PUBLIC AGENCIES AND INVESTOR COMPENSATION: EXAMPLES FROM THE SEC AND CFTC

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TABLE OF CONTENTS

INTRODUCTION

When financial regulators get positive press, it is often when they open investigations or recover large sums of money—in other words, when the regulators are acting in their prosecutorial or counsel role. Similarly, compensation by these regulators hits the headlines when the agency has been the white knight, recovering and distributing funds to injured investors. Rarely do the papers laud financial regulators when they provide the judges in the financial market equivalent of small claims court. This Essay suggests revisiting the unglamorous business of resolving disputes between customers and brokers and recasting it as a potentially valuable source of industry information to the agencies tasked with enforcing securities and commodities laws.

Renewed discussion of regulatory consolidation provides an opportunity to reshape the agencies' involvement in investor compensation. In March 2008, the Department of the Treasury (Treasury) proposed a restructuring

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of U.S. financial regulators in its *Blueprint for a Modernized Financial Regulatory Structure* (*Blueprint*).[1] One aim of this proposal is to eliminate distinctions between securities and futures regulation—the regulatory domains of the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC), respectively. In this respect, the Treasury plan is the latest in a series of proposals to consolidate the two agencies and thus resolve a longstanding problem of their overlapping jurisdictions.

Renewed discussion about consolidation of financial regulators presents an opportunity to ask how (and whether) a combined CFTC and SEC should compensate injured investors. The agencies' two very different approaches to investor compensation provide a concrete way of thinking about public agencies' involvement in the often private domain of compensatory remedies.[2] The SEC's ability to return large, headline-grabbing sums to investors has been enhanced by the Sarbanes–Oxley Federal Account for Investor Restitution Fund (Fair Fund) provision, which allows the SEC to distribute money-penalty amounts to injured investors.[3] The SEC's Enforcement Division obtains this compensation in its role as "public class counsel" to injured investors.[4] In contrast, the CFTC's longstanding Reparations Program resolves disputes between private parties (individual shareholders and financial professionals) in a role akin to that of an arbitrator or judge.[5]

This Essay suggests that designers of a consolidated system consider as part of the cost–benefit mix the fact that, unlike the Fair Fund approach, the Reparations Program has the potential to generate information for financial regulators. In terms of the judge–lawyer divide, when the agency acts as counsel it must draw on its traditional sources of information, such as its own compliance inspections and the financial press, to investigate and develop a case. By providing a forum and decisionmaker, it has the potential to draw out information about industry practices or conduct that would not otherwise be available.

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1. *See generally* DEP'T OF THE TREASURY, THE DEP'T OF THE TREASURY BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008) [hereinafter BLUEPRINT], *available at* http://www.ustreas.gov/press/releases/reports/Blueprint.pdf (recommending immediate regulatory action in response to the recent credit and mortgage crises, proposing the reorganization of regulatory functions, and outlining a model of responsive market regulation).

2. Whether consolidation is a good idea in general, or whether the Department of the Treasury's (Treasury) ambitious proposal for reorganization is viable, is beyond the scope of this Essay.

3. Sarbanes–Oxley Act of 2002 § 308, 15 U.S.C. § 7246 (2006).

4. *See generally* Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103 (2008) (introducing the concept of "public class counsel").

5. *See infra* Part III.

Part I examines proposals to consolidate the SEC and the CFTC, including the Treasury's recent *Blueprint*. Parts II and III detail how the SEC and the CFTC, respectively, compensate investors, focusing on the SEC's use of Fair Funds to distribute penalty amounts to injured investors and the CFTC's Reparations Program. Part IV proposes that the two approaches should be unified in a way that maximizes information generation.

I. PROPOSALS TO CONSOLIDATE THE SEC AND CFTC

The *Blueprint* released by Treasury included proposals to redraw the lines between the SEC and the CFTC.[6] This Part describes the jurisdictions of the two agencies and puts the Treasury *Blueprint* in the context of recurring attempts to consolidate the regulation of futures and securities.

The SEC has jurisdiction to regulate securities and options on securities. One court proposed this working definition of *security*: "an undivided interest in a common venture the value of which is subject to uncertainty."[7] So far, so good; however, the definition of *security* in the securities acts is deliberately broad and inclusive, reaching "any note" or "stock," but also reaching an "investment contract"—a much-litigated term—and, helpfully, "any interest or instrument commonly known as a 'security.'"[8] Instruments labeled "stock" and that have "characteristics usually associated with

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6. *See* BLUEPRINT, *supra* note 1, at 11–13 (recommending a merger of the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) "to provide unified oversight and regulation of the futures and securities industries" while "preserv[ing] the market benefits achieved in the futures area").

7. Chi. Mercantile Exch. v. SEC, 883 F.2d 537, 543 (7th Cir. 1989).

8. The Securities Act of 1933, as amended, defines "security" as

> any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Act of 1933 § 1, 15 U.S.C. § 77b(a)(1) (2006). The definition of *security* in the Securities Exchange Act of 1934 is so similar that the Supreme Court has announced that it will interpret them together. Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (2006) (defining security); Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985) (stating the definition of *security* in both the 1933 and 1934 Acts are "virtually identical and will be treated as such in our decisions dealing with the scope of the term"); LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, 2 SECURITIES REGULATION 856–57 (4th ed. 2006) (discussing the Court's interpretation of the word *security* in *Landreth*).

common stock"[9] provide an example of a relatively obvious security—an easy case. But the definition also reaches "[n]ovel, uncommon, or irregular devices" such as assignments of oil leasehold subdivisions[10] and rights in orange groves.[11]

The CFTC's jurisdiction can similarly be stated simply but is complex in practice. The CFTC is an independent federal agency created in 1974 through the Commodity Futures Trading Commission Act (CFTCA),[12] which gave the agency exclusive jurisdiction over futures and options on futures.[13] The CFTCA moved responsibility from the Commodity Exchange Authority—which had been an agency within the Department of Agriculture chaired by the Secretary of Agriculture—to the CFTC.[14] Interestingly, given later territorial disputes, the SEC was reportedly offered the responsibility of regulating futures, but rejected it.[15]

Two points complicate the CFTC's jurisdictional picture. First, "futures," like securities, are not always straightforwardly defined. A futures contract can be described as an agreement to buy or sell a commodity for delivery in the future.[16] It grows from agricultural roots in

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9. According to the Supreme Court, the characteristics of common stock are "(i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." *Landreth Timber Co.*, 471 U.S. at 686 (citing United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975)).

10. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 345, 351 (1943).

11. SEC v. W.J. Howey Co., 328 U.S. 293, 294 (1946).

12. 7 U.S.C. §§ 1–22 (2006). The Commodity Futures Trading Commission Act (CFTCA) amended the Commodity Exchange Act (CEA), ch. 545, 49 Stat. 1491 (1936) (current version at 7 U.S.C. §§ 1–22 (2006)). *See generally* Egon Guttman, *The Futures Trading Act of 1978: The Reaffirmation of CFTC–SEC Coordinated Jurisdiction over Security/Commodities*, 28 AM. U. L. REV. 1 (1978) (discussing the creation of the CFTC, analyzing the overlapping statutory delegations of jurisdiction to the SEC and CFTC, and arguing for a shared power structure to resolve the confusion).

13. 7 U.S.C. § 2(a)(1)(A) (2006) provides that

> [t]he Commission shall have exclusive jurisdiction . . . with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated or derivatives transaction execution facility registered pursuant to section 7 or 7a of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title.

14. Abelardo Lopez Valdez, *Modernizing the Regulation of the Commodity Futures Markets*, 13 HARV. J. ON LEGIS. 35, 42–43 & n.43 (1975).

15. John D. Benson, Comment, *Ending the Turf Wars: Support for a CFTC/SEC Consolidation*, 36 VILL. L. REV. 1175, 1175 (1991) (describing the SEC Chairman's decision in 1974 to decline an offer by the White House that would have given the agency jurisdiction over the commodity futures industry).

16. *See* Commodity Futures Trading Comm'n, *CFTC Glossary: A Guide to the Language of the Futures Industry*,

which a typical agreement was for delivery of wheat or corn, for example, at some future date at an agreed-upon price.[17] "Commodity," however, reaches beyond physical or agricultural commodities to include "all other goods and articles, except onions . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."[18] Moreover, although delivery is an alternative, most futures contracts are resolved by cash payout (offset): one party pays the other the difference between contract and market price.[19]

The second complication in interpreting the CFTC's jurisdiction is that it was granted "exclusive" jurisdiction over futures.[20] This provision can be a tiebreaker in disputes with the SEC: an instrument reasonably characterized as either a security or future will fall into the jurisdiction of the CFTC because that jurisdiction is exclusive.[21]

As noted above, both securities and futures have an "easy case" or paradigmatic example, but as instruments move away from these examples, distinguishing between futures and securities becomes more difficult. Judge Easterbrook described the task of categorizing one such novel instrument as a future or a security as "decid[ing] whether tetrahedrons belong in square or round holes."[22] Moreover, the target is moving:

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http://www.cftc.gov/educationcenter/glossary/glossary_f.htm (last visited Nov. 17, 2008) (defining the term *futures contract* and providing the following qualifications: the agreement must be "(1) at a price that is determined at initiation of the contract; (2) that obligates each party to the contract to fulfill the contract at the specified price; (3) that is used to assume or shift price risk; and (4) that may be satisfied by delivery or offset").

17. For early U.S. examples of futures contracts, see the Supreme Court's decisions in *Hansen v. Boyd*, 161 U.S. 397 (1896), which considered a wheat futures contract, and *Embrey v. Jemison*, 131 U.S. 336 (1889), which considered a cotton futures contract. *See also* Elliot R. Wolff, *Comparative Federal Regulation of the Commodities Exchanges and the National Securities Exchanges*, 38 GEO. WASH. L. REV. 223, 229 (1969) (noting active trading in physical or agricultural commodities such as "wool tops . . . live hogs and frozen pork bellies").

18. 7 U.S.C. § 1a(4) (2006). The onion lobbyists apparently successfully argued that trading in onion futures adversely affected the price of onions. *See* Bd. of Trade of Chi. v. SEC, 677 F.2d 1137, 1142 n.9 (7th Cir. 1982) (discussing the exemption of onions from the CFTC's reach following enactment of the CFTCA).

19. *See* 13 JERRY W. MARKHAM, COMMODITIES REGULATION: FRAUD, MANIPULATION AND OTHER CLAIMS § 11:5 (2008) ("Rarely is delivery taken. Instead, most contracts are liquidated by offset.").

20. 7 U.S.C. § 2(a)(1)(A) (2006). As noted below, the Commodity Futures Modernization Act of 2000 (CFMA), Pub. L. No. 106-554 app. E, 114 Stat. 2763, 2763A-365 (2000), created certain exceptions to this grant of exclusivity. *See infra* notes 28–30 and accompanying text (discussing relevant exclusions under the CFMA).

21. *See* Chi. Mercantile Exch. v. SEC, 883 F.2d 537, 539 (7th Cir. 1989) ("If an instrument is both a security and a futures contract, the CFTC is the sole regulator because" of the exclusive jurisdiction clause). *See generally* Thomas A. Russo & Edwin L. Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 HOFSTRA L. REV. 57 (1977) (discussing the competition between the two agencies for jurisdiction over financial instruments with aspects of both securities and futures).

22. *Chi. Mercantile Exch.*, 883 F.2d at 539.

financial products are continually introduced with, as their very purpose, innovation and difference from the existing products.[23]

Stemming in part from the difficulties in determining the line between futures and securities, the agencies have battled over their jurisdictions almost since the CFTC was created.[24] Even before the CFTC began operations, the SEC proposed a competing exclusivity clause that would give the SEC exclusive jurisdiction over all "transactions involving a 'security.'"[25] The SEC and the CFTC clashed in court over jurisdiction over novel products (Government National Mortgage Association options and index participations); the CFTC, aided by its exclusivity clause, prevailed.[26] The Commodity Futures Modernization Act of 2000 (CFMA)[27] partially addressed this jurisdictional uncertainty by exempting certain products from the Commodity Exchange Act (CEA),[28] excluding certain products from the definition of *security*,[29] and allowing futures contracts on individual securities, which are acknowledged to be both a security and a futures contract and are thus jointly regulated by the two agencies.[30] This legislative change, however, did not resolve all jurisdictional issues. Fast forward to 2008, when the Treasury *Blueprint* blamed these "jurisdictional disputes" for "often hindering the introduction of new products, slowing innovation, and compelling migration of financial services and products to more adaptive foreign markets."[31] While coordinated efforts such as the President's Working Group on Financial

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23. *Id.* at 544.

24. *See generally* 2 EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS § 14.07 (8th ed. 2006) (tracing the history of the jurisdictional uncertainty and the implications for the marketplace).

25. Benson, *supra* note 15, at 1185–86 (citation omitted).

26. *See* Bd. of Trade of Chi. v. SEC, 677 F.2d 1137, 1138 (7th Cir. 1982), *cert. granted, vacated, and remanded*, 459 U.S. 1026 (1982) (Government National Mortgage Association options); *Chi. Mercantile Exch.*, 883 F.2d at 539 (index participations). *See generally* Benson, *supra* note 15, at 1185–86 (tracing the history of the CFTC–SEC jurisdictional dispute).

27. Pub. L. No. 106-554 app. E, 114 Stat. 2763, 2763A-365 (2000).

28. *See* GREENE, *supra* note 24, § 14.01:

> [T]he CFMA excluded from regulation under the CEA, and accordingly from the prohibition on the trading of products outside a CFTC-regulated trading facility, a wide range of [over-the-counter (OTC)] derivatives transactions between qualifying counterparties and so-called 'hybrid instruments' (that is, securities or banking products that incorporate the economic features of a futures contract or commodity option.

29. *See id.* (noting that the CFMA introduced "individual, and narrow-based indices of, 'nonexempt' securities, a new category of product that is both a security and a futures contract and that is subject to a unique dual regulatory regime under both the securities laws and the CEA"). Some "individually negotiated swap agreements and other derivatives entered into by qualifying counterparties" were also excluded from the definition of *security*. *Id.*

30. *Id.*

31. BLUEPRINT, *supra* note 1, at 4.

Markets do exist,[32] proponents of consolidation can point to significant evidence of conflict.

In sum, the line between securities and futures has become increasingly difficult to draw as innovative products are introduced that erode their differences. Moreover, because of the difficulty of drawing the jurisdictional line, territorial overlap and conflict have characterized the relationship between the agencies.[33] In response to these interrelated problems, consolidation of the two agencies has been repeatedly proposed.[34] The Markets and Trading Reorganization and Reform Act was a bill introduced in 1990[35] and reintroduced in 1995[36] that proposed merging the two agencies and "establish[ing] a single Federal regulatory body with jurisdiction over securities, options, futures, and related markets and instruments."[37]

Consolidation of the SEC and the CFTC has also been suggested as part of a larger consolidation of financial regulators. At one end of the spectrum of possible reorganizations is a proposed single financial regulator.[38] Commentators and policymakers have one eye on the British experience with the Financial Services Authority (FSA), a single regulator of all financial services established after a review of the United Kingdom's financial regulators in the late 1990s.[39]

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32. Exec. Order No. 12,631, 53 Fed. Reg. 9421 (Mar. 22, 1988).

33. *See, e.g.*, Alan R. Bromberg, *Securities Law—Relationship to Commodities Law*, 35 BUS. LAW. 787, 788–89 (1980) ("The CFTC generally follows the SEC . . . in trying to stretch its jurisdiction. 'Every investment is a security' is what they believe at the SEC. At the CFTC, that is translated into: 'Every contract is a futures contract;' or: 'Every contract is a commodity option.'").

34. *See* Benson, *supra* note 15, at 1175 (indicating that the SEC itself has advocated for a merger of the two agencies); *see also* Chi. Mercantile Exch. v. SEC, 883 F.2d 537, 544 (7th Cir. 1989) ("Only merger of the agencies or functional separation in the statute can avoid continual conflict.").

35. *See* H.R. 4477, 101st Cong. (1990) (proposing the creation of a new agency called the Markets and Trading Commission).

36. H.R. 718, 104th Cong. (1995).

37. *Id.* § 2(1); H.R. 4477 § 2(1).

38. *See, e.g.*, Elizabeth F. Brown, *E Pluribus Unum—Out of Many, One: Why the United States Needs a Single Financial Services Agency*, 14 U. MIAMI BUS. L. REV. 1 (2005). The author argues that the United States should consolidate the more than 115 financial regulatory organizations into a single agency because

> [a] single, federal financial regulator would be able to anticipate and plan for future financial crises, more carefully monitor and regulate financial conglomerates, provide better protection for consumers, operate more effectively in international negotiations, quickly adapt to market innovations and developments, be accountable for market failures, eliminate the duplicative regulations and regulatory gaps, harmonize regulations for financial products and firms competing in the market, and avoid being captured by narrow segments within the financial services industry.

Id. at 100–01.

39. *See* BLUEPRINT, *supra* note 1, at 3 (describing the United Kingdom's creation of a tripartite system composed of the central bank, the finance ministry, and one national

While the recent Treasury proposal does not call for a single financial regulator, it does suggest more than a simple merger of the SEC and CFTC. The *Blueprint* calls for three regulators "focused exclusively on financial institutions" as well as a "federal insurance guarantee corporation" and a "corporate finance regulator."[40] One of the three new regulators focused exclusively on financial institutions would be the "Conduct of Business Regulatory Agency" (CBRA), which would regulate "all financial products," including those currently within CFTC and SEC jurisdiction.[41] The "corporate finance regulator" would be responsible for "general issues related to corporate oversight in public securities markets" including "corporate disclosures, corporate governance, accounting and auditing oversight, and other similar issues"[42]—part of the SEC's current role.

Although framed as a response to recent front-page concerns with foreign competition and the subprime mortgage crisis, the Treasury's *Blueprint* is typical of SEC–CFTC merger proposals in that it asks in its request for comments whether "a continued rationale" exists for "distinguishing between securities and futures products and their respective intermediaries" and "having separate regulators for these types of financial products and institutions."[43] The Treasury's response was a clear no to both questions.[44]

Many of the proposals for consolidating the SEC and CFTC conclude not only that consolidation makes sense, but also that the similarities between the legislation governing commodities and securities would enable it.[45] After all, many of the CEA's provisions were modeled on securities legislation, and securities cases have been used as precedent in the CFTC context.[46] Nonetheless, in at least a few areas the legislative powers and tasks of the two agencies significantly diverge.[47] The rest of this Essay

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financial regulatory agency that oversees all financial services).

40. *Id.* at 137.

41. *Id.* at 138.

42. *Id.*

43. *Id.* at 194.

44. The *Blueprint* points out that the "bifurcation between securities and futures regulation[] was largely established over seventy years ago when the two industries were clearly distinct." *Id.* at 2. It pointed to this bifurcation as part of an old-fashioned system "grappling to keep pace with market evolutions and, facing increasing difficulties, at times, in preventing and anticipating financial crises." *Id.* at 4.

45. *See generally, e.g.*, Wolff, *supra* note 17 (tracking similarities between legislation governing commodities and securities).

46. *See* Benson, *supra* note 15, at 1194 (arguing that regulatory similarities would facilitate consolidation); Bromberg, *supra* note 33, at 789 (noting that courts have drawn on securities cases as precedent for deciding issues under the CEA, including in the areas of "the elements of fraud, the standards for granting an injunction, disgorgement remedies, and aiding and abetting").

47. Differences that would have to be resolved on consolidation are not limited to the agencies' compensatory roles, but also include such issues as the approach to preemption

focuses on one of these areas. The two agencies have taken very different routes to the same end: investor compensation. As described below, the SEC has a tool that places the Enforcement Division in the position of counsel to injured investors, seeking penalties which then may be distributed to investors. In contrast, the CFTC's longstanding Reparations Program uses the CFTC to resolve disputes between private parties (individual shareholders and financial professionals) in a role akin to that of an arbitrator or judge.

II. THE SEC'S COMPENSATORY FUNCTION

The SEC has three main methods of compensating injured investors: distributions by receivers put in place by the SEC, distribution of disgorged profits, and distribution of money collected as civil penalties. These three techniques have in common the SEC's posture in the cases that obtain the relief: it acts as counsel, chooses to bring the suit, pursues certain remedies, and negotiates settlement as an opposing party.

First, the SEC may put in place receivers as part of the flexible relief that it can obtain through adjudication or settlement of matters brought by the agency's Enforcement Division. These receivers often are tasked with distributing money to investors. They may be used simply to implement some of the other mechanisms of investor compensation, distributing disgorgement or penalty amounts.[48] Even without such an order of monetary relief, they may be appointed at any point in the process to identify and recover assets.[49]

Second, disgorgement has long been available to the SEC as a remedy in judicial or administrative proceedings brought by the Enforcement Division.[50] The basic idea is that the remedy prevents unjust enrichment by forcing the disgorgement of profits (sometimes defined broadly) from

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and state regulation. For instance, the CEA preempted state regulation of futures, but, on reauthorization, was revised to allow state attorneys general or other state administrators of securities laws to pursue violators of the CEA as *parens patriae* for their citizens. *See* Futures Trading Act of 1978 § 15, 7 U.S.C. § 13(a)(2) (2006) (1978 reauthorization of the CFTC); Guttman, *supra* note 12, at 3 n.11, 4.

48. *See* GOV'T ACCOUNTABILITY OFFICE, GAO-05-670, SEC AND CFTC PENALTIES: CONTINUED PROGRESS MADE IN COLLECTION EFFORTS, BUT GREATER SEC MANAGEMENT ATTENTION IS NEEDED 8 n.8 (2005) [hereinafter SEC & CFTC PENALTIES], *available at* http://www.gao.gov/new.items/d05670.pdf (describing the duties of SEC-appointed receivers).

49. *Id.*

50. *See* SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) (citing securities cases in which disgorgement was ordered); SEC v. Tex. Gulf Sulphur Co., 312 F. Supp. 77, 89, 91 (S.D.N.Y. 1970) (establishing the SEC's power to seek and obtain the ancillary relief of disgorgement in federal court); *see also* 15 U.S.C. § 80a-9(e) (2006) ("In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest.").

violations of securities laws.[51] Disgorged funds may be distributed to injured investors, although they do not have to be, and courts have emphasized that neither identification of harmed investors nor distribution is a prerequisite for imposing the remedy.[52] Likewise, the appropriate measure is the amount of profit to the violator and not the amount of harm to the investors.[53]

Finally, since the passage of the Sarbanes–Oxley Act of 2002, the SEC may distribute money penalty amounts to injured investors through Fair Funds.[54] Until 2002, any civil money penalties (fines) collected by the SEC had to be paid into the United States Treasury.[55] The Fair Fund provision of Sarbanes–Oxley allows penalties paid in enforcement actions to be added—at the SEC's discretion—to disgorgement funds, which then may be distributed to injured investors.[56] The provision does not distinguish between individuals and groups or between financial institutions and public company misstatements. Time will tell how the SEC chooses to exercise its discretion but, to date, the most obvious effect has been in high-profile stock-drop cases (Enron, WorldCom) because of large investor harm and correspondingly large penalties.

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51. *See, e.g.*, SEC v. Blavin, 760 F.2d 706, 713 (6th Cir. 1985) ("The purpose of disgorgement is to force 'a defendant to give up the amount by which he was unjustly enriched' rather than to compensate the victims of fraud." (citation omitted)).

52. *See id.* ("Once the Commission has established that a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged by [defendant's] fraud."); 3 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 16.2[4][B] (4th ed. 2002 & Supp. 2004) (citing cases).

53. *See* HAZEN, *supra* note 52, § 16.2[4][B] (suggesting that disgorgement serves the purpose of assuring that violators do not profit from their wrongdoings).

54. Sarbanes–Oxley Act of 2002 § 308, 15 U.S.C. § 7246 (2006); *see* Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW. 317, 318 (2008) (describing the Fair Fund provision and the SEC's new role in investor compensation); Winship, *supra* note 4 (tracing the development of the SEC's power to compensate injured investors).

55. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub L. No. 101-429, § 101(3), 104 Stat. 931, 933 (1990) (codified as amended in scattered sections of 15 U.S.C.).

56. 15 U.S.C. § 7246(a) (2006) provides that

> [i]f in any judicial or administrative action brought by the Commission under the securities laws . . . the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

III. THE CFTC'S COMPENSATORY FUNCTION

The CFTC is home to its own experiment in investor compensation, the Reparations Program.[57] Through the Reparations Program, the agency provides a forum for resolving disputes between "futures customers and commodity futures trading professionals."[58] In contrast to the SEC's compensatory function described above, the CFTC provides the decisionmaker, akin to a judge or arbitrator, for disputes between private parties.

The Reparations Program grew out of the CFTC's agricultural roots: before the CFTC came into being, futures regulation was under the auspices of the Department of Agriculture.[59] The Reparations Program is modeled on the Packers and Stockyards Program and agricultural legislation.[60] Some commentators have suggested that the Program persisted because of perceived problems with arbitration.[61]

For a claim to be eligible for resolution through the CFTC's Reparations Program, a few prerequisites must be met. The Reparations Program is designed for the resolution of disputes between customers and futures trading professionals, whether firms or individuals. The violation alleged must be a violation of the Commodity Exchange Act or the CFTC rules, such as an allegation of fraud, breach of fiduciary duty, unauthorized trading, misappropriation of funds, or churning (excessive trading in an account in order to generate fees).[62] Moreover, the professional must be registered with the CFTC at the time of the violation or at the time the complaint is filed.[63] Finally, a statute of limitations applies: the complaint

57. *See* 7 U.S.C. § 18 (2006); Rules Relating to Reparations, 17 C.F.R. § 12 (2008) (describing the Reparations Program).

58. Commodity Futures Trading Comm'n, Reparations Program, http://www.cftc.gov/customerprotection/redressandreparations/reparationsprogram/index.htm (last visited Oct. 23, 2008).

59. *See* Marianne K. Smythe, *The Reparations Program of the Commodity Futures Trading Commission: Reducing Formality in Agency Adjudication*, 2 ADMIN. L.J. AM. U. 39, 42 (1988) (relating some of the history behind the CFTC and U.S. Department of Agriculture (USDA) Reparations Programs).

60. *See id.* (tracing the CFTC's Reparations Program to the CFTC's roots in the USDA, which administered the Packers and Stockyards Act that contained a reparations program); *see also* Packers and Stockyards Act, 1921, ch. 64, § 309, 42 Stat. 159, 165 (1921) (allowing violators of the Act to avoid liability by "mak[ing] reparation" for the alleged injury); Lopez Valdez, *supra* note 14, at 60 (comparing the CFTC's Reparations Program to that in the Perishable Agricultural Commodities Act (PACA)).

61. Smythe, *supra* note 59, at 52–53 (noting that exchange arbitration was mistrusted and underutilized).

62. *See* Commodity Futures Trading Comm'n, *supra* note 58 (describing the criteria for filing a complaint with the CFTC).

63. Previous versions of the rule allowed the Reparations Program to reach professionals who were not registered but should have been. The rule was revised to require registration, at least in part as a pragmatic limit to the agency's caseload.

must be filed within two years of the date the investor knew or should have known of the activity.[64]

The program provides three routes for aggrieved investors with qualifying claims: the "voluntary proceeding," the "summary proceeding," and the "formal proceeding."[65] The voluntary proceeding may be elected for any size of claim, provided all participants consent.[66] Evidence is submitted in writing, and no oral hearing is held.[67] Perhaps most significantly, the decision issued by the Judgment Officer—a CFTC employee, who may or may not be a lawyer[68]—is final and unappealable.[69]

An eligible investor who does not elect the voluntary procedure pursues either summary or formal proceedings, depending on the size of the claim. If the claim (or counterclaim) is $30,000 or less, the investor may choose the summary proceeding.[70] Evidence is submitted in writing, but with the possibility of a telephonic oral hearing.[71] Unlike the voluntary proceeding, the Judgment Officer's decision may be appealed to the Commission and ultimately to a United States Court of Appeals.[72] Despite their name, summary proceedings often take longer than formal proceedings, in part because more investors in summary proceedings are pro se.[73]

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64. Other prerequisites also apply: foreign residents must file bonds and respondents must not be in insolvency proceedings. Moreover, the Reparations forum may not be available if the claims are also the subject of other investor-initiated proceedings. *See infra* notes 81–83 and accompanying text (discussing and defining parallel proceedings that preclude use of the Reparations forum).

65. *See generally* Kenneth M. Raisler & Edward S. Geldermann, *The CFTC's New Reparation Rules: In Search of a Fair, Responsive, and Practical Forum for Resolving Commodity-Related Disputes*, 40 BUS. LAW. 537, 554 (1985) (reviewing rule revisions drafted by the authors—the CFTC General Counsel and an attorney for the General Counsel's office).

66. 17 C.F.R. § 12.26(a) (2008); *see also id.* §§ 12.100–.106 (describing the rules for voluntary proceedings).

67. *Id.* §§ 12.100–.106.

68. *See* Smythe, *supra* note 59, at 57–58 (noting that the Judgment Officer is not necessarily a lawyer). The Judgment Officer also may be—but is likely not—an administrative law judge. *See* 17 C.F.R. § 12.2 ("Judgment Officer means an employee of the Commission who is authorized to conduct the proceeding and render a decision in a summary decisional proceeding or a voluntary decisional proceeding. In appropriate circumstances, the functions of a Judgment Officer may be performed by an Administrative Law Judge.").

69. 17 C.F.R. § 12.106(d). Challenges under the Seventh Amendment have not succeeded. *See* Myron v. Hauser, 673 F.2d 994, 1008 (8th Cir. 1982) (denying petition for judicial review of a CFTC order in part because the "Seventh Amendment does not require jury trial upon demand in reparation proceedings before" the CFTC).

70. 17 C.F.R. § 12.26(b); *see id.* §§ 12.200–.210 (describing summary proceedings).

71. *Id.* § 12.206.

72. *See id.* § 12.210 (stating that the "timely filing . . . of an appeal to the Commission . . . is mandatory as a prerequisite to appellate judicial review of a final decision and order").

73. COMMODITY FUTURES TRADING COMM'N, PERFORMANCE AND ACCOUNTABILITY REPORT 70 (2007).

Finally, if the amount claimed in either the complaint or counterclaim is greater than $30,000, the investor may select a formal proceeding, which is heard by an administrative law judge (ALJ) and accompanied by additional procedural protections and steps, including an oral hearing.[74] As in a summary proceeding, this decision is appealable to the Commission and ultimately to a United States Court of Appeals.[75]

Regardless of the label, all of these proceedings are voluntary in that the investor chooses to pursue a claim through the Reparations Program rather than by other avenues. Injured investors have the option of pursuing a private law suit; a private right of action was implied in *Merrill Lynch v. Curran*[76] and later codified in the CEA.[77] Moreover, investors may participate in arbitration. The signing of a predispute arbitration agreement cannot be made a condition to the opening of a futures account.[78] If a customer does enter such an agreement, however, CFTC rules require that the agreement include a notice that the customer agrees to forgo private litigation but will still have a forty-five-day window in which to elect a reparations proceeding.[79] Additionally, the rules provide that institutional customers may enter predispute agreements to waive the right to file a reparations claim.[80] To reduce duplicative actions, the reparations rules prohibit parallel proceedings that involve claims (or counterclaims) concerning allegations against any of the same respondents based on the

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74. *See* 17 C.F.R. § 12.26(c) (2008) (identifying the disputes that qualify for formal proceedings); *see also id.* §§ 12.300–.315 (describing formal proceedings).

75. *See id.* § 12.314 (providing that initial decisions do not become final if a party files a timely appeal, and stating that an appeal to the Commission is a prerequisite for judicial review).

76. 456 U.S. 353, 387–88 (1982).

77. *See* Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322 (codified at 7 U.S.C. § 25) (2006) (explicitly permitting a private right of action for violation of the statute).

78. 17 C.F.R. § 166.5(c)(1) (2008).

79. *Id.* § 166.5(c)(7) provides that predispute arbitration agreements must include the following language:

> By signing this agreement, you: (1) May be waiving your right to sue in a court of law; and (2) are agreeing to be bound by arbitration of any claims or counterclaims which you or [name] may submit to arbitration under this agreement. You are not, however, waiving your right to elect instead to petition the CFTC to institute reparations proceedings under Section 14 of the Commodity Exchange Act with respect to any dispute that may be arbitrated pursuant to this agreement. In the event a dispute arises, you will be notified if [name] intends to submit the dispute to arbitration. If you believe a violation of the Commodity Exchange Act is involved and if you prefer to request a section 14 "Reparations" proceeding before the CFTC, you will have 45 days from the date of such notice in which to make that election.

Id. § 166.5(c)(7).

80. *See* 7 U.S.C. § 18(g) (2006) ("Nothing in this section prohibits a registered futures commission merchant from requiring a customer that is an eligible contract participant, as a condition to the commission merchant's conducting a transaction for the customer, to enter into an agreement waiving the right to file a claim under this section.").

same facts.[81] To qualify as a parallel proceeding and thus to foreclose reparations proceedings, the arbitration or court case must be initiated by the investor[82] and be pending when the reparations complaint is filed. Insolvency proceedings concerning respondents may also qualify as parallel proceedings.[83]

The Reparations Program is focused on individual litigation. In the 1990s, in response to a directive from Congress, the CFTC considered and sought comments on whether it should permit class actions in the reparations forum. However, the CFTC ultimately decided against this expansion.[84] In fact, even modifications to the Reparations Program that intensify third-party practice have been rejected because of the need to keep the program simple.[85]

The remedies in reparations proceedings include actual damages caused by the violation.[86] Punitive damages of up to twice the amount of actual damages are also available in summary and formal proceedings where the actions arise from a "willful and intentional violation in the execution of an order on the floor of a contract market."[87] An investor must claim actual

81. A counterclaim in which the investor alleges violations of the CEA or its regulations would also qualify as a parallel proceeding, as would a claim—whether asserted or not—that must be brought or lost under the compulsory counterclaim rules of federal civil procedure. *See* 17 C.F.R. § 12.24(a)(1) (2008).

82. *Id.*

83. *Id.* § 12.24(a)(3).

84. *See* Complaints Against Registered Persons; Class Action Suits, 58 Fed. Reg. 17,369 (proposed Apr. 2, 1993) (requesting comments on the appropriateness of class actions in reparations proceedings); MARKHAM, *supra* note 19, § 17:8 n.1 (noting that the CFTC requested comments on whether it should allow class actions in reparation proceedings and describing case law relating to the use of class actions in such proceedings). The enabling legislation allows for reparations proceedings brought by "any one or more persons . . . for and in behalf of such person or persons and other persons similarly situated, if the Commission permits such actions pursuant to a final rule issued by the Commission." Futures Trading Practices Act of 1992, Pub. L. No. 102-546, § 224, 106 Stat. 3590, 3617 (codified at 7 U.S.C. § 18(2)(A) (2006)).

85. *See generally* Rules Relating to Reparation Proceedings, 59 Fed. Reg. 9631 (Mar. 1, 1994) (codified at 17 C.F.R. pt. 12) (declining to allow class action suits in the Reparations forum because it would slow proceedings and impose costs on litigants and on the Commission).

86. 7 U.S.C. § 18(a)(1) provides that in a petition for actual damages

> [a]ny person complaining of any violation of any provision of this chapter, or any rule, regulation, or order issued pursuant to this chapter, by any person who is registered under this chapter may, at any time within two years after the cause of action accrues, apply to the Commission for an order awarding . . . actual damages proximately caused by such violation.

7 U.S.C. § 18(a)(1) (2006).

87. 17 C.F.R. § 12.2 (2008); *see also id.* §§ 12.106(b)(3), 12.210(b)(4), 12.314(b)(4); 7 U.S.C. § 18(a)(1)(B) (providing for an award of, "in the case of any action arising from a willful and intentional violation in the execution of an order on the floor of a registered entity, punitive or exemplary damages equal to no more than two times the amount of such actual damages").

and punitive damages in the reparations complaint, prove the actual damages, and show that the punitive damages are appropriate.[88] In keeping with the CFTC's role as decisionmaker rather than lawyer, the parties bear the costs of collection. This allocation of costs contrasts with the SEC's practice under Fair Funds in which the SEC bears the burden of collecting what are, at least nominally, civil fines rather than damages.[89]

The CFTC's involvement in investor compensation is not limited to the Reparations Program or its decisionmaking role. It also pursues enforcement actions in a way similar to the SEC, either in administrative or judicial proceedings, in which it acts in place of counsel to injured investors. Like the SEC, among the available remedies in adjudicated actions or in settlement are civil penalties and disgorgement. Furthermore, the CFTC may seek the equitable remedy of restitution.[90]

The CFTC, like the SEC, has the power to seek penalties. The CEA granted the CFTC the power to impose civil penalties of $100,000 per "violation."[91] The $100,000 figure does not necessarily capture the potential scope of these penalties. For instance, the CFTC's post-Enron investigations into misconduct in the energy markets resulted in $130 million in money penalties.[92] These penalties are assessed according to the "gravity of the violation"[93] and are directed to the U.S. Treasury. Unlike the SEC, the CFTC has no statutory authority to distribute funds that were collected as penalties to injured investors; that is, the statute has not been amended by the equivalent of the Fair Fund provision.[94]

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88. *See* 17 C.F.R. § 12.2 (2008) (defining "punitive damages" and explaining when such damages may be awarded in a reparations proceeding).

89. *See* SEC & CFTC PENALTIES, *supra* note 48, at 8 (describing collection processes used by the SEC and CFTC).

90. *See id.* at 5, 43.

91. *See* 7 U.S.C. § 9 (2006) (noting that available remedies are not limited to monetary remedies such as penalties; the CFTC also can seek injunctive relief and suspend or revoke registration and prohibit people from trading on contract markets); 7 U.S.C. § 13a-1 (2006) (granting the CFTC the authority to enjoin an act or practice, enforce compliance with regulations, or issue injunctions for violations). *See generally* Jerry W. Markham, *Investigations Under the Commodity Exchange Act*, 31 ADMIN. L. REV. 285, 287 (1979) (discussing the CFTC's investigative and enforcement authority).

92. *See* COMMODITY FUTURES TRADING COMM'N, KEEPING PACE WITH CHANGE: COMMODITY FUTURES TRADING COMMISSION STRATEGIC PLAN 2004–2009, at 9 (2004), *available at* http://www.cftc.gov/stellent/groups/public/@aboutcftc/documents/file/2009strategicplan.pdf (noting that eight of ten energy market matters filed by the CFTC have been settled and have resulted in both civil monetary penalties and other sanctions).

93. 7 U.S.C. § 9a (2006); *see also* Brenner v. CFTC, 338 F.3d 713, 722–23 (7th Cir. 2003) (tracing the history of 7 U.S.C. § 9a and affirming civil money penalties of $300,000 and $100,000 where the CFTC had considered the gravity of the offense); A Study of CFTC and Futures Self-Regulatory Organization Penalties, [1994–1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,264, at 42,220 (Nov. 1994) (outlining the three-step process the CFTC has developed to assess the gravity of an offense).

94. *See* SEC & CFTC PENALTIES, *supra* note 48, at 5 tbl.1 (listing the types of remedies

Use of the disgorgement remedy by the CFTC and the SEC is very similar; in fact, securities law precedents have been used in the futures context to determine remedies.[95] Again, disgorgement is aimed at preventing unjust enrichment by extracting any profits from the violation. Disgorgement funds either go to the U.S. Treasury or may be distributed to injured investors through a disgorgement fund created by the CFTC (like the SEC) or a court.[96]

Disgorgement is aimed at depriving violators of profit and is measured by the profit. In contrast, the remedy of restitution focuses on the victims and is measured by the harm caused.[97] So, for instance, restitution of almost $10 million was ordered where customers lost at least $10 million due to misrepresentations—brokers had used lines like "How does it feel to be making money?" to a customer whose account was actually losing money.[98] Relief is not necessarily limited to only one type; in addition to combining monetary and nonmonetary relief, restitution and money penalties might both be ordered. In fact, the $10 million restitution order described above was combined with a $6 million penalty.[99] The CFTC ordered more than $179 million in restitution in 2003 and 2004 combined.[100] Interestingly, although the remedy of restitution is also available to the SEC, restitution has not played a large role in the SEC's practices; instead it typically imposes money penalties and disgorgement.[101] The Fair Fund provision has a restitutionary function—after all, the "FAIR" in Fair Funds stands for "Federal Account for Investor *Restitution.*" Unlike restitution, however, investor harm is not the measure for amounts collected and distributed under this provision or through the disgorgement remedy.

IV. THE INFORMATION ADVANTAGES OF THE AGENCY AS JUDGE

Drawing on the existing Fair Funds and Reparations Programs, this Part suggests how a consolidated CFTC and SEC might obtain compensation for injured investors. It suggests that a Reparations Program benefits one

available for SEC and CFTC violations).

95. *See* Bromberg, *supra* note 33, at 789 (explaining that courts have used securities cases as precedent when reviewing disgorgement remedies in commodities enforcement actions).

96. SEC & CFTC PENALTIES, *supra* note 48, at 5 tbl.1.

97. *See, e.g.*, SEC v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993) ("[D]isgorgement is not precisely restitution. . . . Disgorgement does not aim to compensate the victims of wrongful acts, as restitution does.").

98. *See* CFTC v. Liberty Fin. Trading Corp., Inc., No. 04-61235, at 7 (S.D. Fla. Apr. 24, 2007) (consent order granting permanent injunction and other equitable relief).

99. *Id.* at 14.

100. SEC & CFTC PENALTIES, *supra* note 48, at 43 tbl.6.

101. *Id.* at 5 tbl.1.

or both agencies by generating information in two ways: eliciting facts about industry practices and conduct (input) and developing law (output). This Part concludes that this information-generation function should be weighed heavily when considering how limited resources should be allocated between a judicial (Reparations Program) and counsel (Fair Funds) role. It is also potentially advantageous to pursue compensation through agency action rather than through other avenues to investor compensation.

The threshold question—before reaching what a compensatory mechanism might look like—is, Why have any compensatory mechanism at all? The primary objection to investor compensation can be summed up as a concern with circularity. Investors already harmed by the conduct may be harmed again by a penalty against a corporation in which they own stock. Moreover, diversified investors may be on both sides of a transaction so that "compensation" for them involves shifting money from one pocket to another, minus administrative costs.[102]

For a number of reasons, this concern should not foreclose consideration of which compensatory mechanism makes sense. First, commentators have challenged the circularity argument head-on by, for instance, pointing out that downside losses often exceed upside.[103] Second, the category that raises the circularity concern—investors in the secondary market—does not include all possible injured investors and compensatory relief might target the other categories.[104] The type of individual cases between brokers and customers covered by the Reparations Program does not raise such concerns. SEC penalties against individuals also potentially avoid the critique, although indemnification and insurance often pass costs along to corporations and thus to the shareholders. Finally, compensation is likely a political reality, so it makes sense to consider how to go about it, even if one is critical of it as an independent goal.[105]

Because the two approaches—judge and lawyer—are not mutually exclusive, a consolidated agency could combine them.[106] As described

102. *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1558 (2006) (noting that "diversified investors are largely making wealth transfers among themselves as the result of contemporary securities litigation").

103. *See* Alicia Davis Evans, *The Investor Compensation Fund*, 33 J. CORP. L. 223, 229 (2007) (noting that "losses of the investors on the losing side of trades tainted by fraud are more likely to exceed the gains of the investors on the winning side of such trades").

104. *See* Winship, *supra* note 4, at 1130 (describing limits to the circularity critique).

105. *See id.*; Evans, *supra* note 103, at 225–26 (contending that "as a practical matter, political exigencies make achieving the end of shareholder compensation in the post-Enron era unlikely" so that "an exploration of ways to provide compensation more effectively and efficiently" is appropriate).

106. Although this Essay focuses on proposed consolidation, existing agencies could

above, like the SEC, the CFTC has the statutory authority to seek civil penalties. A provision like the Fair Fund provision could reach the CFTC's money penalties. Likewise, eligibility for the Reparations Program could be enlarged to include matters within the SEC's current jurisdiction. As things stand, the different approaches track the SEC–CFTC jurisdictional division: Fair Funds applies to matters within the SEC's jurisdiction and the Reparations forum is available for CFTC matters. However, in keeping with the recognition that the line between futures and securities is often difficult to draw,[107] the Reparations Program could be a model for broader financial regulation.[108] Thus both of these programs could apply across the board. Alternatively, one could adopt the divisions among financial regulators suggested by the Treasury's *Blueprint.* Under this approach, the CBRA (in charge of regulating financial professionals, whether involved in futures or securities) might administer a Reparations Program, for instance, whereas the corporate finance regulator (regulating issuers) might administer a Fair Fund program.

Although the programs could coexist, the agencies' limited resources are likely to force choices.[109] The comparison between the SEC's Fair Fund counsel role and the CFTC's Reparations Program judicial role lends some support to continuing a program similar to the Reparations Program. One rationale is that the agencies have more expertise in their judicial role. To the extent that agencies are assigned roles and given powers because of their expertise, a program that builds on an existing structure might make more sense. So, in more concrete terms, both agencies already have a structure of ALJs who hear and resolve administrative cases; a forum for customers may simply be an extension of that developed area. While both agencies also have long had a counsel role in one sense—deciding what cases to pursue, and how—in another sense this role has not involved distribution and identification of injured investors to the extent that the Fair Fund program now imposes. The new distribution function has forced the SEC to allocate resources—creating a new office, for instance, as well as taking individual enforcement lawyers' time.[110] The "expertise" basis for

adopt these techniques. For instance, legislation might permit the CFTC to create Fair Funds or might create a program akin to the Reparations Program within the SEC.

107. *See supra* Part I.

108. *See* Smythe, *supra* note 59, at 42–43 (noting the theoretical advantages of the Reparations Program, such as a more flexible structure and neutral and expert adjudicators).

109. *See, e.g.*, John D. Ellsworth, *Disgorgement in Securities Fraud Actions Brought by the SEC*, 1977 DUKE L.J. 641, 651 (describing the SEC's resource constraints, including budgetary and manpower limitations).

110. *See* SEC. AND EXCH. COMM'N, 2007 PERFORMANCE AND ACCOUNTABILITY REP. 26 (2007), http://www.sec.gov/about/secpar/secpar2007.pdf (summarizing the agency's "Improved Management of Disgorgements and Penalties and Fair Funds Distributions"); Press Release, Sec. and Exch. Comm'n, SEC Chairman Cox Announces Creation of New Office,

supporting a judicial role has limits, however, because expertise is not static and can be developed. The Fair Fund provision can be seen as a directive from Congress to the SEC to become expert in investor compensation.

Although the expertise aspect of the judge–lawyer divide provides limited guidance, analyzing the two approaches in these terms can be helpful when related to how each type of actor generates information. This Essay is concerned with two types of information: first, factual information about industry practices and conduct (input); and, second, information about the agency's view of the relevant law (output).

With regard to factual information, when the agency acts as counsel, it must draw on its traditional sources of information to investigate and develop a case. The SEC often looks at market surveillance activities, customer complaints, the financial press, self-regulatory organizations (SROs), and its own inspection offices for information.[111]

Providing a forum and decisionmaker (like the Reparations Program) has the potential to draw out information about industry practices or conduct that would not otherwise be available.[112] The information added by reparations complainants might be analogized to customer complaints, with the advantage that they are supported by evidentiary submissions. In 2007, the SEC received more than 77,000 complaints, questions, and "other contacts" from customers.[113] The most frequent complaint in that period was that the consumer had received spam,[114] which is not a good candidate for adjudication. A reparations program would cover violations different than these informal consumer complaints and would focus on compensable injuries.

Appointment of Leaders, to Expedite Distribution of Billions to Injured Investors (Feb. 5, 2008), http://www.sec.gov/news/press/2008/2008-12.htm (announcing the creation of the Office of Collections and Distributions).

111. Sec. and Exch. Comm'n, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, http://www.sec.gov/about/whatwedo.shtml (last visited Oct. 25, 2008) (explaining the roles and duties of the Division of Enforcement). The Division of Corporation Finance and the Office of Compliance Inspections and Examinations both refer matters to the Enforcement Division. *See* Colleen P. Mahoney et al., *The SEC Enforcement Process: Practice and Procedure in Handling an SEC Investigation in the Sarbanes–Oxley Era, Corporate Practice Series* (BNA) No. 77-3rd, at A-8 (2007) (noting that referrals to the Division of Enforcement are routine).

112. *See* Smythe, *supra* note 59, at 84 ("[A] Reparations Program provides a valuable source of information to the agency about the problems in the regulated industry.").

113. Sec. and Exch. Comm'n, Investor Complaints and Questions, FY 2007 Annual Complaint Data (2008), http://www.sec.gov/news/data.htm (last visited Oct. 25, 2008) ("'Other contacts' includes repeat contacts, contacts with insufficient information to process, and contacts about issues not within the agency's jurisdiction.").

114. *Id.* Following "spam" in the top five complaints were advance fee fraud, manipulation of securities, prices, or markets, and problems with account records and transfers. *Id.*

Complainants in the Reparations Program may be compared to high-profile information sources, such as whistleblowers. Both generate original information: the whistleblowers provide information about internal practices and the investors provide information about harm to consumers or investors. Because complainants are likely to be consumers or clients rather than insiders to the violating company, the type of information that injured investors have differs from that of whistleblowers or qui tam plaintiffs.[115] We might value the insiders' information more, and their stories may more readily lend themselves to plots for movies and novels, but these sources could be a complementary part of the information mix.

As to information about the law, the Reparations Program generates written opinions that communicate the agencies' views of futures or securities laws to regulated industry, investors, and the public more generally. Decisions in both the summary and formal reparations proceedings include factual findings supported by references to the record, a legal determination of violation of the CEA or related rules, and the amount of damages.[116] The decision at the initial stages of the reparations process is not binding on the CFTC absent an opinion and an order (not a summary affirmance) from the Commission on appeal.[117] Nonetheless, the Reparations process may generate binding precedent when appealed to the Commission or a federal court. Moreover, a body of written opinions, even if not strictly binding, is likely to serve as guidance for the agency and for those appearing before the agency.[118]

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115. *See* Jill E. Fisch, *Class Action Reform,* Qui Tam*, and the Role of the Plaintiff*, 60 LAW & CONTEMP. PROBS. 167, 196 (1997) (noting that "the incentive structure of *qui tam* is tailored to place a premium on the contribution of original information"). *See generally* Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes–Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91 (2007) (proposing a bounty model of rewarding whistleblowers to give them an incentive to come forward with original information).

116. *See* 17 C.F.R. § 12.210(b) (2008) (establishing the required content of the initial decision in a summary proceeding); *id.* § 12.314(b) (providing the same outline for the initial decision in a formal proceeding). In contrast, the voluntary proceeding results in a much more limited final decision that contains a conclusion as to violation and remedy, unaccompanied by factual findings. *See id.* § 12.106(b).

117. *Id.* § 12.406(b). Section 12.406(b) provides that,

> [u]nless the Commission expressly indicates otherwise in its order, an order of summary affirmance does not reflect a Commission determination to adopt the initial decision, including any rationale contained therein, as its opinion and order, and *neither initial decision nor the Commission's order of summary affirmance shall serve as a Commission precedent in other proceedings*.

Id. (emphasis added). *See generally* MARKHAM, *supra* note 19, § 20:13 (citing cases about the "precedential effect of ALJ decisions").

118. *Cf.* Barbara Black & Jill Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 17, 21–22, 28 n.53 (2006) (arguing that written opinions would make securities arbitration more like litigation because even nonprecedential opinions would be cited by attorneys and arbitrators).

The next step is to think about how the Reparations Program and the information it generates compares with other types of investor compensation obtained through agency action. The Reparations Program's advantage over Fair Funds in generating factual information is straightforward. Nothing in a program like Fair Funds would change the SEC's responsibility to discover and develop the information or would add to the list of information sources. The process leading up to a Fair Fund distribution is essentially the same as any other SEC matter; the fact that compensation of injured investors may be involved does not elicit any additional information. Even if the ability to distribute money penalties to injured investors changes how the agency chooses to pursue a matter or its choice of remedy, the agency must still identify and investigate a violation in its role as counsel. The Fair Fund provision also does not affect the development of information about the law unless it does so indirectly by affecting whether matters are litigated or resolved through settlement.[119]

Another way the judge–lawyer divide helps us evaluate the two programs is to highlight the problems that arise once a governmental agency "represents" a client. Identifying an agency's client is never straightforward given the different constituencies within an agency (e.g., enforcement lawyers, Commissioners). Even if an agency is treated as a single unit (for instance, the SEC as public class counsel), compensation is only one of the agency's priorities, competing with other goals such as deterrence and developing positions on novel legal issues. Moreover, agencies provide little representation of injured investors in the sense of client voice in whether and how a matter is pursued. For instance, in the Fair Fund context, administrative actions limit the participation of potential claimants to Fair Funds to submission of nonbinding comments.[120] Likewise, in court actions, courts and the SEC have imposed limits on client participation, reasoning that the compensatory function of disgorgement and of Fair Funds is secondary and incidental to the other

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119. The assumption would be that settlements contribute less to development of the law, although the argument made above about the powers of nonbinding written precedent might apply equally in the context of the SEC settlements, information which is readily available on the agency's website. The argument would have to be that the provision allows for increased penalties because compensation either makes corporate penalties more acceptable or because the great degrees of investor harm push the agency to impose higher penalties. Then one would have to speculate about the effects of larger penalties on settlement behavior.

120. Rule 1106 of the SEC's Rules of Practice provides for comments to be submitted as part of the process of approving a Fair Fund distribution plan, but states that "no person shall be granted leave to intervene or to participate or otherwise to appear in any agency proceeding or otherwise to challenge an order of disgorgement or creation of a Fair Fund" or its distribution plan or individual eligibility for disbursements. 17 C.F.R. § 201.1106 (2008).

purposes of disgorgement and civil penalties—preventing unjust enrichment and promoting deterrence, respectively.[121]

There are other reasons that a program like Fair Funds should be limited. The compensatory goal may detract from the agency's focus on deterrence by affecting the cases that the agency chooses to pursue and by diverting resources to the distribution function. This concern might be addressed either by separating the distribution function from the enforcement decisions[122] or by developing guidance for the SEC so that it focuses on the strongest cases for compensation of injured investors and for having the SEC (as opposed to private actors) obtain compensation.[123] Taken with the information advantages of Reparations, these suggest a limited role for Fair Funds in any consolidated agency, despite the high profile of such distributions.

The Reparations Program has both of these information-generating advantages not only over the Fair Fund provision, but to some extent also over the nongovernmental alternatives to these programs. The two main alternatives for an injured investor are to pursue a civil action in court or to arbitrate a claim.[124]

The amount of information generated by private securities lawsuits as currently structured is debatable, although some commentators have suggested that they generate little original information.[125] Complaints are often peppered with colorful quotations from the *Wall Street Journal*, the *New York Times*, and the issuers' own financial restatements. Although understandable, given that plaintiffs and their counsel are acting without discovery at that stage, to the extent that many actions do not progress far before being settled, this reliance on public sources may signal that these suits have limited information benefits.

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121. Official Comm. of Unsecured Creditors of WorldCom v. SEC, 467 F.3d 73, 83 (2d Cir. 2006) ("Deterrence is also the SEC's goal in seeking civil penalties, and the Fair Fund provision does no more than permit civil penalties subsequently to be distributed in the same way as disgorged profits." (citations omitted)); SEC v. WorldCom, Inc., No. 02-4963, 2004 WL 1621185, at *1–2 (S.D.N.Y. July 20, 2004) (rebuffing attempts made by potential claimants to challenge the way the funds are distributed).

122. *See generally* Evans, *supra* note 103 (proposing to use Fair Funds as the beginnings of an investor insurance fund).

123. Winship, *supra* note 4, at 1134 (suggesting that such guidelines should focus the SEC on actions that do not duplicate private actions—and thus collection and distribution costs—and that minimize concerns about the circularity of compensation in the secondary market context).

124. *See* 17 C.F.R. § 166.5(c)(7) (2007) ("Three Forums Exist for the Resolution of Commodity Disputes: Civil Court litigation, reparations at the Commodity Futures Trading Commission (CFTC) and arbitration conducted by a self-regulatory or other private organization.").

125. *See* Rapp, *supra* note 115, at 136 ("In private securities lawsuits, little new information is typically generated. Instead, class action lawyers use information voluntarily provided by companies or piggy-back on information generated by government investigations in filing their suits.").

As to developing the law, the Reparations Program used to be a particularly important source of law creation in the commodities context when it was unclear whether private rights of action existed under the commodities laws; it has become less urgent as courts have implied private causes of action in the commodities laws. High settlement rates may limit legal development through private actions, however.

In contrast, arbitration may generate information in the same way that the Reparations Program does if the agencies are informed about the conduct that is the subject of private or SRO arbitrations. Whether and when customers use arbitration will also affect whether these claims come to light. The identity of the arbitrator—industry- or government-agency-affiliated—may influence whether investors come forward with complaints. The Reparations Program has been viewed as more consumer-friendly,[126] so it might provide a forum for claims that otherwise would not have been heard, thus generating factual information.

The law-generating aspect of an agency reparations program represents an advantage over arbitration.[127] As described above, the Reparations Program provides written opinions subject to CFTC and judicial review. Of course, the flip side of a program of reasoned precedential opinions subject to judicial review is that, as the procedure becomes more judicial, it becomes less useful as an alternative, informal, and quick forum for dispute resolution. Moreover, as arbitration changes—for instance, if written opinions become an option—the relative benefits of the Reparations Program may decrease, putting more pressure on whether the cost of the Reparations Program is worth having an arbitrator who is a government employee.[128]

This Essay urges policymakers to look at these existing programs and to consider as part of the cost–benefit mix the effects the programs have on the factual information that gets to the financial regulators and the legal information that the programs produce. The Reparations Program is not a fix; throughout its history, it has been unpopular with industry,[129] and the

126. *See* Smythe, *supra* note 59, at 83 ("There is a perception that the CFTC's reparations process has a pro-complainant bias.").

127. *See* Jennifer J. Johnson & Edward Brunet, *Critiquing Arbitration of Shareholder Claims*, 36 SEC. REG. L.J., Fall 2008, at 1 (criticizing proposals to arbitrate shareholders' claims).

128. *See* Smythe, *supra* note 59, at 83 (suggesting that "the broader utility of such an ADR program for other federal agencies will depend essentially on one question: whether value is ascribed to expert government employees serving as judges of private disputes arising under a federal regulatory program").

129. Fowler C. West, a former CFTC Commissioner, once noted that he "spent much of [his] ten years at the CFTC defending the Reparations Program because the industry disliked it." Symposium, *New York Stock Exchange, Inc. Symposium on Arbitration in the Securities Industry*, 63 FORDHAM L. REV. 1505, 1523 (1995).

CTFC and Congress have struggled to combat a backlog of cases by imposing pragmatic limitations to the Reparations Program's reach. The history of the Reparations Program lends weight to the critique that it could make the CFTC a "huge small claims court for the Commodity industry,"[130] resulting in a slow system that potentially overwhelms resource-constrained agencies. A large backlog of cases was the impetus for rule revisions in 1984 that introduced pragmatic limitations to the scope of the Reparations Program.[131] The revised rules also added the option of a streamlined, quick and unappealable, voluntary process that does not result in binding precedent,[132] and thus does not contribute to generating law in this area.

This difficult history, taken in conjunction with the Reparations Program's potential contributions to information generation, suggests three main avenues of further inquiry. First, the costs of the Reparations Program need to be tracked and evaluated, particularly if it is expanded to reach a new group of cases. These costs cannot be evaluated in a vacuum; whether the Reparations Program is an appropriate and cost-effective alternative to arbitration may change as arbitration systems change. For instance, if arbitration begins to generate written explanations, as the National Association of Securities Dealers (now the Financial Industry Regulatory Authority) suggested in its "explained awards proposal,"[133] some of the relative information advantages of the Reparations Program would be decreased.

Second, any use of the Reparations Program by a consolidated agency must develop pragmatic limitations that go beyond the division between futures and securities, which proposed consolidation is designed to overcome. The design of a new Reparations Program may provide an opportunity to distinguish among types of investors and design a Reparations Program targeted at the most vulnerable and least likely to pursue a complaint in its absence. For example, the Reparations Program might identify and define a class of sophisticated investor who may contract out of the Reparations Program.[134]

130. Lopez Valdez, *supra* note 14, at 61 (quoting Gary L. Seevers, Comm'r, Commodity Futures Trading Comm'n, Luncheon Address, Regulatory Reform Conference 39, 41 (Sept. 11, 1975)).

131. *See generally* Raisler & Geldermann, *supra* note 65 (describing the perceived problems with the Reparations Program and the responsive rule changes including limiting the eligibility for reparations proceedings).

132. *See id.* at 554.

133. Black & Gross, *supra* note 118, at 21–22, 28 n.53.

134. In the Reparations Program's current structure, even signatories of predispute arbitration agreements have a forty-five day window in which to elect the Reparations forum. The current rule allows predispute agreements with sophisticated investors to include waivers of access to the Reparations forum.

Third, if the benefit of the Reparations Program is information generation, we should investigate how to intensify this aspect. For instance, many of the issues that arise when designing incentives for attorneys and individual investors to bring other actions—such as the appropriateness of punitive damages and the treatment of attorneys' fees—might fruitfully be examined here.

CONCLUSION

Renewed discussion of regulatory consolidation provides an opportunity to revisit and reshape financial regulators' involvement in investor compensation. The CFTC's longstanding Reparations Program and the SEC's relatively recent experience with the Fair Fund provision of Sarbanes–Oxley provide a case study of agency compensatory roles. To the extent that these experiments in investor compensation provide us with data, they lend support to the argument that maintaining regulation by multiple regulators allows experimentation and provides a natural laboratory.

Building on the assumption that compensation by someone of at least some injured investors is appropriate, this Essay makes three arguments: First, the Fair Funds and Reparations Program approaches could exist side by side, but there is no reason to draw the line as it is currently drawn—essentially between futures and securities—based on the jurisdiction of the agencies. Second, although a Fair Funds and Reparations Program could coexist, resource-constrained agencies (or Congress, when deciding what roles to assign these agencies) are likely to have to make allocative choices. The comparison between the counsel and judge approaches may aid this choice. An action in which the agency acts as decisionmaker (as the CFTC does through its Reparations Program) is potentially information-generating in two ways: aggrieved customers who use the forum furnish facts about industry practices and potential violations that may feed the enforcement efforts of the agency, and the decisions that come out of the program develop law in the area. Finally, we should ask whether the agencies—however configured—should take on any role. This requires a comparison of the alternatives to private actions and arbitration. Although more empirical study of the costs and benefits of the Reparations Program is needed and, as arbitration procedures develop, the need for the Reparations Program may change, the Reparations Program's information-generating role should be weighed heavily on the benefit side.