The Harvard Law School Forum on Corporate Governance and Financial Regulation

Another Salvo on SEC Penalties

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SEC Commissioner Luis Aguilar recently spoke against a policy statement concerning corporate penalties that was issued in 2006 by the then-sitting Commissioners. The 2006 statement emphasized two principal considerations: (1) did the corporation receive a benefit from the misconduct; and (2) will a penalty recompense or further harm injured shareholders? Commissioner Aguilar characterized the 2006 statement as "fatally flawed" and noted approvingly that SEC Chair Mary Jo White recently noted that it is not a binding policy. Commissioner Aguilar argued that considering whether there was a benefit to the corporation distracts a penalty analysis from its proper focus—namely, the nature of the misconduct. While the nature of any misconduct is always a relevant and important consideration in determining the appropriate penalty, the statute authorizing penalties does make it relevant to consider whether the corporation received a benefit.

As we have noted before, the Commission's civil penalty authority is limited by statutory language. The statute provides for three tiers of penalties in escalating amounts. In a time when corporate penalties in the tens or even hundreds of millions of dollars are criticized as inadequate or worse, it can be easy to lose sight of the fact that the *maximum* corporate penalty under the statute is currently $775,000 per violation. While the "per violation" language is where creative SEC math can sometimes come into play, as we have noted, some federal judges in litigated cases have followed a more measured approach. See our memo, SEC Penalties: Getting Tougher, and Remembering Some History, from October 17, 2013.

The statute provides an alternative method of calculating a penalty under the second and third tiers: "the gross amount of pecuniary gain to [the] defendant." Thus, the Commissioners who unanimously endorsed the 2006 statement had a sound statutory basis for focusing on the benefit to the corporation as a factor relevant to assessing penalties. This approach also recognized the

nature of the corporate form and the implications of that form in the context of SEC enforcement. The 2006 statement acknowledged that current shareholders really pay corporate penalties, so imposing further costs on those shareholders (in addition to the reputational injury that the corporation in which they have invested will inevitably also suffer as a consequence of the enforcement action) serves little rational purpose unless the prior misconduct produced a financial benefit to them.

The Commission has for years made clear that it will consider such factors as the quality of the corporation's preexisting controls and compliance structure designed to prevent misconduct; and the corporation's response once wrongdoing was detected, including remedial measures undertaken and cooperation with governmental investigations. Indeed, Chair White affirmed the continuing importance of these considerations in the same speech in which she noted that the 2006 statement—as an expression of the then-Commissioners' approach to exercising their discretion—is not a binding policy.

We think this continued emphasis is well-placed, as it helps to encourage corporate management and boards to take the steps best calculated to prevent misconduct, and to respond appropriately when wrongdoing is detected.

Chair White also identified the "egregiousness of the misconduct" as the first in the list of factors to consider in determining penalty amounts. As a practical matter, every penalty determination begins that way, as it should both under the statute and as a matter of policy. But the absence of a benefit inuring to the corporation from employee misconduct (or the amount of that benefit) is also an important factor that should be considered.