: Evidence From Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 693–700 (2012) (studying SEC enforcement against broker-dealers); Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Value of Foreign Bribery to Bribe Paying Firms* 13–18 (June 16, 2015), <http://ssrn.com/abstract=1573222> [<https://perma.cc/TRE2-BT43>] (studying the consequences of DOJ and SEC enforcement for firms caught for bribery). Karpoff, Lee, and Martin have also published a series of three papers on SEC and DOJ enforcement of financial manipulation. One recent exception is a forthcoming study by David Zaring, David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. (forthcoming 2016).

<sup>30</sup> The SEC files many enforcement actions every week. See *Litigation Releases*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/litigation/lit-releases.shtml> [<https://perma.cc/GTN5-XLLM>] (listing all litigation releases filed during the current calendar year). The SEC proposed only ten new rules and amendments to existing rules in all of 2014. See *SEC Proposed Rules: 2014*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/rules/proposed/proposedarhive/proposed2014.shtml> [<https://perma.cc/3WQP-JNJL>].

<sup>31</sup> The press has closely tracked SEC enforcement for several decades. See, e.g., Judith Burns & Kara Scannell, *Moving the Market: SEC Brings Fewer Enforcement Cases*, WALL ST. J., Oct. 27, 2006, at C3 (reporting on an 8–10% decline in SEC enforcement actions in 2006); Jean Eaglesham, *Easy Prey Pads SEC Numbers*, WALL ST. J., Oct. 18, 2013, at C1 (reporting that the SEC brought several dozen follow-on cases in September 2013, possibly to boost enforcement numbers reported in fiscal 2013); Joshua Gallu, *Data: SEC Inflates Enforcement Tally*, WASH. POST, Feb. 23, 2013, at A11 (suggesting that follow-on and delinquent filing cases inflate the overall enforcement tally); Walter Hamilton, *SEC Setting Record Investigation Pace*, L.A. TIMES (Feb. 23, 2002), <http://articles.latimes.com/2002/feb/23/business/fi-sec23> [<http://perma.cc/H3HE-DDWW>] (reporting that SEC enforcement had been steadily increasing between 1998 and 2002); Bruce Ingersoll, *Inundated Agency: Busy SEC Must Let Many Cases, Filings Go Uninvestigated*, WALL ST. J., Dec. 16, 1985, at A1 (reporting that a Congressman from Michigan was “especially concerned” about a 10% decline in SEC enforcement actions between 1984 and 1985); Sarah Johnson, *SEC Enforcement Declines 8.9 Percent*, CFO.COM (Nov. 3, 2006), <http://www2.cfo.com/risk-compliance/2006/11/sec-enforcement-declines-8-9-percent/> [<http://perma.cc/PSY7-V39R>] (noting a steady decline in enforcement actions taken by the SEC from 2004 to 2006).

<sup>32</sup> The SEC prominently features enforcement successes in annual reports and budget justifications. See Anne Krishnan, *Lead by Example, SEC Chief Tells CEOs*, THE HERALD-SUN (Durham), Oct. 23, 2002, at A1 (reporting on Chair Harvey Pitt’s speech in which he referenced the SEC’s enforcement figures); Amit R. Paley

larly called to testify in Congress after scandals and failures of enforcement.<sup>33</sup> It must annually report on its enforcement performance to Congress and the President, and must “use objective metrics to justify its request for budget increases.”<sup>34</sup> The Government Accountability Office, the congressional investigative arm, regularly relies on agencies’ reported figures to assess and propose improvements in agencies’ work.<sup>35</sup> Finally, enforcement is economically significant. The SEC uses its enforcement to communicate to market participants what is appropriate behavior.<sup>36</sup> Legal academics routinely rely on reported enforcement statistics to offer their assessments of the SEC’s performance and propose changes to enforcement practices.<sup>37</sup> Law firms regularly issue reports using the SEC’s en-

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& David S. Hilzenrath, *SEC Chief Defends His Restraint*, WASH. POST, Dec. 24, 2008, at A1 (reporting that Chair Christopher Cox referenced the number of enforcement cases brought under his reign to defend his tenure); Michael Schroeder, *Bush Defends Pitt Amid Calls for Resignation*, WALL ST. J., Oct. 10, 2002, at A6 (quoting President George W. Bush’s press secretary Ari Fleischer as defending the SEC’s successes, in particular the “record number of enforcement actions” brought); Deborah Solomon, *SEC Changes Its Sleuthing, Uses Wider Net*, WALL ST. J., Mar. 18, 2004, at C1 (reporting that SEC “enforcement attorneys were judged on the number of cases they brought”); *SEC Chief on Warpath Against Illicit Insider Trading*, GLOBE & MAIL (Toronto), May 29, 1984, at B11 (suggesting that enforcement against insider trading had helped the Reagan Administration “that is often accused of favoring business to look more even-handed”).

<sup>33</sup> For an analysis of political forces that shape securities enforcement, see Urska Velikonja, *Politics in Securities Enforcement*, 50 GA. L. REV. 17 (2015) [hereinafter Velikonja, *Politics in Securities Enforcement*].

<sup>34</sup> John C. Coffee, Jr., *SEC Enforcement: What Has Gone Wrong?*, CLS BLUE SKY BLOG (Jan. 2, 2013), <http://clsbluesky.law.columbia.edu/2013/01/02/sec-enforcement-what-has-gone-wrong/> [<http://perma.cc/K9BW-UH6C>]; see also Bruce Carton, *SEC’s White Squares Qff With Senate Committee Over FY 2016 Budget*, COMPLIANCE WEEK BLOG (May 8, 2015), <https://www.complianceweek.com/blogs/enforcement-action/secs-white-squares-off-with-senate-committee-over-fy-2016-budget#.VZ7C0caqqko> [<http://perma.cc/ZM6B-V2D2>] (reporting that Chair White requested a 15% increase in the SEC’s budget for 2016).

<sup>35</sup> See, e.g., U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-09-358, SECURITIES AND EXCHANGE COMMISSION: GREATER ATTENTION NEEDED TO ENHANCE COMMUNICATION AND UTILIZATION OF RESOURCES IN THE DIVISION OF ENFORCEMENT 2 (2009) (reporting that the GAO obtained data from the SEC on, among other things, the number of enforcement actions brought, the distribution of enforcement actions by cases type, and annual amounts in penalties and disgorgements ordered).

<sup>36</sup> See Katz, *supra* note 23, at 491 (describing that in the 1960s the SEC began using enforcement actions “to guide and instruct market professionals”).

<sup>37</sup> See, e.g., Coffee, Jr., *supra* note 24, at 262 (comparing SEC-reported statistics with those in the U.K. and Germany); Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253, 280, 283 (2007) [hereinafter Jackson, *Variation*] (using the SEC’s data on enforcement actions without adjustment, thus overstating SEC enforcement by about 200 actions per year); Howell E. Jackson, *Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches*, in 6 CANADA STEPS UP, TASK FORCE TO MODERNIZE SECURITIES LEGISLATION IN CANADA 75, 113, 120 fig.5 (2006), <http://www.tfmsl.ca/docs/>

forcement statistics to warn clients about future legal risks.<sup>38</sup> Flawed reporting thus has the potential to lead agencies to implement changes that are unnecessary and obscure real problems that ought to be addressed.<sup>39</sup> This Article thus pulls back the curtain on the problems with agency reporting of their enforcement performance.

The second area of research to which this Article contributes is the study of the relationship between legal rules and their enforcement, and economic growth. Using international comparisons, a vibrant debate is ongoing in the financial and legal circles about whether and how legal rules or enforcement contribute to the development of financial markets. The first set of studies suggested that the “law on the books” mattered more than enforcement,<sup>40</sup> spurring significant investment in studying and developing efficient rules to support capital market development.<sup>41</sup> Subsequent studies argued that such conclusions were not supported by the data<sup>42</sup> nor warranted.<sup>43</sup> Studies of enforcement emerged, first looking at formal rules regarding enforcement agencies’ sanctioning powers,<sup>44</sup> followed by studies analyzing resources dedicated to enforcement,<sup>45</sup> and finally by studies comparing enforcement

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V6(2)%20Jackson.pdf [https://perma.cc/467C-7TE5] (same) [hereinafter Jackson, *Regulatory Intensity*]. For adjusted numbers, see *infra* Table 3B.

<sup>38</sup> See *infra* note 311.

<sup>39</sup> The Veterans Health Administration reporting scandal is an example of how manipulated results obscured a real problem in the V.A. See Richard A. Oppel, Jr. & Michael D. Shear, *Severe Report Finds V.A. Hid Waiting Lists*, N.Y. TIMES, May 29, 2014, at A1.

<sup>40</sup> See Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FINANCE 1131, 1149 (1997) (concluding that legal rules and enforcement impact the size and extent of a country’s financial market); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1116 (1998) (same); see also Coffee, Jr., *supra* note 24, at 243–44 (discussing La Porta’s focus on the “law on the books”).

<sup>41</sup> See generally WORLD BANK, INSTITUTIONAL FOUNDATIONS FOR FINANCIAL MARKETS 1 (2006), <http://siteresources.worldbank.org/INTTOPACCFINSE/Resourcs/Institutional.pdf> [http://perma.cc/VX3A-AEC9] (concluding that “private monitoring and enforcement drive development more than public enforcement measures”).

<sup>42</sup> Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.’s ‘Anti-Director Rights Index’ Under Consistent Coding*, JOHN M. OLIN CTR. FOR L. ECON. & BUS. FELLOWS’ DISCUSSION PAPER SERIES, no. 7, 2006, at 68, [http://www.law.harvard.edu/programs/olin\\_center/fellows\\_papers/pdf/Spamann\\_7.pdf](http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Spamann_7.pdf) [http://perma.cc/WB2C-6J9C].

<sup>43</sup> See Coffee, Jr., *supra* note 24, at 247–48 n.39 (explaining that the La Porta et al. methodology attracted considerable criticism).

<sup>44</sup> See Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FINANCE 1, 27–28 (2006).

<sup>45</sup> See Jackson, *Variation*, *supra* note 37, at 280, 283 (using the SEC’s data on enforcement actions without adjustment, thus overstating SEC enforcement

outputs.<sup>46</sup> Prominent academics have suggested that comparing enforcement efforts across nations is difficult because enforcement agencies have different jurisdictions, different priorities, and different rates of misconduct.<sup>47</sup> This Article proposes that the list of challenges is incomplete: different jurisdictions also measure their enforcement output differently.<sup>48</sup> High quality data collection on enforcement output should be a priority in any effort to compare enforcement intensity across nations, as well as within nations across various industries. The pilot study reported in this Article is a step in that direction.

The Article proceeds in five parts. Part I provides an overview of agency reporting, the legal requirements for agency reporting, and the challenges of reporting on nonfinancial measures related to agency performance. Part II provides details on the SEC's reporting requirements, and explains how the data were collected and analyzed. Parts III and IV are the substantive core of the study. By studying the SEC's reporting practices from fiscal years 2000 to 2014, Part III exposes significant problems with the validity and reliability of the metrics that the SEC, Congress, the press, and legal commentators widely use to evaluate the SEC's enforcement. By recoding enforcement figures to eliminate double counting, Part IV suggests some of the consequences of biased reporting, including overstatement of the enforcement effort, metrics that suggest false trends and non-existent problems as well as obscure real problems, performance indicators that do not measure what they set out to measure, and distorted enforcement priorities. In Part V, the Article finally proposes several steps to improve agency reporting of their enforcement output. Agencies like the SEC are under considerable pressure from Congress to increase their enforcement output year after year without additional appropriations, so perhaps it should come as no surprise

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by 200 actions per year); Jackson, *Regulatory Intensity*, *supra* note 37, at 113, 120 fig.5 (same). For adjusted numbers, see *infra* Table 3B.

<sup>46</sup> See Coffee, Jr., *supra* note 24, at 262 (comparing enforcement statistics between Germany, the U.K., and the U.S.); Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based Evidence*, 93 J. FIN. ECON. 207, 237 (2009) (proposing that the World Bank or another agency begin collecting data on enforcement activity, including the number of cases filed).

<sup>47</sup> Coffee, Jr., *supra* note 24, at 263 (“[S]ecurities regulators have very different jurisdictions and may have different priorities in terms of what they wish to prosecute.”).

<sup>48</sup> See Holger Spamann, *Empirical Comparative Law*, 11 ANN. REV. L. & SOC. SCI. 131, 131 (2015) (suggesting that collecting data of high quality is crucially important for cross-country comparative work).

that agencies sometimes fudge the numbers to meet unreasonable expectations. The Article considers two possible responses: reduce the pressure on agencies by decoupling the budget process from reported enforcement output, and outsource and possibly standardize reporting conventions. Finally, the Article proposes that agencies share more liberally data on enforcement. Doing so would add credibility to their reporting and, indirectly, to their enforcement programs.

## I

### AGENCY REPORTING

#### A. Why Report?

It is difficult to manage what is not measured. Reporting systems are thus put in place to monitor how well an organization and individuals within it are pursuing their “mission.”<sup>49</sup> Without reporting, the organization does not know whether and to what extent it accomplished what it set out to do, and when to change course.<sup>50</sup> Companies report to enable managers and investors to evaluate how well the company is meeting its goals. Reporting is at least as important for government agencies. It is a precondition for deploying other accountability measures, including evaluating whether government officials, be they legislators, bureaucrats, or judges, act in the citizens’ interests, ensuring that administrative agencies enforce policy consistent with legislative and presidential priorities, and for replacing agents that do not perform.<sup>51</sup>

Despite its obvious importance, reporting is controversial. You get what you measure. And what is measured is managed and rewarded, often to the exclusion of qualities that cannot be measured.<sup>52</sup>

#### B. The Legal Foundations of Agency Reporting

Agencies generally do not have the choice whether to report. Federal agencies’ organic acts require that they prepare annual reports and present them to authorizing congressional

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<sup>49</sup> S.K. Bhattacharyya, *Management Reporting Systems: Structure and Design*, ECON. & POL. WKLY, May 29, 1971, at M-67.

<sup>50</sup> *See id.*

<sup>51</sup> Jacob E. Gersen & Matthew C. Stephenson, *Over-Accountability*, 6 J. LEGAL ANALYSIS 185, 186 (2014); *see also* Jordan Ellenberg, *How Not to Be Misled by Data*, WALL ST. J., June 26, 2015, <http://www.wsj.com/articles/how-not-to-be-misled-by-data-1435258933> [<https://perma.cc/EU7R-TDLY>] (“Unfortunately, numbers turn out to be a lot like words: powerful and illuminating but capable of being deployed to bad ends.”).

<sup>52</sup> *See infra* Part I.C.

committees that oversee their work.<sup>53</sup> Such reports are to include “whatever information, data, and recommendations for further legislation” that the agency considers relevant.<sup>54</sup> In addition, many federal agencies must report at least annually to the House Committee on Appropriations and the Senate Committee on Appropriations.<sup>55</sup> The executive, agency heads, and spending committees submit reports, assessments, and views of existing programs and expected costs.<sup>56</sup> Based on submitted information, each Appropriations Committee adopts a budget resolution, which is then translated into committee allocations and ultimately delivered to authorizing congressional committees.<sup>57</sup>

The adoption of the Government Performance and Results Act of 1993 (the Results Act) reinforced agency reporting. The Results Act was one in a series of statutes designed to improve government performance by reducing “waste and inefficiency” and by “holding Federal agencies accountable for achieving program results.”<sup>58</sup> Influenced by private-sector management practices,<sup>59</sup> it requires agencies to set performance goals,<sup>60</sup> measure performance results, and to report the results annually to the President and Congress.<sup>61</sup> The goals are to be expressed in “objective, quantifiable, and measurable form,” and agencies are instructed to develop performance indicators that are to be used in measuring and assessing agency output and

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<sup>53</sup> See, e.g., 15 U.S.C. § 78w(b)(1) (2012) (requiring the SEC, the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to report annually to Congress); 15 U.S.C. § 46(f) (2012) (authorizing the Federal Trade Commission to report annually to Congress).

<sup>54</sup> 15 U.S.C. § 78w(b)(1) (2012).

<sup>55</sup> Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 4–5. Of financial enforcement agencies, only the SEC and the CFTC must report to the appropriations committees. Other financial enforcement agencies, including FINRA, the Fed, the FDIC, the OCC, etc. are not funded with budget appropriations and thus do not appear before congressional appropriations committees. See *id.* at 5.

<sup>56</sup> See Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197, 1243–44 (2006).

<sup>57</sup> *Id.*

<sup>58</sup> Government Performance and Results Act of 1993, Pub. L. No. 103–62, § 2(a)–(b), 107 Stat. 285, 285 (1993). The GPRA Modernization Act of 2010 amended the Results Act in early 2011. See H.R. 2142, 111th Cong., § 2 (2010); 5 U.S.C. § 306(a) (2012).

<sup>59</sup> See Mary L. Heen, *Reinventing Tax Expenditure Reform: Improving Program Oversight Under the Government Performance and Results Act*, 35 WAKE FOREST L. REV. 751, 768 n.60, 769 (2000) (describing the motivation behind government reforms).

<sup>60</sup> H.R. 2142 § 3; 31 U.S.C. § 1115(a) (2012).

<sup>61</sup> H.R. 2142 § 3; 31 U.S.C. § 1116(a) (2012).

the outcomes of their activities.<sup>62</sup> If an agency misses a performance target, it must report its failure to the Office of Management and Budget (OMB) and submit an improvement plan.<sup>63</sup> If an agency misses a performance target two years in a row, it must submit to Congress what it plans to do to improve performance, including what statutory changes it would propose, and what additional funding it would request.<sup>64</sup> If, however, an agency misses a performance target three years in a row, the OMB may propose to Congress to terminate the program or reduce its budget.<sup>65</sup> In the era of post-financial crisis austerity, appropriations committees have been loath to increase agency budgets.<sup>66</sup>

The Results Act and other reporting statutes cover a wide variety of agencies, from the largest departments to the Peace Corps.<sup>67</sup> Agencies are required to report financial and nonfinancial performance. The OMB has standardized financial reporting.<sup>68</sup> But for most agencies, measures of financial performance are not terribly useful in evaluating how well agencies are meeting their goals.<sup>69</sup> Nonfinancial measures of performance are far more pertinent,<sup>70</sup> yet what and how nonfinancial performance is measured is largely within considerable agency discretion.<sup>71</sup>

<sup>62</sup> Results Act § 4(b), 107 Stat. 285, 287–89.

<sup>63</sup> 31 U.S.C. § 1116(g) (2012).

<sup>64</sup> 31 U.S.C. § 1116(h)(1) (2012).

<sup>65</sup> 31 U.S.C. § 1116(i) (2012).

<sup>66</sup> See, e.g., *Appropriations Committee Approves the Fiscal Year 2016 Labor, Health and Human Services Funding Bill*, HOUSE APPROPRIATIONS COMMITTEE (June 24, 2015), <http://appropriations.house.gov/news/documentsingle.aspx?DocumentID=394290> [<https://perma.cc/8FZD-74FW>] (describing the Committee's attempts to reduce federal discretionary spending).

<sup>67</sup> See generally THE PEACE CORPS, PERFORMANCE AND ACCOUNTABILITY REPORT: FISCAL YEAR 2014 (reporting the Peace Corps' annual performance).

<sup>68</sup> See generally OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-134, FINANCIAL ACCOUNTING PRINCIPLES AND STANDARDS (1993) (standardizing annual performance reports); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-136, FINANCIAL REPORTING REQUIREMENTS (2014) (same).

<sup>69</sup> See U.S. GEN. ACCOUNTING OFFICE, GAO-97-138, MANAGING FOR RESULTS: ANALYTIC CHALLENGES IN MEASURING PERFORMANCE 3 (1997) (“[Agencies often] recognized that simple examination of [fiscal] . . . measures would not accurately reflect their program's performance . . .”).

<sup>70</sup> It is useful, for example, to know what percentage of monetary penalties that the SEC imposes are actually collected. See U.S. SEC. & EXCH. COMM'N, FY 2014 ANNUAL PERFORMANCE REPORT & FY 2016 ANNUAL PERFORMANCE PLAN 43 (2015) (reporting that the SEC collected in FY 2014 \$2,109 million of \$4,166 million ordered) [hereinafter SEC, 2014 ANNUAL REPORT].

<sup>71</sup> For example, the SEC selects performance goals on the basis of the four-year strategic plan, which it drafts. In addition, the SEC itself defines the measures of performance. For example, it would be very useful to know in what

The GAO reported very early after the adoption of the Results Act that translating agency performance into concrete, objective measures would be difficult.<sup>72</sup> The complicated structure of government can impede the collection of relevant data.<sup>73</sup> There are no useful proxies for measuring certain government functions.<sup>74</sup> OMB circulars provide more detailed guidance on reporting. Circular A-11, for example, requires agencies to report data that is complete, reliable, and of high quality.<sup>75</sup> It instructs agencies to note data limitations, including incomplete data, imprecise measurement, and inconsistencies in data collection practices,<sup>76</sup> yet considerable problems remain.

### C. Measuring Performance

In order to be effective, a reporting system must produce information that is reliable, comprehensive, meaningful, and comparable. Reporting conventions that do not satisfy these requirements are useless, or worse.<sup>77</sup>

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percentage of enforcement actions brought does an agency obtain relief on at least one of the claims. The SEC reports in its 2014 Performance and Accountability Report that it obtained such relief in 94% of the enforcement actions it brought. See *id.* at 39. But the term “enforcement action” lumps together regulatory activities that are very different: trading suspensions when a firm has failed to file periodic financial reports are required by statute; follow-on disbarments and suspensions brought on the basis of a prior enforcement action that the SEC settled; and true new enforcement actions. The SEC’s success rate in the latter category is considerably lower than in the first two, so reporting overall success rates is quite meaningless. See discussion *infra* Part IV.E.

<sup>72</sup> U.S. GEN. ACCOUNTING OFFICE, GAO-10.1.20, THE RESULTS ACT: AN EVALUATOR’S GUIDE TO ASSESSING AGENCY ANNUAL PERFORMANCE PLANS 9–10 (1998) [hereinafter GAO GUIDE].

<sup>73</sup> See *id.* at 10; see also GEN. ACCOUNTING OFFICE, MANAGING FOR RESULTS, *supra* note 69, at 3 (“Sometimes selecting an outcome measure was impeded . . . by anticipated data collection problems.”).

<sup>74</sup> See U.S. GEN. ACCOUNTING OFFICE, MANAGING FOR RESULTS, *supra* note 69, at 3. (“For some [agencies], the concept of ‘outcome’ was unfamiliar and difficult especially for program officials focused on day-to-day activities.”).

<sup>75</sup> OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR NO. A-11, PREPARATION, SUBMISSION, AND EXECUTION OF THE BUDGET § 260.9 (2015).

<sup>76</sup> *Id.*

<sup>77</sup> See, e.g., Neil Weinberg, *We Tried to Re-Crete JPMorgan’s Mutual Fund Returns and Gave Up*, BLOOMBERG, Mar. 5, 2015, <http://www.bloomberg.com/news/articles/2015-03-05/we-tried-to-re-create-jpmorgan-s-top-mutual-fund-returns-and-just-gave-up> [<http://perma.cc/QB5R-GCWX>] (reporting that JPMorgan Chase’s complicated method of calculating mutual fund performance made it difficult to compare them with other funds).



Agency goals are usually described in terms of general outcomes: safety,<sup>78</sup> public health,<sup>79</sup> election integrity,<sup>80</sup> and investor protection.<sup>81</sup> Ideally, an agency could describe and measure *its own* impact, directly or indirectly.<sup>82</sup> For example, a tech start-up uses the number of new users it attracts as a key performance indicator—a direct performance measure.<sup>83</sup> A mature public firm measures its performance by reporting its earnings, EBITDA, and the stock price.<sup>84</sup>

But measuring the impact of one agency's varied activities is both difficult and confounded by other changes in the economy or the environment that cannot easily be controlled for. Failing measuring the agency's own impact, tracking changes in the overall quality can be reasonably informative, in particular where other underlying factors either have not changed or can be identified and accurately recorded. Some agencies, like the EPA, can measure directly some of the aggregate environmental outcomes.<sup>85</sup> For example, the EPA reports on air quality by measuring the ambient concentration of fine particulate matter;<sup>86</sup> and on water quality by measuring the number of

<sup>78</sup> See U.S. CONSUMER PROD. SAFETY COMM'N, 2011–2016 STRATEGIC PLAN 12 (2010).

<sup>79</sup> See *Mission, Role and Pledge*, CENTER FOR DISEASE CONTROL (Apr. 14, 2014), <http://www.cdc.gov/about/organization/mission.htm> [<http://perma.cc/6M7V-UUDR>].

<sup>80</sup> See FED. ELECTION COMM'N, FY 2014-2019 STRATEGIC PLAN 1 (2014).

<sup>81</sup> SEC, 2014 ANNUAL REPORT, *supra* note 70, at 7; U.S. COMMODITY FUTURES TRADING COMM'N, *supra* note 3, at 12.

<sup>82</sup> See Michael P. Vandenbergh, *The Private Life of Public Law*, 105 COLUM. L. REV. 2029, 2084 (2005).

<sup>83</sup> See Devika Krishna Kumar & Yasmeen Abutaleb, *Twitter Shares Fall as Growth of Monthly Users Slows*, REUTERS (July 28, 2015, 9:14 PM), <http://www.reuters.com/article/2015/07/29/us-twitter-results-idUSKCN0Q22DR20150729> [<http://perma.cc/5KJX-WQ68>].

<sup>84</sup> See, e.g., Apple Inc., Annual Report (Form 10-K) 23–24 (Oct. 27, 2014) (reporting Apple's stock price and select financial data from 2009 to 2013).

<sup>85</sup> The outcomes will be the product of the EPA's actions as well as many other factors, and so are not a direct measure of the EPA's performance. But there is no doubt that regulation has had a considerable and lasting effect on air and water quality. See Sunstein, *supra* note 26, at 409–10. OSHA, likewise, reports overall workplace deaths and injuries over time and they have declined since 1970. See Occupational Safety & Health Admin., *Worker Fatalities Reported to Federal and State OSHA*, U.S. DEP'T LABOR, [https://www.osha.gov/dep/fatcat/dep\\_fatcat.html](https://www.osha.gov/dep/fatcat/dep_fatcat.html) [<https://perma.cc/2EMA-G2J6>] (“Before OSHA was created 43 years ago, an estimated 14,000 workers were killed on the job every year. Today, workplaces are much safer and healthier, going from 38 fatal injuries a day to 12.”). Some of the decline is due to technological change and some due to OSHA's oversight and enforcement, but it may be impossible to flesh out relative contributions.

<sup>86</sup> U.S. ENVTL. PROT. AGENCY, FISCAL YEAR 2016: JUSTIFICATION OF APPROPRIATION ESTIMATES FOR THE COMMITTEE ON APPROPRIATIONS 1090 (2015), <http://www2>.

months during which drinking water met all applicable health-based standards.<sup>87</sup> By also supplying information on changes in variables that increase fine particulates, such as the number of miles driven, one can make an educated assessment of the EPA's contribution to improved air quality.<sup>88</sup>

Unfortunately, most agencies cannot measure and report outcomes regularly or with any precision.<sup>89</sup> Data regarding outcomes is often difficult to collect reliably.<sup>90</sup> Even more often, outcomes cannot be quantified in a useful way. For example, the Peace Corps' mission is to promote "world peace and friendship."<sup>91</sup> Neither world peace nor friendship can be adequately measured directly, and are measured poorly indirectly. The Peace Corps uses cross-cultural connections as a proxy for friendship, and relies on volunteers' reports that they facilitated contact between an American and a local as a performance indicator.<sup>92</sup>

When outcomes cannot be measured directly, agencies report their output—the number of major rulemakings conducted, the number of seminars organized, the number of investigations opened, the magnitude of penalties collected<sup>93</sup>—and their input, such as the size of agency enforcement staffs and budgets. For example, the SEC's goal is to protect market participants and the public through a robust enforcement program.<sup>94</sup> Much of financial misconduct cannot be observed and

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[epa.gov/sites/production/files/2015-02/documents/fy\\_2014\\_apr.pdf](http://epa.gov/sites/production/files/2015-02/documents/fy_2014_apr.pdf) [<http://perma.cc/PHC5-X42N>].

<sup>87</sup> *Id.* at 1102. Data collection is costly so agencies' data is sometimes unreliable, not collected, or not reported in a manner that would be useful. See Jonathan C. Borck, Cary Coglianese & Jennifer Nash, *Environmental Leadership Programs: Toward an Empirical Assessment of Their Performance*, 35 *ECOLOGY L. Q.* 771, 772 (2008).

<sup>88</sup> See U.S. ENVTL. PROT. AGENCY, *supra* note 86, at 1089.

<sup>89</sup> See generally Richard W. Parker, *Grading the Government*, 70 *U. CHI. L. REV.* 1345 (2003) (showing how regulatory scorecards routinely overstate the costs of government activities by several orders of magnitude).

<sup>90</sup> See Eric Biber, *The Problem of Environmental Monitoring*, 83 *U. COLO. L. REV.* 1, 18–22 (2011) (reporting that data is unavailable in ambient monitoring).

<sup>91</sup> THE PEACE CORPS, *supra* note 67, at iii.

<sup>92</sup> See *id.* at 59–61.

<sup>93</sup> See GAO GUIDE, *supra* note 72, at 16; see also Vandenberg, *supra* note 82, at 2084 (criticizing output reporting).

<sup>94</sup> In efficiency terms, the goals should be to enforce to the point to where the next dollar spent on enforcement yields the benefit of at least one dollar. By that measure, SEC enforcement levels are currently much too low. See generally William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 *U. PA. L. REV.* 69, 162 fig.9 (2011) (showing that per dollar spent, SEC enforcement yields at least \$6.20 in fines).

measured directly.<sup>95</sup> Even for the small subset of public securities that trade in efficient markets, the securities' price will reflect only publicly available information, not nonpublic information, such as undiscovered financial misconduct.<sup>96</sup> And so the SEC reports its output: the number of initiated investigations, the percentage of successful enforcement actions, and the amount of collected monetary penalties.<sup>97</sup> Output measures in enforcement are a product of several factors, including (1) the prevalence of misconduct as well as (2) the agency's ability to detect and prosecute such misconduct. Accounting fraud and offering frauds such as Ponzi schemes are highly cyclical: both types of violations are much more common towards the end of investment booms than otherwise.<sup>98</sup> Even if detection and prosecution rates remained the same, one would expect significant variation in enforcement figures from year to year, as a byproduct of investment boom-and-bust cycles. As a result, aggregate enforcement numbers are a very noisy proxy for how effectively the agency conducts its work.<sup>99</sup>

Output measures are problematic when used to report on the agency's impact on outcomes, but output measures have additional limitations. First, poorly selected output measures can shift the focus from things that cannot be measured to those that can.<sup>100</sup> An agency that is rewarded for the number

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<sup>95</sup> See, e.g., Alexander Dyck, Adair Morse & Luigi Zingales, *How Pervasive is Corporate Fraud?* 2–4 (Rotman Sch. Of Mgmt., Working Paper No. 2222608, 2013), <http://papers.ssrn.com/abstract=2222608> [<https://perma.cc/6G3C-ABQH>] (trying to estimate the prevalence of undetected accounting fraud and noting that it cannot be measured directly).

<sup>96</sup> See Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FINANCE 383, 409–10 (1970) (explaining that stock prices do not reflect all information, and that individuals with monopolistic access to information can profit trading on it).

<sup>97</sup> See SEC, 2014 ANNUAL REPORT, *supra* note 70, at 37, 43.

<sup>98</sup> See Tracy Yue Wang & Andrew Winton, *Industry Informational Interactions and Corporate Fraud* 24 (Jan. 2016) (unpublished manuscript), <http://www.tc.umn.edu/~wangx684/assets/documents/research/Competition-and-Corporate-Fraud.pdf> [<https://perma.cc/XCX5-U7AM>] (showing that fraud rates increase during investment booms).

<sup>99</sup> See Jean Eaglesham, *As SEC Enforcement Cases Rise, Big Actions Are Sparse*, WALL ST. J. (Sept. 29, 2014), <http://www.wsj.com/articles/as-sec-enforcement-cases-rise-big-actions-are-sparse-1412028262> [<https://perma.cc/P3P4-GH6S>] (quoting former SEC attorney Bradley Bondi for the proposition that enforcement statistics are a poor measure of how effectively the SEC deters misconduct).

<sup>100</sup> See David A. Super, *Are Rights Efficient? Challenging the Managerial Critique of Individual Rights*, 93 CALIF. L. REV. 1051, 1108 (2005) (reporting that the USDA's Food and Nutrition Service which used to bring together "state agencies' staffs for annual discussions of a wide range of food stamp administrative issues, now convened dedicated 'payment accuracy conferences' each year").

of enforcement actions it brings may bring enforcement actions that are easier to prosecute instead of actions that require more time and effort, even if the impact of the latter would be greater.<sup>101</sup> Second, agencies select metrics on which they are measured.<sup>102</sup> Because the consequence of an agency's failure to meet a performance metric can be a reduced budget, agencies set themselves easy-to-satisfy goals.<sup>103</sup> This Article is not the first to suggest that because of the threat to cut their budgets, agencies report "statistics that are puzzling at best and misleading at worst because they suggest the Agency is making progress when it is not."<sup>104</sup> Third, metrics used often conflate apples with oranges. The SEC's enforcement statistics discussed in Parts II, III, and IV are only one such example.<sup>105</sup> Finally, sometimes agencies outright misreport to avoid sanctions.<sup>106</sup>

Despite all of these problems, agency reporting remains important and useful. In particular, comparing valid and reliable enforcement statistics of one agency to overall indicators over a longer period of time can provide useful information about the value of various enforcement techniques.<sup>107</sup> Comparing enforcement strategies and successes across agencies can yield insights into what else might work to increase compliance efficiently and effectively.

## II

### A STUDY OF SEC REPORTING

The SEC has reported on its enforcement since it was created in 1934.<sup>108</sup> Its reports are thorough and provide not only

<sup>101</sup> See Posner, *supra* note 28, at 311–12.

<sup>102</sup> Government Performance and Results Act of 1993, Pub. L. No. 103–62, § 4(b), 107 Stat. 285, 287–89 (1993).

<sup>103</sup> See Sidney A. Shapiro & Rena Steinzor, *Capture, Accountability, and Regulatory Metrics*, 86 TEX. L. REV. 1741, 1744 (2008).

<sup>104</sup> *Id.* at 1764.

<sup>105</sup> Commentators have had no difficulty finding other examples. See, e.g., Mary De Ming Fan, *Disciplining Criminal Justice: The Peril Amid the Promise of Numbers*, 26 YALE L. & POL'Y REV. 1, 26 (2007) (discussing that officers face incentives that bias policing in favor of petty traffic violations at the expense of more serious violations that take longer to process).

<sup>106</sup> The Veterans Health Administration reporting scandal is an example of how manipulated results obscured a real problem in the VA. See Opiel, Jr. & Shear, *supra* note 39, at A1.

<sup>107</sup> For example, before the creation of OSHA and federal regulation of workplace safety in 1970, there were 14,000 workplace deaths per year (20 per 100,000 workers). In 2013, 4,585 people died on the job (3.3 per 100,000 workers). See Occupational Safety & Health Admin., *supra* note 85.

<sup>108</sup> See U.S. SEC. & EXCH. COMM'N, FIRST ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION: FISCAL YEAR ENDED JUNE 30, 1935, at 67–70 (1935).

aggregate information and summaries of high-interest cases, but also a complete list of enforcement actions filed.<sup>109</sup> The SEC is also among the agencies whose enforcement record has been of particular interest to Congress and the general public.<sup>110</sup> Both factors make the SEC an appropriate target for a study of an agency's reporting conventions.

Critiques of SEC enforcement routinely revolve around mishandling particular cases,<sup>111</sup> such as failing to uncover the Madoff Ponzi scheme<sup>112</sup> or the Enron fraud.<sup>113</sup> The Commission's usual retort is to highlight its overall enforcement record.<sup>114</sup> Reported SEC enforcement figures regularly grab newspaper headlines and capture the attention of Congress both during budget appropriation season and in post-scandal testimonies.<sup>115</sup>

The SEC's overall enforcement reporting is particularly worthy of studying because the agency is very active and its leadership very proud of the agency's enforcement prowess.<sup>116</sup>

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<sup>109</sup> See, e.g., U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2014, at 3–20 tbls.2–3 (2015) (reporting aggregate information and a complete list of enforcement actions filed in FY 2014).

<sup>110</sup> See, e.g., Peter J. Henning, *Lawmakers Focus on How S.E.C. Does Its Job*, N.Y. TIMES DEALBOOK (Mar. 30, 2015), <http://www.nytimes.com/2015/03/31/business/dealbook/lawmakers-focus-on-how-sec-does-its-job.html> [<https://perma.cc/5MTQ-CHV4>] (describing Congressional scrutiny of how the SEC enforces the securities laws). The EPA's activities may be scrutinized as closely.

<sup>111</sup> See, e.g., Macey, *supra* note 8, at 652–54 (using one salient anecdote to criticize the SEC's pursuit of firms instead of going after individuals).

<sup>112</sup> See OFFICE OF INVESTIGATIONS, U.S. SEC. & EXCH. COMM'N, REPORT NO. OIG-509, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME 1–2 (2009).

<sup>113</sup> See Jonathan Weil & John Wilke, *Systemic Failure by SEC Is Seen in Enron Debacle*, WALL ST. J., (Oct. 7, 2002, 3:22 PM), <http://www.wsj.com/articles/SB1033944629262271233> [<https://perma.cc/2R4Z-YGVX>].

<sup>114</sup> See *Oversight of the Security and Exchange Commission's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 95–105 (2009) (statement of Robert Khuzami, Director, Division of Enforcement, Securities and Exchange Commission & John Walsh, Acting Director, Office of Compliance Inspections & Examinations, Securities and Exchange Commission).

<sup>115</sup> See, e.g., Jean Eaglesham, *SEC Brings Fewer Enforcement Actions, Slows Early-Stage Probes*, WALL ST. J. (Dec. 17, 2013, 12:21 PM), <http://www.wsj.com/articles/SB10001424052702304403804579264293892648268> [<https://perma.cc/R4BR-TV4Y>] (reporting that the SEC brought fewer enforcement cases during the post-financial crisis era).

<sup>116</sup> See, e.g., U.S. Sec. & Exch. Comm'n, *Commission Announces Enforcement Results for FY 2013*, SEC NEWS DIGEST, No. 2013-241 (Dec. 17, 2013), <https://www.sec.gov/news/digest/2013/dig121713.htm> [<http://perma.cc/NWC8-L64E>] (describing the Chair of the SEC's pride in the agency's enforcement efforts); Amir Efrati & Tom McGinty, *Youz Indictin' Who? A Rivalry Grows for Stock Cops in Brooklyn, Manhattan*, WALL ST. J., June 20, 2008, at C1 (quoting SEC spokesman's listing of the number of enforcement actions and penalties secured as

SEC Chairs like to describe enforcement as the agency's "number one priority"<sup>117</sup> and the "bedrock warrant" for its continued existence.<sup>118</sup> Yet, despite intense public interest, SEC enforcement remains understudied.<sup>119</sup> Nearly all law review articles, newspaper reports, and law firm client memoranda regarding SEC enforcement rely exclusively on figures that the SEC releases.<sup>120</sup>

This Part and Parts III and IV explain why and how these figures are flawed. This Part describes in more detail the SEC's

evidence of aggressive enforcement); Bloomberg News, *SEC Plans Tougher Enforcement in '07*, CHICAGO TRIBUNE (Oct. 28, 2006) (reporting that the SEC was planning to bring more enforcement actions in FY 2007).

<sup>117</sup> UK and US "Differ on Enforcement," DAILY TELEGRAPH (LONDON), Dec. 3, 2005, at 30 (quoting SEC Chair Christopher Cox); see also Katz, *supra* note 23, at 509 (explaining that "virtually every Chairman of the SEC in the past thirty years" believed that the SEC is primarily a law enforcement agency).

<sup>118</sup> Bevis Longstreth, *The SEC After Fifty Years: An Assessment of Its Past and Future*, 83 COLUM. L. REV. 1593, 1612 (1983) (reviewing JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET—A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* (1982)).

<sup>119</sup> See Simi Kedia & Shiva Rajgopal, *Do the SEC's Enforcement Preferences Affect Corporate Misconduct?*, 51 J. ACCT. & ECON. 259, 259 (2011) (observing that there is little empirical work studying the overall effectiveness of SEC enforcement).

<sup>120</sup> See Barbara Black, *How to Improve Retail Investor Protection After the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 13 U. PA. J. BUS. L. 59, 72 n.83 (2010) (using SEC data to report the share of enforcement actions against broker-dealers and investment advisors); Bratton & Wachter, *supra* note 94, at 154–57 figs.4–7 (using the numbers in SEC Annual Reports to generate figures without making adjustments for follow-on and duplicative enforcement actions); Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348, 397 (2007) (reporting SEC enforcement statistics); Coffee, Jr., *supra* note 24, at 269 (comparing SEC enforcement actions with similar enforcement actions in the U.K. without adjusting the U.S. figures); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 709 n.46 (2010) (arguing that the SEC's figures understate enforcement against broker-dealers and investment advisers, without adjusting for follow-on cases); Hillary A. Sale, *Banks: The Forgotten(?) Partners in Fraud*, 73 U. CIN. L. REV. 139, 176–77 (2004) (using the SEC's statistics to suggest that enforcement activity increased between 2002 and 2003, when the increase is exclusively due to follow-on and second cases brought—all already counted); Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638, 1667 tbl.3 (2010) (reporting figures from SEC's annual reports); Sonia A. Steinway, Comment, *SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical Analysis of the SEC's New Enforcement Approach*, 124 YALE L.J. 209, 211 fig.1 (2014) (using numbers from the SEC's annual reports without adjusting them).

By contrast, financial economists ordinarily report their own hand-coded results, not the SEC's figures, though such studies are very rare. See, e.g., Jonathan Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581, 588–89 (2008) (using hand-coded results to calculate the number of SEC investigations in a given period of time) [hereinafter Karpoff, Lee & Martin, *The Cost to Firms*].

annual reporting practices, describes the data, and presents the study methodology.

### A. Annual Performance Reports

The SEC has released an annual report every year since 1935, and has included detailed information on each enforcement action brought.<sup>121</sup> As the SEC's enforcement powers expanded, so did reporting on enforcement. Since 1987, the Commission has reported its enforcement in the same manner as it does today, with some minor methodological modifications.<sup>122</sup> The enforcement report begins with a table aggregating enforcement actions by subject-matter and by venue in which they are brought, followed by a list of all enforcement actions organized by subject-matter and date filed.<sup>123</sup> In the years since 1987, the SEC has stopped reporting on case outcomes,<sup>124</sup> and after the Results Act, it switched to performance indicators,<sup>125</sup> which in various ways are less meaningful than enforcement statistics reported decades ago.<sup>126</sup> Fortunately and usefully, the SEC has continued to provide a list of all filed enforcement actions during the fiscal year and a summary table of enforcement [as shown in Table 1]. The Commission uses that same raw data not only to report aggregate numbers but also to generate other performance indicators that it reports to Congress.

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<sup>121</sup> See U.S. SEC. & EXCH. COMM'N, SECOND ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION: FISCAL YEAR ENDED JUNE 30, 1936, at 48–50, 54–57 (1936).

<sup>122</sup> Compare U.S. SEC. & EXCH. COMM'N, 53RD ANNUAL REPORT 144–51 (1987), with SEC. & EXCH. COMM'N, 2008 PERFORMANCE AND ACCOUNTABILITY REPORT 26–34 (2008).

<sup>123</sup> See, e.g., U.S. SEC. & EXCH. COMM'N, 53RD ANNUAL REPORT, *supra* note 122, at 144–51 (listing the enforcement actions brought in FY 1987).

<sup>124</sup> For example, the FY 1987 annual report includes statistics on the number and the outcomes in litigated cases before federal appellate courts and the Supreme Court. See U.S. SEC. & EXCH. COMM'N, 53RD ANNUAL REPORT, *supra* note 122, at 56.

<sup>125</sup> FY 2003 was last annual report to include a complete list of filed enforcement actions. Compare U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT 2003, at 104–23 (2004) [hereinafter ANNUAL REPORT 2003], with U.S. SEC. & EXCH. COMM'N, 2004 PERFORMANCE AND ACCOUNTABILITY REPORT 57–60 (2005) [hereinafter 2004 PERFORMANCE AND ACCOUNTABILITY REPORT].

<sup>126</sup> See *infra* Part IV.B.

TABLE 1: SAMPLE SEC ENFORCEMENT REPORT

Enforcement Action Summary Chart for Fiscal 2014 by Primary Classification (Each action initiated has been included in only one category listed below, even though many actions involved multiple allegations and may fall under more than one category. The number of defendants and respondents is noted parenthetically.)

Primary Classification	Civil Actions		Administrative Proceedings		Total		% of Actions
Broker-Dealer	7	(10)	159	(179)	166	(189)	22%
Delinquent Filing	0	(0)	110	(453)	110	(453)	15%
Foreign Corrupt Practices Act	3	(3)	4	(4)	7	(7)	1%
Insider Trading	40	(75)	12	(13)	52	(88)	7%
Investment Advisors/ Investment Companies	10	(34)	120	(171)	130	(205)	17%
Issuer Reporting and Disclosure	12	(28)	84	(117)	96	(145)	13%
Market Manipulation	17	(57)	46	(51)	63	(108)	8%
Miscellaneous	0	(0)	37	(40)	37	(40)	5%
Municipal Securities & Public Pensions	2	(4)	4	(8)	6	(12)	1%
Securities Offering	52	(261)	29	(42)	81	(303)	11%
Transfer Agent	2	(4)	5	(7)	7	(11)	1%
TOTALS	145	(476)	610	(1085)	755	(1561)	100%

As shown below in Figure 1, the SEC's annual enforcement statistics show a trend that is, more or less, continuously increasing: each fiscal year, the SEC reports that it filed more enforcement actions than the previous year, against more defendants, ordering them to pay larger monetary penalties.<sup>127</sup>

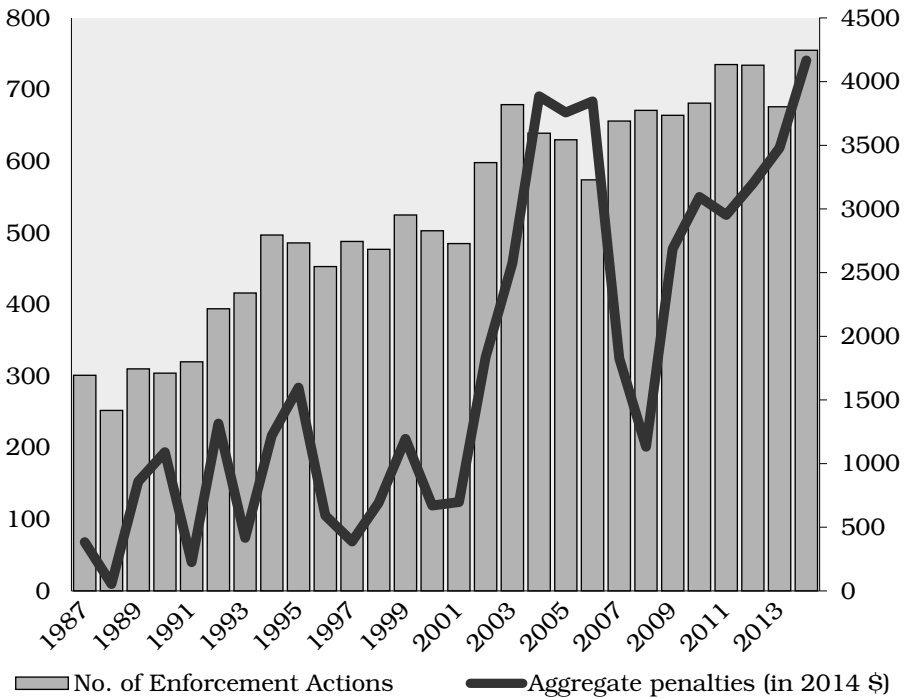
<sup>127</sup> The considerable decline in monetary penalties imposed in 2007 and 2008 was entirely the product of Chair Christopher Cox's change in enforcement policy. In 2006, only a few months after Chair Cox took over, the Commission articulated a set of criteria for imposing a monetary penalty against the firm. The goal of the guideline was to reduce corporate penalties: it limited monetary penalties to cases where the firm received a "direct and material benefit" and against penalties if they would cause additional harm to shareholders who did not violate securities laws. See *Statement of the Securities and Exchange Commission Concerning Financial Penalties*, U.S. SEC. & EXCHANGE COMMISSION (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm> [<http://perma.cc/J5YQ-LUSA>].

In addition, the Commission required enforcement staff to show tangible benefits to the company using an event study and to seek pre-approval of the penalty range before beginning settlement discussions. See U.S. Gov't Accountability



The brief decline in monetary penalties between 2006 and 2008 during Republican SEC Chair Christopher Cox’s administration<sup>128</sup> was quickly reversed in fiscal year 2009, as Chair Cox stepped down, and the Madoff Ponzi scheme and the financial crisis spurred the Commission to change its approach.

FIGURE 1: SEC ENFORCEMENT STATISTICS (1987–2014)<sup>129</sup>



In Part III, the Article discusses in considerable detail why the indicators that the SEC uses do not validly and reliably measure the SEC’s enforcement output. The following section, however, explains how the data was collected and what methodology was used to analyze the data.

Office, *supra* note 35, at 33; Christopher Cox, Chairman, U.S. Sec. & Exch. Comm’n, Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference (Apr. 13, 2007), <http://www.sec.gov/news/speech/2007/spch041207cc.htm> [<http://perma.cc/9LM8-M71J>] (“So in a handful of cases where the need for national consistency is greatest, we’re reviving what had been a long standing policy of the SEC for all cases for many years—that Commission approval be obtained before settlement discussions are commenced.”). The “handful of cases” involved all cases where a corporate penalty was sought.

<sup>128</sup> That is, between October 1, 2006 and September 30, 2008.

<sup>129</sup> Source: SEC annual reports and Select SEC and Market Data reports. See *Reports*, U.S. SEC. & EXCHANGE COMMISSION (Feb. 23, 2016), <https://www.sec.gov/about/secreports.shtml> [<https://perma.cc/RX2J-G3EU>].

## B. Data and Methodology

The SEC begins an investigation into possible securities violations by opening a matter under inquiry.<sup>130</sup> If it finds evidence of misconduct, the Commission opens first an informal investigation,<sup>131</sup> then a formal investigation,<sup>132</sup> and ultimately files an enforcement action.<sup>133</sup> Investigations vary considerably in size and complexity. An investigation into accounting fraud or a pyramid scheme usually includes multiple entities and individuals.<sup>134</sup> Although investigations come in many shapes and sizes, each investigation is related to a specific and unique set of underlying facts. An enforcement action, on the other hand, is a legal proceeding that the SEC initiates by filing a civil complaint in district court or an order instituting proceedings before an administrative law judge (“ALJ”) against a specific firm or firms and/or individuals based on the facts uncovered during the investigation.<sup>135</sup> The SEC files an enforcement action after completing an investigation, on average some twenty-one to twenty-two months after opening an informal investigation.<sup>136</sup>

The SEC often initiates multiple legal proceedings, i.e., enforcement actions, on the basis of a single investigation.<sup>137</sup> In

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<sup>130</sup> See DIV. OF ENFORCEMENT, U.S. SEC. & EXCH. COMM’N, ENFORCEMENT MANUAL 12 (2015).

<sup>131</sup> See *id.* at 16.

<sup>132</sup> See *id.* at 17.

<sup>133</sup> See *id.* at 22.

<sup>134</sup> See *SEC Charges 38 in Multi-Million Dollar Stock Loan Scams*, U.S. SEC. & EXCHANGE COMMISSION (Sept. 20, 2007), <http://www.sec.gov/news/press/2007/2007-192.htm> [<http://perma.cc/JU2L-2KWV>].

<sup>135</sup> See *How Investigations Work*, U.S. SEC. & EXCHANGE COMMISSION (May 24, 2013), <http://www.sec.gov/News/Article/Detail/Article/1356125787012> [<http://perma.cc/FU2F-6VR4>].

<sup>136</sup> SEC, 2014 ANNUAL REPORT, *supra* note 70, at 40.

<sup>137</sup> See Karpoff, Lee & Martin, *The Cost to Firms*, *supra* note 120, at 588, 589 tbl.3 (reporting that between 1978 and 2006, each successful investigation into accounting fraud resulted on average in 1.70 administrative enforcement actions, 2.06 civil actions and 0.56 criminal actions). Karpoff and his collaborators confusingly label investigations that lead to the initiation of legal proceedings “enforcement actions” and the legal proceedings as “regulatory events.” *Id.* at 589 tbl.3; see also Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Consequences to Managers for Financial Misrepresentation*, 88 J. FIN. ECON. 193, 197 (2008) [hereinafter Karpoff, Lee & Martin, *The Consequences to Managers*] (referring to investigations that result in some form of enforcement as “enforcement actions” and to enforcement actions as “proceedings”). In SEC parlance, an enforcement action is a term of art referring to each initiated legal proceeding. Investigations that lead to legal proceedings are usually described as that, investigations, or cases. The legal literature uses the term enforcement action consistent with the SEC’s usage. See, e.g., Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement*, 127 HARV. L. REV. 853, 896 (2014) (referring to enforcement actions by private litigants, which are by definition legal proceedings).

the largest investigations the Commission initiates a dozen or more separate legal proceedings against various players. Following an investigation into accounting fraud at Adelphia, for example, the SEC brought an enforcement action in court seeking penalties and injunctions against the firm and its top officers,<sup>138</sup> a civil action against Adelphia's supplier Scientific-Atlanta for aiding and abetting Adelphia's fraud,<sup>139</sup> two administrative actions against Scientific-Atlanta's insiders,<sup>140</sup> an administrative action against Adelphia's auditor Deloitte & Touche,<sup>141</sup> and another against the engagement partner in charge of the Adelphia audit.<sup>142</sup> Investigations or cases<sup>143</sup> like Adelphia can continue to spawn enforcement actions for several years.<sup>144</sup>

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<sup>138</sup> Complaint at 6, SEC v. Adelphia Commc'ns Corp., No. 1:02-cv-5776 (S.D.N.Y. Jul. 24, 2002).

<sup>139</sup> Complaint at 3, SEC v. Scientific-Atlanta, Inc., No. 1:06-cv-4823 (PKC) (S.D.N.Y. June 22, 2006).

<sup>140</sup> Wallace G. Haislip, Exchange Act Release No. 54,030, 88 SEC Docket 779 (June 22, 2006); Julian W. Eidson, Exchange Act Release No. 54,031, 88 SEC Docket 782 (June 22, 2006).

<sup>141</sup> Deloitte & Touche LLP, Exchange Act Release No. 51,606, 85 SEC Docket 841 (Apr. 26, 2005).

<sup>142</sup> Initial Decision, Gregory M. Dearlove, Initial Decision Release No. 315, 88 SEC Docket 1603 (ALJ July 27, 2006).

<sup>143</sup> The SEC, too, refers to investigations as "cases". See *New Charges in Insider Trading Case Include Former CEO and Professional Baseball Player*, Litigation Release No. 22,451, 104 SEC Docket 1896 (Aug. 17, 2012), <https://www.sec.gov/litigation/litreleases/2012/lr22451.htm> [<https://perma.cc/C7JD-M4W3>].

<sup>144</sup> In 2007, the SEC completed an investigation in stock loan scams. It brought two civil actions in court against 38 individual defendants. See *SEC Charges 38 in Multi-Million Dollar Stock Loan Scams*, *supra* note 134. In 2011, it brought more than a dozen follow-on actions against the same defendants. See, e.g., Craig Demizio, Exchange Act Release No. 63,921, 100 SEC Docket 1635 (Feb. 17, 2011); Darin Demizio, Exchange Act Release No. 63,922, 100 SEC Docket 1635 (Feb. 17, 2011); Shaun Sarnicola, Exchange Act Release No. 63,924, 100 SEC Docket 1637 (Feb. 17, 2011).

This is not a new phenomenon. In 2000, the investigation into the Capital Consultants LLC Ponzi scheme resulted in four enforcement actions: a civil action seeking monetary fines and injunctions, and three administrative cases seeking disbarments. See *Complaint for Federal Securities Law Violations, SEC v. Capital Consultants LLC*, 2000 WL 35449178 (D. Or. Sept. 21, 2000) (3:00-cv-01290-KI) (civil action); *Capital Consultants LLC, Investment Advisers Act Release No. 1,963*, 75 SEC Docket 1451 (Aug. 10, 2001); Jeffrey L. Grayson, *Investment Advisers Act Release No. 1,964* (Aug. 10, 2001); Barclay L. Grayson, *Investment Advisers Act Release No. 1,962*, 75 SEC Docket 1450 (Aug. 10, 2001). In 2002, the SEC investigated Chimneyville Investments Group Inc. and its owner. It filed three enforcement actions: one civil action against the firm and the owner, and two administrative actions seeking permanent bars against each. *Complaint, SEC v. Chimneyville Inv. Grp. Inc.*, 3:98-cv-00574-HTW (S.D. Miss. Sept. 1, 1998) (civil action); *Chimneyville Inv. Grp. Inc.*, Exchange Act Release No. 46,424, 78 SEC Docket 958 (Aug. 28, 2002); Joseph Randolph Belew, Exchange Act Release No. 46,687, 2002 WL 31356634 (Oct. 21, 2002).

The SEC collects information on its enforcement activities and presents it annually, usually in the late fall, soon after the end of the fiscal year.<sup>145</sup> The SEC does not report the number of matters under investigation. It reports the number of informal investigations opened and the number of formal orders of investigation issued during any fiscal year.<sup>146</sup> But the SEC features most prominently enforcement actions it files. The annually-released reports list all enforcement actions filed during the fiscal year and tabulate the data by the primary category by subject-matter and venue.<sup>147</sup> This report used to be included in the annual report as an appendix.<sup>148</sup> Since 2004, the SEC has included some aggregate statistics in the annual report,<sup>149</sup> but the annual report no longer includes detailed information about enforcement. The SEC has continued to release such information in a separate document, entitled *Select SEC and Market Data*, that it makes available on its website,<sup>150</sup> and has continued to feature prominently enforcement statistics discussed in this Article.<sup>151</sup>

In order to analyze the SEC's reporting conventions, I reviewed 9,679 filed enforcement actions that are listed in the SEC's reports released from 2000 to 2014 (inclusive). The search uncovered some inconsistencies. The tables and figures reproduced in this Article report accurate figures. The SEC listed and counted twice a handful of enforcement actions.<sup>152</sup> The report for 2004 is missing pages<sup>153</sup> and so I supplemented the list by reviewing the SEC's litigation releases. In the 2005 report, Delinquent Filing enforcement actions are recorded in the wrong column (as civil actions), yielding a tally of civil actions that is too high by sixty, and a tally of administrative

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<sup>145</sup> See U.S. SEC & EXCH. COMM'N, *supra* note 4, at 2.

<sup>146</sup> See, e.g., U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2013, at 19 tbl.4 (2015) (reporting the number of investigations opened and formal orders issued during FY 2013).

<sup>147</sup> See *id.* at 3–18.

<sup>148</sup> See ANNUAL REPORT 2003, *supra* note 125, at 103–23 tbls.1–2.

<sup>149</sup> E.g., 2004 Performance and Accountability Report, *supra* note 125, at 21–25 (discussing enforcement cases instituted and successfully resolved).

<sup>150</sup> E.g., U.S. SEC. & EXCH. COMM'N, *supra* note 146 (the 2013 version of this report).

<sup>151</sup> See *Reports*, *supra* note 129 (linking to annual compilations of enforcement data from 2004–2014).

<sup>152</sup> See *infra* section III.A.3.

<sup>153</sup> See U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET FISCAL DATA 2004, at 20. The report finishes its list of offering violations in March of 2004, omitting six months of that type of case.

proceedings that is too low by sixty.<sup>154</sup> In addition, the defendant count reported in the 2005 report is too high by forty defendants, primarily in the broker-dealer and investment adviser categories.<sup>155</sup> Because the total number of enforcement actions reported is consistent with the enforcement actions I reviewed, I suspect the SEC's reported defendant count for 2005 must be in error. The tables and figures reproduced in this Article correct for these errors.

The SEC's enforcement budget as well as maximum financial penalties increased considerably in 2002 after accounting scandals and the adoption of the Sarbanes-Oxley Act.<sup>156</sup> I reviewed two years of enforcement actions before the adoption of the Act to see whether there are any obvious differences in reporting conventions used before and after—and there are none.<sup>157</sup>

The SEC reports as an “enforcement action” a legal proceeding initiated in district court or before the ALJ against one or more defendants. The SEC does not include all legal proceedings as enforcement actions. For example, reinstatements after a bar or suspension are not listed as enforcement actions.<sup>158</sup> In some years, the Commission does not count deferred prosecution agreements as enforcement actions, while in others it does.<sup>159</sup>

I coded enforcement actions as follows: (1) primary enforcement action seeking monetary penalties, injunctions, and cease-and-desist orders; (2) follow-on action brought under Section 15(b) of the Securities Exchange Act<sup>160</sup> or Rule 102(e) of the SEC's Rules of Practice<sup>161</sup> brought after the conclusion of

<sup>154</sup> See U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET FISCAL DATA 2005, at 3.

<sup>155</sup> *Id.*

<sup>156</sup> See generally Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>157</sup> In fiscal years 2000 and 2001, the SEC brought fewer enforcement actions and fewer follow-on proceedings than in the later years. See *infra* Tables 3B & 3C. The relative share of follow-on proceedings was not appreciably different.

<sup>158</sup> See, e.g., Jordan H. Mintz, Exchange Act Release No. 65,012, 101 SEC Docket 2852 (Aug. 2, 2011) (permitting Mr. Mintz to resume practice before the commission after a two year ban. The case was not listed in the SEC's 2011 report).

<sup>159</sup> Compare Tenaris to Pay \$5.4 Million in SEC's First-Ever Deferred Prosecution Agreement, Release No. 11-112, 2011 WL 1851249 (May 17, 2011) (listed in 2011 Fiscal Year report), with SEC Announces First Deferred Prosecution Agreement With Individual, Release No. 13-241, 2013 WL 5979519 (Nov. 12, 2013) (not listed in 2014 FY report).

<sup>160</sup> 15 U.S.C. § 78o(b) (2012).

<sup>161</sup> 17 C.F.R. § 201.102(e) (2015).

the primary enforcement action (and based on it) seeking to bar the defendant from appearing before the Commission as auditor or attorney, to bar the defendant from working in the securities industry, or to impose a penny stock bar; or (3) secondary enforcement action where the SEC, based on the same set of facts against the same defendant, filed simultaneously two enforcement actions: a civil action seeking a fine and an administrative action seeking a cease-and-desist order. In such cases, I coded the civil action as a primary enforcement action and the administrative proceeding seeking a cease-and-desist order as a secondary enforcement action. The raw data on enforcement actions are reported in Tables 3A, 3B, and 3C in the Appendix.

The SEC often brings an enforcement action alongside other enforcement agencies, including the DOJ,<sup>162</sup> the CFTC,<sup>163</sup> NASD or FINRA,<sup>164</sup> the PCAOB,<sup>165</sup> the exchanges,<sup>166</sup> or a state securities agency.<sup>167</sup> I coded such enforcement actions as primary if the SEC sought monetary penalties, injunctions, cease-and-desist orders, or censure. Enforcement actions where the SEC sought to disbar or suspend a defendant based on an earlier enforcement action by another agency targeting the same defendant for the same misconduct were coded as follow-on actions. I coded as two separate primary

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<sup>162</sup> See, e.g., *Deferred Prosecution Agreement, U.S. v. Statoil, ASA*, 1:06-cr-960 (S.D.N.Y. Oct. 10, 2006), <http://www.justice.gov/criminal/fcpa/cases/statoil-asa-inc/10-09-06statoil-agree.pdf> [<https://perma.cc/87RH-3E2K>] (DOJ proceeding); *Statoil, ASA, Exchange Act Release No. 54,599*, 89 SEC Docket 283 (Oct. 13, 2006), <https://www.sec.gov/litigation/admin/2006/34-54599.pdf> [<https://perma.cc/6GUG-AV8K>] (related SEC proceeding).

<sup>163</sup> See, e.g., *SEC v. Sunstate FX Inc.*, *Litigation Release No. 16,981*, 2001 WL 456371 (May 1, 2001), <https://www.sec.gov/litigation/litreleases/lr16981.htm> [<https://perma.cc/L23W-PA7W>] (announcing complaint filed simultaneously with CFTC).

<sup>164</sup> See, e.g., *First Command Financial Planning, Inc.*, *Securities Act Release No. 8,513, Exchange Act Release No. 50,859*, 84 SEC Docket 1332, at 7–9 (Dec. 15, 2004) (imposing compliance provisions with NASD supervision); *Knight Securities L.P.*, *Exchange Act Release No. 50,867*, 84 SEC Docket 1417, at 8 (Dec. 16, 2004) (nothing that the respondent previously settled with the NASD); *SEC Charges Goldman, Sachs & Co. Lacked Adequate Policies and Procedures for Research "Huddles."* U.S. SEC & EXCHANGE COMMISSION (Apr. 12, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488258> [<http://perma.cc/M4RW-34SH>] (reporting that the respondent settled with FINRA the same day it settled with the SEC).

<sup>165</sup> See *infra* notes 275–276.

<sup>166</sup> See, e.g., *Van Der Moolen Specialists USA, LLC*, *Exchange Act Release No. 49,502*, 83 SEC Docket 2366, at 14 n.11 (Mar. 30, 2004) (noting that the penalties paid also satisfy damages ordered in a related proceeding instituted by the New York Stock Exchange).

<sup>167</sup> See, e.g., *Deutsche Asset Management*, *Investment Company Act Release No. 27,606*, 89 SEC Docket 1887, at 14 (Dec. 21, 2006) (simultaneous NY and SEC proceeding).

enforcement actions where the SEC sanctioned in separate actions the firm, its owners,<sup>168</sup> or executives.<sup>169</sup> Bringing an enforcement action against a firm is usually considerably easier than bringing one against individuals. Individuals tend to fight charges, in particular those that give rise to temporary or permanent suspensions or bars from the industry, whereas the firm generally settles for financial penalties or less.<sup>170</sup> Similarly, I coded the actions for accounting fraud against the issuer and its external auditor as two primary enforcement actions.<sup>171</sup> Auditors are not ordinarily charged when a firm misrepresents its financials,<sup>172</sup> and so charging an auditor requires additional resources and expertise on the part of the SEC.

I coded as primary enforcement actions where the SEC was the first to bring an enforcement action that was later followed by a conviction.<sup>173</sup> In many cases the SEC coordinates its investigation with the DOJ. In criminal matters, either the DOJ usually moves first,<sup>174</sup> or the SEC and the DOJ announce a

<sup>168</sup> I used the same terminology as the SEC. See *supra* note 137.

<sup>169</sup> See, e.g., SEC Charges CVS With Misleading Investors and Committing Accounting Violations, Litigation Release No. 22,968, 2014 WL 1365924 (Apr. 8, 2014), <https://www.sec.gov/litigation/litreleases/2014/lr22968.htm> [<https://perma.cc/SUS2-6MPP>] (charging CVS Caremark managers with making improper accounting adjustments).

<sup>170</sup> Compare, e.g., SEC Charges Diebold and Former Financial Executives With Accounting Fraud, Litigation Release No. 21,543, 2010 WL 2194786 (June 2, 2010), <https://www.sec.gov/litigation/litreleases/2010/lr21543.htm> [<https://perma.cc/5PG6-MJY8>] (announcing settlement with \$25 million civil penalty against corporation), with SEC v. Geswein, 2 F. Supp. 3d 1074, 1077–78 (N.D. Ohio 2014) (denying the corporation's officers' motion to dismiss charges arising from the same violation).

<sup>171</sup> See, e.g., Complaint for Injunctive Relief at 1–4, SEC v. Yuhe Int'l, Inc., 2013 WL 5669183 (D.D.C. Oct. 18, 2013) (1:13-cv-1598) (charge of accounting fraud against primary issuer); Child, Van Wagoner & Bradshaw PLLC, Exchange Act Release No. 72,557, 109 SEC Docket 1355, at 1–3 (July 8, 2014) (charge of accounting fraud against auditor).

<sup>172</sup> See Simi Kedia, Urooj Khan & Shiva Rajgopal, The SEC's Enforcement Record Against Auditors 14 (Aug. 2015) (unpublished manuscript), <http://www8.gsb.columbia.edu/researcharchives/articles/13983> [<https://perma.cc/65Y5-9CC4>] (finding that from 1996 to 2009, the SEC charged the auditor who signed off on a fraudulent financial statement in only 17% of accounting fraud enforcement actions).

<sup>173</sup> See, e.g., Hector Gallardo, Exchange Act Release No. 65,422, 102 SEC Docket 81 (Sept. 28, 2011) (SEC's initial charge against stock broker); *Stock Broker Arrested on Wire Fraud Charges*, OFFICE U.S. ATT'Y (Nov. 3, 2011), <https://www.justice.gov/archive/usao/nye/pr/2011/2011nov03.html> [<http://perma.cc/G4WN-U52U>] (criminal charges following SEC's initial action).

<sup>174</sup> See *SEC Charges Operators of Fraud Based in Upstate New York*, U.S. SEC. & EXCHANGE COMMISSION (July 30, 2015), <http://www.sec.gov/news/press-release/2015-156.html> [<https://perma.cc/VTB6-PT2F>] (announcing civil charges against defendant whom the DOJ arrested a week earlier).

coordinated settlement simultaneously.<sup>175</sup> Rarely, the SEC moves first. In those cases, if the DOJ ultimately decides to move forward, it routinely moves to intervene in the ongoing SEC proceeding and requests a stay,<sup>176</sup> which is ordinarily granted. If the defendant is convicted, the SEC's original primary enforcement action is effectively converted into a follow-on proceeding, in which the defendant is disbarred or suspended but not otherwise sanctioned.<sup>177</sup> Such cases are rare and were coded as primary enforcement actions.

Further complicating the analysis are changes in SEC reporting during the study period. Fortunately, the Commission did not change the definition of an enforcement action but has changed subject-matter categorizations several times during the study period. It used to break out enforcement actions against broker-dealers into four or five categories.<sup>178</sup> Recently, it has reported all enforcement actions for broker-dealer violations in a single category, except for enforcement actions for municipal securities violations that have been reported separately since 2005, and are no longer included in the overall broker-dealer tally.<sup>179</sup> As a result, the numbers of enforcement actions against broker-dealers before and after 2005 are not directly comparable. Similarly, until fiscal year 2011 the Commission reported enforcement actions brought under the Foreign Corrupt Practices Act (FCPA) as Issuer Reporting and Disclosure actions.<sup>180</sup> Since then, FCPA cases have been reported separately.<sup>181</sup> As a result, the reported numbers on enforcement actions and defendants in Issuer Reporting and Disclosure actions before and after 2011 are not directly comparable. Finally, until fiscal year 2013 the SEC used to report contempt proceedings—actions to enforce compliance with an

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<sup>175</sup> See *SEC Charges Avon with FCPA Violations*, U.S. SEC. & EXCHANGE COMMISSION (Dec. 17, 2014), <http://www.sec.gov/news/pressrelease/2014-285.html> [<https://perma.cc/U3MK-X64Z>] (announcing simultaneous settlement of SEC charges and parallel DOJ criminal charges).

<sup>176</sup> See, e.g., David M. Tamman, Exchange Act Release No. 69,746, 106 SEC Docket 2314, at 1 (ALJ June 12, 2013) (Administrative Law Judge granted stay in proceedings pending resolution of a criminal indictment against the defendant).

<sup>177</sup> See *id.* at 1-2 (granting summary disposition of matter and imposing permanent disqualification of the defendant from practicing before the SEC after he was convicted of ten felony counts in criminal proceedings).

<sup>178</sup> E.g., U.S. SEC. & EXCH. COMM'N, 2002 ANNUAL REPORT 145-46 (2002) (categorizing broker-dealer cases as "Books & Records," "Fraud Against Customer," "Government/Municipal Securities," and "Other").

<sup>179</sup> E.g., U.S. SEC. & EXCH. COMM'N, SELECT SEC & MARKET DATA FISCAL 2006, at 4-6.

<sup>180</sup> E.g., *id.* at 12-15.

<sup>181</sup> E.g., U.S. Sec. & Exch. Comm'n, *supra* note 146, at 9.



earlier enforcement action—in its aggregate tally of enforcement actions filed, but no longer does so.<sup>182</sup> As a result, pre-2013 totals are inflated by the number of filed contempt proceedings compared with fiscal years 2013 and later.

### III

#### PROBLEMS WITH SEC REPORTING

This Part identifies the most serious problems with the SEC's enforcement statistics that the SEC uses to communicate that it is a vigorous enforcer of securities laws. The most important and most commonly used metric to report on the SEC's enforcement effort is the number of enforcement actions initiated during a fiscal year either by filing a complaint or an order instituting proceedings.<sup>183</sup> Yet counting enforcement actions yields an invalid and unreliable proxy for enforcement activity: it double- and triple-counts some cases, lumps together investigations with technical revocation proceedings, is inconsistent from year to year, and can be manipulated without much difficulty.<sup>184</sup> Other enforcement statistics that the SEC reports, including defendant count, subject-matter categorization, and monetary penalties, are similarly problematic.

This Part identifies problems with the validity and the reliability of the statistics that the SEC uses to measure its enforcement output. Then, by using recent examples, Part IV demonstrates the most significant consequences of using invalid and unreliable statistics to report on and analyze securities enforcement.

#### A. Problem 1: Validity

In statistics, the validity of a variable—the proxy used to measure an activity or a condition of interest—is the degree to which it measures what it is supposed to measure.<sup>185</sup>

There are various ways to evaluate securities enforcement. Generally speaking, enforcement statistics can and have been used as both a measure of input (in studies of deterrence) and as a measure of output (in reports about the resources directed

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<sup>182</sup> *Id.* at 3 n.1; see also discussion *infra* in Part III.A.2.

<sup>183</sup> See *supra* Part II.B.

<sup>184</sup> The enforcement staff believe that gross tallies present an incomplete view of enforcement activity and are “vulnerable to manipulation.” U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 35, at 22.

<sup>185</sup> See EDWARD G. CARMINES & RICHARD A. ZELLER, RELIABILITY AND VALIDITY ASSESSMENT 11–13 (1979) (Sage Univ. Paper Series on Quantitative Applications in the Soc. Scis. No. 07-017) (discussing reliability and validity).

at policing securities markets).<sup>186</sup> In order to conduct either type of analysis using statistical methods, one would want to know how many investigations an agency has initiated, against how many securities violators, and for what sorts of violations. For example, in deterrence studies, one would want to get a handle on the number of enforcement defendants targeted and another variable to measure the type and significance of the actions. One could then compare these figures with estimates of underlying misconduct to get a sense of the intensity of enforcement and to have a way to measure whether sanctions are having the desired deterrent effect. One would expect the number and the significance of new cases to vary over time, depending on the rate of misconduct, the available resources for the enforcement agency, and the agency's effective use of those resources. In output studies, one would want to categorize the data by the seriousness of the alleged charges and by the various market segments that enforcement actions purport to regulate.

The most prominently reported statistics about SEC enforcement—the number of enforcement actions filed and the number of monetary penalties ordered—are not useful for any of the purposes identified in the paragraph above.<sup>187</sup> They do not validly measure enforcement activity as conventionally understood: the likelihood of enforcement and the severity of the sanctions, or how well the SEC is meeting its goals. Other statistics that the SEC also reports, including the number of defendants targeted, could mitigate the problems associated with counting enforcement actions if they did not suffer from similar defects. The following sections explain in more detail why the SEC's enforcement statistics are invalid.

### 1. *Counting Enforcement Actions*

Each year, the SEC reports the number of investigations opened, the number of formal orders of investigation secured, and the number of enforcement actions filed. But it is the number of enforcement actions filed, which implies a success-

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<sup>186</sup> I do not want to suggest these are the only purposes for which enforcement statistics can be used. They can be useful not only for Congressional oversight and academic research, they can also be useful to the SEC in monitoring internal management processes and in managing public relations, and generally to study the relationships between the various parties in the regulatory process.

<sup>187</sup> See Macey, *supra* note 8, at 646 ("The more cases that are brought and the greater the amount of fines collected during a particular time frame, the better the enforcement staff at the SEC is thought to perform.").

ful investigation, that is featured most prominently.<sup>188</sup> Five factors make enforcement actions problematic as a measure of enforcement activity. First, the three statistics that the SEC reports on the number of investigated cases—informal investigations, formal orders of investigation, and enforcement actions—are not comparable. An investigation can generate multiple enforcement actions but not every investigation will generate at least one. Nowhere in its annual reports does the SEC explain and report how many investigations yielded at least one enforcement action. As a result, it is not clear how many investigations are ultimately closed without legal action, or whether and why investigations hit stumbling blocks before they become enforcement actions, and it is not obvious that the SEC does either.<sup>189</sup>

Second, counting enforcement actions may be a straightforward and convenient way for enforcement staff to keep track of various ongoing proceedings but it is a poor proxy for the likelihood of enforcement and for measuring enforcement output. The reason is that the SEC sometimes joins several defendants in a single enforcement action and at other times sues them individually.<sup>190</sup> The SEC's practices of filing separate or consolidated actions are not consistent over time and even between regional offices.<sup>191</sup> As a result, the number of enforcement actions will vary from year to year for reasons unrelated to underlying misconduct or the intensity of enforcement.

Third, as explained above,<sup>192</sup> an enforcement action is a legal proceeding initiated by a complaint or an order instituting proceedings, and identified by a docket number. Many of the SEC's enforcement actions are lawsuits in district court or administrative actions seeking to establish that the defendant violated securities laws, and to impose sanctions for violations, including monetary penalties, injunctions, and cease-and-desist orders.<sup>193</sup> In this Article, I dub these *primary* enforcement

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<sup>188</sup> The SEC reports the number of investigations and formal investigations initiated during each fiscal year, but does not report how many formal investigations result in enforcement actions. See, e.g., U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 21.

<sup>189</sup> Cf. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 35, at 3–8; see also SEC v. Caledonian Bank Ltd., 2015 WL 6971535, at \*8 (S.D.N.Y. Nov. 10, 2015) (expressing surprise that that the SEC does not have systems in place to track investigations and enforcement actions to prevent duplicative filings).

<sup>190</sup> Cf. Coffee, Jr., *supra* note 24, at 270 (noting that the SEC “typically pursues multiple individuals in each enforcement action”).

<sup>191</sup> See discussion *infra* Part III.B.1.

<sup>192</sup> *Supra* Part II.B.

<sup>193</sup> *Id.*

actions.<sup>194</sup> In addition, the SEC files so-called follow-on enforcement actions in administrative proceedings seeking to impose a partial or full associational bar against an offender, to suspend or to revoke registration as broker-dealer or investment adviser, or to suspend the right of an auditor or attorney to practice before the Commission.<sup>195</sup> All follow-on actions are *derivative*: they are ordinarily based on an injunction that the SEC imposed in a primary enforcement action against the same offender based on the same set of facts. In all follow-on proceedings, either the defendant already settled an SEC enforcement action (or lost in court or before the administrative law judge), was convicted, or was sanctioned by another federal agency or state securities regulator.<sup>196</sup> None of the follow-on actions are *new* enforcement actions and all have already been counted at least once in the SEC's enforcement tally, or that of another agency.<sup>197</sup> Most have been counted twice, often in the same fiscal year. Some have been counted three or more times.<sup>198</sup>

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<sup>194</sup> In a recent press release, the SEC referred to such proceedings as "independent enforcement actions." *SEC Announces Enforcement Results for FY 2015*, U.S. SEC. & EXCHANGE COMMISSION (Oct. 22, 2015), <http://www.sec.gov/news/pressrelease/2015-245.html> [<https://perma.cc/Q4V6-CCMW>].

<sup>195</sup> DIV. OF ENFORCEMENT, *supra* note 130, at 25.

<sup>196</sup> *See id.*

<sup>197</sup> A large majority of follow-on cases are triggered and/or accompanied by a primary SEC enforcement action. Only a handful of follow-on cases are based on a prior criminal conviction or bar imposed by state securities regulators, without an accompanying SEC primary enforcement action. For example, in fiscal 2009, the SEC brought 146 follow-on enforcement actions and 7 secondary enforcement actions seeking cease-and-desist orders. Of those, only eleven (7%) were not accompanied by a primary SEC enforcement action against the same defendant for the same violation, and thus not already counted at least once in the SEC enforcement tally. In 2010, the SEC brought 223 follow-on enforcement actions and 12 secondary enforcement actions seeking cease-and-desist orders. Of those, only thirteen (6%) were not accompanied by a primary SEC enforcement action against the same defendant for the same violation. In 2011, 16 of 239 (7%) follow-on and secondary actions were not accompanied by a primary SEC enforcement action; in 2012, 26 of 231 (11%) follow-on and secondary actions were not accompanied by a primary SEC enforcement action; in 2013, 23 of 204 (11%) follow-on and secondary actions were not accompanied by a primary SEC enforcement action.

In fiscal 2014, the number of follow-on cases not accompanied by a primary SEC enforcement action increased considerably. Of 246 follow-on enforcement actions, 81 (33%) were not previously included in the SEC enforcement tally: 73 follow-on enforcement actions were triggered by criminal convictions without an accompanying primary SEC enforcement actions and 8 follow-on enforcement actions were triggered by actions of the CFTC or state banking and securities regulators. The best explanation for the uptick is that the enforcement division directed staff to scour criminal records to find defendants to disbar.

<sup>198</sup> In FY 2013 alone, the SEC brought three separate enforcement actions for the same violation against James S. Quay and two follow-on cases against Ken-

For example, in May 2013, the SEC brought a civil action against Robert A. Gist for operating as a broker-dealer without registration, and for defrauding his customers of at least \$5.4 million.<sup>199</sup> Shortly thereafter, and based on the same investigation, the SEC filed two separate follow-on enforcement actions against Gist, one imposing a full associational bar and another suspending him from appearing or practicing before the Commission as attorney.<sup>200</sup> All three enforcement actions were included in the fiscal 2013 tally.<sup>201</sup> The contribution of follow-on cases to the overall enforcement tally is not trivial: each year since 2002, the SEC has filed between 148 and 246 follow-on enforcement actions,<sup>202</sup> boosting the overall number of enforcement actions by between 23% and 34%. Like contempt proceedings,<sup>203</sup> follow-on actions that prevent rogue brokers and investment advisers from working in the securities industry are important and should be reported, but separately.<sup>204</sup> It is misleading to include follow-on actions in a statistic that purports to measure new enforcement activity.<sup>205</sup>

Fourth, the SEC brings enforcement actions in district court and before in-house administrative law judges. In many

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neth Ira Starr, whom the SEC first sued for the violation in 2010. See SEC. & EXCH. COMM'N, *supra* note 109, at 4, 11, 16.

<sup>199</sup> SEC Charges Atlanta Attorney with Converting Investor Funds, U.S. SEC. & EXCHANGE COMMISSION (May 31, 2013), <https://www.sec.gov/litigation/lit-releases/2013/lr22710.htm> [<https://perma.cc/GQB7-MDP3>].

<sup>200</sup> Robert A. Gist, Exchange Act Release No. 70,243, 106 SEC Docket 4900 (Aug. 21, 2013) (suspending Gist); Robert A. Gist, Exchange Act Release No. 69,729, 106 SEC Docket 2274 (June 11, 2013) (imposing associational bar).

<sup>201</sup> SEC. & EXCH. COMM'N, *supra* note 146, at 5, 6, 17.

<sup>202</sup> *Infra* Table 3C.

<sup>203</sup> See discussion *supra* note 182.

<sup>204</sup> About a month after this study was circulated, the SEC released its enforcement report for fiscal year 2015. In it, it reported follow-on actions separately, as proposed in this Article. See SEC Announces Enforcement Results for FY 2015, U.S. SEC. & EXCHANGE COMMISSION (Oct. 22, 2015), <http://www.sec.gov/news/pressrelease/2015-245.html> [<https://perma.cc/C44X-ERZZ>]. In February 2016, in response to a draft of this Article that was circulated in September 2015, the SEC released the *Select SEC and Market Data Report Fiscal 2015* and categorized each action as civil action, stand-alone administrative action, and follow-on action, as proposed in this Article. See SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2015 (2016).

<sup>205</sup> A handful of convictions listed as a reason for the permanent bar imposed in fiscal year 2014 were entered much earlier. See, e.g., Christopher B. Mintz, Exchange Act Release No. 72,353, at 2 (June 9, 2014) (imposing a permanent bar based on 2009 guilty pleas of fraud by an investment adviser). It is admirable for the SEC to keep up with convicted criminals. It also shows just how silly it is to measure the performance of the SEC's enforcement division by counting how many legal proceedings it initiated in a given year.

cases, the agency can choose the forum.<sup>206</sup> But not always: the SEC can seek a cease-and-desist order only in an administrative proceeding and an injunction in district court only;<sup>207</sup> it can obtain an asset freeze in district court only,<sup>208</sup> and can sue a broker-dealer for failing to supervise an employee in an administrative proceeding only.<sup>209</sup> As a result, the SEC must sometimes bring two enforcement actions against the same defendant for the same violation to obtain the full relief it seeks, one in district court and one before the ALJ.<sup>210</sup> The remedies the SEC seeks in different fora are important yet, as is true for follow-on cases, that alone does not imply that both actions should be included in an indicator of the number of new prosecutions. Whether one or two actions are filed is a product of convoluted legal rules, and not of more or less vigorous enforcement, nor does it result in a greater sanction for the defendant.<sup>211</sup> Secondary enforcement actions—filed simultaneously against the same defendant for the same misconduct in court and before the ALJ—are rarer than follow-on enforcement actions. While complete coding remains to be done, in select years between 2000 and 2014, the SEC brought between two

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<sup>206</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1862–65 (2010) (codified at 15 U.S.C. § 77h-1(g)) (granting the SEC authority to impose monetary penalties in proceedings before an ALJ).

<sup>207</sup> 15 U.S.C. § 78u-3(a) (2012).

<sup>208</sup> Asset freezes are court-ordered equitable remedies that prevent defendants from controlling allegedly illegally-obtained funds until the case against them is resolved. See, e.g., *SEC Announces Asset Freeze Against Alleged EB-5 Fraudster in Seattle Area*, U.S. SEC. & EXCHANGE COMMISSION (Aug. 25, 2015), <https://www.sec.gov/news/pressrelease/2015-173.html> [<https://perma.cc/532J-98GZ>] (announcing that a judge in the U.S. District Court for the Western District of Washington issued an order freezing assets of individual accused of defrauding Chinese investors).

<sup>209</sup> Failure to supervise claims arise under the 1940 Advisers Act § 203(e)(6), 15 U.S.C. § 80b-3(e)(6) (2012), or Exchange Act § 15(b)(4)(E), 15 U.S.C. § 78o(b)(4)(E) (2012). Both of these provisions are tied to Commission orders, and thus cannot be imposed by a judge, except by exercise of equitable authority. See *infra* Part IV.C; see also SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS 1 (2015), <https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> [<https://perma.cc/3XRQ-MWTV>] (“[C]harges of failure to supervise . . . can only be pursued in the administrative forum”).

<sup>210</sup> See, e.g., Zurich Financial Services, Exchange Act Release No. 59,083, 94 SEC Docket 2719 (Dec. 11, 2008) (instituting cease-and-desist order against the respondent); Complaint, SEC v. Zurich Fin. Servs., 2008 WL 5594777 (S.D.N.Y. Dec. 11, 2008) (No. 1:08-cv-10760-WHP) (parallel civil action resulting in \$25 million civil penalty).

<sup>211</sup> In fact, the sanction is often less severe because cease-and-desist orders that are imposed in administrative proceedings generally tend to have less significant consequences than obey-the-law injunctions imposed in court actions.

and twenty-one secondary enforcement actions per fiscal year.<sup>212</sup>

And finally, the SEC counts every enforcement action filed, including where the first proceeding is discontinued for failure to serve the complaint and a new legal proceeding is subsequently initiated once the defendant has been located.<sup>213</sup> The SEC sometimes brings an enforcement action before the ALJ after moving to dismiss a civil action against the same defendants for the same violation, and counts both in the enforcement action tally.<sup>214</sup> Such cases are quite rare and alone would not significantly bias enforcement statistics. But they are a manifestation of the same reporting problem.

If measured by the number of filed enforcement actions, the SEC's enforcement activity increased between 2000 and 2014 by 50%, from 503 to 755 enforcement actions, and peaked in 2014.<sup>215</sup> However, once follow-on and secondary enforcement actions are excluded from the count, enforcement actions increased from 388 in fiscal year 2000 to 507 in FY 2014—still a considerable 31% increase.<sup>216</sup> However, primary enforcement actions did not peak in 2014, as suggested by the SEC's preferred statistic,<sup>217</sup> but in 2009, when the SEC filed

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<sup>212</sup> The SEC brought twenty-one secondary enforcement actions in 2004 and in 2007, eleven in 2008 and in 2010, ten in 2000, nine in 2009, three in 2011 and in 2013, and two in 2012 and 2014. Data on file with author.

<sup>213</sup> See, e.g., Christine M. Zamorsky, Administrative Proceedings Rulings Release No. 653, 98 SEC Docket 2223 (ALJ June 4, 2010) (discontinuing the proceeding as to Jeffrey M. Zamorsky for failure to serve); Jeffrey M. Zamorsky, Exchange Act Release No. 62,938, 99 SEC Docket 1368 (Sept. 20, 2010) (re-filing the action against Jeffrey M. Zamorsky); U.S. SEC. & EXCH. COMM'N, *supra* note 146, at 16, 18 (including both actions in the fiscal 2013 tally).

<sup>214</sup> See SEC v. Lawrence B. Irwin, Litigation Release No. 17,302, 2002 WL 27401, at 1 (Jan. 10, 2002), <https://www.sec.gov/litigation/litreleases/lr17302.htm> [<https://perma.cc/WHY5-SGBJ>] (reporting that the SEC dismissed the civil action it brought against an investment adviser and its manager and settled an administrative cease-and-desist that "alleged the same conduct"). In several large-scale market timing cases, the SEC first sued defendants in court, and after dismissing the civil action sued them before the ALJ. See, e.g., Complaint, SEC v. Invesco Funds Grp., Inc., Docket No. 1:03-cv-02421 (D. Colo. Dec. 2, 2003) (beginning lawsuit for market timing against Invesco); Notice of Voluntary Dismissal of Case, SEC v. Invesco Funds Grp., Inc., No. 1:03-cv-02421 (D. Colo. Oct. 8, 2004) (voluntarily dismissing the district court case); Invesco Funds Group, Inc., Order Instituting Administrative and Cease-and-Desist Proceedings, Exchange Act Release No. 50,506, Investment Company Act 34-50506, 83 SEC Docket 2872 (Oct. 8, 2004).

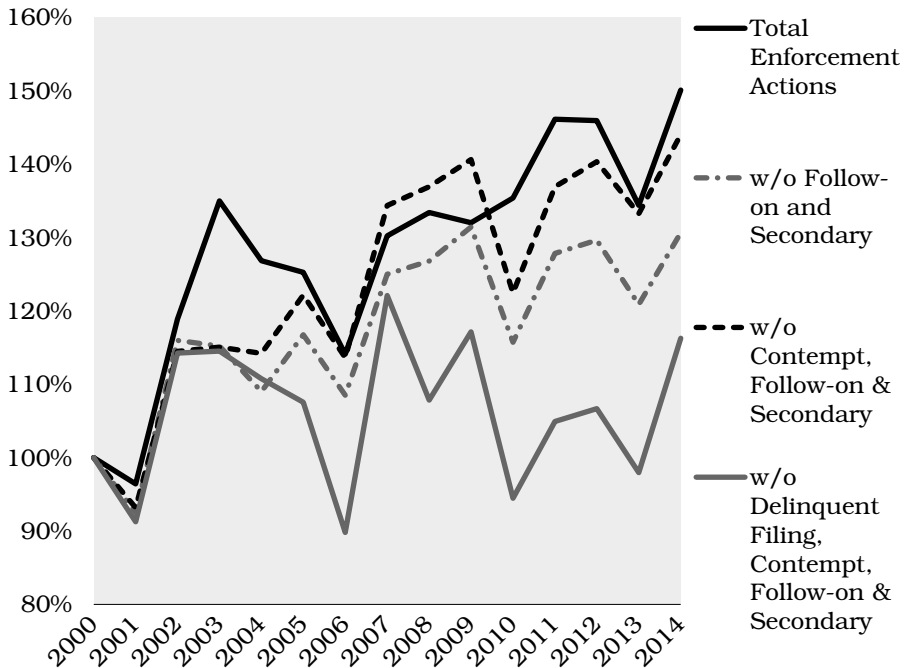
<sup>215</sup> See *infra* Table 3A.

<sup>216</sup> See *infra* Table 3B.

<sup>217</sup> See Jonathan Weil, *The Best SEC Speech Ever*, BLOOMBERG VIEW (Apr. 8, 2014), <http://www.bloombergyview.com/articles/2014-04-08/the-best-sec-speech-ever> [<http://perma.cc/9YDT-2ETG>] (citing a retiring SEC enforcement

510 new enforcement actions.<sup>218</sup> If contempt proceedings and delinquent filing cases also are removed from the enforcement action count,<sup>219</sup> then SEC primary enforcement has remained more or less flat between 2002 and 2014, as shown in Figure 2.

FIGURE 2: SEC ENFORCEMENT ACTIONS AS PERCENTAGE OF THE 2000 BASELINE (2000–2014)<sup>220</sup>



That, by itself, is not problematic. Misconduct rates change over time, declining in normal times and peaking during and immediately after investment booms.<sup>221</sup> If enforcement resources are kept constant, one would not expect the number of serious enforcement actions to continue to increase year after year. What is problematic, however, is that SEC leadership continues to highlight the number of filed enforcement

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employee for the proposition that the SEC's enforcement division is obsessed with measuring its performance by the number of cases it brings).

<sup>218</sup> *Infra* Table 3B.

<sup>219</sup> See discussion *infra* Part III.A.2.

<sup>220</sup> For the raw data, see *infra* Table 2.

<sup>221</sup> See, e.g., Paul Povel, Rajdeep Singh & Andrew Winton, *Booms, Busts, and Fraud*, 20 REV. FIN. STUD. 1219, 1222 (2007) (showing that fraud can prolong and exacerbate investment booms, leading to more painful busts); Wang & Winton, *supra* note 98, at 24 (explaining study "consistent with the theory of Povel at al. (2007)").



actions as the single most important statistic measuring its enforcement activity.<sup>222</sup>

## 2. Including Contempt Proceedings and Delinquent Filing Cases

The SEC's enforcement activity varies over time, depending on the violations that occur, their detection, and prosecution. Most enforcement actions involve misconduct that clearly deserves punishment. Two reported categories that the SEC includes in its enforcement statistics are different from the rest: contempt proceedings and delinquent filing cases.

The SEC brings contempt proceedings against defendants who do not comply with prior SEC enforcement orders. For example, the Commission targets auditors who audit SEC-registered broker-dealers despite being permanently barred from appearing or practicing before the Commission.<sup>223</sup> It sues defendants who fail to pay fines and disgorgements.<sup>224</sup> Contempt orders prosecute violations of remedial orders, not violations of securities laws. Contempt proceedings are, by definition, derivative. They presumably increase compliance with SEC and court orders, and boost the deterrent effect of securities enforcement. There is no doubt that the SEC should aggressively pursue defendants who violate its orders, and should report the number of contempt proceedings filed, but separately. Contempt proceedings do not belong in a statistic designed to measure how many securities violations the SEC prosecutes and how many *new* cases it brings each year. The SEC finally removed contempt proceedings from its count of enforcement actions in 2013, but reported enforcement figures for the earlier fiscal years remain inflated.<sup>225</sup>

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<sup>222</sup> See discussion *infra* Part IV.A.

<sup>223</sup> See SEC Seeks Contempt Finding Against Certified Public Accountant Joseph S. Amundsen, Litigation Release No. 22,150, 102 SEC Docket 1606, at 1 (Nov. 10, 2011), <https://www.sec.gov/litigation/litreleases/2011/lr22150.htm> [<https://perma.cc/46PM-LE6P>].

<sup>224</sup> See Court Finds Bay Area Hedge Fund Manager in Civil Contempt for Failing to Pay More than \$12 Million in Disgorgement to Defrauded Investors, Litigation Release No. 22,397, 2012 WL 2377217, at 1 (June 25, 2012), <https://www.sec.gov/litigation/litreleases/2012/lr22397.htm> [<https://perma.cc/XC3L-36PR>].

<sup>225</sup> Between 2000 and 2012, the SEC filed enforcement actions in between nine and forty-seven contempt proceedings, representing between 1% (in 2012) and 8% (in 2002) of enforcement actions. See *infra* Table 3B.

By contrast, enforcement actions brought for delinquent filings are usually not derivative;<sup>226</sup> they are new enforcement proceedings for never-before prosecuted violations of securities laws. Firms whose securities trade on the stock exchanges or in the over-the-counter market must file quarterly and annual reports with the SEC on forms 10-Q and 10-K.<sup>227</sup> If a publicly traded firm fails to file mandatory periodic reports, the SEC has the power to revoke registration of the firm's common stock and other securities.<sup>228</sup> Doing so is important because such companies' stock is often used by third parties in pump-and-dump<sup>229</sup> and other schemes, and thus poses real risk to investors as long as the securities trade publicly.<sup>230</sup>

But, delinquent filing actions are very different from other primary enforcement actions.<sup>231</sup> First, delinquent filing is a strict-liability offense: no mens rea is necessary.<sup>232</sup> In fact, if

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<sup>226</sup> The word *usually* was chosen deliberately. It is not uncommon for a delinquent filing action to follow a primary enforcement action for securities violations. For example, in September 2010 the SEC prosecuted Spence-Lingo & Company LTD in an enforcement action for falsely registering as a transfer agent and for fraudulent disclosures on fund registration statement. FreedomTree Mutual Funds and Asset Management LLC, Exchange Act Release No. 63,019, 99 SEC Docket 1583 (Sept. 30, 2010), <https://www.sec.gov/litigation/admin/2010/34-63019.pdf> [<https://perma.cc/A599-Z44Q>]. On the same day, the SEC also filed an enforcement action seeking to revoke registration of Spence-Lingo's common stock because Spence-Lingo was delinquent in its filings. Spence-Lingo & Company Ltd., Exchange Act Release No. 63,020, 99 SEC Docket 1586 (Sept. 30, 2010), <https://www.sec.gov/litigation/admin/2010/34-63020.pdf> [<https://perma.cc/7AMY-84UM>]. The SEC proceeded similarly in its enforcement actions against Rica Foods. After two primary enforcement actions filed in 2003 and 2008, the SEC brought a delinquent filing proceeding in 2009 to revoke registration of Rica Foods' common stock. Rica Foods, Inc., Exchange Act Release No. 59,174,94 SEC Docket 3174 (Dec. 30, 2008), <https://www.sec.gov/litigation/admin/2008/34-59174.pdf> [<https://perma.cc/W6QM-JLNC>].

<sup>227</sup> See 15 U.S.C. § 78m(a) (2012).

<sup>228</sup> See 15 U.S.C. § 78l(j) (2012).

<sup>229</sup> A "pump-and-dump" scheme involves fraudsters making misleading statements about a company's stock to the public to increase, or "pump," the company's stock prices. Once the prices increase, the fraudsters typically "dump" their stocks and new investors lose money. "Pump-and-Dumps" and Market Manipulations, U.S. SEC. & EXCHANGE COMMISSION (June 25, 2013), <http://www.sec.gov/answers/pumpdump.htm> [<https://perma.cc/P4B5-KDWT>].

<sup>230</sup> See Greg Farrell, *SEC Enforcement Activity Lags*, USA TODAY (Aug. 20, 2006), [http://usatoday30.usatoday.com/money/companies/regulation/2006-08-20-cox-usat\\_x.htm](http://usatoday30.usatoday.com/money/companies/regulation/2006-08-20-cox-usat_x.htm) [<http://perma.cc/DQ23-9EC5>] (reporting an increase in delinquent filing cases and noting that such actions require less work than accounting fraud investigations).

<sup>231</sup> See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 35, at 22 (citing enforcement staff's concerns about giving delinquent filing cases equal weight as "enforcement case[s] involving significant violations or market practices").

<sup>232</sup> See 15 U.S.C. § 78l(j) (2012) ("The Commission is authorized . . . to revoke the registration of a security, if the Commission finds . . . that the issuer[] of such security has failed to comply with any provision of this chapter . . .").

the SEC has evidence of false disclosure, it seeks a different remedy, either a stop order or accounting fraud charges.<sup>233</sup> By contrast, most primary enforcement actions require the SEC to show at least negligence and many require a showing of scienter.<sup>234</sup> To be fair, the Commission has brought a considerable number of enforcement actions for strict-liability violations in fiscal years 2013 and 2014,<sup>235</sup> but that is not the norm in securities enforcement.<sup>236</sup>

Second, when a firm fails to file periodic reports, the SEC first suspends trading in its common stock and then revokes registration of its common stock.<sup>237</sup> In delinquent filing actions, the SEC never imposes sanctions that are common in other primary enforcement actions, such as those for insider trading, accounting fraud or investment adviser violations. It never orders a company to pay monetary penalties, obtains an injunction or a cease-and-desist order, or orders that a corporate monitor be appointed. The only sanction is to revoke registration of the common stock.

And third and finally, delinquent filing actions are ordinarily decided by default. Firms, usually empty shells, fail to respond to the SEC's order instituting proceedings and an order of default is entered.<sup>238</sup> By contrast, defendants charged with other types of securities misconduct, from accounting fraud and market manipulation to insider trading, routinely fight the charges; default judgments are relatively rare. For example, of 1,149 defendants targeted in enforcement actions filed during the 2009 fiscal year (not including delinquent filing

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<sup>233</sup> See, e.g., Registration Statement of Shopeye Inc., Initial Decision Release No. 615, 109 SEC Docket 639, at 1 (ALJ June 16, 2014), (issuing a stop order against a company that made false statements in its registration statement); Registration Statement of Mobile Vault, Inc., Securities Act Release No. 9,576, 2014 WL 11022164, at 1 (Apr. 22, 2014), (same).

<sup>234</sup> See, e.g., Latour Trading LLC, Exchange Act Release No. 73,125, 2014 WL 4630258, at 12 (Sept. 17, 2014) (finding that defendant Latour willfully violated securities laws). In recent years, the SEC has ramped up enforcement of strict-liability offenses, such as Rule 105 of Regulation M, 17 C.F.R. 242.105 (2015), and Section 16(a) of the Securities Exchange Act, 15 U.S.C. § 78p (2012).

<sup>235</sup> See *infra* Table 3B (noting a considerable number of delinquent filing cases, which are strict-liability actions, in 2013 and 2014).

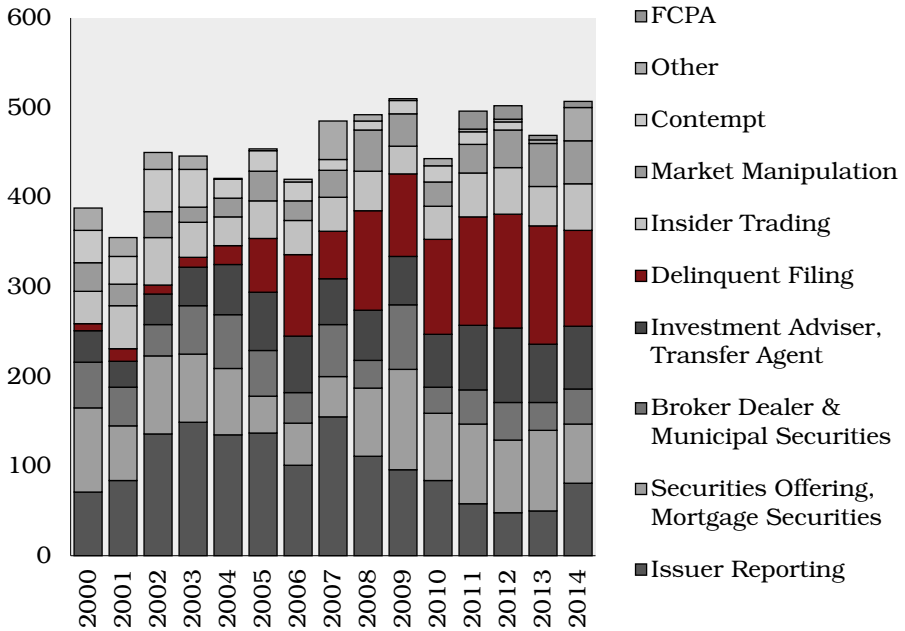
<sup>236</sup> See discussion *infra* Part IV.D.

<sup>237</sup> See 15 U.S.C. § 78l(j) (2012). See generally OFFICE OF INV'R EDUC. & ADVOCACY, U.S. SEC. & EXCH. COMM'N, INVESTOR BULLETIN: TRADING SUSPENSIONS (2012), <http://www.sec.gov/investor/alerts/tradingsuspensions.pdf> [<https://perma.cc/CN3X-X5P8>] (noting the SEC's authority to suspend trading during investigation and subsequently take further enforcement action).

<sup>238</sup> See, e.g., Initial Decision on Default, La Paz Mining Corp., Initial Decision Release No. 580, at 2 (Mar. 20, 2014) (finding respondents in default for failing to file an answer, appear at the hearing, or "otherwise defend the proceeding").

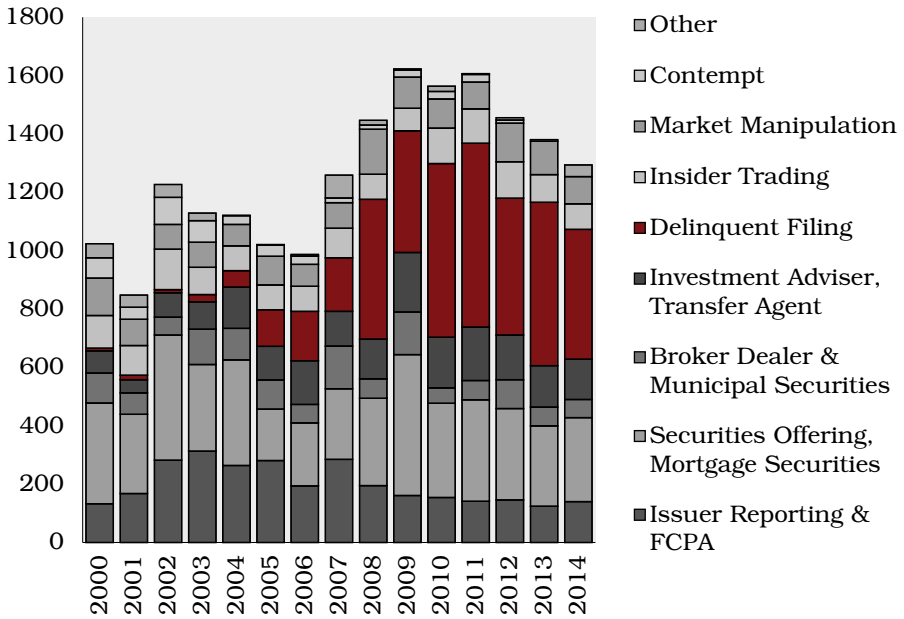
cases and contempt proceedings), 104 defendants (9.1%) failed to file a responsive pleading, and the SEC obtained a default judgment. In fiscal year 2010, 112 defendants (10.7%) of 1,047 charged defaulted.<sup>239</sup>

FIGURE 3: UNIQUE SEC ENFORCEMENT ACTIONS (2000–2014)  
(not incl. follow-on cases)



<sup>239</sup> The figure does not include delinquent filing cases (596 defendants), contempt proceedings (26 defendants), and relief defendants (151 defendants). Including those, the SEC prosecuted 1,817 defendants in 2010. See U.S. SEC. & EXCH. COMM’N, SELECT SEC AND MARKET DATA FISCAL 2010, at 3.

FIGURE 3B: UNIQUE DEFENDANTS IN SEC ENFORCEMENT ACTIONS  
(2000–2014)  
(not incl. follow-on cases)



The SEC’s effort to reduce the risk of manipulation should be celebrated. The SEC used to bring ten or so enforcement actions for delinquent filing against ten or so defendants each fiscal year.<sup>240</sup> Since 2005, it has filed more than fifty delinquent filing actions per year, and since 2010 it has brought more than one-hundred delinquent filing enforcement actions against five-hundred or more defendants per year.<sup>241</sup> Between 2005, when the SEC began seriously policing delinquent filing, and 2014, it revoked the common stock registration of 4,075 publicly traded firms.<sup>242</sup>

At the same time, delinquent filing actions really are different from other enforcement actions. Including them in the overall measure of enforcement output will tend to bias the indicator upward, as shown in Figures 3A and 3B. The share of delinquent filing actions has increased from 2% of the total number of enforcement actions (and 1.8% of defendants) in

<sup>240</sup> See *infra* Table 3B.

<sup>241</sup> See, e.g., U.S. SEC. & EXCH. COMM’N, *supra* note 146, at 3 (reporting 132 delinquent filing cases against 560 defendants).

<sup>242</sup> Based on the number of cases listed in annual reports and Select SEC and Market Data reports between 2005 and 2014. See *Reports*, *supra* note 129.

fiscal 2003 to 20% (and 35% of defendants) in fiscal 2013.<sup>243</sup> Since 2004, the overall numbers of enforcement actions and defendants targeted have increased by about one hundred, less than the increase in the number of delinquent filing cases. As a result, the number of enforcement actions that require the SEC to show a guilty or at least negligent mind has declined.<sup>244</sup> Yet the statistics on enforcement activity and defendant counts that the SEC reports to Congress obscure this potentially significant trend.

### 3. *Counting Defendants*

The SEC reports the number of defendants in addition to reporting the number of enforcement actions.<sup>245</sup> Reporting the number of discrete individuals and firms investigated and prosecuted for securities violations could mitigate considerably the measurement bias introduced by the way in which the SEC counts enforcement actions. Unfortunately, when the SEC counts defendants, it does not count discrete individuals and firms that it targets. Rather, it counts up the parties named in enforcement actions filed and reports them as defendants targeted. For example, Robert A. Gist, whom the SEC targeted in 2013 in one primary and two follow-on enforcement actions arising from the same violation, was counted in the 2013 tally of defendants three times, instead of only once.<sup>246</sup> As a result, just as the Commission counts follow-on and secondary cases more than once, it also counts defendants identified in such actions two or three times. According to my research, between 150 and 300 defendants each year are counted more than once due to follow-on and secondary enforcement.

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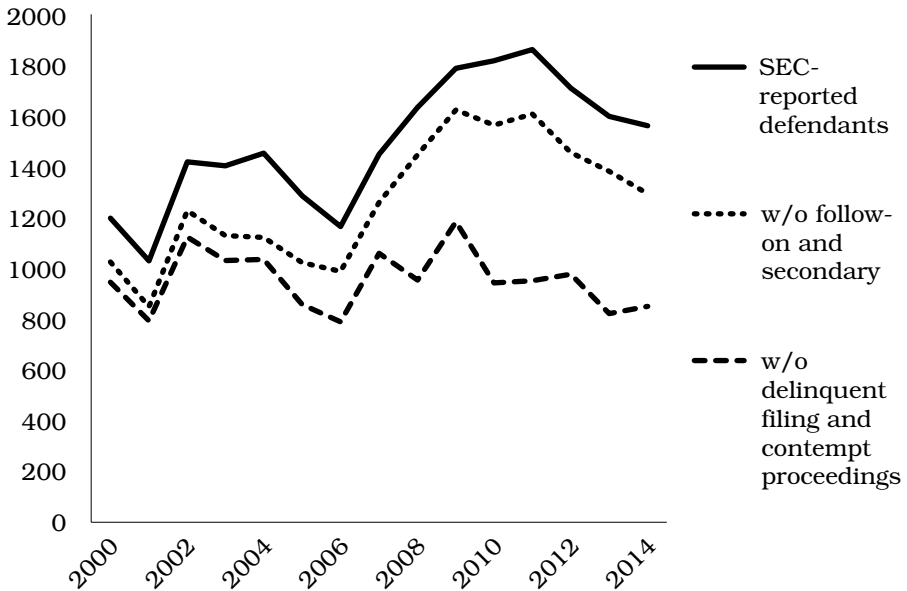
<sup>243</sup> Excluding follow-on and secondary cases, delinquent filing cases were 28% of primary enforcement actions and 41% of defendants in 2013. See *infra* Table 3B.

<sup>244</sup> Cf. Burns & Scannell, *supra* note 31, at C3 (reporting that the increase in delinquent filing enforcement actions “conceal[s] a steep decline in enforcement cases”).

<sup>245</sup> See, e.g., U.S. SEC. & EXCH. COMM’N, *supra* note 109, at 3.

<sup>246</sup> See *supra* notes 200–02 and accompanying text.

FIGURE 4: DEFENDANTS IN SEC ENFORCEMENT ACTIONS  
(2000–2014)



In addition, the SEC reports as defendants not only those violating securities laws but also relief defendants: individuals and entities who are not charged with securities violations. Rather, they are named as relief or nominal defendants because they received property that was originally obtained illegally and to which they have no legitimate claim.<sup>247</sup> An argument in favor of including relief defendants in the count is that relief defendants tend to fight SEC’s charges much in the same way as primary defendants,<sup>248</sup> requiring the SEC to expend its limited enforcement resources. At the same time, nonculpable individuals are, by definition, not securities violators that the SEC punishes.

If the number of relief defendants remained stable over time, including them in the count would merely overstate the true number of securities violators targeted in SEC enforcement. But the number is not stable. Unlike “real” defendants, whose assets are often frozen when the SEC brings a significant enforcement action, the SEC cannot freeze relief defendants’ assets. As a result, it usually pursues relief defendants

<sup>247</sup> See U.S. Sec. & Exch. Comm’n v. Collelo, 139 F.3d 674, 677 (9th Cir. 1998) (explaining that a “nominal defendant” is someone who “has received ill gotten funds and . . . does not have a legitimate claim to those funds”).

<sup>248</sup> See *id.* at 676–77 (relief defendant fighting the SEC’s charges in much the same way as a primary defendant).

only when the primary defendant is judgment proof, and the amount that the relief defendant received is large.<sup>249</sup> This is very common in Ponzi schemes and offering frauds, and much less common in accounting fraud and insider trading cases. The number of relief defendants thus varies considerably from year to year, depending largely on the number of offering frauds and Ponzi schemes prosecuted.<sup>250</sup> In 2009, the fiscal year in which Madoff's Ponzi scheme came to light, the SEC prosecuted a record number of similar schemes.<sup>251</sup> It also prosecuted 197 relief defendants (11% of all defendants). By contrast, in fiscal 2013, the SEC went after 55 relief defendants (3% of all reported defendants).

#### 4. *Aggregate Monetary Penalties*

The second most significant and widely reported statistic, after the number of enforcement actions filed, is the amount of monetary penalties ordered by the SEC. It is also the only statistic that reports on the remedies secured in securities enforcement, and not on the number of filings. As noted above, the SEC prevails in the vast majority of enforcement actions. It secures some monetary penalties in many of its actions, but certainly not in all.<sup>252</sup> In addition to ordering defendants to pay, it also secures injunctions, which defendants often fight more than monetary penalties because injunctions often lead to a permanent or temporary ban from the securities industry and trigger automatic disqualifications.<sup>253</sup> In actions against firms, the SEC usually requires independent consultants to

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<sup>249</sup> *Proceedings of the 2007 Midwest Securities Law Institute Symposium*, 8 J. BUS. & SEC. L. 59, 96 (2007) ("We don't charge relief defendants in every case. It's probably more the exception to the rule.") (quoting Steven Klawans, Chicago Branch Chief, U.S. Sec. & Exch. Comm'n Enforcement Div.).

<sup>250</sup> *See id.* at 95. In 2014, the SEC sued seventy-one relief defendants. Of the seventy-one, fifty-nine were sued in connection with offering fraud or Ponzi schemes.

<sup>251</sup> *See* U.S. SEC. & EXCH. COMM'N, 2009 PERFORMANCE AND ACCOUNTABILITY REPORT 9–11, 128–29 (2009) (detailing the SEC's efforts against Ponzi schemes in FY 2009).

<sup>252</sup> According to my research, of cases filed in fiscal 2009 (not including contempt proceedings, follow-on and secondary actions, delinquent filing actions, and relief defendants), the SEC secured some monetary penalties against 45% of defendants. Another 15% were put in receivership or were ordered to pay monetary penalties that were simultaneously waived because of restitution ordered in a parallel criminal action and/or defendant's inability to pay.

<sup>253</sup> *See* Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, *Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws* (March 12, 2015), <https://www.sec.gov/news/speech/031215-spch-cmjw.html> [<https://perma.cc/SDK3-NFVM>] (discussing the relationship between disqualifications and enforcement remedies and waivers from those remedies).



oversee compliance, sometimes requires that employees be terminated, and so forth. To perform any sort of deterrence analysis, much more comprehensive data on sanctions would be needed.

Monetary penalties as reported are less problematic than the enforcement action count,<sup>254</sup> but still require three adjustments to be valid. First, it is not unusual for the SEC to prosecute a defendant concurrently with criminal authorities. The U.S. Attorney's Office usually intervenes in the parallel SEC's civil proceeding and requests a stay,<sup>255</sup> but not always. In a nonnegligible number of cases, the SEC orders the defendant to pay disgorgement, agreeing to credit dollar-for-dollar any amount that the defendant is ordered to pay as restitution in a criminal case.<sup>256</sup> In addition, the SEC sometimes includes a civil fine ordered by another enforcement agency or one of the exchanges in its enforcement order.<sup>257</sup> If one were to report aggregate monetary penalties imposed by various enforcement agencies, such fines and disgorgements would be counted twice: once in the SEC's tally and for the second time in the tally reported by the U.S. Department of Justice, other agencies, or the exchanges. The amounts involved are routinely in the tens, sometimes hundreds of millions.

Second, the SEC also includes in its aggregate tally monetary penalties ordered but waived either due to defendant's inability to pay, in light of criminal penalties imposed, or to reward defendant's cooperation.<sup>258</sup> A defendant punished with a decade or longer prison sentence would usually be unable to pay any fine imposed. But such penalties should generally not be included in reported aggregate monetary penalties.

Finally, and less problematically, the SEC highlights monetary penalties ordered, not collected. Of \$4.17 billion in ordered monetary penalties in fiscal 2014, the SEC has been able

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<sup>254</sup> In fact, because of the challenges involved in cross-country comparisons of enforcement actions, one commentator proposed to focus on monetary penalties instead. See Coffee, Jr., *supra* note 24, at 270.

<sup>255</sup> See *supra* note 176 and accompanying text; see also Thomas C. Newkirk, Assoc. Dir., Div. of Enf't, U.S. Sec. & Exch. Comm'n & Ira L. Brandriss, Staff Att'y, Div. of Enf't, U.S. Sec. & Exch. Comm'n, Speech by SEC Staff: The Advantages of a Dual System: Parallel Streams of Civil and Criminal Enforcement of the U.S. Securities Laws, at IX(B) (Sept. 19, 1998), <http://www.sec.gov/news/speech/speecharchive/1998/spch222.htm> [<https://perma.cc/HL6L-5JYA>] (hereinafter Advantages of a Dual System).

<sup>256</sup> See Advantages of a Dual System, *supra* note 255, at IV(C).

<sup>257</sup> See *id.*

<sup>258</sup> See SEC, 2014 ANNUAL REPORT, *supra* note 70, at 43 (comparing financial penalties ordered to those actually collected).

to collect \$2.1 billion, or just about half of the amount ordered.<sup>259</sup> The aggregate amount collected is still higher than in any prior year except for 2005, but it is considerably smaller than the amount ordered. The SEC's ability to collect fines depends on whether defendants it targets are solvent or not.<sup>260</sup> The J.P. Morgans of the world pay the entire monetary penalty ordered, while Ponzi schemers like Allan Stanford cannot and do not.<sup>261</sup> Focusing too much on collections could skew the SEC's enforcement effort toward solvent defendants, at the expense of pursuing penny stock frauds, pyramid schemes, and the like.

But the way that the Commission presents its statistics on monetary penalties makes it very easy even for informed researchers to miss that the SEC collects far less than it orders.<sup>262</sup> For example, the SEC uses the terms "secured"<sup>263</sup> or "obtained"<sup>264</sup> when describing monetary penalties, implying that the amounts were collected, not merely that such orders were imposed.

## B. Problem 2: Reliability

A reliable measure is one that is consistent, producing similar results under consistent conditions. For example, tracking the venue in which the SEC files an enforcement action—district court or the administrative forum—tells us something meaningful about litigation choices and can be reported reliably: one only needs to record where the action was filed which the SEC reports unambiguously. A measure can be reliable but not valid: the variable "enforcement action" discussed

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<sup>259</sup> See *id.*

<sup>260</sup> See *id.* at 43, Performance Indicator 2.3.5 (explaining why the SEC orders defendants to pay monetary penalties that it knows that they cannot pay).

<sup>261</sup> Allen Stanford was convicted of convicted of defrauding almost 30,000 investors in a \$7 billion Ponzi scheme across over 100 countries. See Clifford Krauss, *Stanford Convicted by Jury in \$7 Billion Ponzi Scheme*, N.Y. TIMES, Mar. 6, 2012, at B1.

<sup>262</sup> For example, in fiscal year 2011, the SEC ordered \$2.8 billion in monetary penalties and collected about half, \$1.5 billion. See SEC, 2014 ANNUAL REPORT, *supra* note 70, at 43. Yet an article published in the *Harvard Law Review* in 2014 reports the higher figure as the amount that the SEC recovered, not the lower, correct figure. See Lemos & Minzner, *supra* note 137, at 855 (noting that the SEC reported "total recoveries of \$2.8 billion") (emphasis added).

<sup>263</sup> U.S. SEC. & EXCH. COMM'N, FY 2011 PERFORMANCE AND ACCOUNTABILITY REPORT 192 (2011), <http://www.sec.gov/about/secpar/secpar2011.pdf#2011review> [<https://perma.cc/Y7NW-QYP7>].

<sup>264</sup> U.S. SEC. & EXCH. COMM'N, IN BRIEF: FY 2013 CONGRESSIONAL JUSTIFICATION 1 (2012), <http://www.sec.gov/about/secfy13congbudgjust.pdf> [<https://perma.cc/W4W8-MXTP>].

above measures consistently the number of initiated proceedings, but because those include many follow-on and secondary actions against the same defendant for the same misconduct, it does not measure what we want to measure: new securities enforcement activity.<sup>265</sup>

A measure is not reliable when it cannot be reproduced consistently.<sup>266</sup> As noted in the previous section, when reporting its enforcement output, the SEC counts the number of legal proceedings initiated. It can increase the number by filing separate complaints against multiple defendants charged with the same violation based on the same set of facts when it could file a single complaint. Also, the SEC categorizes enforcement actions by primary subject-matter. Case categorization is within the discretion of the enforcement staff at the first instance, and then reviewed by the Office of the Secretary.<sup>267</sup> Because categorization is inconsistent from year to year, reliability suffers.

### 1. *Slicing and Dicing*

Litigated cases are usually consolidated to preserve resources. In securities litigation, plaintiffs ordinarily file two, three, or more complaints in different courts.<sup>268</sup> The cases are ultimately consolidated, and defendants—the fraud firm, its auditor, sometimes officers or directors—litigate a single case and pay damages into a single pot.<sup>269</sup> Because securities class actions are routinely consolidated, reporting the number of filed securities class actions provides a useful and reliable metric to track securities litigation over time.<sup>270</sup>

This is not the case with SEC enforcement. Like securities litigation, a majority of SEC cases are ultimately settled.<sup>271</sup> But unlike private suits, which are never settled at the time

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<sup>265</sup> See discussion *supra* Part III.A.1.

<sup>266</sup> See CARMINES & ZELLER, *supra* note 185, at 12 (describing a measure as reliable when repeated measures yield the same result).

<sup>267</sup> Telephone Interview with Jason Flemmons (Sept. 27, 2015).

<sup>268</sup> Cf. Adam B. Badawi & David H. Webber, *Does the Quality of the Plaintiffs' Law Firm Matter in Deal Litigation?*, 41 J. CORP. L. (2016) (forthcoming) (reporting that 2.8 complaints are filed on average in each class action targeting acquisitions).

<sup>269</sup> Cf. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2014 YEAR IN REVIEW 8 (2015), <https://www.cornerstone.com/GetAttachment/52bfaa16-ff84-43b9-b7e7-8b2c7ab6df43/Securities-Class-Action-Filings-2014-Year-in-Review.pdf> [<https://perma.cc/WU7Y-L458>] (reporting percentage of filings where class action suit also targeted underwriter or auditor).

<sup>270</sup> See, e.g., *id.* at 4 (reporting the number of cases filed annually as a measure of litigation activity).

<sup>271</sup> See JORGE BAEZ, JAMES A. OVERDAHL & ELAINE BUCKBERG, NAT'L ECON. RESEARCH ASSOCS., SEC SETTLEMENT TRENDS: 2H12 UPDATE 2 (2013).

they are filed, many of the SEC's cases are. In fiscal 2009, for example, the SEC sued 1,149 defendants.<sup>272</sup> Of those, 436 (37.9%) had settled by the time that the legal proceeding was initiated. Of 1,047 defendants sued in fiscal year 2014, 547 (52.2%) settled with the SEC before the enforcement action was filed.<sup>273</sup>

When the SEC litigates cases, it has the same incentive as every other litigant: consolidate to the extent possible to preserve resources.<sup>274</sup> By contrast, when the SEC brings a settled enforcement action, the cost pressure to consolidate disappears. Because the SEC counts legal proceedings filed, and not investigations that yield at least one enforcement action, it has an incentive to file multiple settled actions where it could file one to increase the number of enforcement actions filed. For example, in a coordinated action with the Public Company Accounting Oversight Board (PCAOB) against an audit firm, the PCAOB brought a single action against the audit firm and two of its partners.<sup>275</sup> By contrast, the SEC brought three separate settled enforcement actions: against the firm and each of the partners.<sup>276</sup> Similarly, in December 2005 the SEC completed its investigation into campaign contributions and subsequent participation in municipal bond offerings. Executives of CIBC World Markets Corporation (CIBC) made contributions for California Governor Gray Davis' re-election bid.<sup>277</sup> The rules barred CIBC from participating in municipal offerings for two

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<sup>272</sup> U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2009, at 3 (2009). The count does not include contempt proceedings and delinquent filing cases, and only includes defendants charged with securities violations, not relief defendants.

<sup>273</sup> Data on file with author. The count does not include contempt proceedings and delinquent filing cases, and only includes defendants charged with securities violations, not relief defendants.

<sup>274</sup> See, e.g., Thomas Y. Jimenez (CPA), Exchange Act Release No. 65,466, 102 SEC Docket 266, at 2 (Oct. 3, 2011) (explaining that the court consolidated 2007 and 2008 cases against GlobeTel and its former CFO).

<sup>275</sup> See Chisholm, Bierwolf, Nilson & Morrill, LLC, Todd D. Chisholm, CPA & Troy F. Nilson, CPA, PCAOB Release No. 115-2011-003, at 1 (Apr. 8, 2011), <http://pcaobus.org/Enforcement/Decisions/Documents/Chisholm.pdf> [<https://perma.cc/R5CV-DD8L>].

<sup>276</sup> See Chisholm, Bierwolf, Nilson & Morrill, LLC, Exchange Act Release No. 64,280, 100 SEC Docket 3209, at 1 (Apr. 8, 2011); Todd D. Chisholm, CPA, Exchange Act Release No. 64,279, 100 SEC Docket 3204, at 1 (Apr. 8, 2011); Troy F. Nilson, CPA, Exchange Act Release No. 64,277, 100 SEC Docket 3194, at 1 (Apr. 8, 2011).

<sup>277</sup> CIBC World Markets Corp., Exchange Act Release No. 52,942, 86 SEC Docket 2262, at 2-4 (Dec. 12, 2005).

years,<sup>278</sup> but CIBC served as underwriter in several offerings during the disqualification period.<sup>279</sup> The firm and three individuals, all employees of CIBC, settled before the SEC initiated formal legal proceedings. The SEC could have brought one enforcement action but brought four instead, one against each participant in the scheme.<sup>280</sup>

I do not want to suggest that the SEC files multiple enforcement actions in order to improve its end-of-the-year numbers. I have no evidence that the SEC brings separate cases opportunistically, merely that it does so without a good explanation as to why. More often than not, the SEC files separate actions because some of the defendants have settled while the others have not. There are several examples in the fiscal year 2014 alone. The SEC investigation into accounting manipulation at the Regions Financial Corporation targeted the firm and three individuals. Regions Financial Corporation entered into a deferred prosecution agreement that was not reported as an enforcement action.<sup>281</sup> Two of three individual defendants settled, while the third fought the charges. The SEC filed two separate enforcement actions,<sup>282</sup> closed the one against settling defendants quickly while the second settled a year later,<sup>283</sup> and reported two enforcement actions in its annual enforcement report.<sup>284</sup> The Commission did something very

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<sup>278</sup> See *id.* at 2 n.2 (stating that the contribution violated Municipal Securities Rulemaking Board Rule G-37(b) and Exchange Act § 15B(c)(1), 15 U.S.C. § 78o-4(c)(1)).

<sup>279</sup> *Id.* at 3-4.

<sup>280</sup> *Id.* at 1; Paul D. Rogers, Exchange Act Release No. 52,941, 86 SEC Docket 2260, at 1 (Dec. 12, 2005); Peter J. Crowley, Exchange Act Release No. 52,943, 86 SEC Docket 2264, at 1 (Dec. 12, 2005); Robert J. Dentice, Exchange Act Release No. 52,944, 86 SEC Docket 2266, at 1 (Dec. 12, 2005).

<sup>281</sup> U.S. SEC. & EXCH. COMM'N, DEFERRED PROSECUTION AGREEMENT 9 (2014), <http://www.sec.gov/news/press/2014/2014-125-dpa.pdf> [<https://perma.cc/XY3Z-7KGM>] (signed agreement between Regions Financial Corp. and the SEC); see also *supra* note 161 and accompanying text (deferred prosecution agreements not included in 2014 enforcement action count).

<sup>282</sup> See Jeffrey C. Kuehr, Securities Act Release No. 9,606, Exchange Act Release No. 72,471, 109 SEC Docket 656, at 1 (June 25, 2014) (case against settling defendants); Thomas A. Neely, Jr., Securities Act Release No. 9,605, Exchange Act Release No. 72,470, 109 SEC Docket 561, at 1 (June 25, 2014) (case against non-settling defendant).

<sup>283</sup> See Thomas A. Neely, Jr., Securities Act Release No. 9,772, Exchange Act Release No. 74,976, 2015 WL 2328702 (May 15, 2015).

<sup>284</sup> See U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 15.

similar following its investigations into accounting fraud at QSGI Inc.<sup>285</sup> and Natural Blue Resources.<sup>286</sup>

In addition, at least sometimes the SEC conducts one investigation but files multiple enforcement actions based on the same set of facts because of a statutory directive. For example, Section 8(d) of the Securities Act sets out the requirement for initiating stop order proceedings, implying that the SEC must bring separate proceedings for each affected registration statement.<sup>287</sup> In 2014 the SEC investigated John Briner's scheme in which he set up twenty mining companies and filed registration statements offering stock to public investors.<sup>288</sup> The statements contained misrepresentations and failed to disclose that Briner, a recidivist, was promoting the offerings.<sup>289</sup> Based on one investigation, SEC initiated twenty separate administrative stop order proceedings and reported them as twenty enforcement actions.<sup>290</sup>

Even if the SEC rarely slices and dices investigations into many enforcement actions opportunistically, which would

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<sup>285</sup> See Edward L. Cummings, Exchange Act Release No. 72,722, 109 SEC Docket 2614, at 1–2 (July 30, 2014) (settling with the SEC); Marc Sherman, Exchange Act Release No. 72,723, 109 SEC Docket 2620, at 1–2 (July 30, 2014) (opposing the SEC's charges); U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 15 (counting both actions separately in the annual report).

<sup>286</sup> See Erik H. Perry, Securities Act Release No. 9,615, Exchange Act Release No. 72,618, 109 SEC 1519, at 1–2 (July 16, 2014), <https://www.sec.gov/litigation/admin/2014/33-9615.pdf> [<https://perma.cc/3UL7-ZWBJ>] (settling at the time of filing on both liability and monetary sanctions); Toney Anaya, Securities Act Release No. 9,613, Exchange Act Release No. 72,616, 109 SEC Docket 1509, at 1–2 (July 16, 2014), <https://www.sec.gov/litigation/admin/2014/33-9613.pdf> [<https://perma.cc/52RT-5TH2>] (settling at the time of filing on liability but deferring decision on monetary sanctions); Natural Blue Resources, Inc., Securities Act Release No. 9,614, Exchange Act Release No. 72,617, 109 SEC Docket 1512, at 1 (July 16, 2014), <https://www.sec.gov/litigation/admin/2014/33-9614.pdf> [<https://perma.cc/G5YS-ZKGT>] (instituting proceedings against defendants that contest liability); U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 15 (counting both actions separately in the annual report).

<sup>287</sup> 15 U.S.C. § 77h(d) (2012).

<sup>288</sup> See *SEC Seeks Stop Orders Against 20 Purported Mining Companies With Misleading Registration Statements*, U.S. SEC. & EXCHANGE COMMISSION (Feb. 3, 2014), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540716442> [<https://perma.cc/TR2Y-L6BC>].

<sup>289</sup> *Id.*

<sup>290</sup> See, e.g., The Registration Statement of La Paz Mining Corp., Securities Act Release No. 9,523, 108 SEC Docket 751, at 2 (Feb. 3, 2014), <https://www.sec.gov/litigation/admin/2014/33-9523.pdf> [<https://perma.cc/N2AZ-JJR7>] (noting that the respondent company was controlled by John Briner); see also U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 14 (listing each of the twenty enforcement actions separately). While the SEC charged each defendant firm separately, it produced a single order suspending all twenty registration statements. See Initial Decision on Default, La Paz Mining Corp., Initial Decision Release No. 580, 108 SEC Docket 2239, at 5 (Mar. 20, 2014).

clearly render the measure unreliable, it is still problematic to use the number of enforcement actions as a measure of the likelihood of enforcement; the count depends on the defendants' willingness to settle and other extraneous factors unrelated to the prevalence of misconduct or the SEC's ability to detect and prosecute misconduct.<sup>291</sup>

## 2. *Inconsistent Case Categorization*

In addition to reporting the aggregate number of enforcement actions, the SEC also reports the primary subject-matter for each action.<sup>292</sup> The SEC's subject-matter categorization could be exceptionally useful for studying enforcement trends in a subset of offenses, such as insider trading or accounting fraud. The SEC regularly includes aggregate figures on the number of actions filed in various categories in reports and congressional testimony as evidence of vigorous activity.<sup>293</sup>

Unfortunately, the categories are overbroad and combine types of violations that should not obviously be lumped together. For example, penny stock frauds and strict-liability violations of Rule 105 of Regulation M are both included under the umbrella category Market Manipulation, although the violators, victims, and affected markets do not overlap. Similarly, accounting frauds are nearly always categorized as Issuer Reporting and Disclosure cases,<sup>294</sup> but not all Issuer Reporting and Disclosure cases are accounting frauds. Some prosecute books-and-records violations that are not fraudulent, others require officers to reimburse firms for unjustified bonuses received. Finally, a considerable number are follow-on and sec-

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<sup>291</sup> See discussion *supra* Part III.A.1.

<sup>292</sup> See U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 3.

<sup>293</sup> See, e.g., *supra* notes 21, 114 (demonstrating prominent instances where the SEC used its aggregate numbers); see also Mary L. Schapiro, Chair, Testimony Concerning SEC Oversight: Current State and Agenda, Before the United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises (July 14, 2009), <http://www.sec.gov/news/testimony/2009/ts071409mls.htm> [<https://perma.cc/Z82F-ST2Z>] (highlighting a number of cases in specific enforcement categories).

<sup>294</sup> One important exception are cases where investment managers overstate the value of assets in their funds, which the SEC records as an Investment Adviser case even though it is at core accounting fraud. See Evergreen Investment Management Company, LLC & Evergreen Investment Services, Inc., Exchange Act Release No. 60,059, Investment Company Act Release No. 2,888, 96 SEC Docket 118, at 2 (June 8, 2009), <https://www.sec.gov/litigation/admin/2009/34-60059.pdf> [<https://perma.cc/YE4E-J8QM>] (alleging that Evergreen overstate the value of assets in one of its funds); see also U.S. SEC. & EXCH. COMM'N, *supra* note 272, at 10 (listing the enforcement action in the category Investment Adviser).

ondary proceedings, a problem described in more detail in Part III.A.1. These concerns render quick assessments of SEC enforcement by looking at the number of enforcement actions in each subject-matter category largely pointless.<sup>295</sup>

Removing follow-on and secondary cases does not fix the problem with vagueness in subject-matter categorization. Many cases that the SEC investigates could be included in more than one category, but are reported in only one. For example, Bernard Madoff's Ponzi scheme was categorized as a violation of rules pertaining to investment advisors.<sup>296</sup> It was also a violation of the rules pertaining of the offering of securities—many Ponzi schemes are classified as such<sup>297</sup>—and a violation of rules regarding broker-dealers.<sup>298</sup> This is a known challenge in SEC reporting and the Commission readily acknowledges it.<sup>299</sup> The SEC's primary concern with reporting only primary subject-matter categories is that the SEC's reported figures *understate* the number of enforcement actions filed in a given subject area, such as insider trading.<sup>300</sup>

But the reported figures also *overstate* the number of enforcement actions filed in each category. The primary cause for inflated figures is duplicative counting of follow-on and secondary actions, discussed above.<sup>301</sup> The secondary cause is the fact that subject-matter categorization is at first step within the discretion of the enforcement staff and secondarily reassessed by the SEC's Office of the Secretary. When an enforcement action can plausibly fit into more than one category, the staff or the Office of the Secretary can categorize the action as one category in one year and another category in a subsequent year.

Some inconsistent categorizations are clearly errors. But other inconsistencies seem biased. For example, the Commission has traditionally classified all enforcement actions

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<sup>295</sup> See, e.g., Eaglesham & Rapoport, *supra* note 6 (tracking enforcement actions for accounting fraud using the SEC's reported figures without adjustment).

<sup>296</sup> OFFICE OF INVESTIGATIONS, *supra* note 112, at 24.

<sup>297</sup> *Oversight of the Security and Exchange Commission's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 98 (2009) (statement of Robert Khuzami, Director, Division of Enforcement, Securities and Exchange Commission & John Walsh, Acting Director, Office of Compliance Inspections & Examinations, Securities and Exchange Commission).

<sup>298</sup> *Id.*

<sup>299</sup> See U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 3 ("Each action initiated has been included in only one category listed below, even though many actions involved multiple allegations and may fall under more than one category.").

<sup>300</sup> See IMF, *supra* note 24, at 186 n.349.

<sup>301</sup> *Supra* notes 195–205 and accompanying text.



brought under section 12(j) of the Exchange Act as Delinquent Filing actions.<sup>302</sup> In 2014, however, three such cases were classified as Issuer Reporting and Disclosure actions,<sup>303</sup> one as Market Manipulation and another as Securities Offering. But no Market Manipulation or Issuer Reporting action was coded as a Delinquent Filing action. Similar miscategorizations appear in enforcement reports for the years 2010, 2012, and 2013. Miscategorization is not a new problem. In 2004, the SEC categorized five Contempt Proceedings as primary enforcement actions in Broker-Dealer and Investment Adviser categories, and in 2010, it categorized four Contempt Proceedings as Miscellaneous actions and four Delinquent Filing actions as Issuer Reporting and Disclosure and Investment Adviser actions.

In addition, twenty-seven enforcement actions filed in 2014 and categorized as “Issuer Reporting and Disclosure” actions were stop order proceedings under Section 8(d) of the Securities Act.<sup>304</sup> In these actions the Commission sought to suspend the effectiveness of a registration statement that it believed included an untrue statement or omission of material fact. Issuers file registration statements when they seek to offer new securities to the public. And so, such actions should be categorized as Securities Offering actions. By contrast, Issuer Reporting and Disclosure actions primarily involve accounting, auditing, and reporting issues in periodic reports that issuers are required to file, not fraud in offering documents.<sup>305</sup> In fact, in fiscal year 2013, the SEC classified a stop order under Section 8(d) as a Securities Offering case,<sup>306</sup> but in fiscal year 2015, the SEC again classified eleven stop orders as

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<sup>302</sup> Classification errors occur. For example, in fiscal 2010, one delinquent filing case is classified under Investment Adviser category and another as Issuer Disclosure and Reporting violation. See U.S. SEC. & EXCH. COMM’N, *supra* note 239, at 6–14.

<sup>303</sup> See Jason S. Flemmons & Martin S. Wilczynski, *SEC Enforcement’s Accounting Statistics for Fiscal 2014—Up or Down*, SECURITIES DOCKET (Jan. 21, 2015), <http://www.securitiesdocket.com/2015/01/21/sec-enforcements-accounting-statistics-for-fiscal-2014-up-or-down/> [https://perma.cc/M59H-ZP79] (reporting that the SEC classified five delinquent filing cases and issuer reporting cases).

<sup>304</sup> *Id.*; see also 15 U.S.C. § 77h(d) (2012) (codifying Securities Act § 8(d)).

<sup>305</sup> *Id.*

<sup>306</sup> See The Registration Statement of Counseling International, Inc., Securities Act Release No. 9,444, 106 SEC Docket 4854, at 1 (Aug. 22, 2013); U.S. SEC. & EXCH. COMM’N, *supra* note 146, at 17. But back in 2002, the SEC classified two stop orders as “Issuer Reporting and Disclosure Cases.” SEC. & EXCH. COMM’N, *supra* note 178, at 151, 154.

Issuer Reporting and Disclosure actions, not Securities Offering actions.

These might seem like small infractions except that the SEC has celebrated the increase in Issuer Reporting and Disclosure cases prosecuted in 2014.<sup>307</sup> Once follow-on and secondary actions, and miscategorized actions are removed from the tally, the number of enforcement actions for accounting fraud filed in fiscal 2014 is the same as in fiscal 2013.<sup>308</sup> Although categorization inconsistencies are likely due to human error, they are problematic because they render the SEC's reported figures unreliable for long-term study of enforcement trends. To obtain reliable results, one cannot use the SEC's reported tables but must code enforcement actions by hand.<sup>309</sup>

#### IV

#### THE CONSEQUENCES OF REPORTING PROBLEMS

The SEC has used invalid and unreliable statistics in congressional reports and testimony, press releases, and public speeches to suggest an increase in activity, to calm wary investors and the general public after scandals, and to suggest a better use of resources.<sup>310</sup> In turn, consumers of the SEC's statistics, including law firms and legal academics, have relied on them to identify enforcement trends in widely distributed client memoranda<sup>311</sup> and to offer policy prescriptions regarding securities enforcement.

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<sup>307</sup> See Mary Jo White, Chair, Chairman's Address at SEC Speaks 2015 (Feb. 20, 2015), <http://www.sec.gov/news/speech/2015-spch022015mjw.html> [<https://perma.cc/MH2L-2F3S>] (highlighting the 40% increase in financial reporting cases in 2014); Andrew Ceresney, Director Div. of Enforcement, Testimony on "Oversight of the SEC's Division of Enforcement" (Mar. 19, 2015), <http://www.sec.gov/news/testimony/031915-test.html#.VRPx7vnF-n8> [<https://perma.cc/3649-2XY8>] (referencing a 40% increase in financial reporting and auditing enforcement actions in FY 2014).

<sup>308</sup> See *infra* Table 3B.

<sup>309</sup> In addition, SEC reporting used to be more useful. The Commission used to produce a more detailed classification than it does now. Compare U.S. SEC. & EXCH. COMM'N, *supra* note 178, at 144 (breaking down enforcement actions into 18 different classifications), with U.S. SEC & EXCH. COMM'N, *supra* note 146, at 3 (reporting 13 classifications).

<sup>310</sup> It is possible that Congress is aware that the numbers are fuzzy and does not object because increasing SEC enforcement statistics make Congress look good too. After all, few members of Congress want to come out in favor of more fraud. For a more detailed discussion, see Velikonja, *Politics in Securities Enforcement*, *supra* note 33.

<sup>311</sup> See, e.g., Tracy Richelle High & Malaika R. Staten, *New Trends in SEC Enforcement Activity*, in COLLEEN VALLEN ET AL., BASICS OF ACCOUNTING FOR LAWYERS 2015: WHAT EVERY PRACTICING LAWYER NEEDS TO KNOW 207 (2015) (citing the SEC's unadjusted statistics); David B. Bayless & Tammy Albarrán, Covington & Burling

The problems identified in Part III distort the SEC's reporting in a variety of ways. First and most obviously, they overstate the Commission's activity levels and distort assessments of enforcement intensity. The figures also obscure real problems and suggest the presence non-existent problems. Flawed statistics bleed into other aspects of SEC reporting when the Commission uses one statistic as a denominator to generate a new performance indicator, such as its success rate. Finally, not only do the used statistics fail to represent the SEC's true enforcement output, they also have the potential to distort its enforcement choices in favor of easier investigations of strict-liability violations that are more likely to yield reportable results.

### A. Overstatement

The SEC's statistics regularly overstate its enforcement output: reporting follow-on and secondary cases in the enforcement action tally inflates the number of new cases filed, and overstates the number of individuals and firms targeted in SEC enforcement;<sup>312</sup> so does including in the SEC's overall count monetary penalties imposed by other agencies or waived.<sup>313</sup>

Overstating enforcement statistics is problematic because it suggests that SEC enforcement is more vigorous than it really is. It renders comparisons with other enforcement agencies that do not misreport in the same manner meaningless.

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LLP, *The Changing Composition of SEC Enforcement Actions*, LAW360.COM (Feb. 21, 2013), <http://www.law360.com/articles/416542/the-changing-composition-of-sec-enforcement-actions> [https://perma.cc/ECV8-WSLR] (article written by law firm partners using the SEC's statistics unadjusted); Sara Gilley et al., *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360.COM (May 27, 2015), <http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup> [http://perma.cc/4UDF-XUKR] (same); Ben A. Indek et al., Morgan Lewis & Bockius LLP, *A Snapshot of 2012 SEC and FINRA Enforcement*, LAW360.COM (Feb. 19, 2013), <http://www.law360.com/articles/416009/a-snapshot-of-2012-sec-and-finra-enforcement> [http://perma.cc/B5WY-9ZG6] (same); David F. Marcus & Sara E. Gilley, *The Changing Nature of SEC Enforcement Actions*, LAW360.COM (Oct. 8, 2013), <http://www.law360.com/articles/477979/the-changing-nature-of-sec-enforcement-actions> [http://perma.cc/4UDF-XUKR] (same); SHEARMAN & STERLING LLP, *SEC ENFORCEMENT YEAR IN REVIEW* (2014), <http://www.shearman.com/~/media/Files/NewsInsights/Publications/2014/01/SECEnforcementYearinReview2013Litigation021114.pdf> [https://perma.cc/U8C7-H65E] (using the SEC's unadjusted statistics in a note to the firm's clients); WilmerHale, *A Memorandum from Bill McLucas* (Mar. 9, 2015), [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/Publications/Documents/review-of-sec-enforcement-developments-in-2014.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/review-of-sec-enforcement-developments-in-2014.pdf) [https://perma.cc/F7A9-6HSP] (same).

<sup>312</sup> See *supra* notes 196–205.

<sup>313</sup> See *supra* notes 250–252.

Overstatement in the numbers of enforcement actions and defendants is greater in subject-matter categories with a disproportionate share of follow-on and secondary cases, such as enforcement against broker-dealers and investment advisers. Almost 60% of enforcement actions classified as Broker-Dealer between 2000 and 2014 are follow-on actions triggered by other securities violations, such as insider trading or offering fraud; 40% of enforcement actions in the Investment Adviser category are follow-on actions.<sup>314</sup> Inflated statistics thus suggest that the SEC is a much more serious enforcer in the financial industry than it really is.<sup>315</sup>

Despite known problems with enforcement statistics, high-ranking SEC employees routinely use them without acknowledgment that they might be overstated. For example, former SEC enforcement director Linda Chatman Thomsen testified before the U.S. Senate Committee on the Judiciary that between 2001 and 2006, the SEC brought over 300 enforcement actions (304) categorized as Insider Trading cases against well over 600 defendants (646).<sup>316</sup> But once the figures are adjusted for follow-on and duplicative cases, the total falls to 252 enforcement actions against 589 unique defendants.<sup>317</sup> In fact, during her testimony, Ms. Thomsen suggested that the count she reported was *too low* because insider trading actions are sometimes categorized as Broker-Dealer actions.<sup>318</sup> The suggestion omits that all such cases were follow-on proceedings against broker-dealers who had already been fined for insider trading violations, and the primary enforcement actions for insider trading were already counted and included in the SEC's annual report.

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<sup>314</sup> Between 2011 and 2014, the relative shares of follow-on actions were 73% for Broker-Dealer cases and 50% of Investment Adviser cases. See *infra* Tables 3A, 3B & 3C.

<sup>315</sup> Even in the two enforcement categories where the SEC has been most active during the last decade and a half—Issuer Reporting and Disclosure (i.e., accounting fraud) and Securities Offering—follow-on cases represent 27–28% of all enforcement actions filed between 2000 and 2014 and thereby inflate the count by that percentage. See *id.*

<sup>316</sup> See Linda Chatman Thomsen, Director, Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Testimony Concerning Insider Trading, Before the U.S. Senate Committee on the Judiciary (Sept. 26, 2006), <https://www.sec.gov/news/testimony/2006/ts092606lct.htm#18> [<https://perma.cc/5PCF-XDMY>].

<sup>317</sup> See *infra* Table 3B.

<sup>318</sup> See Thomsen, *supra* note 316, at n.18.

## B. Meaningless Trend Analysis

The number of follow-on and secondary cases fluctuates over time.<sup>319</sup> As a result, not only does the SEC's preferred method of counting enforcement actions and defendants overstate the SEC's enforcement activity, it also renders trend analysis useless unless such cases are analyzed separately.<sup>320</sup>

Agencies are required by statute to report on trends related to their activities.<sup>321</sup> Moreover, there is considerable public interest in identifying trends and reading the tea leaves in enforcement. In the last decade, and in particular during the last five years, the SEC's press releases and reporting on SEC enforcement have relied heavily on reported enforcement statistics to suggest an increase or a decline in the Commission's enforcement overall or in a subset of cases.<sup>322</sup>

For example, including the ever-growing number of delinquent filing actions in the number of enforcement actions filed obscures the fact that SEC enforcement for negligence- and scienter-based securities violations has not increased since 2002.<sup>323</sup> The analysis of enforcement actions brought in subject-matter categories as reported by the SEC, such as insider trading or accounting fraud, is even more prone to biases. It is not rare that the SEC reports an underlying decline as improvement. For example, after Madoff's Ponzi scheme was uncovered during the 2009 fiscal year, the SEC reportedly ramped up enforcement against broker-dealers and investment advisers.<sup>324</sup> Looking at the SEC's reported figures might give one that impression: in fiscal 2010–14, the SEC brought on average 121 enforcement actions against broker-dealers and 139 against investment advisers, a significant increase over eighty-nine and seventy-nine per year, respectively, that it brought between 2000 and 2009.<sup>325</sup> But in reality, much of the increase is due to follow-on actions. Primary enforcement ac-

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<sup>319</sup> See Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 35 fig.2.

<sup>320</sup> One might contend that trend analysis is useless. I do not defend analyses of SEC enforcement trends since they probably *are* meaningless. But they are required by the Results Act, and so they should be done right.

<sup>321</sup> See, e.g., H.R. 2142 § 3, 111th Cong. (2010) (proposing changes to reporting of agency performance plans); 31 U.S.C. §§ 1121(a)(1), 1122(b)(6) (2012) (requiring the Director of OMB to report "overall trend data" in agency reports).

<sup>322</sup> See, e.g., U.S. SEC. & EXCH. COMM'N, YEAR-BY-YEAR ENFORCEMENT STATISTICS, <https://www.sec.gov/news/newsroom/images/enfstats.pdf> [<https://perma.cc/JS5V-9AP2>] (suggesting an increase in overall enforcement actions and actions in specific categories).

<sup>323</sup> Compare *infra* Table 3A, with Table 3B.

<sup>324</sup> Bayless & Albarrán, *supra* note 311.

<sup>325</sup> See *infra* Table 3A.

tions against broker-dealers declined between 2010 and 2014, whereas primary enforcement actions against investment advisers increased more modestly, by 44% and not by 77% as the SEC's numbers would imply.<sup>326</sup>

Similarly, in 2008, the SEC celebrated the most insider trading cases ever brought, sixty-one.<sup>327</sup> But seventeen of the actions were follow-on actions; sixteen of the seventeen disbarment proceedings were filed because the SEC secured a permanent injunction and monetary penalties against the same defendants for the same violations in an earlier enforcement action that was already included in the count.<sup>328</sup> Once those are removed from the tally, the number of enforcement actions brought in 2008 (forty-four) is lower than in 2002 and 2003 (forty-eight and fifty-three, respectively), while the number of new defendants sued for insider trading in 2008 is near its nine-year low.<sup>329</sup>

Even where the reported direction of the trend is correct, the magnitude is distorted by follow-on and secondary actions. In 2008, the SEC brought sixty enforcement actions against broker-dealers, compared with eighty-nine in 2007.<sup>330</sup> The 33% decline was considered significant because large Wall Street investment banks are usually prosecuted for broker-dealer violations.<sup>331</sup> Excluding follow-on actions, however, the decline is larger: from 58 to 31 enforcement actions (47% decline) and from 137 to 58 defendants (58% decline).<sup>332</sup> Similarly, at the end of fiscal 2011, the SEC celebrated record numbers of enforcement actions against investment advisers and broker-dealers.<sup>333</sup> The numbers were indeed higher than

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<sup>326</sup> The result is the same if we look at defendants. See *infra* Table 3B.

<sup>327</sup> See *Fiscal 2008 Enforcement Results*, U.S. SEC. & EXCHANGE COMMISSION (Oct. 22, 2008), <https://www.sec.gov/news/press/2008/2008-254.htm> [<https://perma.cc/NJ7Y-JHQ>] ("The SEC brought the highest number ever of insider trading cases in FY 2008."); *infra* Table 3A.

<sup>328</sup> See U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA FISCAL 2008, at 8-9 [hereinafter MARKET DATA FISCAL 2008]. The one exception is a follow-on case against Laurence McKeever that was brought after McKeever pleaded guilty to insider trading. The SEC did not separately sue McKeever for insider trading other than seeking a full collateral bar. See *Seven Defendants Settle SEC Charges in Wall Street Serial Insider Trading Ring*, Litigation Release No. 20,725, 94 SEC Docket 331 (Sept. 18, 2000), <https://www.sec.gov/litigation/litreleases/2008/lr20725.htm> [<https://perma.cc/KMP7-6J7Z>].

<sup>329</sup> Compare *infra* Table 3A, with 3B.

<sup>330</sup> See Paley & Hilzenrath, *supra* note 32, at A4 (referencing a study by Morgan, Lewis & Bockius LLP).

<sup>331</sup> See *id.*

<sup>332</sup> Data on file with author.

<sup>333</sup> See Mark Schoeff Jr., *SEC Sets Record in Crackdown on Advisers, B-D's*, INVESTMENT NEWS, Nov. 14, 2011, at 4.

the year before, but enforcement against broker-dealers was down considerably compared with the period between 2003 and 2009.<sup>334</sup>

The bias in reported numbers does not always favor the SEC. For example, in 2008 the SEC celebrated a 45% increase in market manipulation enforcement actions using its noisy figures.<sup>335</sup> When follow-on actions are removed, the increase is actually larger: a 53% increase in enforcement actions targeting market manipulation and a 75% increase in the number of defendants prosecuted.<sup>336</sup>

Because of these problems, any effort to analyze SEC enforcement by comparing the SEC's reported numbers of enforcement actions brought in various categories over time is largely pointless. In addition, since financial enforcement agencies not only adopt different enforcement practices but also employ different reporting conventions, comparisons across agencies are meaningless, whether domestically or internationally.

### C. Problems Obscured

The SEC's reported enforcement statistics produce both false negatives (i.e., obscure problems) and false positives (i.e., identify a non-problem as a problem).

The publication of data assembled using unreliable and invalid reporting conventions can obscure real underlying problems. As noted above, most enforcement against Wall Street falls in the category of broker-dealer violations. This Article reports that primary enforcement actions against broker-dealers, as well as the number of defendants prosecuted, have declined since 2009.<sup>337</sup> But the SEC's reported figures show a different picture, suggesting a considerable increase in enforcement against broker-dealers.<sup>338</sup> Although the SEC has been criticized for failing to bring large cases,<sup>339</sup> it is not obvious that the agency itself is aware of the decline in primary enforcement actions for broker-dealer violations.

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<sup>334</sup> See *infra* Table 3B.

<sup>335</sup> See *SEC Announces Fiscal 2008 Enforcement Results*, U.S. SEC. & EXCHANGE COMMISSION (Oct. 22, 2008), <https://www.sec.gov/news/press/2008/2008-254.htm> [<https://perma.cc/W7WF-JYMD>]; *SEC Probes Reach 671 in Fiscal Year*, L.A. TIMES, Oct. 23, 2008, at C5.

<sup>336</sup> See *infra* Table 3B.

<sup>337</sup> See *id.*

<sup>338</sup> See *infra* Table 3A.

<sup>339</sup> See Eaglesham, *supra* note 99.

Also, the SEC reports the number of initial investigations and the number of formal orders of investigation, but does not report how many formal orders of investigation yield at least one enforcement action. Since 2003, the SEC has opened at least 900 informal investigations per year, except in three years.<sup>340</sup> It issued about 250 formal orders of investigation per year until 2009; since then, the number has more than doubled.<sup>341</sup> The number of enforcement actions certainly has not doubled since 2009, even if one included all follow-on and secondary cases in the count. The SEC's figures do not explain whether the agency is closing more formal investigations without bringing an enforcement action than before 2009, whether it changed how it counts formal investigations, or whether something else is going on.

Finally, a review of all follow-on actions suggests that two modifications may be in order. Under existing law, a professional or associational bar is not automatic upon conviction or the imposition of a permanent injunction for violating anti-fraud provisions of securities laws. Rather, the SEC must initiate an enforcement action.<sup>342</sup> The process to impose a collateral bar or to suspend an attorney or an accountant from appearing before the Commission appears to be burdensome and costly without any countervailing benefit. Targeted individuals frequently fight such efforts even though their opposition is futile. The SEC wins all follow-on cases, so long as it is able to locate and serve the defendant. For example, between fiscal 2008 and 2014 the SEC initiated follow-on proceedings against 1,575 individuals and firms.<sup>343</sup> About 70% of defendants settled at the time the proceeding was initiated, but 117 (7%) fought the charges. Only nine of them prevailed—all because the underlying conviction or permanent injunction was vacated.<sup>344</sup> Perhaps professional and associational bars ought to be automatic, with a right to reapply for admission or registration, like most collateral consequences of criminal and civil enforcement.<sup>345</sup>

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<sup>340</sup> See *Reports, supra* note 129 (containing the *Select SEC and Market Data* reports for years 2003 through 2014).

<sup>341</sup> Compare MARKET DATA FISCAL 2008, *supra* note 328, at 21 (reporting 223 formal orders of investigation), with U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 21 (reporting 576 formal orders of investigation).

<sup>342</sup> See *supra* notes 174–177 and accompanying text.

<sup>343</sup> See *infra* Table 3C.

<sup>344</sup> Data on file with author.

<sup>345</sup> See, e.g., Urska Velikonja, *Waiving Disqualification: When Do Securities Violators Receive a Reprieve?*, 103 CALIF. L. REV. 1081, 1088–89 (2015) (describ-



Moreover, even if disbarment is not automatic, the SEC should have the authority to disbar or suspend a defendant in the primary enforcement action regardless of whether the action is filed in court or before the ALJ. A large majority of follow-on proceedings are triggered by the imposition of a permanent injunction in a civil action that the SEC brought in district court.<sup>346</sup> Under existing laws, the Commission cannot obtain a professional or associational bar in court; it must initiate an administrative proceeding.<sup>347</sup> But, the Commission has the power to impose an officer and director bar and a penny stock bar in both proceedings.<sup>348</sup> To avoid wasting resources by having to prosecute multiple enforcement actions, the SEC ought to be expressly authorized to obtain a professional or associational bar against a defendant in court when the primary enforcement action is filed in court.

#### D. Nonproblems Misidentified as Problems

At least as troublesome as problems obscured by reporting are alleged “problems” that the SEC’s reporting reveals. For example, much has been made of the SEC’s recent shift towards bringing more enforcement actions before administrative law judges in lieu of filing civil actions in district court.<sup>349</sup> Looking at SEC-reported figures during the last fifteen years, it looks like the SEC used to bring about half of all enforcement actions in court and half in administrative proceedings.<sup>350</sup> Between 2010 and 2013, after the Dodd-Frank Act authorized the Commission to file more actions before ALJs, it brought about two-thirds of enforcement actions before ALJs. And in 2014, it brought 81% of enforcement actions before ALJs. These

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ing collateral consequences of securities enforcement that are triggered automatically upon imposition of certain sanctions).

<sup>346</sup> See Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 15 (explaining that collateral bar proceedings often involve a settled enforcement action or a loss in court or before an ALJ).

<sup>347</sup> A court may exercise “equitable authority” and impose an associational bar in a judicial proceeding, but it is quite rare. See *SEC v. Gupta*, No. 1:11-cv-7566-JSR, 2013 WL 3784138, at \*3 (S.D.N.Y. July 17, 2013) (holding that although courts are not specifically authorized to impose an associational bar, a bar can be imposed pursuant to court’s equitable authority).

<sup>348</sup> Compare, e.g., 15 U.S.C. § 80b-3(f) (2012) (permitting Commission to impose an associational bar for investment advisers after notice and administrative hearing), with 15 U.S.C. § 78u(d) (2012) (requiring the Commission bring an action in district court to impose an officer and director bar).

<sup>349</sup> See, e.g., WilmerHale, *supra* note 311, at 2 (noting that the SEC increased its number of ALJs and ALJ staff in anticipation of bringing more enforcement actions administratively).

<sup>350</sup> Data on file with author.

figures imply that the SEC is shifting enforcement actions to in-house administrative law judges, possibly depriving defendants of procedural rights they would enjoy if sued in court.<sup>351</sup> Several defendants have raised constitutional objections.<sup>352</sup> Jonathan Macey went as far as to suggest that the SEC chooses arbitrarily and stupidly what defendants to sue before administrative law judges.<sup>353</sup>

But these conclusions imply that nothing else has changed in SEC enforcement, during a time when much has changed. Of 755 enforcement actions brought in fiscal 2014, 145 were filed in district court and 610 in administrative court.<sup>354</sup> Of those 610, a record 254 were follow-on actions, which are always filed in the administrative forum, and another 112 were delinquent filing cases, also always filed in the administrative forum. If these cases are excluded, the SEC brought between 60% and 74% of primary enforcement actions in court between 2000 and 2013.<sup>355</sup> The shift to the administrative forum occurred in fiscal 2014, when the SEC brought 37% of enforcement actions in court and 63% before ALJs.<sup>356</sup>

In addition, some subject-matter categories saw larger shifts towards administrative enforcement than others. The two subject-matter categories with the largest shifts in filings away from district courts are Market Manipulation and Issuer Reporting and Disclosure cases. In 2012, the SEC sued 117 of 129 (91%) securities violators in primary enforcement actions categorized as Market Manipulation in district court; in 2014, it sued only 56 of 92 (61%) securities violators in primary enforcement actions filed in court.<sup>357</sup> The 30% decline seems to imply that many more equally-situated defendants must defend themselves before administrative law judges in 2014 than

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<sup>351</sup> See, e.g., Michael Dvorak, Note, *SEC Administrative Proceedings and Equal Protection "Class of One" Challenges: Evaluating Concerns About SEC Forum Choices*, 2015 COLUM. BUS. L. REV. 1195, 1197 (2015) (suggesting that SEC forum selection may violate equal protection).

<sup>352</sup> See, e.g., Jean Eaglesham, *SEC Is Steering More Trials to Judges it Appoints*, WALL ST. J. (Oct. 21, 2014), <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> [<https://perma.cc/P526-VNE2>] (quoting at least one defendant who "alleged the SEC is violating his constitutional rights to due process and equal protection under the law").

<sup>353</sup> Stephanie Russell-Kraft, *Why Challenges to SEC Admin Court Will Likely Keep Failing*, LAW360.COM (Mar. 6, 2015), <http://www.law360.com/articles/628601/why-challenges-to-sec-admin-court-will-likely-keep-failing> [<http://perma.cc/WLP7-KFW2>] (quoting Yale Law Professor Jonathan Macey).

<sup>354</sup> U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 3.

<sup>355</sup> Data on file with author.

<sup>356</sup> See U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 3.

<sup>357</sup> Data on file with author.

did in 2012. But the SEC also changed enforcement priorities between 2012 and 2014. It began vigorously prosecuting compliance with Rule 105 of Regulation M<sup>358</sup> in lieu of going after penny stock fraudsters.<sup>359</sup> The former actions have nearly always been brought before administrative law judges while the latter are always filed in court. If Rule 105 actions are removed from the count, the SEC's forum choices for market manipulation have changed in favor of filing more actions in district court, not the opposite: 117 of 127 (92%) primary securities violators (excluding those charged with violations of Rule 105 of Regulation M)<sup>360</sup> were sued in district court in 2012, and 56 of 56 (100%) such defendants were sued in district court in 2014.<sup>361</sup> As a result, the SEC's forum choices in market manipulation cases seem perfectly consistent over time—but the types of enforcement actions the Commission brings for market manipulation have, in fact, changed considerably.

Similarly, in 2013, the SEC reported that it sued 56 of 132<sup>362</sup> (42%) defendants for Issuer Reporting and Disclosure violations in administrative forum; in fiscal 2014, it sued 117 of 145 (81%) in administrative forum.<sup>363</sup> However, many of these were follow-on actions and in 2014, the SEC listed twenty-seven stop orders as Issuer Reporting actions.<sup>364</sup> If correctly coded, these should be included in the Securities Offering category.<sup>365</sup> Once these actions are removed, the SEC sued 76 of 117 (65%) primary securities defendants in Issuer Reporting actions in administrative forum in 2013; and 73 out of 100

<sup>358</sup> Rule 105 of Regulation M prohibits underwriters in public offerings of equity securities from shorting such securities during a restricted period before the public offering. See 17 C.F.R. § 242.105 (2015).

<sup>359</sup> In FY 2013, the SEC initiated twenty-three enforcement actions for Rule 105 violations. U.S. SEC & EXCH. COMM'N, FISCAL YEAR 2013 AGENCY FINANCIAL REPORT 137 (2013). In FY 2014, it initiated thirty. By contrast, in FY 2012, it initiated two such enforcement actions.

<sup>360</sup> See Touradji Capital Management L.P., Exchange Act Release No. 65,923, 102 SEC Docket 2193 (Dec. 9, 2011); Wesley Capital Management LLC, Exchange Act Release No. 67,510, 104 SEC Docket 1054 (July 26, 2012).

<sup>361</sup> The number is very similar in FY 2015, when the SEC reported suing 140 of 159 defendants (88%) in court. Once the figure is adjusted for relief defendants and follow-on actions, the SEC sued 134 of 150 defendants in court (90%)—a figure very similar to that before the shift to administrative adjudication.

<sup>362</sup> *Select SEC and Market Data Report 2013* lists 138 defendants. U.S. SEC. & EXCH. COMM'N, *supra* note 146, at 3 tbl.2. Of those, two are relief defendants, three are in 12(j) actions that should have been categorized as Delinquent Filing, and one is a stop order. *Id.*

<sup>363</sup> Data on file with author.

<sup>364</sup> See U.S. SEC. & EXCH. COMM'N, *supra* note 109, at 13–15.

<sup>365</sup> See *supra* Part III.A.2.

(73%) primary securities defendants in 2014.<sup>366</sup> In both years, nearly three-quarters of such actions were settled. The enforcement staff brought several settled actions before ALJs to avoid litigating the same issue twice, now that the SEC can obtain monetary penalties against unregistered individuals, such as CEOs and CFOs, in administrative proceedings.<sup>367</sup> There has been a shift in enforcement of accounting fraud to the administrative forum, but smaller than SEC-reported figures would imply.

### E. The Denominator Problem

The variables used to measure SEC enforcement activity, most notably the number of enforcement actions and the number of defendants, are used as the denominator to evaluate and report on other aspects of the SEC's performance, such as its success rate.<sup>368</sup> As a result, measurement problems bleed into other important parts of the entire performance report.

The SEC reports its success in an annual report:<sup>369</sup> it is measured by the percentage of defendants in enforcement actions against which the SEC prevails on at least one of the counts.<sup>370</sup> The fact that follow-on cases are lumped together with primary enforcement actions biases the success rate upwards. The Commission wins all follow-on cases, including contested cases, except for a handful of actions where it cannot locate the defendant or where the defendant's conviction is vacated.<sup>371</sup> The Commission does not win all primary enforce-

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<sup>366</sup> The result is very similar in fiscal year 2015. The SEC reported that it sued 52 defendants in court and 161 in administrative forum (76%). Data on file with author. Once relief defendants and defendants in follow-on actions and stop orders are removed, the Division of Enforcement sued 46 defendants in court and 113 in administrative forums (71%). *Id.*

<sup>367</sup> As a result, the SEC brought fewer *secondary* enforcement actions in 2014. *See supra* notes 206–254 and accompanying text.

<sup>368</sup> The denominator problem is very common in agency performance reporting. For example, in its 2006 Performance and Accountability Report the SEC reported collection rates. But both the numerator and the denominator were incorrect, and this yielded a collection rate that exceeded the actual rate by a considerable percentage (for example in 2003, the actual collection rate was 7%, not 40%). *Compare* U.S. SEC. & EXCH. COMM'N, 2006 PERFORMANCE AND ACCOUNTABILITY REPORT 54 exhibit 2.20 (2006), *with* U.S. SEC. & EXCH. COMM'N, 2005 PERFORMANCE AND ACCOUNTABILITY REPORT 47 exhibit 2.20 (2005).

<sup>369</sup> *See, e.g.*, SEC. & EXCH. COMM'N, FY 2010 PERFORMANCE AND ACCOUNTABILITY REPORT 27 (2010) (reporting number of enforcement actions successfully resolved in FY 2010).

<sup>370</sup> *See id.*

<sup>371</sup> *See, e.g.*, Gary K. Juncker, Administrative Proceedings Rulings Release No. 673, 101 SEC Docket 545 (ALJ May 19, 2011), <https://www.sec.gov/alj/al-jorders/2011/ap673bpm.pdf> [<https://perma.cc/36JF-52S9>] (Commission una-

ment actions, but lumping all actions together biases the success rate upwards.

According to the 2010 annual report the agency prevailed against 92% of defendants in enforcement actions resolved during the fiscal year.<sup>372</sup> My analysis of all enforcement actions filed in FY 2010, a somewhat different sample, nevertheless shows a similar figure. Overall, the SEC prevailed against 95% of defendants,<sup>373</sup> while defendants prevailed in fewer than 1% of enforcement actions. Enforcement actions against the remaining defendants are either still ongoing, or were dismissed voluntarily because the entity ceased to exist or the defendant passed away, because the entity defendant agreed to wind down operations, or because the owner-manager defendant paid the disgorgement, so the case against the defunct entity became moot. But success rate thus measured overstates the SEC's success in primary enforcement actions because it includes follow-on cases. In follow-on cases filed in 2010, the SEC prevailed in all but 6 actions in which it was unable to serve process on the defendant, for a 98% success rate.<sup>374</sup> In primary enforcement actions, the SEC prevailed against 94% of defendants and lost against 1%.<sup>375</sup>

#### F. Changed Enforcement Incentives

With little information about what drives the SEC's enforcement choices, legal academics have speculated about the SEC's incentives. Adam Pritchard suggested that the SEC's prosecutions are politically motivated.<sup>376</sup> By contrast, Joseph Grundfest and Amanda Rose have proposed that the SEC, as an expert agency, considers the public interest while avoiding bringing enforcement actions that it does not believe it can win.<sup>377</sup> While this study cannot shed light on how the SEC

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ble to locate respondent); Todd Newman, Investment Advisors Act Release No. 4084, 2015 WL 2328705 (May 15, 2015), <https://www.sec.gov/litigation/opinions/2015/ia-4084.pdf> [<https://perma.cc/5DVE-5NZW>] (reversing associational bar because defendant's conviction was reversed).

<sup>372</sup> U.S. SEC. & EXCH. COMM'N, *supra* note 369, at 27.

<sup>373</sup> Excluding relief defendants, delinquent filing, and contempt proceedings.

<sup>374</sup> Data on file with author.

<sup>375</sup> Data on file with author.

<sup>376</sup> See A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 1018 (1999).

<sup>377</sup> See Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 970 (1994); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1306 (2008).

selects whom to prosecute,<sup>378</sup> it suggests that the dominant statistics on enforcement that it reports to Congress likely influence what types of actions it brings.

The SEC takes great pride in its enforcement program and likes to report that it is continuously improving.<sup>379</sup> Contested cases consume greater resources, so the agency has an incentive to bring cases that are more easily brought: delinquent filing actions where targeted firms put up no resistance, strict-liability offenses, and actions that do not allege violations of the antifraud provisions of securities laws.<sup>380</sup> The increase in enforcement actions targeting delinquent filing, a strict-liability offense, may be driven as much by the concern about fraud as it is by statistics. Similarly, the SEC filed thirty-six enforcement actions in September 2014 for failure to report insiders' transactions in the company's stock under Section 16(a) of the Exchange Act, a strict-liability offense.<sup>381</sup> These enforcement actions served as a reminder to market participants that the Commission is serious about policing even the smallest infractions.<sup>382</sup> They also had the fortunate side effect of boosting the SEC's enforcement statistics. In 2013 and 2014 the SEC brought several dozen enforcement actions for violation of Rule 105 of Regulation M, another strict-liability offense;<sup>383</sup> most were filed in September, the last month of the fiscal year. Until 2013, the SEC brought one or two such actions per year. In addition to reminding market participants that the SEC is al-

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<sup>378</sup> Two studies released recently suggest that the SEC is sensitive to pressure from Congress and influential congressmen in selecting enforcement targets. See Maria M. Correia, *Political Connections and SEC Enforcement*, 57 J. ACCT. & ECON. 241, 255 (2014) (finding that firms that contribute to congressmen who sit on oversight committees are only about half as likely to be subject to SEC enforcement as those that do not); Jonas Heese, *Government Preferences and SEC Enforcement* 15–17 (Harvard Bus. Sch., Working Paper No. 15-054, 2015), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2542242](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2542242) [<https://perma.cc/RK2T-3L3P>] (finding reports that the SEC is less likely to prosecute large employers, in particular during presidential election years if they are headquartered in politically important states).

<sup>379</sup> See Marc J. Fagel, *What The SEC Enforcement Stats Really Tell Us*, LAW360.COM (Mar. 3, 2015), [http://www.law360.com/articles/627323/what-the-sec-enforcement-stats-really-tell-us?article\\_related\\_content=1](http://www.law360.com/articles/627323/what-the-sec-enforcement-stats-really-tell-us?article_related_content=1) [<http://perma.cc/BZP9-E4AG>].

<sup>380</sup> See generally Posner, *supra* note 28, at 311–12 (concluding that a rational administrative agency has an incentive to focus on smaller cases).

<sup>381</sup> See Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 13.

<sup>382</sup> Policing “broken windows” has been one of SEC Chair Mary Jo White’s enforcement priorities since she was appointed in 2013. See Mary Jo White, Chair, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100> [<http://perma.cc/3NA7-LDER>].

<sup>383</sup> See Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 13.

ways watching, these cases boosted the SEC's enforcement tally.

By using the wrong statistics to measure its performance—focusing on the number of actions, as opposed to frauds prevented, sanctions secured, or some other measure of quality—the Commission communicates to its staff the wrong things about what matters and what should not.<sup>384</sup> Because they are rewarded for the number of enforcement actions brought, the SEC staff rationally focus on cases that can be investigated and prosecuted quickly,<sup>385</sup> regardless of whether doing so increases compliance with securities laws and protects investors.<sup>386</sup>

## V

### TOWARD MORE MEANINGFUL REPORTING

Quality reporting can help identify areas that need improvement, as well as indicate what things work well. Reporting thus helps direct resources to where they are needed. However, bad reporting produces none of the benefits, but at significant cost, including the direct cost of preparing reports and the opportunity cost engendered by shifts in priorities of the agency and its staff, wasted opportunities to improve, and undermined oversight.

The metrics used to measure the SEC's enforcement performance are invalid and unreliable for the purposes for which they are being used. Because the data collection is still in progress, this Part cannot and does not develop better measures. Rather, it elaborates on why the SEC has continued to use flawed statistics to suggest improvements in performance and increased deterrence, and suggests possible ways to improve their quality. Like many other agencies, the SEC is under enormous pressure to report increasing enforcement figures despite a modest budget appropriation. Moreover, a generally hostile Congress, relying on the Results Act, has threatened to punish agencies that fail to meet performance targets with budget cuts, even where targets are missed be-

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<sup>384</sup> Katz, *supra* note 23, at 506.

<sup>385</sup> *Id.* ("Because people strive to achieve the results that are measured, the choice of measures strongly determines what people try to do. When an agency uses faulty measures to evaluate its staff, it rewards the wrong people for the wrong actions.")

<sup>386</sup> See J. Robert Brown, *Reforming the SEC: The Unnecessary Emphasis on Stats*, THE RACETOTHEBOTTOM.ORG (Oct. 5, 2009, 5:00 AM), <http://www.theracetothetottom.org/the-sec-governance/reforming-the-sec-the-unnecessary-emphasis-on-stats.html> [<http://perma.cc/TK8F-D7E6>].

cause of meager appropriations.<sup>387</sup> The SEC has responded rationally by reporting statistics that are nearly useless. There are two possible approaches to improving reporting. First, reduce incentives for biased reporting, and second, remove reporting discretion from the agencies' hands. This Part discusses both in turn. Finally, this Part proposes that agencies share more liberally their raw enforcement data to encourage external research.

#### A. Reducing Incentives for Biased Reporting

Misconduct rates are cyclical and noisy. In the aftermath of a crisis, wrongdoers are easier to identify than earlier, when capital is plentiful and investors are paying less attention.<sup>388</sup> As a result, enforcement rates usually move in step with misconduct rates (with a lag of a year or two), unless enforcement budgets receive a significant and sustained increase. Trying to avoid cuts, agencies might pursue nickel-and-dime cases at the expense of more significant prosecutions in order to report high-enforcement figures.

To reduce shifts in enforcement and biased reporting, agencies should not be punished with budget cuts for bringing fewer enforcement actions or reporting a lower success rate than they forecast. In addition, it appears plausible that less congressional oversight would yield better results, while more congressional oversight over enforcement would be counterproductive.<sup>389</sup> And so, rather than tracking enforcement annually, multiple-year budgeting or partial budgetary independence, and greater discretion might allow agencies to deploy resources more effectively, including to save in low-misconduct years and shift to later years, and vice versa. Multiple-year budgeting would reduce the frequency of congressional meddling and would enable the SEC to plan several years in advance. Partial budgetary independence, likewise, would reduce congressional influence and limit the "binge-purge ap-

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<sup>387</sup> Certainly, many in Congress must be aware that SEC enforcement statistics are fuzzy, and are not fooled by the SEC's numbers. The better interpretation of the game played is that the congressional oversight committees want the SEC to show good numbers because no one wants to be seen as in favor of fraud, while at the same time limiting the SEC's budget. See Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 4–5.

<sup>388</sup> See Amitai Aviram, *Allocating Regulatory Resources*, 37 J. CORP. L. 739, 745 (2012) (stating that during economic booms the public will likely underestimate the threat of fraud); Wang & Winton, *supra* note 98, at 25 (discussing fraud risk at the end of investment booms).

<sup>389</sup> For a more detailed discussion as applied to SEC enforcement, see Velikonja, *Politics in Securities Enforcement*, *supra* note 33, at 20–21.



proach” to the SEC’s budget.<sup>390</sup> Annual changes in SEC output are mostly noise, yet they command an inordinate amount of attention and hand wringing. Constant pressure on SEC leadership and, in turn, staff lowers morale and leads to short-term focus. Longer-term financial security would enable the SEC Chair to shift resources from year to year, and to pursue goals that will not necessarily produce results in the same fiscal year.

In fact, Section 991 of the Dodd-Frank Act includes a longer-term budget planning for the SEC.<sup>391</sup> It authorizes annual budgets of \$1.3 billion in 2011 increasing to \$2.25 billion in 2015.<sup>392</sup> Unfortunately, Dodd-Frank’s mandate has not been honored.<sup>393</sup> Actual appropriations have lagged those enacted in the Dodd-Frank Act: in 2012, the actual budget was approximately \$180 million less (12%) than commanded by the Dodd-Frank Act; in 2013 it was \$500 million less (29%); in 2014 it was \$650 million less (33%); and in 2015 it was \$750 million less (33%).<sup>394</sup>

## B. Standardizing Agency Reporting

Agencies possess considerable discretion in developing performance indicators on which they are assessed.<sup>395</sup> As a result, some agencies include a lot of information in annual reports, while others include very little. Agencies also report very different performance indicators, and use different methods to calculate performance indicators that nominally measure the same thing. As a result, comparisons among agencies are difficult or impossible.

Changing incentives may improve reporting somewhat, but will likely be insufficient when favored performance metrics are as “built into the soul” of an agency as they are at the SEC.<sup>396</sup>

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<sup>390</sup> See Joel Seligman, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1, 22 (2011).

<sup>391</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-302, § 991, 124 Stat. 1376, 1950 (2010).

<sup>392</sup> *Id.* § 991(c).

<sup>393</sup> It is not uncommon for one statute to increase an agency’s workload and budget appropriation, and for the budget committees to approve lower budget figures.

<sup>394</sup> See *Frequently Requested FOIA Document—BA vs. Actual Obligations (\$ in 000s)*, U.S. SEC. & EXCHANGE COMMISSION (Mar. 2, 2016), <https://www.sec.gov/foia/docs/budgetact.htm> [<https://perma.cc/V2J7-NDDC>] (showing budget authority of \$1.321 billion in 2012 and 2013, \$1.35 billion in 2014, and \$1.5 billion in 2015).

<sup>395</sup> See *supra* Part I.

<sup>396</sup> J. Robert Brown Jr., *The SEC, Enforcement, and the Problem of Stats*, THE RACETO THE BOTTOM.ORG (June 6, 2014, 6:00 AM), <http://www.theracetothetbot>

Like financial reporting, performance indicators regarding important non-financial items should be removed from agency discretion and, to the extent possible, standardized across agencies, at least those with similar powers and functions. Many of the agencies' annual performance reports feature similar indicators, such as the number of investigations, enforcement actions, sanctions, success rates, collection rates, and the like. Ensuring that such indicators are measured consistently would shed some light on enforcement overall. In addition, like it did for agency financial reporting, OMB could develop indicators to measure both the quantity and the quality of enforcement more accurately.<sup>397</sup>

Standardized reporting of nonfinancial indicators would likely improve the accuracy and the quality of reports, and would allow for comparisons among enforcement agencies. It would be useful to know whether enforcement rates and actual sanctions vary across agency jurisdictions. To some extent, agencies already report comparable figures. For example, the largest SEC monetary penalty imposed is \$800 million against AIG for accounting fraud.<sup>398</sup> The largest monetary penalty that the Occupational Safety and Health Administration ever imposed against recidivist BP Products North America Inc. for hundreds of serious and willful violations was \$81.34 million.<sup>399</sup> General Motors paid \$35 million to the U.S. Department of Transportation, "the highest civil penalty amount ever paid as a result of a National Highway Traffic Safety Administration investigation,"<sup>400</sup> after it failed to do anything for ten years about an ignition switch defect that killed at least thirteen people and led to a massive recall.<sup>401</sup>

Whether these penalties are effective or not has not been seriously explored, in part because information is unavailable, and in part because we know so little about what works and

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tom.org/the-sec-governance/the-sec-enforcement-and-the-problem-of-stats.html [https://perma.cc/AJZ9-HSFC] (quoting an SEC enforcement attorney saying that the metric of counting enforcement actions to report on enforcement performance "is built into the soul of the [Enforcement] Division").

<sup>397</sup> See discussion *supra* note 68.

<sup>398</sup> See BAEZ, OVERDAHL & BUCKBERG, *supra* note 271, at 18.

<sup>399</sup> The second largest ever OSHA fine was imposed against BP Products North America Inc. four years earlier, for similar violations. See Occupational Safety & Health Admin., *Top Enforcement Cases Based on Total Issued Penalty*, U.S. DEP'T LABOR, [https://www.osha.gov/dep/enforcement/top\\_cases.html](https://www.osha.gov/dep/enforcement/top_cases.html) [https://perma.cc/4CYE-TCY8].

<sup>400</sup> Alex Rogers, *GM to Pay Record \$35 Million Fine Over Ignition Switch Recalls*, TIME (May 16, 2014), <http://time.com/102906/gm-fine-ignition-recalls/> [https://perma.cc/2HCS-CAAH].

<sup>401</sup> *Id.*

what does not in enforcement. Standardized reporting would likely reveal persistent and large discrepancies between enforcement and sanctioning authority of various agencies (and within agencies), and set the stage to begin a conversation on overall enforcement priorities. Moreover, it could help agencies learn about what works in enforcement and what does not.

### C. Public Access to Information

However, if standardizing enforcement reporting across agencies is too large of a project, or turns out to not be useful, agencies should outsource: make available their enforcement raw data to researchers for analysis. In fact, banking regulators which do not face the annual appropriations process in Congress that the SEC, the CFTC, and many other agencies face, already share their enforcement data liberally. The Federal Reserve,<sup>402</sup> the Office of the Comptroller of the Currency,<sup>403</sup> and the Federal Deposit Insurance Corporation<sup>404</sup> all make their enforcement data available, searchable, and easy to download.

There is currently no publicly-available database of SEC enforcement actions. The *Wall Street Journal* collects the data and publishes the occasional article based on the information in its database, but according to the *Journal*, the database is proprietary.<sup>405</sup> NERA Economic Consulting, a private consultancy, used to publish a biannual SEC enforcement report.<sup>406</sup> It also used to share its enforcement action database with academics in return for credit. It discontinued the practice in early 2013. NYU recently joined hands with Cornerstone to make available a database of securities enforcement, but they only include actions against public companies. As a result, any academic analysis of securities enforcement would require an investment of considerable resources and time to

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<sup>402</sup> Board of Governors of the Federal Reserve System, *Search Enforcement Actions*, FED. RESERVE (Sept. 19, 2014), <http://www.federalreserve.gov/apps/enforcementactions/search.aspx> [<https://perma.cc/D84G-E8VH>].

<sup>403</sup> *Enforcement Actions Search Tool*, OFF. COMPTROLLER CURRENCY, <http://apps.occ.gov/EnforcementActions/> [<https://perma.cc/Q2D6-PH4F>].

<sup>404</sup> *FDIC Enforcement Decisions and Orders*, FED. DEPOSIT INS. Corp. (Jan. 21, 2016), <https://www5.fdic.gov/EDO/DataPresentation.html> [<https://perma.cc/95WJ-63E3>].

<sup>405</sup> Author's request for data was denied.

<sup>406</sup> See, e.g., MAX GULKER, ELAINE BUCKBERG & JAMES OVERDAHL, NAT'L ECON. RESEARCH ASSOCS., *SEC SETTLEMENT TRENDS: 2H11 UPDATE 2 (2012)* (collecting SEC settlement data for FY 2011); BAEZ, OVERDAHL & BUCKBERG, *supra* note 271, at 2 (same for 2012).

collect the needed data. Not surprisingly, such studies remain limited to small subsets of SEC enforcement activity.

Sharing enforcement data would not impose a significant cost on the SEC. The SEC ordinarily publishes a litigation or administrative release at the time that it files an enforcement action and often releases updates as the action proceeds. But press releases are incomplete because they are not published consistently, they do not include complete relief obtained, and are almost never published when the SEC loses. SEC annual reports and inspector general reports suggest that the Commission maintains a database of open and closed enforcement actions called “The Hub.”<sup>407</sup> Releasing such information in a format that can be analyzed without a considerable investment of time and effort would attract academic research.

External research should be attractive to the Commission because it does not currently have the resources in-house to analyze much of the information it produces,<sup>408</sup> yet accurate research and analysis would be very useful.<sup>409</sup> Data access would enable researchers to address serious concerns about SEC enforcement quickly and effectively. For example, the SEC routinely faces criticism that it punishes firms at the expense of going after individual defendants.<sup>410</sup> Yet there is a considerable amount of evidence to the contrary,<sup>411</sup> but the SEC has not analyzed the data in its possession to deflect such criticisms. Also, there is widespread belief that defendants the

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<sup>407</sup> OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM’N, SURVEY OF ENFORCEMENT’S HUB SYSTEM (2008), <http://www.sec.gov/oig/reportspubs/449final.pdf> [<https://perma.cc/PF2N-VH63>].

<sup>408</sup> See Michael S. Piowar, Comm’r, U.S. Sec. & Exch. Comm’n, Remarks at the University of Notre Dame, Mendoza College of Business, Center for the Study of Financial Regulation (Mar. 13, 2015), <http://www.sec.gov/news/speech/remarks-at-university-of-notre-dame.html> [<http://perma.cc/P99K-LMNX>] (encouraging academics to use the SEC’s Market Information Data Analytics System in their research).

<sup>409</sup> The SEC appears quite eager to attract external research, just not by sharing any data. See William D. Cohan, *SEC Raises Barrier to Disclosure of Information*, N.Y. TIMES DEALBOOK (Nov. 4, 2014, 11:47 AM), <http://dealbook.nytimes.com/2014/11/04/s-e-c-raises-barrier-to-disclosure-of-information/> [<http://perma.cc/97NN-47D5>].

<sup>410</sup> Macey, *supra* note 8, at 651.

<sup>411</sup> See Michael Klausner & Jason Hegland, *SEC Practice in Targeting and Penalizing Individual Defendants*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 3, 2013), <http://corpgov.law.harvard.edu/2013/09/03/sec-practice-in-targeting-and-penalizing-individual-defendants/> [<https://perma.cc/NAF7-G9LS>]; see also Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC’s Fair Fund Distributions*, 67 STAN. L. REV. 331, 376, 382 tbl.6 (2015) (showing that individuals pay fines more often than firms in cases that give rise to a fair fund distribution).

SEC sues in court are much more likely to prevail than those it sues before the administrative law judges.<sup>412</sup> The source of the information purported to compare outcomes in contested actions filed in district court and before the ALJs. Yet it compared trial verdicts with initial decisions by ALJs,<sup>413</sup> and omitted dozens of contested court cases that are decided by summary judgment or dismissed each year. After those are added, defendants' odds of prevailing against the SEC are the same in court and before an ALJ.<sup>414</sup> Although the SEC possesses all the information it needs to correct the misapprehension,<sup>415</sup> it apparently lacks the resources to analyze the information in its hands. Instead, the SEC has responded with vague statements that the administrative process is "very fair,"<sup>416</sup> which are considerably less effective at deflecting criticism and, more importantly, congressional action.

The SEC appears quite thin-skinned about criticism, yet it is likely that much of academic research would help the agency further its enforcement objectives.<sup>417</sup> Finally, disclosure would add credibility to SEC reporting and, indirectly, to its enforcement program.

#### CONCLUSION

Enforcement agencies are often criticized for their failures. These critiques routinely revolve around mishandling particular cases. That approach is not wrong because individual failures often reflect systemic failures. But it is incomplete and could lead to changes in policy that are not warranted. A better assessment would be based on overall enforcement performance. In order to be useful, that performance should be reported in a manner that is reliable, meaningful, standardized, and comparable from year to year.

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<sup>412</sup> This belief finds support in a newspaper article published in the *Wall Street Journal*. Eaglesham, *supra* note 352 (reporting that the SEC won 100% contested administrative cases and 61% of contested court cases between September 2013 and September 2014).

<sup>413</sup> *See id.*

<sup>414</sup> The research is complete for fiscal years 2007 to 2015; *see also* Zaring, *supra* note 29. A note of caution: cases filed in court and before ALJs are very different, so it is certainly plausible that similarly situated defendants fare differently in different venues.

<sup>415</sup> *See* SEC, 2014 ANNUAL REPORT, *supra* note 70, at 39 (listing a source for SEC success rates).

<sup>416</sup> Eaglesham, *supra* note 352 (quoting SEC Chair Mary Jo White).

<sup>417</sup> *See, e.g.,* Velikonja, *supra* note 411, at 295 (commending the SEC's fair fund program).

This Article pulls back the curtain on the SEC's reporting of its enforcement activities. By carefully reviewing fifteen years of data, the Article shows that many of the SEC statistics developed to measure enforcement are deeply flawed. The way that the SEC counts enforcement actions filed and aggregate monetary penalties ordered consistently overstates the SEC's enforcement output, masks trends, obscures real problems in enforcement, and reveals non-existent "problems" that the SEC then tries to resolve. Furthermore, flawed statistics bleed into other aspects of SEC reporting when the Commission uses one statistic as a denominator to generate a new performance indicator. Finally, not only do the used statistics fail to represent the SEC's true enforcement output, they also have the potential to distort its enforcement choices in favor of easier-to-prosecute strict-liability violations that are more likely to yield reportable "results."

As a pilot study, this Article merely reveals reporting problems and proposes possible reasons as to why the problems persist. Once more data is collected, we can begin to develop statistics that could better measure the qualities of interest.

#### APPENDIX

TABLE 2: NUMBER OF SEC ENFORCEMENT ACTIONS FILED  
(2000-2014)

	Reported Number	w/o Follow-on and Second Cases	w/o Follow-on/Second & Contempt Proceedings	w/o Follow-on/Second, Contempt & Delinquent Filing
2000	503	388	352	344
2001	485	359	328	314
2002	598	450	403	393
2003	679	447	405	394
2004	638	423	402	381
2005	630	453	430	370
2006	574	421	400	309
2007	655	485	473	420
2008	671	492	482	371
2009	664	510	495	403
2010	681	449	431	325
2011	735	496	482	361
2012	734	503	494	367
2013	676	469	469	337
2014	755	507	507	400

TABLE 3A: SEC ENFORCEMENT ACTIONS AS REPORTED  
(2000–2014)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	103	112	163	199	179	184	138	219
Securities Offering	125	95	120	109	98	60	61	68
Broker Dealer & Municipal Securities	72	65	73	137	141	98	83	94
Investment Adviser	46	46	57	77	94	106	102	83
Delinquent Filing	8	14	10	11	21	60	91	53
Insider Trading	40	57	59	50	42	50	46	47
Market Manipulation	48	40	42	32	39	46	27	36
Contempt	36	41	47	42	21	23	21	12
Other	25	25	23	22	4	2	5	44
Total	503	485	598	679	639	629	574	656

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	157	143	126	89	79	68	99	2058
Broker Dealer & Municipal Securities	62	111	76	121	151	130	172	1590
Securities Offering	121	141	144	123	89	103	81	1538
Investment Adviser	90	84	113	151	155	140	137	1481
Delinquent Filing	111	92	106	121	127	132	107	1064
Insider Trading	61	37	53	57	58	44	52	753
Market Manipulation	52	39	34	35	46	49	63	628
Contempt	10	15	18	14	9	n/a*	n/a*	299
Other	7	2	11	4	5	5	37	221
FCPA	n/a	n/a	n/a	20	15	5	7	47
Total	671	664	681	735	734	676	755	9679

Source: U.S. Securities & Exchange Commission, Select SEC and Market Data FY 2000–2014.

\* In 2013, the SEC stopped including contempt proceedings (i.e., actions to enforce payment of previously imposed monetary penalties or compliance with a prior enforcement action). As a result, enforcement tallies after FY 2013 are depressed compared with prior years.

TABLE 3B: SEC ADJUSTED ENFORCEMENT ACTIONS (I.E., NOT INCL. FOLLOW-ON AND SECONDARY CASES) (2000–2014)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	71	84	136	149	135	137	101	155
Securities Offering	94	61	87	76	74	41	47	45
Broker Dealer & Municipal Securities	51	43	35	54	60	51	34	58
Investment Adviser	35	29	34	43	56	65	63	51
Delinquent Filing	8	14	10	11	21	60	91	53
Insider Trading	36	48	53	39	32	42	38	38
Market Manipulation	32	24	29	17	21	33	22	30
Contempt	36	41	47	42	21	23	21	12
Other	25	21	19	15	1	2	3	43
Total	388	355	450	446	421	454	420	485

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	111	96	84	58	48	50	81	1496
Broker Dealer & Municipal Securities	31	72	29	38	42	31	37	666
Securities Offering	76	112	75	89	81	90	66	1114
Investment Adviser	56	54	59	72	83	65	68	833
Delinquent Filing	111	92	106	121	127	132	107	1064
Insider Trading	44	31	37	49	52	44	52	635
Market Manipulation	46	36	29	32	42	48	48	489
Contempt	10	15	18	14	9	n/a*	n/a*	299
Other	7	2	8	3	3	4	3	193
FCPA	n/a	n/a	n/a	20	15	5	7	47
Total	492	510	445	496	502	469	503	6836

\* In 2013, the SEC stopped including contempt proceedings (i.e., actions to enforce payment of previously imposed monetary penalties or compliance with a prior enforcement action). As a result, enforcement tallies after FY 2013 are depressed compared with prior years.



TABLE 3C: FOLLOW-ON AND SECONDARY ENFORCEMENT ACTIONS  
(2000–2014)

	2000	2001	2002	2003	2004	2005	2006	2007
Issuer Reporting and Disclosure	32	28	27	50	44	48	36	64
Securities Offering	31	34	33	33	24	19	14	23
Broker Dealer & Municipal Securities	21	21	42	82	79	47	49	36
Investment Adviser & Transfer Agent	11	14	23	34	37	41	39	32
Delinquent Filing	0	0	0	0	0	0	0	0
Insider Trading	4	9	6	11	10	8	8	9
Market Manipulation	16	16	13	15	18	14	5	6
Contempt	0	0	0	0	0	0	0	0
Other	0	4	4	7	3	0	2	0
Total	115	126	148	232	215	177	153	170

	2008	2009	2010	2011	2012	2013	2014	All (2000 – 2014)
Issuer Reporting and Disclosure	45	47	40	31	31	18	18	559
Securities Offering	45	29	69	34	8	13	15	424
Broker Dealer & Municipal Securities	31	39	46	83	109	99	132	916
Investment Adviser	35	30	53	79	71	75	68	642
Delinquent Filing	0	0	0	0	0	0	0	0
Insider Trading	17	6	16	8	6	0	0	118
Market Manipulation	6	3	7	3	4	1	15	142
Contempt	0	0	0	0	0	n/a	n/a	0
Other	0	0	2	1	2	1	0	26
FCPA	n/a	n/a	n/a	0	0	0	0	0
Total	179	154	233	239	231	207	248	2827