

**SEC HISTORICAL SOCIETY  
ANNUAL MEETING  
June 2, 2011**

**RICHARD NESSON:** Good afternoon and welcome to the 2011 Annual Meeting program of the SEC Historical Society. I am Richard Nesson, a founding partner of Luness Partners and the current President of the Historical Society. On behalf of my colleagues on the Society's Board of Trustees, it is a pleasure to welcome you today, both those who are seated here in the SEC's auditorium in Washington, as well as those joining us online at [www.sechistorical.org](http://www.sechistorical.org).

Today's program is an historic event for both the SEC and the Society. Our program is being held in commemoration of the upcoming 77th anniversary of the founding of the U.S. Securities and Exchange Commission. The Society is honored to help celebrate the more than seven decades of the SEC's contribution to financial regulation. As a former member of the Commission's staff who continues to be very proud of my association with the SEC, I would like to pay particular tribute to the staff, both current and past, for their dedication and hard work, serving to help ensure fair and open markets for all investors.

Today also marks the beginning of the Society's celebration of the upcoming 10th anniversary of our virtual museum and archive at [www.sechistorical.org](http://www.sechistorical.org). Since its opening just nine years ago, the museum has grown to be the authoritative online resource on the history of financial regulation in the U.S. The museum is free and accessible worldwide at all times. Last year, the museum welcomed more than 300,000 visitors, including practitioners from law, accounting, financial services firms; regulators from federal, state, municipal, and international agencies; academics, both professors and students, and the media. Every day, people log on to our site because they know they will be able to access information, not to be found on the other online sources, and materials that they can trust to be authoritative and objective. We, in turn, look to donors like you to ensure that the museum remains current, independent, and growing. We are grateful to all of those who give to build and sustain the museum. We are proud that over 80% of gift revenue goes directly to the growth and outreach of the virtual museum and archive.

Today's program also gives the Society opportunity to welcome our leaders for this year. As I begin my tenure as President, I would like to recognize my fellow officers, our Chairman, Susan Coffey of the AICPA; Bob Kueppers of Deloitte, the President- Elect and my successor; David Martin of Covington and Burling, our Vice President - Museum; George McKann of Drinker Biddle & Reath, our Vice-President -Development; our Treasurer, Abbie Arms, of Shearman and Sterling; and Stacy Chittick of FINRA, the Society's Secretary.

I would also like to welcome our new trustees. They are in addition to David Martin, Alan Beller of Cleary Gottlieb, Hardy Calcott of Bingham McCutchen, Jackson Day of Ernst & Young, Peggy Foran of Prudential Financial, Cyndi Fornelli of The Center for Audit Quality, Pamela Parizek of KPMG, and Jim Tricarico of Edward Jones.

While the Society and the virtual museum and archive remain independent of and separate from the SEC and receive no government funding, we continue to be grateful for their close friendship and support that the SEC has given the Society since its

founding. We are delighted that three current members of the Commission - Chairman Mary Schapiro, Commissioner Elisse Walter and Commissioner Troy Paredes - previously served as the leaders of the Society. We are also pleased to honor the Commission staff by hosting an ice cream social at the conclusion of this program to celebrate the SEC's 77th anniversary. We invite all staff who are present here today, as well as those who are watching us online upstairs, as well as guests, to join the social. It is now my pleasure to introduce Mark Cahn, the SEC's General Counsel, who will make some remarks on behalf of the Commission.

**MARK CAHN:** Good afternoon. It is a pleasure to be here today. Thank you, Richard, and of course, Executive Director, Carla Rosati, and all the people who have worked so hard to make the SEC Historical Society a living reminder of the SEC's importance, it deserves special recognition today. And thanks as well to the supporters of this important institution who are here today.

It is a particular pleasure for me to address this body as I have been an avid consumer of the society's resources since I joined the Commission in early 2009. I'm particularly drawn to the website's oral histories. As someone who grew up as a securities lawyer, hearing my mentors, luminaries like Manny Cohen, it is a marvel and a delight to be able to listen and learn from them myself. I challenge anyone to listen to Chairman Cohen talk about the Saturday evening phone call with President Johnson requesting additional funds for the SEC's budget and not be totally charmed, which the historical society offers those to take the time to explore such an extraordinary gift. John Kenneth Galbraith wrote once that as a protection against financial illusion or insanity, memory is far better than law for protecting people from the cupidity of others. Their own history is highly utilitarian. That thought is why the historical society's efforts to keep alive the memory of the SEC's efforts over 77 years and of the economic and financial events that inspired those efforts is so important. You are not just commemorating the agency's work, you are reinforcing all of our memories and you are supporting them with the documents and history and photographs that make available to people, that you make available to people all over the world.

I know that it is a conceit of every generation that their experiences are unique and uniquely important. I am extraordinarily honored to be working at the Commission during what I believe to be particularly important time, as the Commission implements the most far-reaching financial reform law since the decade when the SEC was created. But as we look to the future, as we face challenges and questions, as we invest in the human and electronic capital necessary to give the agency the capacity to keep up with the breathtakingly complex and ever-changing market, we must not only continue to listen and learn from each other, as I am looking forward to doing today, but also from those who came before us. We must remember and learn from our past, the lessons that Manny Cohen and William Douglas and so many can continue to teach us, both inside the Commission and out. That is why I'm so glad to see so many of you here representing so many backgrounds and professions. Your involvement with the Society sends a strong signal that there are those of us who do remember. It's an indication that we are determined both to preserve memories and put into place effective law and regulation. And it is a sign of support for the efforts of the 3,800 talented and dedicated individuals who are making history at the SEC today. Thank you.

**KURT HOHENSTEIN:** Thank you, Mark. Welcome all. I am Kurt Hohenstein, Associate Professor of History at Winona State University and curator for the upcoming gallery on

the Supreme Court and financial regulation, which will open in the virtual museum and archive on December 1st of this year. Today's program, the Supreme Court and the SEC, will feature a discussion of the role that the courts played in the history of securities and financial regulation. I am especially pleased to moderate this discussion because we have with us two of the leading experts on our topic. Joining me today are David Becker and Adam Pritchard. David was SEC General Counsel under Chairman Schapiro from 2009 to 2011; he also served as General Counsel under Chairmen Arthur Levitt and Harvey Pitt. Mr. Becker began his legal career as a law clerk to Judge Harold Leventhal at the Court of Appeals for the District of Columbia and for retired Associate Justice Stanley Reed of the Supreme Court. He is a graduate of Columbia College and of the Columbia Law School and is currently a partner in the law firm of Cleary Gottlieb Steen & Hamilton.

Also with us is Adam Pritchard. Adam is Frances and George Skestos Professor of Law at the University of Michigan Law School. Professor Pritchard holds degrees from the University of Virginia and the University of Chicago. He clerked for Judge J. Harvey Wilkinson III of the U.S. Court of Appeals for the Fourth Circuit and served as a fellow in the Office of the Solicitor General at the U.S. Department of Justice. Professor Pritchard is also a former senior counsel in the SEC Office of the General Counsel. He received the SEC's Law and Policy award for his work in the United States v. Dirks, where the U.S. Supreme Court upheld the misappropriation theory of insider trading.

Before we begin, I would like to take this time to recognize Eric Summergrad, a former Deputy Solicitor in the SEC Office of General Counsel who died in 2007. Eric was a recipient of the Philip A. Loomis Jr. Award in 1995. In 1997, Eric developed the SEC's successful argument in U.S. v. O'Hagan. There appears in the museum's collection a letter from Milton Freeman, one of the giants of securities law, written to Eric after the court's decision. Freeman wrote, "You have won the O'Hagan case. I hold you exclusively responsible for this great victory by the Commission. I hope never to find myself in a position where I have to face your formidable talents and opposition again." I would like to think the family of Eric Summergrad, who has made a generous gift in his memory to the building of the gallery on the Supreme Court and financial regulation. His service, along with the service of David and Adam and countless current and former staff members, speak volumes to the quality and dedication of the work of the SEC Office of the General Counsel.

Over the next hour or so, we will examine what legal and constitutional history tells us about the development of securities regulation, the role of economic philosophy and the impact of the New Deal, the fight over the Public Utility Holding Company Act, the interplay between the SEC and the D.C. Circuit Court of Appeals, the role of former Associate Justice Lewis Powell as the securities expert on the court, the role of the SEC and the courts today, and, with some trepidation, some discussion about what history tells us the future may hold for securities regulation. So we hope to have a full discussion about those topics and anything else that might come up.

Before we talk about the New Deal, and we are going to spend quite a bit of time talking about the New Deal, it is important to get a basic understanding of the role that two doctrine's played prior to the new deal because the new deal was such a transformation from that period, those two doctrines are dual federalism and laissez-faire constitutionalism, both important documents that justices on the courts considered and follow with particular respect all the attempts at securities regulation. We just described

what those are. Dual federalism was a doctrine that claimed that there were separate and distinct roles for state and federal regulations. And before 1930, in many areas, such as the regulation of banks, and insurance and securities sales, the state role, in fact was predominant. In addition, the doctrine of laissez-faire constitutionalism, as it applies to the courts, held that government interference in the markets was thought to be injurious because markets were self-correcting, and also that government interference was an unconstitutional interference with the rights of property.

These two doctrines created great impediments to many forms of securities and financial regulation because of how the courts applied them. But there were problems. And by 1917, states had begun to address some of those problems particularly with respect to securities practices. In reaction to unscrupulous practices that defrauded customers, consumers and purchasers of securities who promised everything under the blue sky, states began to enact legislation that began to regulate the legislation and sales of securities and of dealers' practices, not unlike you might see in the 1930's, that these were states doing state actions. These laws were different among the states. Some demanded different licensing rules, some required different kinds of regulations for securities, and they uniformly imposed them on any securities firm or salesman that sold securities inside a particular state. So states were regulating intra-state activity.

Now, these laws clashed against the two doctrines I talked about. What were the rights of the states, and were any kind of regulations by the states, violations of laissez-faire constitutionalism? In 1917, the Supreme Court took a trio of cases from the states of South Dakota, Michigan and Ohio and heard those cases, all of which were blue sky law cases, these are commonly known as 'Blue Sky Cases.' In these cases, the Supreme Court determined that the states had the power to regulate intra-state sales of securities, including the power to deny licenses and penalize violators of those state laws. Now this may at first glance appear an aberration to the principles of laissez-faire constitutionalism. The court is clearly regulating the market. The laws of regulating the market of course say this is constitutional. But, in fact the blue sky cases were entirely consistent with the concept of dual federalism because it was recognized that states had some right and obligation to do exactly that. The Supreme Court in fact granted the power to states to regulate economic activity within state borders.

Now, you can imagine these three cases and the consequences of these three cases especially for national securities firms, firms that did business in multiple states. These decisions created immense problems for securities firms which now face the patchwork of perhaps 40 or more states with different laws they must comply with and they weren't all the same. This is sort of the parameters of where we were after 1917. And obviously, the collapse of the stock market in 1929 and the depression that followed in the 1930's changed much about the ways Congress and the courts facing a new regimen of regulation looked at those two theories. So we want to talk about that when we talk about the new deal and how the new deal really transformed some of those ideas and how the courts interplayed with the legislation that Congress passed to do that. So we will turn to Adam for that to begin with. Adam, would you discuss the effect that those events, the collapse of the stock market and depression, had on the shaping of securities laws in the '30's?

**ADAM PRITCHARD:** Thank you very much, Kurt. So, today, we think about the securities laws, at least when I am teaching them to my students, as a fairly technical body of law that is governing the financial markets. But in the 1930s and 1932, it was a

political issue and the central theme of Franklin Roosevelt's 1932 campaign that capitalism had failed because of the excesses of the capitalists. And Roosevelt was swept into power, promising to tame Wall Street, was one of the central promises that he made.

So, the first two securities laws enacted, and the ones that are probably the most familiar today, were the Securities Act and the Exchange Act. The first was to tame the power of the investment bankers and the commercial banks. The Exchange Act, the primary target, was to tame the power of the New York Stock Exchange and, of course, it had the incidental effect of creating the SEC.

But, the securities law that actually was the most controversial was the Public Utilities Holding Company Act, which has now been repealed. But in the 1930's, this was the real firestorm over the federal takeover of securities laws. Kurt talked about the state regulation that existed prior to that. PUHCA, which I like to call it because it is fun to say it that way, went a step beyond what the Securities Act and the Exchange Act had done. The Securities Act and the Exchange Act focused on disclosure. PUHCA was going to transform the sprawling public utility holding companies, including the regulation of their financial structure, the regulation of their corporate governance, and, for its supporters, it was really a trial run at federal corporate law, that was going to displace the state's. If PUHCA worked out, there would be impetus to take over corporate law at the federal level altogether. And the intersection with the Court comes even before the securities laws make their way into the Supreme Court because a number of the future justices that Roosevelt would appoint to the Supreme Court had critical roles to play in the drafting of the federal securities laws. So, Hugo Black, who was Roosevelt's first appointee to the Supreme Court, had collected a good deal of good will from Roosevelt by leading the campaign to enact the Public Utility Holding Company Act in the face of very stiff opposition from the utility holding companies, which were not anxious to be broken up. Stanley Reed was the solicitor general at the time that the constitutionality of the Public Utility Holding Company Act was being adjudicated. Felix Frankfurter oversaw the drafting of the Securities Act by James Landis and Ben Cohen, two of his protégés. He pushed Roosevelt to challenge the holding companies in 1935 and played an important role in its legislative history. A name familiar to people around here, William O. Douglas was the director of a protective committee study that led to the enactment of the Chandler Act, the first of the bankruptcy reforms. The success of that study launched him to a position as SEC Commissioner and subsequently its Chairman, where he led the fight to tame the New York Stock Exchange. And then the last justice with an important role in securities laws was Robert Jackson, who had been both the solicitor general and attorney general at the time the holding company cases were being adjudicated.

So the SEC got off to a rough start in the Supreme Court. They started out oh and one in the case of SEC versus Jones in 1936. Keep this date in mind because it is important. So Jones had filed a registration statement with the SEC. The SEC had initiated a stop order proceeding against Jones, claiming there was fraud in the registration statement. Jones tried to stop the proceeding by withdrawing the registration statement. And the case makes its way up to the Supreme Court and Jones wins 6 to 3, saying the SEC does not have the power to prevent the withdrawal of a registration statement. But the opinion gets a good deal of popular attention in the press because the majority opinion by Justice Sutherland compares the SEC to a star chamber proceeding and talks about the overreaching by this administrative agency run amok. So, for the officials in the

Justice Department trying to uphold the constitutionality of the Public Utility Holding Company Act, the operative strategy was delay. We got the four horsemen, they are hostile to federal regulation of the securities markets. The Holding Company Act, because it takes over corporate governance, traditionally thought of as a state function, was the most vulnerable. So, the key part of the litigation strategy was to drag things out as long as possible. And that turned out to be a stroke of genius because when Van Devanter retired, he was replaced by Hugo Black, who turns out was much more sympathetic to the goals of the Holding Company Act. Sutherland, who wrote the Jones decision retired; he is replaced by Stanley Reed, who had been in charge of adjudicating the constitutionality of the holding company case. So, the litigation over the holding company legislation, in 1938 and the Electric Bond case, the Supreme Court upholds the disclosure provisions of the Holding Company Act which implicitly affirms the constitutionality of the Securities Act and Exchange Act. The death penalty provision, which allowed the SEC to break up the public utilities holding companies, does not get decided until 1946, by which time the New Deal constitutional revolution is over. And it is kind of a foregone conclusion that the SEC is going to have the power to break up the holding companies. So, at this point, by the 1940's, Roosevelt has transformed the Supreme Court, some people say by his threats, his court packing threats, but on the ground, Roosevelt has transformed the Supreme Court in the old fashioned way. He has replaced the old justices who have retired or died with new ones that are amenable to his policy goals. So, the transformation of the Supreme Court sets the stage for the SEC to go on a very long winning streak in the Supreme Court because the people who are occupying the positions on the Supreme Court had played a role in promulgating the securities laws, pushing for their enactment. They are sympathetic to the rise of the administrative state, believed in expert administration of the securities laws, through the SEC.

The only place where there is any dissent among the New Deal justices is just how much discretion will be given to that SEC. So, there are two factions, one, a more populist faction led by Black that wants to be deferential to the SEC. Felix Frankfurter and Robert Jackson are quite happy to be deferential to Congress, but wanting to keep that SEC in line through judicial review. And this initially begins with the SEC versus Chenery case where Felix Frankfurter gives the SEC an extended lecture on what fiduciary duties means because after all, he was the professor and the SEC gets knocked down in their efforts to define what counts as a fiduciary duty. It gets remanded back to the SEC. They adopt the same holding that they had before, send it up with a new rationale, new justices on the court more deferential to the SEC, and the SEC gets to do what it wants. And that sets the tone for the next 30 years on the Supreme Court is, we are going to defer to the SEC as the expert agency. The SEC basically does not lose until the 1970's. But, we will hold off on that for a couple of minutes.

**KURT HOHENSTEIN:** Let me follow up with just a couple of questions, Adam. You talked about the administrative state and the way you have described it, it looks like the change in personnel was sort of the factor. And obviously it is important, but how much of a role did the increasing administrative expertise of the SEC play in the courts accepting the SEC's argument? In other words, was this just a matter of Roosevelt setting out justices that were going to retire or was there more to the story?

**ADAM PRITCHARD:** It is hard to imagine this Supreme Court questioning the expertise of any administrative agencies. Whether the SEC was doing a good job or a bad job was not terribly important except to people like Frankfurter. So, the person who writes the

most opinions in this utility holding company line of cases, it is 13 cases over about a 15-year period after the securities law gets adopted, is Frank Murphy, who knows nothing about the subject. He was the Governor of Michigan, he has no particular background. The fact that he is writing all of these opinions tells you something about the importance that the justices attributed to the securities laws, which I would contend is very little. They're not very interested in this topic, there are more interesting things to be involved in. Murphy, it pains me to say this, is a University of Michigan graduate, was not held in high regard by his colleagues; he was not considered a leading light among the justices. So, the fact that he is been assigned this opinion, they are kind of the equivalent of tax cases, right? Somebody has got to do them, and Frank Murphy is the guy. So, I think the difference is all of these people are new dealers. They have cut their teeth in the 1930's Roosevelt administration, either inside it or as an ally of it, and they believed in this new era of government, and it shaped how they approached the cases.

**KURT HOHENSTEIN:** Okay, just one more. Frankfurter seems to be a little bit different. He is also a New Dealer. He comes up through the system. Some of the same folks that sit on the same court were his colleagues in the New Deal, but he has a different take on this in terms of the scope of the SEC's power. And he is also very focused on what the court can and cannot do. You do not get this from reading the decisions, but you do get this from reading the papers. Can you talk a little bit about how Felix Frankfurter's approach differed, say from the other justices who at this point had accepted the administrative state?

**ADAM PRITCHARD:** One of the things that is being worked out in the Supreme Court in the first part of the 1940's is administrative law. We do not get the Administrative Procedure Act until after World War II, so at this point we have a common law of judicial review, and the prior common law of judicial review under the old court had been a fairly exacting scrutiny of administrative agencies as being bodies that were encroaching on the common law, and the set of entitlements that the common law had created. We get these New Deal justices, and the majority of them, the Blacks', the Murphys', the Douglas', are ready to go to all the way to the other extreme, which is to be very deferential to administrative agencies, the point of having administrative agencies is that they are experts and interfering with administrative agencies was part of what was wrong about the old courts. There is a certain tension for Frankfurter, because he believes in administrative expertise, and wants the Roosevelt revolution to succeed, but he is also Congress-centric; Congress has to create laws for the agencies to follow, and the role of judges is to make sure that the agencies are following the direction provided by Congress. And of course, anytime you are asked to be a judge, the line between what Congress has mandated, and what you, as a judge think is a sensible policy is going to be a blurry one. If you were as smart as Felix Frankfurter, you would have definite views about what the correct approach should be. So, I think the other justices, the majority of them, were more humble in their attitude toward the administrative agencies and the SEC.

**KURT HOHENSTEIN:** So, the story you have described is interesting, because from 1936, where the Supreme Court has essentially said the SEC is acting like a star chamber, really is striking down the administrative action of the agency, you cannot do what you did, it is beyond your powers, beyond your purview; two, four years later, when the transformation has essentially begun and you say, describe it as continuing for another 30 years.

**ADAM PRITCHARD:** Complete deference from 1940 to 1974.

**KURT HOHENSTEIN:** In a lot of this information that you get, we want to talk about just briefly because I am the historian on the panel. In terms of materials that we get, could you get this story if you had just read the decisions? Where do we all discern where this information comes from?

**ADAM PRITCHARD:** I spent a good deal of time at the Library of Congress, unfortunately. There is a lot of digging involved in the justice's papers, the correspondence between Frankfurter and his colleagues, and he is a big letter writer, apparently. He couldn't walk down the hallway to talk to colleagues, he had to dash off a letter. So, a lot of it is shed in those exchanges between the justices. You see the disagreements in the opinions. You do not get a sense of the depth of the disagreement until you get into the justice's correspondence.

**KURT HOHENSTEIN:** And they are commonly writing letters to each other about the opinions as it is being written, and you see the opinion changing over time, which is really how the courts operate in many cases, which you cannot get from just reading the decisions themselves.

**ADAM PRITCHARD:** There is a lot of back and forth in the creation of the final opinions.

**DAVID BECKER:** Adam, how much of this is deference, and how much of it do you think was agreement? That is to say, I am perfectly willing to defer to these folks if they get it right, and then I stop agreeing, when I stop agreeing I stop deferring?

**ADAM PRITCHARD:** We do not know, because it does not get tested. I am confident from what I have read that they all believed whole-heartedly in the project. Right? They had written editorials or lobbied on behalf of the securities laws, the creation of the SEC. They would not have gotten the job as Supreme Court justices unless they were on board with Roosevelt's program. So, I think they agree, but there is room in the agreement for a little bit of difference of opinion between Frankfurter and the other block, where they all agree with the project, the other justices are more willing to be deferential to the SEC than Frankfurter is, and their views prevail. Frankfurter is in the minority.

**KURT HOHENSTEIN:** We are going to come back to the 30 year in a little bit, but we do want to talk about, sort of beyond the Supreme Court. Historians like to focus on the Supreme Court because it is easy to get those materials, but really, much of the history of the development of securities and financial regulation comes from decisions made on the lower courts, particularly the D.C. Court of Appeals, and also from inside the SEC, which is tougher to discover because certainly their archives are not as available and sometimes inside the SEC, it is really difficult to get. But a lot of the history occurs there, those decision-making processes. David had tremendous experience and I would just like you to describe, if you could, some of your experiences inside the General Counsel's Office, particularly with cases before the D.C. Court of Appeals that you are familiar with.

**DAVID BECKER:** Sure. Before doing that, I was struck listening to you, to the reference to Eric Summergrad, who was a terrific lawyer, and just a sweet, wonderful guy.

The D.C. Circuit may well be in many matters the most important circuit for the Commission. I do know that judges of the D.C. Circuit, some of them, certainly think they

are the most important court in the country. The Commission does not have a great record in the D.C. Circuit, particularly if one looks at the rule-making side of the house. I think it is safe to say it has a dreadful record in the D.C. Circuit. In preparing for this, I took a look at the Commission's record with respect to rule-making cases over the last 25 years. I did not find that much older than 25 years, and I certainly did not even find very much within that time period. It is only eight cases, which is rather astonishing, considering how it is not all that hugely expensive to appeal from a Commission action. At this point, the 800 number is supposed to flash, but we are not set up for that.

But in any event, only eight cases, and depending on how one counts, the Commission has lost them all. The possible exception is the Blunt case, which was not really a challenge to an SEC rule, but to an MSRB rule. The Commission, you can say, is either one for eight, or 0 for 7. The one thing we know is that it is not because of the quality of the lawyering, present company excluded. And so, you say, "Well, what is behind this?"

Half of the cases the Commission lost were, for lack of adequate authority. The Commission misinterpreted the statute; it just did not have the authority to do what it did. The earliest one of this group of cases, the American Bankers Association case, was one in which the D.C. Circuit invalidated what was then Rule 3-b9, which was a rule that expanded the definition of broker-dealers to include banks that engage in certain activities. It was a bit of a neat trick because banks are explicitly excluded from the definition of a broker-dealer. That was not lost on the court.

Then, we had the Business Roundtable case, in which the D.C. Circuit found that the Commission did not have the authority to require exchanges to have in their listing standards of one share/one vote rule. More recently, we had the Goldstein case, and I must say a good example of how it does not take a lot of money and time to challenge a Commission rule, at least on an authority basis. It invalidated the Commission's rule that would have required hedge fund advisers to register by counting their clients, not the funds, but investors. And most recently the D.C. Circuit, in the Financial Planners Association case, invalidated a rule that in which the Commission excluded, from the definition of investment advisers, broker dealers who were giving investment advice but that was not solely incident to providing brokerage services. Again, a fairly tough argument to make, given the explicit statutory language.

In the first Chamber of Commerce case, the D.C. Circuit remanded a rule to the Commission to consider and inform itself as of the cost to investment companies of rules that would require 75% independent directors and independent chairman. And when the Commission did that, with great expedition, the case went back up to the Court of Appeals, and the Court of Appeals invalidated it again, saying, "Well, you might have been informed yourself, but you informed yourself on the basis of sources that were not public and you did not reopen the comment period and give the public an opportunity to comment on your sources, sources on which you relied." And once again, it remanded the rule to the Commission. Most recently, in 2010, in the American Equity Life Insurance case, the D.C. Circuit invalidated a rule with respect to definitions of indexed annuity products, saying that the Commission, under the statute, has to make a finding as to the extent to which the rule would promote efficiency, competition, and capital formation. The Court said, "Well, the Commission acted arbitrarily and capriciously, because fundamentally it is conclusions as expressed in the release, as it was it was irrational." So, again, it was remanded, a chance to do it again. And that was ultimately

the Commission's authority to promulgate those rules, and ultimately withdrawn by virtue of a provision of Dodd-Frank.

So, all in all, this is a pretty spectacular record of failure. I do not want to mean to suggest that the Commission always loses, or even that inevitably it always will lose in rule-makings. It wins the vast majority of enforcement cases that are appealed to the D.C. Circuit. So, why does this happen and what can be done about it? I don't think, not withstanding the consistency, we are talking about relatively small numbers here. I do not think there is one unified theory that explains the Commission's performance. Each case is particular. Each has particular reasons why it came out as it did. I would caution against over simplifying all of this.

If you look at the American Bankers Association case, the one in which the Commission was defining broker-dealer to include banks under certain circumstances, there are certain lessons to be drawn from that. The first is that the death struggle between the Commission and banking regulators is not new. It is old, and that most of the time, when matters get put before courts, or before Congress, bankers win. The other cases are examples of, I think, an attitude that prevails in most courts of appeals, certainly the D.C. Circuit, not necessarily an appropriate attitude, which is, when it comes to authority issues, they do not like a great deal of creativity expressed by the regulators.

People always talk about, "He is a wonderful lawyer, he is so creative." I think when judges, and some of the rest of us hear that, their senses starts to tingle. One does not want unfettered creativity in one's lawyers. One prefers a sort of fidelity to the rule. The Commission is responding to very real regulatory problems, and as we know, it is not a simple thing to go to Congress and say, "You know there is this hole that people have found, could you fill it up?" Congress is often not willing to do it, and maybe they are willing to do other things that you just assume the Congress did not do. So, it is an understandable reaction on the Commission's part, but when you get these tough cases, it is often the courts are simply going to say no, and certainly a court that skews pretty closely to statutory language.

I think what is going on there, cannot prove it, have not seen anybody's paper, is a sense that the Commission needs to engage more data-driven, decision-making, on the rules-making front. One can agree with that. One can disagree with that, but I think it is true. I was at the American Equity argument in the D.C. Circuit that Mike Conley was arguing, and Michael made some comment about, the Commission is trying to engage in economic analysis, or they did not engage in economic analysis, and the court overturned this and Judge Ginsburg said something like, "Yes, and the Commission did not learn the lesson." I may have the words quite wrong, but the message was unmistakable, which as we think you folks are not sufficiently data-driven and in particular, are not relying enough on economic analysis. Now, one can quarrel with that view. One can even quarrel whether in the particular cases, if you want economic analysis, the court wants economic analysis, those particular issues lend themselves to it, or whether the Commission's decisions as expressed in the releases really did not show that. But, I think that is where the court is. The second Chamber case has enough internal inconsistency in it that I think one could say the court was driven by annoyance at the rapid turnaround as much as anything else. And it was sort of, "Listen, we gave you guys a nice out by simply saying you have got to study this issue, but when you come back here two weeks later, and say, 'Okay, we have studied it, now we know the answer', we are not going to let you get away with that."

**KURT HOHENSTEIN:** Very quick study?

**DAVID BECKER:** In fairness, I do not think the issues were terribly difficult and needed study in a rigorous academic sense. How much does it cost to have an independent chairman? You do not have to pay him more to be independent. Maybe you have to pay him more not to be independent, I guess, depending on the quality of independence you want. We are not talking about huge costs, but nonetheless, the court was plainly irritated. So, what the Commission should do in my view is, and I stress, you know I am alone and these are my thoughts, and only my thoughts. The Commission ought to be sending this message to the courts. We understand your views. We need to show you we have taken a look at the world as it is without this rule, and what we have done our best is we have done our best to figure out what the burden is going to be on the world as a result of this rule, and what the benefits are going to be. And we have weighed the two, and we have rationally decided that the benefit outweighs the burden. And though, we do not think we can develop data for everything, we have been data-driven to the extent that we can be.

I will say this, to the extent that the Commission was able to, and there are limits to what available personnel could do. It is not like the Commission has a bunch of economists sitting around until someone comes in and says, hey, we need you guys to do an emergency study. I believe the Commission in the proxy-access case did the best it could to look anticipate the concerns of the Court of Appeals, and to address them both by study and then by writing. I think that is the approach the Commission ought to take. There are obstacles. Some people here do not want to do that. They believe it would be futile because the D.C. Circuit is so ideologically opposed to the Commission. In that respect, it might be useful for the court to affirm the support the Commission's rule-making on proxy-access. It is hard for the Commission to do meaningful economic analysis, particularly given some of the time frames. This is going to come up in Dodd-Frank. Dodd-Frank has always ridiculous deadlines. Some members of Congress say, , nothing will happen to you if you do not follow the deadlines. Other members say, what are you talking about, it is the law? We passed the statute, that in itself is a remarkable conversation to be having. But the Commission is going to do its best, I am quite sure, to meet as many of these deadlines as it can. Some of these rules are going to be appealed to the Court of Appeals, and some folks are going to want to make the arguments that it had been successful recently, you did not study this, this analysis was not present, or this analysis was irrational. And one of the things that the Commission might be tempted to argue it is, "Look, we did the best we could within the time allotted us. We did not have the opportunity to go out and commission a whole bunch of studies on this and that. Those studies would take a year and half, two years. I have a deadline." To which one could also argue, "Wait a minute, we do not see anything in the statute that repealed any pieces of the Administrative Procedures Act." The Administrative Procedure Act says in essence, among other things, you cannot have rules that are facially irrational, stupid. So, there is nothing in the Dodd-Frank Act that says you have got to get this done in 18 months, even if it is a stupid rule. And all you can do in 18 months is a stupid rule. So, it is going to be phrased, I hope, somewhat more elegantly than that, but the tension between getting things done rapidly within the timeframe that Congress enacted, and getting things done methodically, in a way that the Court of Appeals might like, is going to be a difficult one.

**KURT HOHENSTEIN:** David, it is interesting that the first groups of cases that you talked about, you were discussing the creative of lawyer, and the court's sort of hesitance to accept that the fidelity to the legislation; that sounds very much like Frankfurter's judicial deference. So, these kinds of things sort of come back. And one of the things we left the first discussion with was the success of the New Deal, but obviously in 1972 with the arrival of Justice Powell, things changed, dramatically changed. I think, Adam, you are an expert in that area. Just tell us a little bit about the impact of Justice Powell and how he became such a powerful voice.

**ADAM PRITCHARD:** I talked earlier about the SEC's winning streak in the Supreme Court up until the 1970's. Justice Powell came to the court with a very unusual background, which was that he was a corporate lawyer, had been a corporate lawyer for more than 30 years at the time of his appointment to the Supreme Court. He did not get the job because he was a corporate lawyer, he got the job because he was the president of the American Bar Association and had spoken out against some of the Supreme Court's more adventurous criminal procedure decisions in the Warren Court era, so Richard Nixon liked that and that is how Powell got the job. But once Powell got on the court, there is all this criminal law, constitutional law that his experience and background he knows nothing about, he feels a little uncertain in that area, but he knows securities law. He had been doing registration statements since the 1930's, when the SEC was just going into the business of regulating public offerings. Here was an area where he knew what the answers were, and he had a real interest, and wanted to see the cases get sorted out. One aspect of Powell's influence is that the number of cases goes way up, so it is very hard to get four votes for a petition for certiorari and a securities case in the Supreme Court. From 1933 to 1971, the Supreme Court averaged one per term, it was not high priority. During Powell's time on the court, the court averages in three per term. Powell cares a lot and is pushing the court to take more cases. So, there is more securities law to be made in the Supreme Court. The other aspect of Powell's influence is that he cares a lot, and nobody else does. The attitude that was prevalent during the 1940's and '50's that let Murphy be the leading holding company expert on the Supreme Court is still there in the 1970's and 1980's, the other justices are willing to defer to Justice Powell. Justice Powell comes to this job with the experiences of being a corporate lawyer, and the winning streak for the SEC turns, in part it is a reaction to the things that are going on in the lower courts and particularly in the Second Circuit. One example of the expansion of the securities law in the lower courts would be the Texas Gulf Sulphur, a decision, which is expansive in two kind of revolutionary ways, a very broad parity of information theory of insider trading that was being pushed by the SEC at the time. The second circuit says sign me up, that sounds good, that seems fair. Also, an expansion of securities class actions, rejecting a privity requirement for plaintiffs in a securities class action. You do not have to have purchased or sold the securities to be a defendant. And that expansive view of the law, along with the expansion of Rule 23 of the Federal Rules of Civil Procedure, which really enabled large-scale class actions, meant that corporations were facing a brand new threat in these securities class actions. Powell, with his experience and attitudes thought this was a very dangerous development, and he was in a position to do something about it. So, that is one aspect, is the need to curtail securities class actions. The other aspect of Powell's time on the court was that he strongly favored predictability. Corporate lawyers, clients ask them questions, they like to be able to provide answers. And when corporate lawyers tell the clients, "Well, it is not entirely clear, you could argue it this way", the clients tend to throw things at them and say, "I am paying this much money for you to give me advice like that, that is useless". So, that is an aspect of Powell's approach to the law.

The other thing was, in some aspects, Powell was the return of Felix Frankfurter, in that he was not intimidated by the SEC. He had plenty of experiences as corporate lawyer and his view, the SEC was pushing the boundaries of its authority, coming up with creative theories, I think as David would characterize them and needed to be reined in. And the most notable decisions from this period revolve around 10-b5, both in the class action context, as well as the insider trading context. So Powell's most important opinion in the class action context is Ernst & Ernst which required scienter in a 10b5 clause of action, the SEC was pushing a negligence standard as a operative provision for 10b5. Powell writes the opinion rejecting it. The text of the opinion, if that is all you were going on, you would read and say, "If Powell is closely focused on the text of Section 10b and the opinion is driven by that." If you look at the internal correspondence, the memos that Powell wrote to himself, you get a different picture as a historian. Powell has this delightful practice of dictating memos to himself. He reads the briefs, assesses the arguments and then spends 15 minutes with the Dictaphone, dictating what he thought about the case and the issues presented there, which Sally beautifully typed down and left for historians to find 30 years later. So, we know what he thought. He is very scared of the expansion of the securities class actions. Ernst and Ernst is a response to that. There are other cases from this period as well that Powell doesn't ride like blue chip which requires a purchaser or seller standing. Rehnquist writes a policy oriented menace sort of opinion which Powell doesn't like the tone but generally favors the outcome. The other opinion is Santa Fe. Rule 10b5 requires deception, opinion written by Justice White, but clearly one that Powell lobbied for in conference. So, a relatively narrow construction of Rule 10b5, rejecting the SEC 's position largely in amicus cases and no deference to the agency's interpretation of the statute, particularly in these private causes of action where it did not directly implicate the commission's mission.

The other set of cases are the insider trading cases, this is where insider trading law gets made in the Supreme Court, first with the Chiarella decision. I had an Italian LLM student this semester, she says 'Chiarella' and I am trying to do my best to pronounce it correctly now. Putting a common law framework on insider-trading under Rule 10b5. Putting some constraints around the SEC's ability to create a lot of insider trading out of the statutory provision which on its face does not seem to deal with insider trading, and then following it up with Dirks, creating space for securities analysts to operate, in Powell's view, by putting limits on the scope of the insider trading prohibition. So, those two areas, the class actions, and the insider trading, you can see Powell's influence as considering himself equally expert with the SEC on the topic of securities law, and we get very different results from the Supreme Court. The SEC's winning percentage goes way down during this period. Powell's percentage is excellent. He is in dissent only one time in a securities case in his 15 years on the court.

**DAVID BECKER:** Which one was that? Do you remember?

**ADAM PRITCHARD:** It is a very obscure one, I forgot. It was not of importance.

**DAVID BECKER:** The opinion in that in that period that always intrigued me, which I am sure you are familiar with is the chief justice's dissent. In, forgive me, Chiarella.

**ADAM PRITCHARD:** You are butchering the pronunciation.

**KURT HOHENSTEIN:** A revenge takes a while but...

**DAVID BECKER:** Why such an uncharacteristic opinion for him?

**ADAM PRITCHARD:** So, Powell gives some credence to the notion that there should be an insider trading prohibition, right? He finds the practice personally distasteful as someone who takes ethics quite seriously and when he was a lawyer, he was a leader of the bar. I think that also is what is driving Burger. It is just personally offensive to see people abusing their positions of trust that way. I do not think Burger was as skeptical of the SEC as Powell was. I think Powell had to do some work to get a majority coalition in Chiarella, and was able to do so in part because the Justice Department, in hindsight, had litigated the case incorrectly. They did not indict on the misappropriations theory, so it was not passed on to the jury to decide, and I think that is how Powell gets a majority in Chiarella. He is trying to put as much structure on insider trading law as he can while maintaining that majority coalition. Because there are certainly justices like Stevens who are open to the idea of the misappropriations theory that Powell is suspicious of. The misappropriation theory gets squarely presented in the Carpenter case, but Powell is retired and he would have voted no, but the misappropriation theory, they split four to four on that in Carpenter. And so, it survives for another 10 years before the Supreme Court finally gets around to deciding it in O'Hagan.

**KURT HOHENSTEIN:** I'm curious about what goes on inside of the General Counsel's Office when we are getting nothing like this. You see Powell come on, you have had this sort of unparalleled winning streak, and you start to see you are losing cases. I mean do you decide to do what they did in the PUHCA case, delay, delay? Keep cases from the court, or you file amicus briefs in some cases? Do you pull back? Can you talk about that at all that experience?

**DAVID BECKER:** PUHCA is a little bit different, in that it is occasioned by Commission action. But in the enforcement context you need to go forward, it is a little bit more compelling. And you do not know how a case is going to shake out in terms of what the issues are, will be after trial and on appeal. I think litigators everywhere do not want to lose. There are a broad variety of cases that you just have to take. But, you try to be strategic. Before O'Hagan went up, O'Hagan was not the first case in which the Court of Appeals rejected the misappropriations theory or accepted it, I don't remember which way O'Hagan came up first.

**KURT HOHENSTEIN:** Bryant.

**DAVID BECKER:** And in that case, also fairly compelling facts, as I recall, the Commission said, "We are not going to take it up." The decision was, "We want better facts, the issues more clearly drawn." I have to say that, because the Commission is an agency headed by people who are appointed by the President and confirmed by the Senate, which is to say, people with one leg in the political process, there can sometimes be a shorter term view. We will take this action, even though there is a risk that it will not work out in the Court of Appeals because, first of all, I will not be here, and second of all, it is very important to send the following message to the public. So, the General Counsel's Office may be viewed sometimes as a little conservative as far as that is concerned. But now, I think litigators, including appellate litigators, do not want to lose. They hate losing, and they will do what they can to win.

**KURT HOHENSTEIN:** Obviously Justice Powell does not stay on the court. It seems like we are killing off a hundred justices today that four horsemen and the New Deal that Justice Powell has gone after 1987. Since 1987, is there any distinct philosophy in securities and financial regulation cases that you can point to, and then we will move into maybe a little bit of prediction here in the last 15 minutes or so of this program? Any distinct philosophy that the court has espoused, or trends, anything that you can talk about since Powell has left the bench?

**DAVID BECKER:** Let me try. We do not like private securities' actions. We are not principally interested in making it difficult for the SEC to enforce the securities laws, but we think private securities' actions are highly abusive, and, from the doctrinal standpoint, since we created them, we can treat them almost the same way. We can tinker with them. We have greater freedom to proceed not so much from the usual sources of statutory construction, but from what we proceed to be, sound policy. I don't know whether you agree with that.

**ADAM PRITCHARD:** No, I think that is definitely part of what is going on is trying to curtail private class actions without unduly constricting SEC enforcement actions. And I think that jumps out at you from the Stoneridge case. Because the question is, how far scheme liability should extend, and there is a long policy-oriented discussion from Kennedy about how the securities law should not intrude into these other areas of business. You read that discussion, and you might have thought the conclusion that the end of those paragraphs might be, "And therefore this conduct is not in connection with the purchase or sale of securities, right, that is where it would naturally fit, it seems to me in terms of the elements of Rule 10b5. But the SEC is bound by the limits of in connection with the purchase or sale of securities. So, that is not where Kennedy puts this reasoning. He says, "This is part of the reliance requirement.", And the reliance requirement in the post- Powell era is perfectly elastic, and perfectly elastic in part because the SEC and the Justice Department are not limited by it. So in Basic versus Levinson, first case post- Powell era, Justice Blackman adopts a very aggressive, expansive interpretation of 10b5 in adopting the fraud on the market presumption of class action. And then in Stoneridge, Kennedy's concerned about excessive liability for third party defendants, he says this is beyond the reliance requirement, which draws a dissent from Justice Stevens, which says, well, Basic set out a very broad reliance requirement, and Kennedy is indifferent to that. Because I think he feels a lot of latitude in the area where they are defining the contours of the private class action. Stoneridge also says, "This is basically a mistake. We should not have done this. We should not have adopted a private right of action under Section 10b under our jurisprudence for private rights of action. Generally, we would not do that today, but we are stuck with it. Congress seems to have validated it to some extent by not rejecting it in the Private Securities Litigation Reform Act, so we're going to interpret it as it is, but we're not going to expand it."

**DAVID BECKER:** And the remarkable thing is how explicit the court is on that. I think a similar example of that is the Matrix case, in which I think that was harder for the court to deal with. You could see some of the members of the court chatting among themselves, or sending them e-mails saying, "Look, if all you have is one or two, or three or four reports of somebody having an adverse reaction, my God, you can sue anybody under those circumstances. Can't you do anything about that?" And I do not think they came up with anything that would be limited to private rights of action. And so because it was

the materiality requirement that was at the core of 10b-5 for everyone, and I maybe just seeing shadows here is that, we reading that opinion it almost seems like the court was saying, “Well, it would be reasonable for an investor to think there might be a causal relationship between this product and this reaction based on this information.” It is not clear to me whether the court was trying to leave open the circumstance in which it was almost like this was a product liability case. The court was trying to leave open or foreclose the circumstance where it would not be reasonable, but that is what people would do anyway. That is to say certain information gets out in the market, and the market gets frightened. Was the court trying to leave open the circumstance in which reasonable investors behave unreasonably, as they have been known to do? We will see.

**ADAM PRITCHARD:** I think in materiality determinations, the lower courts want to preserve space for a judicial assessment of materiality. Because if you were serious about the materiality standard, you would look for stock price reactions, right? This is what investors do because they responded to the change in the stock or not. But the courts want to preserve a role to say, “Well, there was a stock price reaction, and yet it is not material, or there is not a stock price reaction, and yet we are still going to say that it is material.” In the other case, I think, that implicates the scope of private causes of action, most notably, is National Australia, how broadly the securities laws are going to reach. We get a very strident opinion from Justice Scalia on this topic, but I do not think it is because he cares all that much about the securities law. I think he cares very much about the presumption against extraterritorial application of U.S. law, and this just happened to be the area that he could write a lecture for lower courts on how to approach the question of extraterritorial application. So, the Second Circuit, very broad, open-ended standard, according to Scalia, gets –rebuffed in this area, he locates a new standard in the text, it has got to be revolving around the purchase or sale. Scalia originally describes the test that he is creating in a way that would contradict the holding of the case because in the National Australia case, the securities were listed in the United States as ADRs, and yet the court is saying it is not actionable for you to sue if you bought those securities on the Australia stock exchange instead. So, there is not a fine-grained understanding of how the securities markets work, but there is a very definite view on extraterritoriality.

**KURT HOHENSTEIN:** It sounds to me like what you are both describing is a period of time where there is not a Powell, there may not even be a Murphy, and if lawyers want to win cases, they are going to have a real hard time predicting what this court might do. Looking into the future, what kinds of issues is a court likely to face? Can we learn from history about how this court might react to the kinds of cases that it might face in reference to securities and financial regulation, over the next few years? And you are not bound by this, obviously.

**ADAM PRITCHARD:** I think there are two sets of responses. The modal response is we are going to defer to the SEC. If they persuaded the Solicitor General that this is a defensible position, and allow it to be argued in the Supreme Court, they will generally defer to the SEC. And the exceptions are going to be where the justices have gotten hold of an issue that animates them, so National Australia, a presumption against extraterritoriality. In Stoneridge, Kennedy who wrote Central Bank 15 years before, sees Stoneridge as an end run around the restrictions that he had put around aiding and abetting in Central Bank, and he was not going to allow it to be eroded in that way. But it

is hard to predict when there is going to be an issue that will grab a particular justice, and the other justices will defer to that justice who is animated about it. Powell was animated about securities law generally because he liked it and was interested in it. I do not think that is true for the current members of the court.

**DAVID BECKER:** I think the other side of the Central Bank coin, which I would regard as understandable, but nonetheless incoherent is the progeny of the cases in which the question as to who is a primary violator and who is a secondary violator, have worked themselves through the Court of Appeals in ways which are still understandable, but also often in conflict. And I do think that one of those conflicts may be presented before the Supreme Court, and certainly will be within the next couple of years. And how they will resolve it, I would not venture a guess.

**KURT HOHENSTEIN:** This brings us to the conclusion of today's program. I appreciate David and Adam for their insights on the courts and the SEC. This has been a great entre into the hidden but extraordinarily important aspect of securities' legal history. Today's broadcast is now permanently preserved in the collection of the virtual museum and archive at [www.sechistorical.org](http://www.sechistorical.org). We get paid for saying that, I think, don't we? I encourage you to access it and the thousands of other primary resources at any time. An edited version of this transcript will be added later this summer, and I invite you to visit the Gallery on the Supreme Court and the SEC opening in the museum on December 1<sup>st</sup>. Thank you to all of you for being with us today, and good afternoon.