Securities Law Developments

D.C. CIRCUIT RULES ON SCOPE OF SEC'S POWER TO BAR INDIVIDUALS

On June 1, 1999, in Teicher v. SEC, the United States Court of Appeals for the District of Columbia Circuit held:

- Securities Exchange Act of 1934 ("Exchange Act") Section 15(b)(6) does not give the SEC authority to bar an individual from associating with an investment adviser; and
- Investment Advisers Act of 1940 ("Advisers Act") Section 203(f) gives the SEC authority to bar an individual from associating with an unregistered investment adviser.[1/]

The decision significantly alters the securities enforcement landscape. For years the existence of the Commission's power to bar individuals from an area of the securities industry in which they do not participate (a so-called "collateral bar") and from association with unregistered entities has been the subject of debate in settlement negotiations with the Division of Enforcement. As a result of the Teicher decision, and absent Congressional action, significant remedies that have been a part of many SEC administrative proceedings against associated persons are no longer available to the Commission.

Case History

After criminal convictions for insider trading, the Division of Enforcement sought to bar Ross Frankel and Victor Teicher from associating with registered and unregistered investment advisers. The administrative law judge ("ALJ") ruled that the Commission had no authority to bar Frankel from associating with an investment adviser because he had not committed any violations of the Advisers Act.[2/] Exchange Act Section 15(b)(6) authorizes the Commission to censure, place limitations on the activities or functions of, suspend, or bar from association with a broker-dealer, persons associated or seeking to become associated with a broker-dealer.[3/] Similarly, Advisers Act Section 203(f)

1/ -- F.3d --, No. 98-1287, 1999 WL 343074 (D.C. Cir. June 1, 1999).

2/ In re Teicher, SEC Release No. ID - 61, File No. 3-8394, 1995 WL 95076, at *15 (Feb. 27, 1995).

3/ Exchange Act Section 15(b)(6)(A) provides:

> With respect to any person who is associated, who is seeking to become associated, or, at the time of the alleged misconduct, who was associated or was seeking to become associated with a broker or dealer, or any person participating, or, at the time of the alleged misconduct, who was participating, in an offering of any penny stock, the Commission, by order, shall censure, place limitations on the activities or functions of such person, or suspend for a period not exceeding 12 months, or bar such person from being associated with a broker or dealer, or from participating in an offering of penny stock, if the Commission finds, on the record after notice and opportunity for a hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person -- (i) has committed or omitted any act or omission enumerated in subparagraph (A), (D), or (E) of paragraph (4) of this subsection.

15 U.S.C. § 78o(b)(6)(A).

authorizes the Commission to censure, place limitations on the activities or functions of, suspend, or bar from association with an investment adviser, persons associated or seeking to become associated with an investment adviser.[4/] The ALJ reasoned that Exchange Act Section 15(b)(6) and Advisers Act Section 203(f) are clear "as to their jurisdictional limits" and are not "in some manner interchangeable."[5/] The ALJ rejected the Division of Enforcement's arguments that statutory language authorizing the Commission to "place limitations" on activities permits collateral bars and that the legislative history of Exchange Act Section 15(b)(6) supports this interpretation.[6/]

Regarding Teicher, the ALJ agreed with the Division of Enforcement's argument that Advisers Act Section 203(f) gives the Commission power to restrict association with unregistered advisers because it applies to "investment advisers" and Advisers Act Section 202(a)(11) defines "investment advisers" to include unregistered advisers.[7/] "As the Division notes and the [statutory] language makes clear, the section contains no exclusion for those advisers who are not required to register."[8/] Teicher was not able to persuade the ALJ that the structure of the Advisers Act and context of Section 203(f) show that Congress did not intend to include remedies related to unregistered investment advisers.[9/] Both Frankel and Teicher appealed.

After the initial decision in Teicher, but before the Commission's decision on the appeal, the Commission addressed the same collateral bar issue in In re Blinder in which the Division of Enforcement challenged an ALJ's ruling that the Commission has no collateral bar power.[10/] The Commission held that the "place limitations" language in Exchange Act Section 15(b)(6) gives the Commission the power to issue collateral bars in light of the purposes of the securities laws and Congress' intent to give the Commission flexibility to fashion remedies.[11/] In addition, the Commission explained that, without collateral bar power, a person such as Blinder could associate with an unregistered investment adviser without notifying the Commission.[12/] In dissent, Commissioner Hunt argued that while Blinder was a "poster-boy" for a bar from the entire securities industry, the Commission had no authority to do so.[13/]

In Teicher, the Commission, with Commissioner Hunt again dissenting, reversed the ALJ's rejection of the Division of Enforcement's request to bar Frankel from association with an investment adviser based on the

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[4/] Advisers Act Section 203(f) provides in full:

> The Commission, by order, shall censure or place limitations on the activities of any person associated, seeking to become associated, or at the time of the alleged misconduct, associated or seeking to become associated with an investment adviser, or suspend for a period not exceeding twelve months or bar any such person from being associated with an investment adviser, if the Commission finds, on the record after notice opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in paragraph (1), (5), (6), or (8) of subsection (e) of this section or has been convicted of any offense specified in paragraph (2) of subsection (e) within ten years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct, or practice specified in paragraph (4) of subsection (e).

15 U.S.C. § 80b-3(e).

[5/] Teicher, 1995 WL 95076, at *15 (Initial Decision).

[6/] Id.

[7/] Id. at *6-*7.

[8/] Id. at *5.

[9/] Id. at *6.

[10/] Exchange Act Release No. 39180, File No. 3-8305, 1997 WL 603788 (Oct. 1, 1997).

[11/] Id. at *3-*6.

[12/] Id. at *5-*6.

[13/] Id. at *8.

Commission's Blinder decision.[14/] The Commission also upheld the ALJ's conclusion regarding the Commission's power to bar Teicher from association with an unregistered investment adviser. The Commission agreed with the ALJ that the language of Advisers Act Sections 202(a)(11) and 203(f) is clear and unambiguous and gives the Commission power to restrict association with investment advisers without regard to registration.[15/]

D.C. Circuit Opinion

On appeal to the D.C. Circuit, the Court of Appeals adopted the reasoning of Commissioner Hunt and the ALJ who decided the original proceeding. The Court of Appeals soundly rejected the Commission's reasoning regarding collateral bars and concluded that the statutory structure made it clear that Congress did not intend to give the Commission the power to issue collateral bars.[16/] As the Court explained, each branch of the securities industry has its own associational bar provision, and each provision requires a nexus to the branch in question. Accordingly, it made no sense to read the "place limitations" language as allowing the Commission to "move seamlessly from one licensing regime to another, imposing unlimited sanctions throughout all the branches of the industry within its bailiwick."[17/] The Court seemed to chastise the SEC for reading Exchange Act Section 15(b)(6) too broadly, explaining that "[e]ven the Commission doesn't suggest that the phrase ['place limitations'] allows it to bar one of the offending parties from being a retail shoe salesman, or to exclude him from the Borough of Manhattan."[18/] The Court added that, even assuming that the statutory language were ambiguous, the Commission's interpretation of the language was not reasonable and thus was not entitled to Chevron deference.[19/] The Court gave no weight to the Commission's policy arguments and responded that "[a] congressional discount of a peril is hardly the strongest argument why we should see it as urgent."[20/]

In contrast, the Court of Appeals concluded that "[n]o language in [Advisers Act Section 203(f)] remotely suggests that its application is limited to 'registered' investment advisers" and affirmed the Commission's bar prohibiting Teicher from associating with unregistered investment advisers.[21/]

Impact of the D.C. Circuit's Rejection of Collateral Bar Power

- The Staff can no longer seek and the Commission can no longer impose collateral bars or other types of collateral restrictions (e.g., suspensions) in administrative proceedings, unless and until Congress amends Exchange Act Sections 15(b)(6) and 15B(c)(4), and Advisers Act Section 203(f).[22/]

- While the Teicher holding does not address the Commission's power to bar individuals from association with unregistered broker-dealers, the Court's plain meaning interpretation of Adviser's Act Sections 203(f) would seem to dictate a similar result under the Exchange Act. Accordingly, the Commission should retain the power to bar individuals from associating with unregistered broker-dealers under Exchange Act Section 15(b)(6).

[14/] In re Teicher, Exchange Act Release No. 40010, File No. 3-8394, 1998 WL 251823 (May 20, 1998).

[15/] Id. at *3.

[16/] Teicher, 1999 WL 343074, at *1 (D.C. Cir.).

[17/] Id. at *4.

[18/] Id. at *3.

[19/] Id. at *5 (citing Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 836 (1984)).

[20/] Id. at *5.

[21/] Id. at *1.

[22/] It is at least theoretically possible, however, that the Commission could still obtain the functional equivalent of a collateral bar in federal district court in the form of an injunction based on the district court's equitable powers to fashion an appropriate remedy. See, e.g., SEC v. Posner, 16 F.3d 520 (2d Cir. 1994) (affirming a district court's use of its equitable powers to enjoin defendants from acting as an officer or director of a public company based on the district court's conclusion that an officer and director bar was necessary to protect public investors.).

- Persons who consented to collateral bars in the past may try to reopen their settlements. However, they will likely have a steep hill to climb.[23/]

- Teicher is one of a number of recent Commission setbacks in the federal courts of appeals.[24/] As a result of these decisions:

  - ALJs may be more willing to reject aggressive statutory interpretations by the Division of Enforcement. ALJs should be particularly encouraged by cases like Teicher in which the ALJ rejected the Staff's statutory interpretation and a federal court of appeals subsequently agreed with the ALJ's conclusion.

  - Persons negotiating with the Division of Enforcement may have a better chance of persuading the Staff to back away from aggressive statutory interpretations, and the Staff may be inclined to be more flexible in future negotiations. Persons negotiating with the Staff may be more inclined to challenge and appeal the Staff's legal interpretations.

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[23/] Cf. Callen v. Pennsylvania R.R. Co., 332 U.S. 625, 630 (1948) ("One who attacks a settlement must bear the burden of showing that the contract he had made is tainted with invalidity, either by fraud practiced upon him or by a mutual mistake under which both parties acted."); United States v. Bank of New York, 14 F.3d 756 (2d Cir. 1994) (holding that an intervening change in decisional law is not a basis for vacating a settlement for a sum of money).

[24/] See, e.g., SEC v. Adler, 137 F. 3d 1325 (11th Cir. 1998) (holding that to prove an insider trading case, the SEC must establish that inside information was a substantial factor in the decision to trade).