THE DODD-FRANK ACT AND GOVERNMENT OVERREACH:

HOW EXPANDED SEC AUTHORITY AFFECTS THE INVESTING PUBLIC AND HOW TO BETTER REGULATE THE FINANCIAL INDUSTRY

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CONTENTS

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INTRODUCTION

Charles L. Hill, Jr. is a self-employed real estate developer in Atlanta accused of insider trading by the Securities and Exchange Commission (SEC).[1] He purchased shares of Radiant Systems stock based on information from a friend, a self-employed artist, who first heard of the information from a childhood friend then employed at the company.[2] Because Mr. Hill purchased shares based off that friend's recommendation, which included information that was material and non-public, the SEC filed suit seeking civil penalties against him for insider trading in its administrative court.[3]

Mr. Hill is neither registered with the SEC individually nor affiliated with a registered entity.[4] However, expanded SEC authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") subjects Mr. Hill to the same SEC authority and administrative proceedings as if he *were* a registered individual or associated with a registered entity.[5] Thus, though Mr. Hill never voluntarily subjected himself to SEC authority by means of registering individually or working for a registered entity, Mr. Hill must face administrative proceedings in which he is subjected to significant disadvantages he otherwise would not be in federal court.[6] His case was

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1. Matthew Heller, *Real Estate Developer Accused of Insider Trading*, CFO (Feb. 13, 2015), http://ww2.cfo.com/regulation/2015/02/friend-coo-accused-insider-trading/.

2. *Id.*

3. Rebecca L. Dandy, *SEC Administrative Proceedings Under Constitutional Scrutiny*, SEC. LITIG. & GOV'T ENFORCEMENT TRENDS (Vetter Price, Chi., Ill.), Aug. 2015, at 6, 6, http://www.vedderprice.com/sec-administrative-proceedings-under-constitutional-scrutiny/ (follow "Download Attachment" hyperlink); Heller, *supra* note 1.

4. Heller, *supra* note 1. Mr. Hill is a self-employed real estate developer. *Id.*

5. Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, Pub. L. No. 111-203, sec. 929P(a)(1), § 8A(g)(1), 124 Stat. 1376, 1862 (2010) (codified as amended at 15 U.S.C. § 77h-1(g)(1) (2012)).

6. *See* Dandy, *supra* note 3, at 6. SEC administrative proceedings are widely criticized for their "home court" advantages that pose disadvantages to defendants. *Id.* They include "accelerated hearing schedules, the inapplicability of the Federal Rules of Civil Procedure and the Federal Rules of Evidence, limited pre-hearing discovery and the elimination of a jury trial." *Id.*

recently vacated after United States District Judge Leigh Martin May issued a preliminary injunction halting the administrative proceedings on a separate constitutionality issue.[7]

Though Mr. Hill is not, by any means, struggling financially—he did invest in several hundred thousand shares—his case exemplifies how far-reaching SEC authority has become under the Dodd-Frank Act. Any person equally uninvolved in the stock market, aside from shares purchased, can be subjected to SEC administrative proceedings under its current authority, rich or poor.[8] Someone with means equal to Mr. Hill may not suffer much, but there are many others with money in the stock market against whom an imposition of fines could greatly affect their financial stability. Indeed, over a fifth of adults in the United States making less than $30,000 a year have money invested in the stock market.[9] This completely contradicts the Dodd-Frank Act's intent to promote consumer financial protection and only creates an increased potential for serious harm against individuals with the least amounts of money. Further, it is wholly unfair to subject such a broad range of individuals to the one-sided environment of administrative proceedings rather than seek civil penalties in federal court, where they are afforded more rights.[10]

For background as to why and how Congress granted the SEC such broad authority, Part I of this Note will provide a historical overview of several landmark pieces of legislation affecting SEC power and authority in regulating the financial and securities industry. The acts will show a general pattern of Congress responding to a major problem in the financial industry by passing sweeping after-the-fact legislation.[11] The

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7. Hill v. SEC, 114 F. Supp. 3d 1297, 1320–21 (N.D. Ga. 2015), *vacated*, 825 F.3d 1236, 1252 (11th Cir. 2016). The preliminary junction was issued on a separate constitutionality claim regarding the SEC's in-house judge appointment process. *Id.* at 1319.

8. *See infra* notes 40–47 and accompanying text. The Dodd-Frank Act no longer limits SEC authority to impose civil penalties in administrative proceedings only to persons registered with the SEC or affiliated with a registered entity. Dodd-Frank Act sec. 929P(a)(1), § 8A(g)(1).

9. Justin McCarthy, *Little Change in Percentage of Americans Who Own Stocks*, GALLUP (Apr. 22, 2015), http://www.gallup.com/poll/182816/little-change-percentage-americans-invested-market.aspx.

10. Dandy, *supra* note 3, at 6. In federal court, Federal Rules of Civil Procedure and Federal Rules of Evidence apply. *Id.* Defendants also have the right to a trial by jury. *Id.*

11. *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *see also* Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)). With 27,669 more rules, the Dodd-Frank Act adds more than five times as many rules as any other law and more than the total number of new regulations passed in Obama's time served as President. *How Dodd-Frank Ate the U.S. Economic Recovery*, INV.'S BUS. DAILY (July 28, 2015), http://www.investors.com/politics/editorials/doddfrank-bank-

acts will also share common goals of better protecting and informing consumers, addressing fraud, and preventing what caused the problems in the first place.[12] Finally, each act will gradually expand SEC authority, and, aside from the Dodd-Frank Act, provide other safeguards to balance out its expansion.[13]

Next, Part II will discuss the SEC's current authority over all persons under the Dodd-Frank Act and the disadvantages defendants face in SEC administrative proceedings as compared to a suit filed in federal court. It will first argue how each disadvantage would most significantly affect individuals of lesser means, especially non-registered persons, because it is less likely they are familiar with SEC rules and regulations. It will also apply a balancing test the Supreme Court uses in considering whether an administrative agency's procedure is too restrictive of due process. It will further explain why this expansion is unnecessary, because it does not change SEC authority over registered individuals and only opens up all other persons to greater liability. Then, Part II will discuss whether a repeal of the Dodd-Frank Act's provisions providing for the SEC's current authority is a proper solution.

Finally, Part III will address the problems with overregulation and implementation of sweeping reforms. It will also offer alternative approaches for addressing future problems in the financial industry by offering suggestions for both the federal government and private sector to consider in creating future policies.

I. History of SEC Enforcement Authority

Legislative acts granting the SEC power, from its creation in the Securities Exchange Act of 1934 to its broad expansion of authority as part of the largest financial overhaul in American history through the Dodd-Frank Act, were drafted with the general purpose of protecting the investing public from the corrupt and powerful banks and bankers on Wall Street.[14] Common among these acts is that they are all responsive in nature.[15] Indeed, the Securities Act of 1933 and Securities Exchange Act of 1934 responded to the market crash of 1929; the Securities Enforcement Remedies and Penny Stock Act of 1990 responded to the

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regulation-killed-economic-growth-after-2010/.

12. *See The Laws That Govern the Securities Industry*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/about/laws.shtml#df2010 (last modified Oct. 1, 2013).

13. *Id.*

14. *How Dodd-Frank Ate the U.S. Economic Recovery*, *supra* note 11; *The Laws That Govern the Securities Industry*, *supra* note 12.

15. *The Laws That Govern the Securities Industry*, *supra* note 12.

abuse of penny stock sales in the 1980s; the Dodd-Frank Wall Street Reform and Consumer Protection Act responded to the financial crash causing the Great Recession of 2008.[16]

Also common is expansion of the SEC's enforcement authority. Since the SEC's creation, financial regulations have greatly expanded its authority to a point where the SEC is now allowed to seek civil penalties in administrative proceedings against "any person," including individuals not registered under the SEC or associated with registered entities.[17]

Prior to the passage of the Dodd-Frank Act, there appeared to be a balance of concern for granting too much power to the SEC while still providing for more effective enforcement.[18] This is initially evidenced in the Securities Enforcement and Penny Stock Act of 1990, in which Congress first granted the SEC authority to seek civil penalties in administrative proceedings, but limited it only to "registered" persons out of this concern.[19]

Now, however, under the Dodd-Frank Act, the SEC's authority is so broad as to be potentially dangerous to the investing public rather than achieve Congress's general goal of protecting it. Allowing *any* individual to fall subject to an SEC proceeding risks serious financial loss and limitations on due process rights, rendering investing even a small amount of money too risky for those who literally cannot afford to lose.

A. Securities Act of 1933 and Securities Exchange Act of 1934

After the Great Depression of 1929, the need for federal securities

16. Andrew Beattie, *The SEC: A Brief History of Regulation*, INVESTOPEDIA, http://www.investopedia.com/articles/07/secbeginning.asp (last visited Dec. 26, 2016); *Dodd-Frank Wall Street Reform and Consumer Protection Act*, INVESTOPEDIA, http://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp (last visited Dec. 26, 2016); *Penny Stock Reform Act*, INVESTOPEDIA, http://www.investopedia.com/terms/p/penny-stock-reform-act.asp (last visited Dec. 26, 2016); *Securities Act of 1933*, INVESTOPEDIA, http://www.investopedia.com/terms/s/securitiesact1933.asp (last visited Dec. 26, 2016).

17. Dodd-Frank Act, Pub. L. No. 111-203, sec. 929P(a)(1), § 8A(g)(1), 124 Stat. 1376, 1862 (2010) (codified as amended at 15 U.S.C. § 77h-1(g)(1) (2012)); Gary S. Lincenberg & Jean Y. Rhee, Dodd-Frank's Impact on Securities Law Enforcement At-a-Glance 9−10 (2011) (paper presented at the Town Hall Meeting at the 2011 Fourth Annual Fall Institute), http://www.americanbar.org/content/dam/aba/events/criminal_justice/Fall2012/WCC_Town Hall_Dodd_Frank_Impact_on_Securities_Law_Enforcement.doc.

18. Mark K. Schonfeld et al., *The Expansion of SEC Enforcement Under the Dodd-Frank Act*, 27 REV. BANKING & FIN. SERVICES 21, 26 (2011), http://www.gibsondunn.com/publications/Documents/ExpansionofSECEnforcement0311.pdf. *See generally* Penny Stock Reform (Penny Stock Reform) Act of 1990, Pub. L. No. 101-429, sec. 202(a), § 21B, 104 Stat. 931, 937 (codified as amended at 15 U.S.C. § 78u-2) (granting expanded enforcement power to SEC).

19. Schonfeld et al., *supra* note 18, at 26.

rules and regulations became obvious and the Securities Act of 1933 and Securities Exchange Act of 1934 were enacted.[20] The Securities Act of 1933 aimed to achieve greater transparency in financial statements and established general laws against misrepresentation and fraud in securities markets.[21] Also known as the "truth in securities" law, it intended to serve as the stronger federal version of already in-place state securities laws, known as "Blue Sky Laws," which aimed to protect investors from fraud.[22]

The Securities Exchange Act of 1934 first established the Securities and Exchange Commission.[23] It was created to address the lack of enforcement in state Blue Sky Laws and federal securities laws.[24] The act granted the SEC authority over all aspects of the securities industry, including "the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (SROs)."[25] It also lists prohibited conduct and grants the SEC disciplinary powers over regulated entities and persons associated with it.[26] Most importantly, the act first granted the SEC authority to seek civil penalties against regulated entities and individuals, but it had to do so in federal court.[27]

B. Securities Enforcement Remedies and Penny Stock Act of 1990

The next expansion of SEC enforcement power was passed in response to "the growing incidence of penny stock fraud in the 1980s."[28] At the time, advancements in technology led to high-pressure "boiler room" environments on Wall Street in which brokers reached out to and convinced uninformed investors to invest in penny stock.[29] The investors would do so based on a broker's false or highly exaggerated information, and brokers and institutions would subsequently make millions in commissions by selling the stocks while their values were temporarily

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20. Beattie, *supra* note 16; *Securities Act of 1933*, *supra* note 16.

21. *Securities Act of 1933*, *supra* note 16.

22. Beattie, *supra* note 16; *The Laws That Govern the Securities Industry*, *supra* note 12.

23. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 4(a), 48 Stat. 881, 885 (codified as amended at 15 U.S.C. § 78d); *The Laws That Govern the Securities Industry*, *supra* note 12.

24. Beattie, *supra* note 16.

25. *The Laws That Govern the Securities Industry*, *supra* note 12.

26. *Id.*

27. Beattie, *supra* note 16; Schonfeld et al., *supra* note 18, at 26.

28. *Penny Stock Reform Act*, *supra* note 16. *See generally* Penny Stock Reform Act of 1990, Pub. L. No. 101-429, sec. 504, § 15(b)(6), 104 Stat. 931, 952 (codified as amended at 15 U.S.C. § 780(b)(6)) (granting power to SEC to regulate penny stock).

29. *Penny Stock Reform Act*, *supra* note 16.

much higher.[30] These techniques were known as "pumping and dumping" or "churning" stocks.[31] After the companies profited, investors ultimately suffered considerable losses when the brokers no longer pushed for a penny stock's sale and the stock's value fell.[32]

In response to these problems, Congress passed the Securities Enforcement Remedies and Penny Stock Act of 1990 ("Penny Stock Reform Act").[33] To prevent fraud, it required penny stock brokers and dealers to disclose information about specific stocks offered and the penny stock market in general to customers before purchase.[34] It also granted the SEC authority over penny stock issuers, brokers, and dealers.[35] Further, this act first granted the SEC authority to seek civil penalties in administrative actions, whereas previously the SEC had to file separately in federal court.[36]

However, concerned the authority to impose quasi-criminal civil remedies against any person was overreaching, Congress limited such authority only to registered persons and persons associated with registered entities.[37] Therefore, even after the Penny Stock Reform Act's passage, the SEC was still required to file separately in federal court against all other persons in order to seek or impose civil monetary penalties.[38]

Unlike most federal securities acts, this is a rare example in which Congress addressed a narrow, targeted issue—a specific type of

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30. *Id.*

31. David Dayen, *The Money is Gone: A Look at the Pump-And-Dump in Penny Stocks*, HUFFINGTON POST (Sept. 28, 2016, 2:31 PM), http://www.huffingtonpost.com/entry/the-money-is-gone-a-look-at-the-pump-and-dump-in-penny-stocks_us_57ec039be4b0c2407cdb 2f47. "Pump and dump" scams involve investors promoting a stock they hold and selling it soon after, profiting off of the short-term surge in interest. *How Does a Pump and Dump Scam Work?*, INVESTOPEDIA, http://www.investopedia.com/ask/answers/05/061205.asp (last visited Dec. 26, 2016). "Churning" occurs when brokers excessively trade a stock for the purpose of generating commissions. *Churning*, INVESTOPEDIA, http://www.investopedia.com/terms/c/churning.asp (last visited Dec. 26, 2016).

32. *How Does a Pump and Dump Scam Work?*, *supra* note 31.

33. *Penny Stock Reform Act*, *supra* note 16.

34. Penny Stock Reform Act of 1990, Pub. L. No. 101-429, sec. 505, § 15(g)(3)(A), 104 Stat. 931, 953–54 (codified as amended at 15 U.S.C. § 78o(h)(3)(A) (2012)); *Penny Stock Reform Act*, *supra* note 16.

35. *Penny Stock Reform Act*, *supra* note 16.

36. Ryan Jones, *The Fight Over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 65 SMU L. REV. 507, 512 (2015). Prior to this, the Securities Exchange Act of 1934 granted the SEC authority to seek civil penalties by filing suit in federal court. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 21(e), 48 Stat. 881, 900 (amended 1990).

37. Schonfeld et al., *supra* note 18, at 26.

38. *Id.*

fraudulent conduct involving a specific type of stock, penny stock—and provided a narrow, targeted act responding to such.[39]

C. Dodd-Frank Wall Street Reform and Consumer Protection Act

Most recently, in response to the Great Recession of 2008, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[40] The act created 27,669 new regulations—five times more than any other law, and more than the total regulations previously passed in Obama's presidency.[41] It attempted "to reshape the U.S. regulatory system in a number of areas including . . . consumer protection, trade restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency."[42] Overall, the Dodd-Frank Act's goal was to protect consumers and satisfy the political climate's demand for taking down the corrupt banks and brokers on Wall Street that caused the 2008 recession.[43]

The Dodd-Frank Act also greatly expanded the SEC's enforcement authority by allowing it to seek and enforce civil penalties in administrative proceedings against *all* persons rather than just registered persons and entities.[44] Prior to the Dodd-Frank Act's passage, as discussed earlier, Congress's concern over granting the SEC too much authoritative power limited the expansion of its ability to use administrative proceedings for civil penalties only to registered persons and persons associated with registered entities.[45] In contrast, the "Dodd-Frank [Act] washes away this distinction" in allowing the SEC to enforce civil penalties in administrative proceedings against "any person," meaning it has authority to seek civil penalties in administrative proceedings over any individual.[46] As this Note will argue, this expansive

39. The Penny Stock Reform Act is only 21 pages in the *Statutes at Large*, compared to the Securities Exchange Act of 1934 (371 pages in the *Statutes at Large*) and the Dodd-Frank Act (974 pages in the *Statutes at Large*). *See generally* Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931; Securities and Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881; Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 and 15 U.S.C.).

40. *See generally* Dodd-Frank Act sec. 929P, §§ 8A, 21B(a), 9(d)(1), 203(i)(1), 22, 27, 214, 20(a) (granting enforcement powers to SEC).

41. *How Dodd-Frank Ate The U.S. Economic Recovery*, *supra* note 11.

42. *The Laws That Govern the Securities Industry*, *supra* note 12.

43. *How Dodd-Frank Ate The U.S. Economic Recovery*, *supra* note 11.

44. Dodd-Frank Act sec. 929P(a)(1), § 8A(g)(1).

45. Schonfeld et al., *supra* note 18, at 26. *See generally* Penny Stock Reform Act of 1990, Pub. L. No. 101-429, sec. 202(a), § 21B, 104 Stat. 931, 937 (codified as amended at 15 U.S.C. § 78u-2 (2012)) (granting civil remedies over registered entities).

46. Schonfeld et al., *supra* note 18, at 21, 26.

language effectively subjects a majority of Americans to SEC authority, regardless of their involvement in the securities industry or whether they volunteered to be subject to such authority.[47] Consequently, it also subjects consumers to greater liability and an increased risk of facing serious fines because of the many disadvantages these defendants face in administrative proceedings as opposed to federal court.

II. SEC AUTHORITY UNDER THE DODD-FRANK ACT IS OVERREACHING AND SUBJECTS INVESTORS TO GREATER RISK AND LIKELIHOOD OF FINANCIAL HARM

A. Subjecting "Any Person" to Civil Penalty Enforcement in Administrative Proceedings Is Overreaching

SEC authority to enforce civil penalties in administrative proceedings against "any person" under the Dodd-Frank Act is overreaching because its authority is as broad as it has ever been while lacking provisions balancing the expanded authority, as was the case in past acts.[48] The majority of Americans as a whole, from every socioeconomic class, have some form of involvement in the stock market and thus can be subject to SEC administrative proceedings under its authority according to the Dodd-Frank Act.[49] To be precise, as of April 2015, 55% of Americans reported having money invested in the stock market either through an individual stock, mutual fund, self-directed 401(k), or IRA.[50] Broken down by income, 88% of those surveyed reported making at least $75,000, 56% reported making $30,000 to $74,999, and 21% reported making less than $30,000 annually.[51] Further, this report surveyed American adults as a whole—it was not limited to those with knowledge or work experience in the financial and/or securities industries.[52]

Though there is a general history of financial regulations expanding

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47. McCarthy, *supra* note 9 (stating that a majority of Americans own stock); Schonfeld et al., *supra* note 18, at 26.

48. Dodd-Frank Act sec. 929P(a)(1), § 8A(g)(1). The Securities Exchange Act of 1934, Pub. L. No. 73-291, § 21(e), 48 Stat. 881, 900 (amended 1990) required filing separately in federal court for civil penalties, the Penny Stock Reform Act limited SEC authority to seek civil penalties in administrative proceedings to registered persons and persons associated with registered entities. *See generally* Penny Stock Reform Act of 1990 sec. 202(a), § 21B (limiting SEC authority to seek civil penalties in administrative proceedings to registered persons and persons associated with registered entities).

49. McCarthy, *supra* note 9; Schonfeld et al., *supra* note 18, at 26.

50. McCarthy, *supra* note 9.

51. *Id.*

52. *Id.*

SEC authority, past acts were not as egregiously overreaching because they provided a check to balance out the broader authority. For example, the Securities Exchange Act of 1934 first granted the SEC authority over "any person," but the SEC's authority over said persons was balanced by the requirement that the cease-and-desist orders and penalties be bifurcated—that is, in order to enforce civil penalties against non-registered persons, the SEC had to file separately in civil court.[53] Congress also looked for balance when passing the Penny Stock Reform Act.[54] Moreover, both acts also required a scienter requirement in theories of secondary liability.[55]

Unlike the aforementioned and other past acts, there are no provisions balancing SEC authority in the Dodd-Frank Act.[56] In fact, they do quite the opposite—coupled with expanding its authority to "any person," the Dodd-Frank Act makes it easier for the SEC to win its cases by lessening the requisite standard of knowledge for secondary liability from "knowingly" to "recklessly."[57] Though this most definitely promotes efficiency in SEC proceedings, unchecked sweeping authority to hail anyone into the SEC's administrative tribunal does not provide "the strongest consumer financial protections in history."[58] Rather, it puts any American invested in the stock market at greater risk of severe monetary penalties because of the many disadvantages they face when subject to the "home-court advantage" of SEC administrative proceedings as opposed to federal court.

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53. Securities Exchange Act of 1934 § 32; Schonfeld et al., *supra* note 18, at 26.

54. Penny Stock Reform Act of 1990, Pub. L. No. 101-429, sec. 202(a), § 21B, 104 Stat. 931, 937 (codified as amended at 15 U.S.C. § 78u-2 (2012)).

55. *See generally* Penny Stock Reform Act of 1990 sec. 202(a), § 21B(a)(2) (imposing liability on individuals who "willfully" aid and abet another in violating the Act); Securities Exchange Act of 1934 § 9(e) (imposing penalties on those who "willfully" violate the Act).

56. *Compare* Penny Stock Reform Act of 1990 sec. 202(a), § 21B(a)(2) (imposing liability on individuals who "willfully" aid and abet another in violating the Act), *and* Securities Exchange Act of 1934 § 9(e) (imposing penalties on those who "willfully" violate the Act), *with* Dodd-Frank Act, Pub. L. No. 111-203, sec. 929P(a)(1), § 8A(g)(1), 124 Stat. 1376, 1862 (2010) (codified as amended at 15 U.S.C. § 77h-1(g)(1)). Indeed, there is no provision within the Dodd-Frank Act otherwise limiting SEC authority. *See generally* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (containing no provisions limiting SEC authority to impose liability on individuals).

57. Schonfeld et al., *supra* note 18, at 27. Because "any person" other than registered or affiliated persons are not directly involved in securities, the SEC will pursue cases under a theory of secondary liability, specifically that defendant "aided and abetted" a publicly traded company in violation of the law. *Id.* at 26–27.

58. Matt Taibbi, *How Wall Street Killed Financial Reform*, ROLLING STONE (May 10, 2012), http://www.rollingstone.com/politics/news/how-wall-street-killed-financial-reform-20120510.

B. The SEC's Administrative Proceedings Versus Federal Court: How "Home-Court Advantage" Disadvantages Defendants and Who It Affects the Most

Another reason why SEC authority under the Dodd-Frank Act is overreaching, and particularly most dangerous to non-registered defendants of lesser means, is because of its due process limitations in administrative proceedings. An SEC administrative proceeding is criticized as a "home-court advantage" for the SEC because it poses several significant disadvantages to defendants as opposed to federal court.[59] With the SEC's current authority under the Dodd-Frank Act, any person is now subject to these disadvantages rather than the better protections offered in federal court, and the forum in which they must appear is chosen by sole discretion of the SEC.[60] These disadvantages make it less likely that defendants will succeed, and therefore are the most significant threat to non-registered persons, particularly those of lesser socioeconomic classes, because of the increased likelihood of imposition of fines.

First, unlike federal court, administrative proceedings are subject to accelerated hearing schedules and a strict time limit. "Initial decisions in SEC administrative proceedings must be completed no later than 300 days from the date of service of the Commission's order instituting proceedings."[61] The need for adherence to a strict schedule is disadvantageous to a defendant because it provides for less time to put together an appropriate defense and makes it more difficult to account for responsibilities outside of trial.

An accelerated schedule would be especially detrimental to a non-registered person because, generally, he or she lacks the experience and knowledge about the SEC's proceedings and rules a registered person or persons associated with a registered entity would have. This lack of knowledge would only make it more difficult to prepare a defense within a time restriction, especially if a defendant represents himself pro se. Considering Americans making as little as under $30,000 annually could fall subject to such proceedings, it is also unlikely many defendants can afford corporate attorneys with expertise in SEC administrative proceedings.[62] Further, if a defendant is of limited financial means, the strict scheduling rules can pose an additional financial burden since he or

59. Dandy, *supra* note 3, at 6.

60. *Id.* at 9. *See generally* Dodd-Frank Act sec. 929P(b)(1), § 22(c) (granting jurisdiction over actions brought by the SEC to the United States District Courts).

61. Lincenberg & Rhee, *supra* note 17, at 9–10.

62. McCarthy, *supra* note 9.

she would have to miss work to attend court.

Second, SEC administrative proceedings offer limited discovery.[63] Whereas federal court must abide by the Federal Rules of Civil Procedure and Federal Rules of Evidence, administrative proceedings do not.[64] This restricts a defendant's due process by limiting his or her right to a fair trial, because limited discovery provides for less time to gather evidence and prepare a defense against the SEC's claims. This is especially detrimental to non-registered persons for the same reason an accelerated schedule is—they would benefit the most from more time to prepare and more leniency in discovery as they would have in federal court, because it is more likely they are unfamiliar with SEC proceedings and rules.

Third, unlike federal court, SEC administrative proceedings provide for no right to a jury trial.[65] Instead, the SEC's administrative judges, in-house judges appointed by the SEC itself, decide cases.[66] The record reflects a clear trend of home court advantage—"[a]n analysis by the *Wall Street Journal* found that, in the last five years, the SEC has prevailed in 90% of the cases in which it brought claims in its own administrative courts, but only in 69% of the cases when a federal court judge heard the claims."[67] In fact, the constitutionality of the SEC's judicial appointment process is currently being challenged in several high-profile cases.[68]

Though it is commonplace for administrative judges to make decisions for their respective agency's tribunals, the SEC is the only agency with the ability to deny defendants, who it does not normally regulate, the constitutional right to a jury of their peers.[69] Considering in-house judges are more likely to rule in favor of the SEC, this restriction on due process is especially detrimental to defendants' likelihood of succeeding in administrative proceedings, and it is unfair to deny those

63. Dandy, *supra* note 3, at 6; Lincenberg & Rhee, *supra* note 17, at 10.

64. Lincenberg & Rhee, *supra* note 17, at 10.

65. *Id.*

66. Peter J. Henning, *S.E.C. Finds Itself in a Constitutional Conundrum*, N.Y. TIMES (June 15, 2015), http://www.nytimes.com/2015/06/16/business/dealbook/sec-finds-itself-in-a-constitutional-conundrum.html?_r=1.

67. Christopher Elliott & David B. Gordon, *Is the SEC's Home Court Advantage Coming to an End?* (Mitchell Silberberg & Knupp, L.A., Cal.), Aug. 2015, at 1, 1 (citing Jean Eaglesham, *SEC Wins With In-House Judges*, WALL STREET J. (May 6, 2015, 10:30 PM), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803), http://www.msk.com/pp/alert-2433.pdf.

68. *See* Tilton v. SEC, No. 15-CV-2472 (RA), 2015 U.S. Dist. LEXIS 85015, at *1, *3 (S.D.N.Y. June 30, 2015), *aff'd*, 824 F.3d 276 (2d Cir.), *stay denied*, 137 S. Ct. 29 (2016) (mem.); *see also* Hill v. SEC, 114 F. Supp. 3d 1297, 1301 (N.D. Ga. 2015), *vacated*, 825 F.3d 1236, 1252 (11th Cir. 2016).

69. *See* Elliott & Gordon, *supra* note 67, at 1.

not normally regulated of a constitutionally protected right.

Fourth, an administrative judge's decision is upheld on appeal unless a defendant can prove a lack of substantial evidence supports the administrative judge's findings of fact at the trial level, making winning on appeal unlikely.[70] This disadvantage also affects individuals with lesser means most significantly because it requires more time and money spent on appeal, which also means more spent on attorneys' fees. In fact, the costs of appeal with an unlikely chance of reversal may deter such individuals from appealing purely for the sake of saving money.

On top of these disadvantages, the Dodd-Frank Act makes it easier for the SEC to prove its case by eliminating the scienter requirement for theories of secondary liability.[71] This especially affects non-registered persons because those who are unaware of the rules are more likely to unintentionally violate them. It also increases maximum penalties the SEC can impose by fifty percent.[72] Consequently, defendants are subject to even heavier fines. Obviously this would affect defendants of lesser means the most, for heavy fines would be most detrimental to them.

All in all, combined with the Dodd-Frank Act's elimination of scienter in secondary liability and increased maximum penalties, its expansion of SEC authority over any person it so chooses to haul defendants, including those it does not normally regulate, into a tribunal with minimal rights and an even lesser chance of success is egregious and unprecedented government overreach. Though the SEC is within its right as an administrative agency to do so, extending these restrictions to non-registered persons creates a highly restrictive environment in which a majority of Americans risk finding themselves, while essentially setting them up for failure. This is especially true for defendants lacking substantial financial means and who have little knowledge of SEC proceedings, for the disadvantages would affect their ability to prepare a defense the most.

C. Analyzing the Fairness of SEC Authority from a Doctrinal Standpoint

The Supreme Court created a balancing test to determine whether an administrative agency's authority excessively deprives individuals of

70. Schonfeld et al., *supra* note 18, at 27.

71. Dodd-Frank Act, Pub. L. No. 111-203, sec. 929O, § 20(e), 124 Stat. 1376, 1862 (2010) (codified as amended at 15 U.S.C. 78t(e) (2012)); Lincenberg & Rhee, *supra* note 17, at 10.

72. Dodd-Frank Act sec. 929P(a)(1), § 8A(g)(2).

their rights (the *Mathews* balancing test).[73] The Court first considers the extent of individual rights deprived versus the public interest in maintaining the administrative agency's authority as is.[74] Here, there are several aspects of individual due process limited in SEC proceedings.[75] Individuals also face deprivation of property if found guilty by way of severe monetary penalties.[76] Considering "non-registered persons" include individual incomes ranging from less than thirty thousand dollars annually, potential defendants risk facing penalties that could financially devastate them.[77] Therefore, for defendants subject to SEC administrative proceedings, the risk of this deprivation is great. Further, because the SEC authority is so broad as to subject defendants it does not normally regulate to an environment so restrictive of their individual rights, the deprivation of individual rights in this case is important because of the wide range of people it has the potential to affect.

There is also no public interest benefit in the SEC's expanded authority. The public interest issue here would be to better protect the investing public against bad actors in the financial and securities industry. However, the expanded authority under the Dodd-Frank Act does not address this because it only subjects the investing public to greater liability while maintaining the same authority over registered persons and entities prior to the act's passage.

In fact, it goes against this public interest because it subjects the investing public to potentially greater harm. As discussed earlier, the SEC administrative proceeding is wholly unfair to defendants. Defendants are stripped of multiple due process protections otherwise afforded to them in federal court, and are more likely to lose considering SEC in-house judges' track records and the Dodd-Frank Act's expansion of secondary liability.[78] Further, the increased maximum penalties put them at greater

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73. Mathews v. Eldridge, 424 U.S. 319, 334–35 (1976) (citing Goldberg v. Kelly, 397 U.S. 254, 263–71 (1970)).

74. *Id.* at 335–48.

75. Schonfeld et al., *supra* note 18, at 27. In SEC administrative proceedings an individual is subject to an accelerated schedule and strict time limit, limited discovery, no right to trial by jury, and an unlikely chance of reversal on appeal. *Id.* The Dodd-Frank Act's expansion of secondary liability by ridding the requirement of proving scienter also makes it easier for the SEC to prove its case. *Id.*

76. The Dodd-Frank Act increases this risk by increasing maximum penalties originally created in the Securities Act of 1933 by fifty percent. *Compare* Securities Act of 1933, ch. 38, §24, 48 Stat. 74, 87 (amended 1975) (establishing a $5000 penalty against individuals), *with* Dodd-Frank Act sec. 929P(a)(1), § 8A(g)(2) (establishing a $7500 penalty against individuals).

77. McCarthy, *supra* note 9.

78. Schonfeld et al., *supra* note 18, at 27.

risk for heavier fines.[79]

Arguably, there is also a public interest in better streamlining SEC proceedings by allowing it to seek civil penalties against anyone in one administrative proceeding versus having to file a separate suit in federal court. However, the deprivation of individual rights and its significant effect on non-registered persons greatly outweighs this minor administrative benefit. Considering registered persons and entities are more likely to work in securities regularly and thus have a higher chance of violating an SEC rule (especially those who intend to do so), streamlining cases against non-registered persons would not improve the SEC's overall efficiency by much. Therefore, the deprivation of individual rights outweighs the public interest in maintaining current SEC authority.

The Court next considers the likelihood of erroneous deprivation of individual rights as compared to the government burden in adding procedural safeguards.[80] Here, the likelihood is great because SEC authority encompasses any American participating in the stock market.[81] Further, the SEC has already begun taking advantage of this authority—it almost always seeks civil penalties in administrative court versus federal.[82] Therefore, it is likely non-registered persons will fall subject to erroneous deprivation through highly restrictive administrative proceedings rather than federal court, where they are offered better protection.

Compared to this, the government burden of changing procedures is slight. Prior to the Dodd-Frank Act, the SEC still had authority to seek civil penalties in administrative proceedings against persons registered individually or affiliated with a registered entity.[83] This provided the government with the benefit of streamlining cease-and-desist orders and the imposition of civil penalties in one administrative proceeding against registered persons and associated persons, while still offering a procedural safeguard to non-registered defendants by requiring the SEC to file suit for penalties sought against them in federal court.[84] Thus, if the government were to propose an act amending the Dodd-Frank Act as

79. *Id.* at 26.

80. *Id.*

81. The Dodd-Frank Act expands SEC authority to "any person." sec. 929P(a)(2), § 21B(a)(2). Hill v. SEC, 114 F. Supp. 3d 1297, 1301 (N.D. Ga. 2015), *vacated*, 825 F.3d 1236, 1297 (11th Cir. 2016).

82. Henning, *supra* note 66.

83. Penny Stock Reform Act of 1990, Pub. L. No. 101-429, sec. 202(a), § 21B, 104 Stat. 931, 937 (codified as amended at 15 U.S.C. § 78u-2 (2012)).

84. *Id.*

to limit SEC authority to what it was prior to its passage, it would still maintain efficiency in enforcing penalties against those involved in the industry while affording non-registered defendants greater individual protections.

Arguably, the government's burden could be greater because the legislative process is lengthy, arduous, and inefficient.[85] However, there are many less-intrusive rule changes the SEC could make within its administrative procedures that would minimize this burden, such as requiring consideration of a defendant's alleged violations, overall participation in the stock market, wealth, and whether he or she is registered or non-registered when deciding whether to seek penalties through administrative proceedings or federal court. The SEC could also pass a rule within its administrative procedure requiring filing suit in federal court for non-registered persons, effectively yielding the same results as repeal of the Dodd-Frank Act's expansion without having to go through Congress.

In summation, current SEC authority can erroneously deprive defendants of many aspects of due process with little public interest rationale to support doing so. It also has a high chance of erroneously depriving defendants because it favors using its administrative proceedings, even against non-registered persons. Moreover, as there are several procedural steps the SEC can take internally to provide an additional protection to defendants, government burden can be minimal. Thus, SEC authority fails under the Supreme Court's *Mathews* balancing test.

D. Should This Provision Be Repealed?

One approach to addressing the SEC's overreaching authority is to repeal the Dodd-Frank Act, either as a whole or just the sections relevant to SEC authority expansion.[86] However, this would be a grueling and lengthy process likely to get nowhere. Indeed, to repeal a federal law, Congress would have to draft and pass a new act making the Dodd-Frank Act, or specific sections within it, invalid.[87] Further, as seen with the many attempts to repeal the Affordable Care Act, Congress can spend years debating the political issues surrounding controversial legislation

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85. *The Legislative Process*, U.S. HOUSE REPRESENTATIVES, http://www.house.gov/content/learn/legislative_process/ (last visited Dec. 26, 2016). This Note later describes the bill process at length and why repeal of Dodd-Frank Act would not be a viable or realistic solution to minimizing SEC authority and overreaching acts as a whole. *See infra* notes 86–92 and accompanying text.

86. Dodd-Frank Act, sec. 929P, §§ 8A, 21B(a), 9(d)(1), 203(i)(1), 22, 27, 214, 20(a).

87. *See The Legislative Process*, *supra* note 85.

and why it should be repealed, and get nowhere.[88]

Even if an act were passed, the President has the power to veto it.[89] Though Congress and the Senate can vote with two-thirds majority to override Presidential veto and sign it into law, this is highly unlikely.[90]

Moreover, as a practical matter, repeal would simply be more trouble than it is worth. Like the Affordable Care Act, the Dodd-Frank Act's regulations are already implemented,[91] and companies have invested in changes necessary to comply. Repeal would again cause widespread change in the financial industry, and companies would be furious over money wasted on compliance provisions no longer in place.

Even if a proposed act only repealed the provision expanding SEC authority to enforce civil penalties against non-registered persons, in today's political climate, the standoff that would ensue along party lines would make the process difficult and painful.[92] Therefore, repeal is not a suggested alternative. Rather, better approaches require looking at the resulting effects the Dodd-Frank Act had on the financial industry, and how to avoid the many problems it, like past sweeping pieces of legislation, has caused.

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88. *Cf.* Jonathan Cohn, *An Iowa Voter Forced Ted Cruz to Confront the Human Toll of Repealing Obamacare*, HUFFINGTON POST (Jan. 30, 2016 10:48 PM), http://www.huffingtonpost.com/entry/ted-cruz-obamacare-iowa_us_56ad66a1e4b077d4fe8e6396 ("Republicans have spent nearly six years promising to repeal Obamacare . . . .").

89. *The Legislative Process*, *supra* note 85.

90. *The First Congressional Override of a Presidential Veto*, U.S. HOUSE REPRESENTATIVES HIST., ART & ARCHIVES, http://history.house.gov/Historical-Highlights/1800-1850/The-first-congressional-override-of-a-presidential-veto/ (last visited Dec. 26, 2016). Today, Congress overrides the President less than five percent of the time. *Id.*

91. *History and Timeline of the Affordable Care Act (ACA)*, EHEALTH (Sept. 22, 2016), https://www.ehealthinsurance.com/resource-center/affordable-care-act/history-timeline-affordable-care-act-aca. The Dodd-Frank Act took effect in 2010; Obama's Affordable Care Act was signed into law on March 23, 2010 and most of its regulations were implemented by 2014, with more to take effect through 2020. Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *History and Timeline of the Affordable Care Act (ACA)*, *supra*.

92. The 113th Congress, serving from 2013 to 2014, was called "the worst Congress ever." *Id.* It passed 294 bills compared to the "do nothing Congress of 1948," which passed 900. It achieved a record low approval rating of fourteen percent in 2013, fifteen percent in 2014, and was equally disdained by Americans identifying as Democrat, Republican, and Independents. Dana Milbank, *Good Riddance to the Worst Congress Ever*, WASH. POST: OPINIONS (Dec. 19, 2014), https://www.washingtonpost.com/opinions/dana-milbank-good-riddance-to-the-worst-congress-ever/2014/12/19/1f25b99e-8796-11e4-9534-f79a23c40e6c_story.html.

III. Alternative Approaches to Sweeping Regulatory Overhauls

A. Sweeping Regulations and the Counterproductive Effects of Overregulation

Overall, the Dodd-Frank Act has yet to prove its worth.[93] Though a majority of Americans from all levels of income still participate in the stock markets, today only fifty-five percent of Americans are investing compared to the sixty-two percent participating in the stock market before the financial collapse in 2008.[94] Further, five years after its passage, required compliance of the thousands of regulations the Dodd-Frank Act imposed made it too expensive for small firms to survive, while the big firms and banks it meant to target merely acquired greater market shares.[95]

As to how it affects individuals, sweeping overhauls such as the Dodd-Frank Act do not promote consumer participation because the sheer amount of new rules and regulations alone likely overwhelm those with minimal knowledge of the industry. When asked why they are not investing, young adults reported they do not feel educated enough about the stock market, do not trust brokers, and think it is too risky.[96] The Dodd-Frank Act's expansion of SEC authority would likely only increase these feelings because of the added disadvantages any person can face in SEC administrative proceedings.[97] Therefore, rather than meeting its goal of protecting and encouraging the public to invest, the Dodd-Frank Act achieved opposite results in furthering the already skeptical from participating.

As to how it affects businesses, the Dodd-Frank Act caused the collapse of many small firms and startups because they could not afford costs required to comply with all the new rules and regulations under the Act.[98] Indeed, sweeping acts such as the Dodd-Frank Act make it most difficult for small firms and investors to grow their businesses and succeed, even if they are doing relatively well.[99] Facebook, for example,

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93. *How Dodd-Frank Ate the U.S. Economic Recovery*, *supra* note 11.

94. McCarthy, *supra* note 9.

95. *How Dodd-Frank Ate the U.S. Economic Recovery*, *supra* note 11.

96. *See* Heather Long, *Over Half of Americans Have $0 in Stocks*, CNN MONEY (Apr. 10, 2015, 3:06 PM), http://money.cnn.com/2015/04/10/investing/investing-52-percent-americans-have-no-money-in-stocks/.

97. Schonfeld et al., *supra* note 18, at 26.

98. *How Dodd-Frank Ate the U.S. Economic Recovery*, *supra* note 11.

99. John Berlau, *Overregulation Makes for 'Cheers IPOs,'* INSIDE BUS. (May 25, 2012), http://pilotonline.com/inside-business/news/columns/overregulation-makes-for-cheers-ipos/article_94abb5af-dd41-5e38-9c59-6a7308bb74f6.html.

only went public in 2012 despite becoming one of America's largest companies because in its early years, it was difficult to afford compliance with new regulations.[100] In its first Initial Public Offering (IPO) filing it stated the following: "[C]ompliance with these rules and regulations will increase our legal and compliance costs, make some activities more difficult, time-consuming, or costly, and increase demand on our systems and resources."[101] Also, Home Depot co-founder, Bernie Marcus, has repeatedly commented his company "never could have gotten off the ground if . . . today's regulations had been in effect."[102] In fact, the SEC itself calculated the cost of complying with one Sarbanes-Oxley Act provision alone—it came to $2.3 million.[103]

On the other hand, the Dodd-Frank Act left big banks relatively unaffected, if not better off, because they had ample financial resources to comply and the ability to acquire a greater share of the market as small firms collapsed.[104] A similar result occurred after the passage of the Sarbanes-Oxley Act, suggesting overregulation is the problem.[105] Unlike Facebook, JP Morgan Chase was "going strong" after Sarbanes-Oxley took effect in 2002, and after Dodd-Frank took effect in 2010.[106] Therefore, overregulation may result in more harm than good, especially against individuals and smaller firms.

B. Considering No Regulation

With overregulation identified as a problem, as seen in the Dodd-Frank Act, it follows that an alternative approach is to stop regulating the financial industry altogether. Instead, the free market would allow companies to compete with each other and fully utilize time and money on building up their businesses, rather than waste it on overly complicated compliance procedures.

However, this is also not the answer. Problems in the industry where no regulation existed are why federal acts creating securities regulations and the SEC originated in the first place—there were problems that could

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100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.* The Sarbanes-Oxley Act was a financial overhaul passed by the Bush Administration in 2002 implementing sweeping regulations for big banks and financial entities. Berlau, *supra* note 99. It was not discussed in detail because it did not expand SEC authority for the purposes of this Note. *Id.*; *The Laws that Govern the Securities Industry*, *supra* note 12.

104. Berlau, *supra* note 99.

105. *Id.*

106. *Id.*

only be addressed with rules and procedures and a governing entity to enforce them.[107] Further, a complete lack of regulation enables bad actors to take advantage of lack in government oversight, increasing the chance of widespread fraud before a remedy can be provided.

For example, before the Penny Stock Reform Act implemented regulations and procedures for penny stock, the penny stock market's complete lack of regulation made it easy for unethical brokers and issuers to take advantage of uninformed consumers and cause widespread financial devastation while raking in profits for themselves.[108] Therefore, instead of leaning toward either extreme, regulations appropriately tailored to address present and identified potential risks may be the best option in creating future securities laws.

C. Penny Stock Reform Act: An Example of a Successful Alternative to Sweeping Regulatory Reforms

An alternative to sweeping regulatory reforms like the Dodd-Frank Act is to instead move toward shorter, targeted acts that implement smarter regulations within particular areas of the financial industry. The Penny Stock Reform Act is a successful example.[109] Like other federal securities acts, it was passed in response to address a problem in the financial industry—specifically, the problem of penny stock fraud in the 1980s.[110] However, instead of passing regulations addressing every aspect of the financial industry, the Penny Stock Reform Act's regulations targeted only the problem at hand—misrepresentations, exaggerations, and fraud in connection with the sale of penny stock.[111] It addressed the fraud problem by requiring that penny stock issuers make general disclosures about the specific stock and penny stock market to customers.[112] It also slightly expanded SEC administrative authority by

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107. *Securities Act of 1933*, *supra* note 16. President Roosevelt implemented the Securities Act of 1933 and the Securities Exchange Act of 1934 because of lack of enforcement of Blue Sky Laws, resulting in a high incidence of investor fraud. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 2, 48 Stat. 881, 881–82 (codified as amended at 15 U.S.C. § 78b (2012)); *Securities Act of 1933*, *supra* note 16.

108. *Penny Stock Reform Act*, *supra* note 16. *See generally* Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 502, 104 Stat. 931, 951–52 (codified as amended at 15 U.S.C. § 78o note) (explaining that the Penny Stock Reform Act attempted to curb the incidences of penny stock fraud).

109. Randolph Beatty & Padma Kadiyala, *Impact of the Penny Stock Reform Act of 1990 on the Initial Public Offering Market*, 46 J.L. & ECON. 517, 538 (2003).

110. *Penny Stock Reform Act*, *supra* note 16. *See generally* Penny Stock Reform Act of 1990 § 502 (explaining that the Penny Stock Reform Act attempted to curb the incidences of penny stock fraud).

111. *Penny Stock Reform Act*, *supra* note 16; § 502.

112. *Id.*

allowing them to enforce civil penalties against registered persons and entities, including those involved in penny stock.[113]

Further, there is no criticism about this act.[114] Likely, this is because it is so narrow in scope that it barely affects the securities industry as a whole. Rather, it addressed a particular problem with penny stock and provided for equally narrow solutions, successfully remedying the problem at hand without causing widespread affects in other areas of the industry. The balanced expansion of SEC authority made it more efficient to crack down on penny stock criminals such as Jordan Belfort, and the required disclosures no longer made penny stock a lucrative business for those intending to abuse them for personal gain.[115]

Therefore, if several smaller acts are passed gradually rather than compounding everything within one giant reform bill, multiple benefits can result. First, like the Penny Stock Reform Act, each can be expertly crafted to address one issue at hand instead of attempting to juggle and remedy all identifiable problems at once. A targeted solution makes it more likely it will properly address the problem at hand, and in the chance it does not work, the harm will not be widespread. Indeed, many investors (particularly individuals and small businesses), were negatively impacted by the widespread effects of the Dodd-Frank Act's overreaching regulations.[116]

Second, the acts would save the government time and businesses money. If future acts are smaller with less regulation, it is more likely the government can satisfy public demand for increased efficiency because there would be less substance to debate about. Businesses would also not have to spend as much money on compliance, so this would especially benefit small firms struggling in today's heavily regulated environment.

D. What Companies and the SEC Can Do to Maximize Efficiency in Financial Regulations

Another approach is for private companies to foster a better working

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113. *Id.*

114. Despite an exhaustive search, the author was unable to find scholarly articles criticizing the Penny Stock Reform Act, discussing negative effects, or arguing it was a failure.

115. *See* Ronald L. Rubin, *How the 'Wolf of Wall Street' Really Did It*, WALL STREET J. (Jan. 3, 2014, 6:40 PM), http://www.wsj.com/articles/SB10001424052702303453004579290450707920302. Post-Penny Stock Reform Act, issuers generally moved away from offering penny stock to customers. *See generally* Beatty & Kadiyala, *supra* note 109 (presenting evidence of abnormal declines in returns after the Penny Stock Reform Act).

116. Berlau, *supra* note 99; *How Dodd-Frank Ate The U.S. Economic Recovery*, *supra* note 11.

relationship with the SEC. Companies do not want to be involved in an SEC investigation—both the financial and reputational costs are significant.[117] However, so many specific and technical regulations make it easy for firms and individuals to unintentionally violate the rules despite a good faith attempt to comply. Therefore, an alternative solution is a transition to bright-line rules and guidelines by the government that provide room for firms to develop specific policies that work for them within boundaries set by the SEC.

One benefit of moving to bright-line rules is that they tend to be easier to understand, and are not so technical that slight deviation results in violation. For example, the *Google Code of Conduct* is as follows:

> "Don't be evil." Googlers generally apply those words to how we serve our users. But "Don't be evil" is much more than that. Yes, it's about providing our users unbiased access to information, focusing on their needs and giving them the best products and services that we can. But it's also about doing the right thing more generally—following the law, acting honorably and treating each other with respect.
>
> The Google Code of Conduct is one of the ways we put "Don't be evil" into practice.[118]

Indeed, companies have found "a colloquial tone is more effective than forbidding and off-putting legalese."[119] When provided with general guidelines yet still leaving room for leniency, firms can adapt to a policy within said guidelines that works best for their specific corporate cultures.

Further, the ability to work within a set guideline as opposed to rigid compliance of thousands of regulations can foster a better working relationship between private firms and the SEC. If firms are given greater leniency to develop a policy based off general guidelines, it is more likely they can approach the SEC regarding what works and what does not. One example where this approach is currently implemented is in development of company compliance programs for the Foreign Corrupt Trade Practices Act.[120]

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117. In 2010, an SEC and internal investigation resulted in Office Depot incurring costs of over twenty million dollars. Kevin LaCroix, *Guest Post: Internal Investigation Costs: How Investigations Coverage May Fail*, D&O DIARY (Mar. 2, 2012), http://www.dandodiary.com/2012/03/articles/d-o-insurance/guest-post-internal-investigation-costs-how-investigations-coverage-may-fail/.

118. *Google Code of Conduct*, ALPHABET INV. REL., https://abc.xyz/investor/other/google-code-of-conduct.html (last updated Apr. 11, 2012).

119. GEOFFREY PARSONS MILLER, THE LAW OF GOVERNANCE, RISK MANAGEMENT, AND COMPLIANCE 172 (2014).

120. *Id.* at 446. Currently, it works in firms' favor to have a compliance team and compliance policy in place when investigated by the SEC. *Id.* Provided a company "implements in good faith a comprehensive, risk-based compliance program, even if that

In the case of small firms, this approach better serves them in particular because unlike mandatory compliance of thousands of new regulations, it would provide them with the opportunity to create a policy within their financial limits so as not to hinder their ability to grow. Moreover, generally fostering a working relationship with the SEC can lead to earlier detection of problems and proactive government involvement, instead of maintaining Congress's tendency to impose after-the-fact legislation.[121]

E. How Companies Can Reduce the Likelihood of Bad Actors and Corruption to Prevent Future Financial Disasters

Finally, companies should also work in their own capacities to develop better internal procedures that prevent infractions and violations of rules. To target the issue of bad actors, firms should seek to improve corporate culture by hiring management with strong ethical standards and a genuine commitment to abiding by the rules.[122] "Even the best compliance programs will fail if the people are unreliable or unethical."[123] Thus, in hiring, consideration of ethical standards should be important—if the chairmen of a company and executive hires are ethical and act with becoming moral conduct, especially in the sense that all rules and procedures apply just as equally to them as they do to their subordinates, it so follows the rest of the company will adopt the same mentality.[124]

Further, in a workplace where the corporate culture promotes strong ethics and good behavior, it is easier to identify a malicious criminal looking to break the laws because it is less likely they will find coworkers with whom to collaborate, and employees will feel more comfortable reporting said bad behavior to the appropriate superior. Both companies and the SEC seek to improve this with implementation of better whistleblower protections.[125]

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program does not prevent an infraction in a low risk area because greater attention and resources had been devoted to a higher risk area," the Department of Justice and the SEC will give said company "meaningful credit" in violation and enforcement procedures. *Id.*

121. *The Laws that Govern the Securities Industry*, *supra* note 12. Congress tends to react after-the-fact with legislation responding to crisis. *See generally id.* (describing various securities reforms since 1933).

122. MILLER, *supra* note 119, at 171.

123. *Id.* at 176.

124. *Id.* at 171. This is known as "tone at the top," or an attitude of receptivity and support for compliance values spearheaded by management of the company. *Id.*

125. *Id.* at 276–77. Whistleblowers are afforded many protections and often provided rewards for coming forward with information about company violations of laws. MILLER, *supra* note 119, at 276–77.

CONCLUSION

Ultimately, continuing to expand SEC authority is simply not the right way to better protect the investing public. Today, young adults already choose not to participate in the stock market because they do not feel knowledgeable enough about the industry.[126] This trend will only worsen with greater expansion and increased rules and regulations. Further, the limits on individual rights in SEC administrative proceedings combined with expanded secondary liability and increased penalty maximums under the Dodd-Frank Act are counterproductive to protecting consumers.[127] This is so because the combination results in subjecting a majority of Americans to significant disadvantages they otherwise would not face in federal court without the protection of procedural safeguards balancing SEC authority to do so. This is particularly dangerous to stock market participants of lesser means, because the financial impact of civil penalties would affect them the most.

Though there is no definite solution to current problems in the financial industry, there are better alternatives to sweeping regulatory reform and its resulting overregulation. The financial industry is constantly changing, and will therefore continue to face new problems requiring changes in regulations. However, it is clear neither excessive regulation nor a true, unregulated market are answers that will both provide businesses with enough freedom to properly grow and protect the investing public from malicious actors.

Indeed, the better approach lies somewhere in between the two. Further, the non-associated individual should not fear falling subject to the SEC, but rather, should feel protected by legislative and administrative safeguards and, therefore, feel more confident about investing in the stock market.

Thus, in drafting future acts affecting the securities industry, the government should look toward a more proactive and targeted approach that both deters and punishes bad actors, but also welcomes and protects all others who wish to take part in the stock market. Further, the private sector should equally take responsibility in promoting an ethical corporate culture, starting from management. Moreover, if both the government and private sector companies work in good faith to move toward having a better working relationship, they can work together and ultimately create the most successful and efficient policies going forward.

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126. Long, *supra* note 96.