

WELCOME BACK, SEC?

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INTRODUCTION

One place to look for clues as to the current thinking of the Securities and Exchange Commission on bankruptcy is the SEC's own website.¹ Here, in the question and answer format the SEC uses when it communicates with ordinary investors, is what the SEC website says in a publication called "What Every Investor Should Know . . . Corporate Bankruptcy":

Question: "What is the Role of the U.S. Securities & Exchange Commission in Chapter 11 Bankruptcies?" Answer: "Generally, the SEC's role is limited." "The SEC will . . . review the disclosure document" and "ensure that stockholders are represented by an official committee."²

If this were the end of the story, we might simply marvel at how much the SEC's role has shrunk since the mid twentieth century, and leave it at that. From 1938, when Congress enacted the Chandler Act,³ until 1978, the SEC patrolled nearly every large corporate reorganization. Under the 1978 Code, Congress sharply curtailed the SEC's role, leaving it with the diminished presence described on the SEC website.

But this is not the end of the story. Contrary to the chastened official account of its principal responsibilities I just quoted, the SEC has steadily expanded its bankruptcy presence over the past decade.⁴ In cases like WorldCom in 2002 and the Bernie Madoff scandal more recently, the SEC has used its authority under the securities laws to intervene in the bankruptcy and insolvency context. Much as Italian governments look wistfully back to ancient Rome, there is evidence that the SEC is trying to recapture some of its former glory.

My goal in this essay is to offer one scholar's assessment of the SEC's reemergence in bankruptcy. As will not surprise anyone who has stumbled across my work in this area, I'll start with a historical explanation for the SEC's demise in bankruptcy, which was capped by the sharp reduction of the SEC's role after the enactment of the 1978 Code. I'll keep the historical discussion brief, since I've written about it at length elsewhere. But it strikes me as one of the most remarkable

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¹ U.S. SEC (Nov. 13, 2010), <http://www.sec.gov/>.

² *What Every Investor Should Know . . . Corporate Bankruptcy*, U.S. SEC, (Nov. 13, 2010), <http://www.sec.gov/investor/pubs/bankrupt.htm>.

³ Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978) (amending Bankruptcy Act of 1898 "to establish a uniform system of bankruptcy throughout the United States").

⁴ The SEC's recent reappearance in bankruptcy has created substantial tensions with the U.S. Trustee, the regulator charged with serving as the principal watchdog under current bankruptcy law.

rise-and-falls in American regulatory history. I'll then say a few words about the resurgence of the SEC in bankruptcy, which I think can be fairly though loosely traced to the Enron and WorldCom scandals.

To assess these developments, I'll distinguish among four different kinds of oversight the SEC might provide. The first two are disclosure and antifraud, which are the SEC's traditional focus under the securities laws.⁵ The third is governance strictures that are procedural in form, and the fourth is substantive intervention, each of which characterized the SEC's oversight in bankruptcy under the Bankruptcy Act. If we map the SEC's reemergence against these categories, the exercise may offer some useful insights into the predicament the SEC faces as it attempts to reestablish its presence.

I. THE POLITICAL STORY

The origins of SEC involvement in bankruptcy date back to the end of the receivership era in the early twentieth century. First used to reorganize railroads in the second half of the nineteenth century, the equity receivership was the ancestor of today's chapter 11.⁶ Under the old equity receiverships, Wall Street banks like J.P. Morgan & Co. formed committees to represent the bondholders whose bonds they had underwritten, and they then negotiated with the debtor over the terms of the reorganization. The reorganization was effected through a sham sale of the assets to a new entity whose creditors were the same creditors as with the old entity—a structure remarkably similar to the maneuvers the government used in the recent Chrysler and GM bankruptcies.⁷

The law professor-reformers of the New Deal—William Douglas, Abe Fortas, and Jerome Frank especially—wanted to put an end to this Wall Street dominated practice. And they did. Chapter X of the Chandler Act of 1938, which was the fruit of a multi-volume SEC study of corporate reorganization practice overseen by Douglas,⁸ drove a stake in the heart of existing reorganization practice in several ways. Most importantly, it prohibited any bank or law firm that had represented a debtor before bankruptcy from continuing to represent it in bankruptcy, and it

⁵ See, e.g., A.C. Pritchard, *The SEC at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1073 (2005) ("[The SEC] has largely moved beyond the tasks that dominated much of its early agenda . . . and ensconced itself firmly as the arbiter of corporate disclosure and the primary enforcer of antifraud rules.").

⁶ See, e.g., Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1421 (2004) (emphasizing limits of receiverships as compared to chapter 11).

⁷ The similarities are discussed in more detail in Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 767–70 (2010) (comparing Chrysler's "pseudo-sale" with equitable receivership in *Northern Pacific Railway Company v. Boyd*, 228 U.S. 482 (1913)).

⁸ SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES (1936–1940) (examining problems with corporate reorganization under pre-Chandler Act practices through report consisting of eight volumes and spanning time frame of four years).

required that the business be taken over by a trustee in every case.⁹ In addition, chapter X gave the SEC sweeping powers, including the authority to issue a report before a reorganization plan was submitted to the parties, and the right to intervene on any issue in the case.¹⁰

Although chapter X transformed large scale corporate reorganization and ended the old receivership practice, many corporate debtors managed to circumvent its strictures. At the risk of violating the scholarly norm against autobiographical digressions, I cannot resist noting that pursuing the evidence of companies' evasion of chapter X by filing under chapter XI, which was the chapter designed for small companies, and of William Douglas's ironic role in the events that led to the SEC's almost complete ouster from bankruptcy by the 1978 Code, was the single most exciting part of writing my book *Debt's Dominion*.¹¹ (The student law review editors did not seem to find it quite so exciting; I could not persuade any of them to publish the article that became chapter 6 of the book.¹²)

I gradually concluded that the SEC had accidentally wired the Bankruptcy Act for its own demise. Chapter X cases were cumbersome as a result of the need to turn things over to a trustee and to wait for an SEC report. Early on, the bankruptcy judge, then known as a referee, could not even handle a chapter X case; he had to turn it over to the district court. And later on, bankruptcy referees sometimes saw the SEC as a competing source of authority in the case, since the SEC was passing

⁹ The trustee's control over the business and the reorganization plan was in Chandler Act sections 189 and 169. Chandler Act of 1938 § 169, Pub. L. No. 75-696, 52 Stat. 840, 890 (repealed 1978) (creating duty of trustee to prepare and file plan of reorganization, or inform court of reasons why plan cannot take effect); *id.* § 189, 52 Stat. at 892 (granting trustee power to run business operations upon authorization of judge). The exclusion of banks and lawyers was in the disinterestedness requirements of Chandler Act sections 157 and 158. *Id.* § 157, 52 Stat. at 888 (requiring attorney appointed to represent trustee be disinterested party); *id.* § 158, 52 Stat. at 888 (providing list of interested parties, including attorneys for debtor and underwriters for securities of debtor). The prohibition against pre-petition banks working for the debtor survived into the 1978 Code but was recently removed, as part of the 2005 amendments to the Bankruptcy Code. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. § 101(14) (2006) (defining disinterested person as any person who is not creditor or insider, was not employee or director of debtor within two years, and does not have adverse interest to estate).

¹⁰ SEC authorization to report on reorganization plans came in Chandler Act sections 172 and 173, and section 208 made the SEC a party in interest. Chandler Act § 172, 52 Stat. at 890 (requiring debtor in certain situations to submit plan of reorganization to SEC for advisory report); *id.* § 173, 52 Stat. at 891 (prohibiting judge from granting reorganization plan before SEC has filed report or notified judge that it will not file report); *id.* § 208, 52 Stat. at 894 (allowing SEC to become party in interest upon granting of SEC motion by judge or upon judge's request). In addition, section 265(2) gives the SEC the power to set compensation. *Id.* § 265(2), 52 Stat. at 903 (authorizing SEC to fix compensation of attorneys, examiners, other experts, officers, and employees).

¹¹ In addition to his role in the drafting of chapter X (discussed in the next paragraph), Douglas, who became a Supreme Court justice in 1939, wrote the majority opinion in *General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956). *Shlensky* held that courts should consider the "needs to be served" when they determined whether it was permissible for a company to file its case in chapter XI. *Id.* at 466. Under this malleable standard, increasingly large companies managed to squeeze into chapter XI in the late 1950s and early 1960s. The history is recounted in DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 160–83 (Princeton Univ. Press 2001).

¹² David A. Skeel, Jr., *The Rise and Fall of the SEC in Bankruptcy* (Univ. of Pa. Law Sch. Inst. for Law and Econ., Working Paper No. 267, 1999), available at <http://ssrn.com/abstract=172030>.

judgment on the terms of the reorganization. Many bankruptcy lawyers hated the SEC; one prominent lawyer said the best predictor of how many regulators the SEC would devote to a case was whether the case was in Hawaii or somewhere else.¹³ On the other hand, if the debtor filed its case in chapter XI, the chapter designed for mom and pop companies, the debtor's managers could continue running the business, the debtor did not need to find a new lawyer, and the judge did not need to deal with the SEC. Just about everyone other than the SEC thought that removing the SEC from bankruptcy, so that evasive maneuvers would no longer be necessary, was a great idea.

The final straw, in a sense, was committee jurisdiction. Bankruptcy legislation was and is the province of the Judiciary Committee, which in those decades tended to listen to bankruptcy lawyers and the National Bankruptcy Conference. The SEC was largely a stranger to the Judiciary Committee, since securities issues were handled by the Banking and Interstate Commerce Committees. As a result, the SEC's fate was decided in the 1970s by an unsympathetic committee.¹⁴ With the enactment of the 1978 Code, it was relegated to a minor role, and its influence in bankruptcy seemed all but over. A shadow, to adapt an old saying, cannot cast a shadow.

II. THE WEDGE BETWEEN CORPORATE LAW AND BANKRUPTCY SCHOLARSHIP

Before I turn to the SEC's recent resurgence, I'd like to very briefly pick up on a theme that Douglas Baird raises in his contribution to this symposium.¹⁵ In his exploration of the SEC's campaign to incorporate the absolute priority rule into the Chandler Act, Baird points out that an academic consensus can sometimes shape the law in unfortunate ways.¹⁶ It seems to me that legal change can also influence the academy—that is, that causation sometimes works in the opposite direction, or in both directions.

In William Douglas's era, the leading corporate law scholars were also reorganization experts. Douglas wrote in both areas, as did Jerome Frank and even

¹³ See SKEEL, *supra* note 11, at 179 (citing interview with Ron Trost).

¹⁴ It is perhaps worth digressing briefly to note that these technical committee issues also seem to have featured in the recent the Dodd-Frank Act. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 203, 124 Stat 1376 (2010). One reason Congress did not seriously consider using bankruptcy reform, rather than FDIC resolution, as the strategy of choice for handling financial institution failures is that Representative Barney Frank and Senator Christopher Dodd would not dare let the legislation escape their House Financial Services and Senate Banking Committees, and make its way to the Judiciary, which oversees bankruptcy legislation.

¹⁵ Douglas G. Baird, *Present at the Creation: The SEC and the Origins of the Absolute Priority Rule*, 18 AM. BANKR. INST. L. REV. 591 (2010).

¹⁶ Baird argues that the SEC's campaign to persuade the courts to read absolute priority into the Chandler Act of 1938 reflected an academic consensus about the virtues of absolute priority that has been called into question by subsequent research. *Id.*

Adolph Berle.¹⁷ But the Chandler Act of 1938 helped bring an end to this. The enactment of chapter X destroyed large scale reorganization practice, and severed the connection between securities issuance and restructuring.¹⁸ Barring the debtor's securities underwriters from bankruptcy disrupted the continuity between these two stages in the corporate life cycle that had existed since the emergence of the first publicly held corporations in the nineteenth century.¹⁹ For decades after the Chandler Act, few law professors taught both corporations and bankruptcy, and bankruptcy was treated as something entirely separate from corporate law. The leading bankruptcy scholars of the 1950s and 1960s, for instance, were men like Vern Countryman and Frank Kennedy, whose gaze was trained on bankruptcy and commercial law, and who appear to have had less familiarity with corporate and securities law.

This artificial and unfortunate separation has given more recent bankruptcy scholars something to write about, but it distorted corporate law and bankruptcy thinking for many years. Bankruptcy scholars wrote with little appreciation for and understanding of the corporate and securities laws that governed healthy firms, and bankruptcy was an even greater mystery for corporate law scholars. The increasing use of bankruptcy to restructure major corporations shortly before, and much more pervasively after the enactment of the 1978 Code, seems to have contributed to the reintegration of corporate law and bankruptcy. So too did the emergence of the law and economics movement, with its emphasis (parallel in striking respects, though often with a different political valence, to the legal realism of leading New Dealers like Douglas and Frank) on functionalist accounts of regulation.²⁰

We cannot yet say that corporate law and bankruptcy are fully reintegrated. But both scholarship and practice have moved far in this direction.²¹ In a sense, one theme of this symposium is rethinking the SEC's role in a world where corporate and securities law, on the one hand, and bankruptcy law, on the other, are once again integrated.

¹⁷ See, e.g., William O. Douglas, *A Functional Approach to the Law of Business Associations*, 23 ILL. L. REV. 673 (1929); William O. Douglas, *Protective Committees in Railroad Reorganizations*, 47 HARV. L. REV. 565 (1934).

¹⁸ This separation and its legacy in current bankruptcy law is the subject of David A. Skeel, Jr., *Bankruptcy Boundary Games*, 4 BROOK. J. CORP. FIN. & COM. L. 1 (2009).

¹⁹ See *id.* at 1.

²⁰ For a caution about linking law and economics to legal realism, see RICHARD A. POSNER, *OVERCOMING LAW* 3 (Harvard Univ. Press 1995) ("The 'crits' worry that the practitioners of law and economics will contest with them the mantle of legal realism. They need not worry. We economic types have no desire to be pronounced the intellectual heirs of Fred Rodell, or for that matter of William Douglas, Jerome Frank, or Karl Llewellyn.").

²¹ One small data point on the scholarly side: Nearly all of the scholars in the conference that gave rise to this symposium (Barry Adler, who moderated one of the sessions; Kelli Alces; Douglas Baird; Jonathan Lipson; Keith Sharfman) have taught both corporate law and bankruptcy and draw on each in their scholarship.

III. A RESURGENCE SINCE ENRON AND WORLDCOM?

The resurgence of SEC involvement—if there is one—can probably be traced to the corporate scandals of the early 2000s, WorldCom and Enron in particular.²² With WorldCom and then Parmalat, the Italian dairy conglomerate that collapsed in late 2002, the SEC pressed successfully for innovative corporate governance changes as part of enforcement actions against the two companies.²³ In *Enron* and in other cases, the SEC has taken advantage of a Sarbanes-Oxley provision that invites the Commission to funnel corporate penalties assessed against corporations to shareholders who would not otherwise be entitled to them in bankruptcy.²⁴

I do not think it is coincidental that this stepped up involvement came at a time when the SEC was perceived as having slipped in its regulatory effectiveness. The Commission apparently had not even looked at Enron's disclosures in the several years before Enron went up in flames.²⁵ But the SEC's better-late-than-never strategy seems to have worked then, and worked again in the recent crisis. The SEC got a big increase in funding under Sarbanes-Oxley, and has been given substantial new authority by the Dodd-Frank Act.²⁶

²² See, e.g., Alistaire Bambach & Samuel R. Maizel, *The SEC's Role in Public Company Bankruptcy Cases Where There is a Significant Enforcement Interest*, 2005 ANN. SURV. BANKR. L. 99, 99 (2006) (dating increased SEC participation to 2000 and emphasizing "mega-cases" such as Enron and WorldCom").

²³ WorldCom agreed to the engagement of former SEC Chairman Richard Breeden as its corporate monitor, and adopted a wide range of Breeden-recommended governance reforms when it emerged from bankruptcy as MCI. The changes included requirements that at least one director be replaced each year and that any shareholder proposal with at least 1% support be submitted for a company vote, as well as separate audit, governance, compensation and risk management committees, and a limit on the use of poison pills. The proposed changes are outlined in Report from Richard C. Breeden, Corporate Monitor on Corporate Governance for the Future of MCI, Inc. to Hon. Jed S. Rakoff, The United States District Court for the Southern District of New York, 3–11 (Aug. 26, 2003), <http://news.findlaw.com/hdocs/docs/worldcom/corpgov82603rpt.pdf>.

The SEC used a consent decree to effect similar reforms at Parmalat. In accordance with the decree, Parmalat's bylaws require that a majority of its directors be independent and that they serve for limited terms, and that the chief executive officer and board chairman be different people. The decree also called for the board to adopt a Code of Conduct and establish an Internal Control and Governance Committee. Consent and Undertakings of Defendant Parmalat Finanziaria, S.p.A. ¶¶ 7–8, *incorporated in SEC v. Parmalat Finanziaria, S.p.A.*, Civ. No. 03 CV 10266 (S.D.N.Y. July 28, 2004) (Judgment of Permanent Injunction Against Defendant Parmalat Finanziaria, S.p.A.).

²⁴ Known as Fair Funds, the provision has been codified at 15 U.S.C. § 7246(a) (2006).

²⁵ See, e.g., R.T. McNamar, *New Technology Can Help Avoid a Second Enron: the SEC Needs Reporting Processes for the Information Age*, 26 REGULATION 62, 62 (Fall 2003), available at <http://www.cato.org/pubs/regulation/regv26n3/v26n3-14.pdf> ("The Enron 10(k) for 1997, which was filed in April 1998, was the last Enron periodic filing to be examined by an SEC staff member until the Commission reacted to comments in the press about the firm's problems and opened an enforcement investigation during the third quarter of 2001.").

²⁶ SOX increased the SEC's funding from \$437 million in 2002 to \$776 million in 2003. See, e.g., John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91, 95 (2007) (discussing increased funding of SEC after Sarbanes-Oxley). Dodd-Frank gives the SEC greatly expanded regulatory authority over securities-based derivatives, and makes the SEC the receiver of systemically important investment banks under the new Dodd-Frank resolution rules. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 203, 124 Stat 1376, 1450–51 (2010).

What should we make of this renewed role? To lay the foundation for an assessment, I will distinguish among four kinds of roles the SEC might play: the first and second are the SEC's traditional emphases: disclosure and policing fraud. The third and fourth are governance and substantive oversight.²⁷ By governance, I mean imposing or implementing procedural safeguards such as the minimum time period for tender offers or the new proxy access rule that gives minority shareholders the right to include minority directorial nominees in the company's proxy materials.²⁸ By substantive oversight, I mean intervention to police outcomes. A familiar historical example of substantive intervention was state regulators' "merit review" of proposed securities offerings—their decision whether to allow them to go forward.²⁹

Of these four functions, the SEC's role in disclosure and policing fraud is well established under the securities laws, and generally (although not completely) uncontroversial.³⁰ SEC intervention in governance is sometimes appropriate but is more controversial. The two sets of rules just mentioned—tender offer regulation and the new proxy access rule—illustrate the benefits and dangers of the SEC's governance role. The procedural requirements that are imposed on tender offers

²⁷ The SEC's oversight of investment banks adds another form of oversight—risk regulation—which combines aspects of both governance and substantive oversight. I put risk regulation—prudential regulation, as it's called in the banking context—to one side for present purposes.

²⁸ Congress added tender offer regulation to the Securities Exchange Act of 1934 as part of the 1968 Williams Act. See W. Brewster Lee III, *SEC Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance*, 68 CORNELL L. REV. 914, 914 (1983). The current rules require, among other things, that the offeror keep a tender offer open for twenty days, and make it available to all shareholders on a pro rata basis. See 17 C.F.R. § 240.14e-1 (2009) (banning tender offer held "for less than twenty business days from the date such tender is first published or sent to security holders," and less than sixty calendar days if "tender offer involves a roll-up transaction . . . and the securities being offered are registered (or authorized to be registered) on Form S-4 (17 C.F.R. § 229.25) or Form F-4 (17 C.F.R. § 229.34)"). The new Dodd-Frank Act's proxy provision invited the SEC to adopt a rule requiring that a company include proposed directorial nominations by shareholders in the company's own proxy materials. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 203, 124 Stat 1376, 1915 (2010). Under the rule adopted by the SEC, shareholders with 3% of the company's stock, and who have held the stock for at least three years, can nominate directors for up to 25% of the board. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,467, 56,674–75 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 200, 232, 240 and 249).

²⁹ See, e.g., Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & ECON. 229, 230 (2003) (noting merit review statutes allowed administrators to disallow securities offerings). Some states also adopted provisions providing for merit review of tender offers until these laws were struck down by the Supreme Court in *Edgar v. Mite Corp.*, 457 U.S. 624, 630 (1982) (ruling provisions of Illinois Act preempted by Williams Act and declaring Illinois Act unconstitutional).

³⁰ For a comparatively skeptical assessment of mandatory disclosure, see generally FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 276–314 (Harvard Univ. Press 1991) (discussing various aspects of problems of mandatory disclosure system). Although few commentators question the SEC role in policing fraud altogether, some commentators question aspects of SEC enforcement. Henry Manne has long argued that insider trading should not be forbidden. See HENRY G. MANNE, *INSIDER TRADING AND THE STOCK* (1966). And Jonathan Macey and Geoffrey Miller once argued that companies should be permitted to waive the 1934 Act's prohibitions against misdisclosure. Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1076 (1990). But the clear weight of scholarly opinion supports mandatory disclosure and the SEC's role in policing fraud. As we shall see, the case for more intrusive oversight is far more problematic.

under the 1968 Williams Act³¹ and subsequent amendments have the effect of tilting the playing field against outside bidders and in favor of the managers of a target. Although some of the requirements impose dubious burdens on potential bidders, the overall effect of the rules is quite beneficial, protecting shareholders against manipulative behavior by bidders.

The SEC's new proxy access rule, which is equally procedural in form, is harder to justify.³² Not only does it largely displace an evolving state law on the question of how much the company should do to subsidize shareholder directorial nominations,³³ but the SEC's rule also seems designed to facilitate the participation of some shareholders but not others. A public pension fund, which may hold stock for a relatively long period of time, might satisfy the three year holding period required for shareholders who wish to invoke the rule. Rare is the hedge fund that will have held stock long enough to qualify.³⁴

While procedural intervention is sometimes defensible, substantive intervention—that is, intervention that addresses "fairness" of an offering, proposal, or agreement, or which picks winners and losers—is nearly always problematic.³⁵ Regulators rarely have the competence for substantive intervention, and even if they did, their decision making may be infected by psychological or political biases. The concerns are both familiar and compelling.

So what does this tell us about the SEC's role in bankruptcy? One of the problems with the SEC's authority under the Chandler Act from 1938 to 1978 was that the SEC's role took it well beyond disclosure and anti-fraud, which was its focus under the securities laws, and into governance and even substantive intervention. This was particularly true after the Supreme Court read the absolute priority rule into the Bankruptcy Act in 1939.³⁶ When the SEC issued its report on a proposed reorganization plan in chapter X, it did focus on the adequacy of the proposal's disclosure. But its principal objectives went far beyond this, encompassing both governance concerns such as assuring compliance with the absolute priority rule, and substantive concerns, such as the overall fairness of the proposed plan. In theory, the SEC's role was advisory rather than controlling. But

³¹ 15 U.S.C. §§ 78a–78III (2006).

³² Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,467, 56,674–75 (Sept. 16, 2010) (to be codified at 17 C.F.R. pt. 200, 232, 240 and 249).

³³ Delaware had taken a tentative step into proxy access by enacting Del. G.C.L. section 112, which allows shareholders to propose bylaws that would provide for proxy access; and Del. G.C.L. section 113, which authorizes bylaws that would require the company to reimburse shareholders' expenses in a proxy contest. DEL. CODE ANN. tit. 8, §§ 112–13 (West 2010).

³⁴ The rule also seems to be susceptible to the claims made by Joe Grundfest that it will serve primarily as a "megaphone" for unions and public pensions. See, e.g., Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law* 17 (Stan. Law & Econ. Olin Working Paper No. 386, 2009) (describing "megaphone externalities" generated by proxy access as additional publicity valuable to interest groups like labor unions and public pension funds).

³⁵ For evidence that early twentieth century blue sky laws benefitted small banks, see Mahoney, *supra* note 29, at 249.

³⁶ See *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 119–20 (1939).

the Commission's conclusions were often treated as decisive, as the New Deal reformers surely intended.³⁷

In retrospect, this looks like unnecessary overreaching on the reformers' part. The Chandler Act changes that destroyed the old receivership process set up a new governance structure in corporate reorganization. The new framework might have worked quite effectively without heavy-handed SEC involvement, at least if the mandatory trustee requirement were softened.³⁸ By taking decision making authority away from Wall Street banks and lawyers, and giving it to the individual stock and bondholders, the changes would have promoted the democratization of corporate reorganization that many of the reformers advocated.³⁹

But the reformers threw an additional framework on top of this democratization. Rather than trusting investors to use the franchise themselves, the reformers essentially gave the SEC the authority to make the decision for them. The overlay of two different regulatory approaches—democratization, on the one hand, and substantive intervention on investors' behalf, on the other—made chapter X very cumbersome. (Indeed, the interference with corporate reorganization may have contributed to the shift in focus of American retail investment from bonds to stocks after World War II. Given that the SEC viewed public bondholders as its principal constituency—the shift may have been, at least in part, a further unintended consequence of the Chandler Act.⁴⁰)

From this perspective, we can begin to see both the good intentions and intractable predicament in the SEC's recent reemergence in bankruptcy. Start with the reasons for praise. With many of its recent initiatives, the SEC seems to be trying to focus on its traditional functions, disclosure and policing fraud.⁴¹ Running through a list of the SEC's activities in recent years—pursuing disgorgement actions,

³⁷ See *SEC v. U.S. Realty & Imp. Co.*, 310 U.S. 434, 459 (1940) ("The Commission did not here intervene to perform the advisory functions required of it by chapter X, but to object to an improper exercise of the court's jurisdiction which . . . would defeat the public interests which the Commission was designated to represent."); *DuBois v. Consol. Rock Prods. Co. (In re Consol. Rock Prods. Co.)*, 114 F.2d 102, 108 (9th Cir. 1940), *aff'd*, 312 U.S. 510 (1941) (finding SEC amicus brief persuasive and previously affirmed plan applying "relative" over absolute priority was "clearly insufficient" (quoting *Los Angeles Lumber*, 308 U.S. at 119)); *In re Detroit Int'l Bridge Co.*, 30 F. Supp. 127, 127 (E.D. Mich. 1939) (using SEC report as basis for details of reorganization plan).

³⁸ The mandatory displacement created a strong incentive for managers of a troubled company to avoid chapter X at all costs, which discouraged timely initiation of bankruptcy cases. A more flexible rule might have avoided this disincentive.

³⁹ Roger Foster called, for instance, for more meaningful bondholder voice in the choice of their representative: "Let machinery be provided for bondholder election of representatives by plurality or majority vote," he argued, "with requirement that candidates disclose, or free themselves from, inconsistent interests. . . . To dislodge the bankers, the reformer will be forced to change his democratic slogan and call in Democracy at large." Roger S. Foster, *Book Reviews*, 43 *YALE L.J.* 352, 357 (1933) (reviewing MAX LOWENTHAL, *THE INVESTOR PAYS* (Alfred A. Knopf 1933)).

⁴⁰ SKEEL, *supra* note 11, at 173.

⁴¹ The two major exceptions are the SEC's governance experiments and its use of receiverships in recent Ponzi scheme cases, each of which is discussed below. See Skeel, *infra* note 59, at 720–27 (discussing SEC involvement in reorganization of corporate governance of Worldcom and Parmalat); see also *infra* note 65 (examining SEC use of equity receiverships in Madoff and Stanford Ponzi schemes).

determining whether a trustee or examiner is necessary, reviewing disclosure statements⁴²—it quickly becomes apparent that nearly all of them involve disclosure or policing fraud. These are the issues at which the SEC is best, and is most likely to improve the process.

But there are two very big difficulties with this role. These difficulties are the source of the SEC's predicament. The first, which will occupy much of our attention, is that the SEC's efforts to police fraud are far more problematic in chapter 11 than they would be outside of bankruptcy. Most of the SEC's enforcement activity has been based on the antifraud provisions of the Securities and Exchange Act of 1934, such as Rule 10b-5, which prohibits misstatements or omissions and insider trading. The SEC increasingly has pursued disgorgements and penalties from the corporate wrongdoers in these cases, and has used the "fair funds" authority established by the Sarbanes-Oxley Act to direct some of these payments to investors.⁴³ What's not to like about this?

To answer this question and to begin to unpack the first problem with the SEC's recent bankruptcy campaigns, we need to consider several different dimensions of antifraud litigation under the securities acts. The principal distinction is between actions involving material misstatements or omissions that do not directly benefit the company (as with most "fraud on the market" actions) and the smaller category of cases in which the company has profited by selling securities whose price is inflated by misstatements or omissions.

Begin with fraud on the market actions alleging that the company made misstatements without directly profiting by selling securities itself.⁴⁴ In the classic fraud on the market action, the company told investors that it was not involved in merger discussions, although it was.⁴⁵ The company did not profit from the misstatement; the victims were shareholders who sold their stock before the truth about the proposed merger led to substantially higher stock values. More often, fraud on the market cases arise when the company hides bad news that will prompt a downward adjustment in its stock price. But here too the company does not directly profit from its misstatement.

⁴² These activities are described in Bambach & Maizel, *supra* note 22.

⁴³ Sarbanes-Oxley Act of 2002, § 308, Pub. L. No. 107-204, 116 Stat. 745, 784 (codified as amended at 15 U.S.C. 7246 (2006)). Disgorgement has a restitutionary flavor. In a disgorgement, the SEC seeks to recover the illicit gains received by a wrongdoer, as when a corporation sells securities at a price that is inflated by the corporation's misrepresentation of its financial condition. SEC penalties are designed to punish the wrongdoer under circumstances when the wrongdoer may or may not have benefitted from its misbehavior. The SEC's penalties are discussed in more detail below. *See infra* notes 48–51 and accompanying text.

⁴⁴ In a fraud on the market action, the plaintiff (a shareholder rather than the SEC in most cases) relies on fraud of the market doctrine rather than actual reliance to demonstrate reliance. Under *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), reliance is presumed on fraud on the market grounds if the company's shares are actively traded. The intuition is that, with an actively traded stock, the market price will be affected by the misdisclosure. *See id.* at 246. As a result, even if investors do not directly rely on the misstatement (because they often do not hear or read it), they do rely on the integrity of the market price. *See id.* at 247.

⁴⁵ *Id.* at 229.

It has become increasingly clear that the traditional fraud on the market action is hard to justify under any circumstances, even outside of bankruptcy. Because the company itself invariably pays the damages—either directly or through its directors' and officers' insurance—these actions simply to take money from one group of investors (current shareholders) and give it to another (the shareholders included in the class of victims).⁴⁶ This pocket shifting suggests that any compensatory benefit from the litigation is attenuated at best. Defenders of fraud on the market litigation point to deterrence as an alternative benefit, but here too the apparent benefits shrink on inspection. Because directors and officers can expect the company or the insurer to pay any damages in most cases, it does not seem likely that the threat of litigation will have a large deterrent effect.⁴⁷

Many of the SEC's enforcement actions against bankrupt companies are the public enforcement version of these fraud on the market actions. In these cases, the SEC seeks penalties (or penalties in addition to disgorgement of actual benefits) to punish the company for its defalcation. Until recently, any penalties would have been paid to the U.S. Treasury rather than to investors. But the Sarbanes Oxley Act's "Fair Funds" provision authorizes the SEC to distribute penalty funds to investors, and the SEC has taken up the offer.⁴⁸

The *WorldCom*⁴⁹ case is a good illustration. In *WorldCom*, the company agreed to pay \$500 million as part of its settlement of allegations related to WorldCom's \$11 billion accounting fraud, and distributed these funds to investors.⁵⁰ A settlement like this one is, if anything, even more dubious than an ordinary private fraud on the market action. Not only does it shift funds from one group of investors to another, but punishing a company by imposing a financial penalty has little point if the company is already in bankruptcy.⁵¹

The cases in which the SEC seeks disgorgement solely of benefits improperly received by the company are more compelling outside of bankruptcy. If a company lies about financial condition and sells securities at an inflated price as a result, forcing it to return the excess payments is entirely appropriate. But even here, the action serves very little purpose if the company has filed for bankruptcy. If the defrauded investors are shareholders, it treats these shareholders as if they were

⁴⁶ One of the first articles to make this point was Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 623 (1992) (addressing difficulties of actions for fraud).

⁴⁷ My colleagues Bill Bratton and Michael Wachter critique each of the arguments for fraud on the market litigation in detail in a new article. William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market* (2010) (unpublished manuscript) (on file with the American Bankruptcy Institute Law Review).

⁴⁸ See *id.* at 50–52 (discussing patterns of SEC enforcement outside of bankruptcy).

⁴⁹ SEC v. WorldCom, Inc., 273 F. Supp. 2d 431 (S.D.N.Y. 2003).

⁵⁰ *Id.* at 435 (announcing WorldCom agreed to pay \$500,000,000, which will be disbursed to victims of company's fraud).

⁵¹ In the SEC's defense, it does try to limit its penalty actions to cases in which the company has profited in some way from its wrongdoing. But this does not justify pursuing these actions when the company is in bankruptcy. Kelli Alces makes a similar point about the lack of a justification for SEC antifraud litigation in the bankruptcy context. Kelli A. Alces, *Limiting the SEC's Role in Bankruptcy*, 18 AM. BANKR. INST. L. REV. 631 (2010).

priority claimants in the bankruptcy by diverting funds that would otherwise go to creditors. The bankruptcy laws ordinarily subordinate a shareholder's securities claims, but the SEC has evaded this rule and ignored the priority framework by arguing that its action is equitable in nature (rather than seeking compensatory damages) and that it has independent enforcement authority under the securities laws.⁵²

To be sure, it is possible to defend this subversion of ordinary priorities. If creditors face the prospect that some of their recovery will be diverted to shareholders if the company lies about its financial condition, the reasoning might go, this will give them a stronger incentive to monitor.⁵³ But the SEC's decisions whether and when to pursue these actions are too haphazard to generate consistent incentives of any kind.⁵⁴ And even if there were a valuable incentive effect, this would not justify giving the funds to shareholders or other low priority investors. The SEC could achieve just as much deterrence by requiring disgorgement but holding onto the funds.

So the first problem is that the SEC is pursuing litigation that often does little more than show that it is not ignoring a company's egregious misbehavior. These actions may help to demonstrate that the SEC matters, despite its lapses in enforcement. But their social value is dubious.

The second problem is that the roles that do make sense for the SEC in bankruptcy are already occupied by other regulators. The New Deal reformers wanted to punish managers who had misbehaved before bankruptcy, and bankers and lawyers who had lined their own pockets before or during bankruptcy.⁵⁵ Many of these functions are now the domain of the U.S. Trustee—particularly functions such as policing attorneys' fees.⁵⁶ The task of policing for pre-bankruptcy preferences and fraudulent payments, which is another function the SEC theoretically might serve, has fallen to private examiners.⁵⁷

⁵² The bankruptcy provision subordinating securities claims is 11 U.S.C. § 510(b) (2006). The SEC's arguments for circumventing it are described in Bambach & Maizel, *supra* note 22, at 105 (citing and discussing SEC v. Rind, 991 F.2d 1486 (9th Cir. 1993)).

⁵³ Barry Adler made this point, without endorsing it, at the conference on which this symposium was based.

⁵⁴ The effect is also very different from Douglas Baird's argument that relative priority may be a more sensible priority scheme than traditional absolute priority.

⁵⁵ The SEC Report on corporate reorganization complained, for instance, that "[m]anagements and bankers seek perpetuation of [their] control . . . to perpetuate that control in order to stifle careful scrutiny of the past history of the corporation. Thereby, claims based on fraud or mismanagement are stilled." SEC, *supra* note 8, at I:1089.

⁵⁶ See 28 U.S.C. § 586 (2006) (delineating various U.S. Trustee functions, including oversight of fees); see also U.S. Trustee Program, About the United States Trustee Program & Bankruptcy, http://www.justice.gov/ust/eo/ust_org/about_ustp.htm (setting forth "[s]pecific responsibilities of the United States Trustee includ[ing]: [t]aking legal action to enforce the requirements of the Bankruptcy Code and to prevent fraud and abuse; referring matters for investigation and criminal prosecution when appropriate; ensuring that bankruptcy estates are administered promptly and efficiently, and that professional fees are reasonable").

⁵⁷ 11 U.S.C. § 1104(c) instructs the bankruptcy court to appoint an examiner if a party in interest requests one and no trustee has been appointed. The best study of examiners is Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1,

Would we be better off if the SEC were to take over some of these roles, as it seems to be trying to do in some of the most high profile cases? Maybe, but I do not think so. A large majority of chapter 11 cases do not implicate the public markets in any direct way. A bankruptcy specific regulator like the U.S. Trustee is a more sensible overseer of these issues.⁵⁸

IV. THE SEC'S GOVERNANCE EXPERIMENTS

At the height of the corporate scandals of the early twenty-first century, the SEC installed former SEC Chairman Richard Breeden as Corporate Monitor of WorldCom, and it subsequently negotiated settlements with WorldCom and Parmalat that required the two companies to restructure their corporate governance. As recommended by the Corporate Monitor, MCI (the company that emerged from WorldCom's bankruptcy) adopted a board structure with no insiders except the CEO, established separate Audit, Governance, Compensation and Risk Management committees, and adopted several bylaws designed to give shareholders more say.⁵⁹ Parmalat added bylaws requiring that a majority of its directors be independent, that the CEO and board chair be different people, and that the board establish an Internal Control and Governance Committee.⁶⁰

The SEC's governance experiments reflect the third of the four general kinds of SEC regulation—governance or procedural protections—but with a twist. Rather than implementing governance rules for all corporations, the SEC effected firm-specific reforms in its WorldCom and Parmalat settlements. Both the SEC's venturing beyond its core disclosure and anti-fraud roles, and its targeting of individual firms are reasons to be wary of the governance experiments. The single-firm reforms are indeed heavy-handed, potentially costly, and of uncertain benefit to the targeted firms. They are nevertheless more defensible than the SEC's imposition of monetary penalties on companies that have filed for chapter 11 and its intervention on issues already patrolled by the U.S. Trustee and private examiners. The fraud committed by these companies fully justified a radical regulatory response. Moreover, any costs would be borne by the enterprise as a whole, and thus would not unsettle ordinary priorities, as the SEC's use of its Fair Funds authority does. The reforms also were reversible. Because they were included in WorldCom's and Parmalat's bylaws, rather than the companies' certificates of

4 (2010), which finds that examiners are not appointed nearly as frequently as the language of section 1104(c) would suggest.

⁵⁸ Note, too, that taking these functions away would take away the most attractive of the U.S. Trustee's functions, making it a dreary regulatory post.

⁵⁹ The WorldCom experiment is discussed at length in David A. Skeel, Jr., *Governance in the Ruins*, 122 HARV. L. REV. 696, 720–27 (2008) (reviewing CURTIS J. MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD* (Univ. of Chicago Press 2008)). The governance changes are outlined *id.* at 724–25.

⁶⁰ See *id.* at 731 (noting Parmalat governance changes).

incorporation, the directors could simply amend the bylaws if the reforms proved prohibitively costly.⁶¹

In a sense, the SEC's single-firm governance reforms shame and (more importantly) reintegrate companies that have committed egregious fraud.⁶² Market participants may be skeptical of these firms' claims to have mended their ways before emerging from chapter 11. Their adoption of SEC-approved governance reforms functions as a seal of approval that the company has indeed changed. So long as the SEC uses this strategy only in egregious cases, it is a more desirable role for the SEC than the other interventions we have discussed thus far.

V. SUBSTANTIVE REGULATION: MADOFF, STANFORD AND THE SEC'S RECEIVERSHIPS

The SEC's latest regulatory adventure has come in a series of recent Ponzi scheme cases, including the Madoff and Stanford scandals.⁶³ The cases follow a somewhat similar pattern to the scandals of a decade ago. The SEC failed to detect Bernie Madoff's and Robert Allen Stanford's frauds,⁶⁴ but moved in after the scandals erupted.

In both cases, the Commission set up receiverships to resolve the financial distress of the businesses and took the unusual step of asking the district court to issue an order enjoining any of the parties from filing a bankruptcy petition.⁶⁵ With

⁶¹ If the reforms were included in the company's certificate of incorporation, amendment would require both approval of the directors and an affirmative shareholder vote. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242 (2001) (listing requirements for amending certificate).

⁶² The classic treatment of shaming and reintegration is JOHN BRAITHWAITE, *CRIME, SHAME, AND REINTEGRATION 1* (Cambridge Univ. Press 1989) (discussing shame as way to understand criminal behavior). Others are more skeptical of shaming. *See, e.g.*, Toni M. Massaro, *Shame, Culture and American Criminal Law*, 89 MICH. L. REV. 1880, 1943 (1991) (condemning shaming as ineffective punishment due to harmful consequences and cultural conditions).

⁶³ Both Bernard Madoff and Robert Allen Stanford operated Ponzi scheme style investment businesses in which early investors were paid lavish profits that were funded by the contributions of later investors rather than by investment earnings. *See, e.g.*, Craig T. Lutterbein, Note, "Fraud and Deceit Abound" But Do the Bankruptcy Courts Really Believe Everyone is Crooked: The Bayou Decision and the Narrowing of "Good Faith," 18 AM. BANKR. INST. L. REV. 405, 405–06 (2010) (noting almost half of Madoff investors profited using this investment scheme). The experience of Madoff's victims, who included many prominent figures, are recounted in MAUREEN A. EBEL ET AL., *THE CLUB NO ONE WANTED TO JOIN—MADOFF VICTIMS IN THEIR OWN WORDS* (Erin Arvedlund ed., 2009).

⁶⁴ *See, e.g.*, Marcy Gordon, *Lawmakers Blast SIPC, Madoff Bankruptcy Trustee*, ABCNEWS.GO.COM, (Dec. 9, 2009), <http://abcnews.go.com/Business/wirestory?id=9291285> (describing SEC as "already under fire for bungling numerous investigations of Madoff's business and failing to detect his scheme despite red flags").

⁶⁵ The receivership order in the Madoff case preventing any party from filing for bankruptcy is Order on Consent Imposing Preliminary Injunction, Freezing Assets and Granting Other Relief Against Defendants at 4–5 SEC v. Madoff, No. 08 civ. 10791 (LLS) (S.D.N.Y. Dec. 18, 2008), available at <http://www.sec.gov/news/press/2008/2008-293-order-2.pdf> (ordering that all parties "are preliminarily enjoined from filing a bankruptcy proceeding against Defendants without filing a motion on at least three (3) days' notice to the Plaintiff, and approval of this Court after a hearing"). Under the Stanford order, only the receiver is permitted to file a bankruptcy petition. *See* Amended Order Appointing Receiver at 6 SEC v. Stanford Int'l Bank, Ltd., No. 3:09-CV-0298-N (N.D. Tex. Mar. 12, 2009), available at

the businesses of Bernard Madoff, the effect of this circumvention of bankruptcy was limited, because the SEC and Securities Investor Protection Corporation ("SIPC") initiated a SIPC proceeding on behalf of the customers of Madoff's investment firm. In a SIPC proceeding, bankruptcy rules generally apply, which would make the preference and fraudulent conveyance provisions and other bankruptcy protections fully available.⁶⁶ But the Stanford receivership was not accompanied by a parallel SIPC proceeding, and the district court's receivership order prohibited anyone other than the receiver from filing a bankruptcy petition.⁶⁷

Although it cannot dictate the decisions of the receivers in these cases once they are appointed, the SEC has tried to shape the frameworks by which the defrauded investors are paid. In effect, the SEC is trying to pick winners and losers in the receiverships, much as it did under the old Chandler Act in bankruptcy.⁶⁸ The Ponzi scheme cases are particularly difficult to unravel because of the need to decide whether to force early investors who received payments before the scheme collapses to return some of the funds. These investors have plausible arguments for keeping most or all of the payments—they were innocent, for instance, and the money is now long gone—but the investors who got nothing have strong arguments that they should not bear all the losses. Given this zero sum battle, the SEC's concern to prevent the parties from fighting over whether a receiver, a bankruptcy judge or someone else will determine the repayment formula is understandable.

But the SEC's efforts to dictate the outcomes in these cases based on its own views as to who should get what are ominous. Ad hoc resolution by regulators, which is the SEC's objective in these cases, invariably distorts the resolution process and is almost never a desirable regulatory strategy.⁶⁹ Given the SEC's

http://www.stanfordfinancialreceivership.com/documents/Amended_Order_Appointing_Receiver.pdf [hereinafter Stanford Receiver Order] ("The Receiver shall have . . . the sole and exclusive power and authority to petition for relief under the United States Bankruptcy Code . . ."). For overviews of the receiverships, see, for example, Clarence L. Pozza, Jr., Thomas R. Cox, and Robert J. Morad, *A Review of Recent Investor Issues in the Madoff, Stanford and Forte Ponzi Scheme Cases*, 10 J. BUS. & SEC. L. 113, 116 (2010) (considering fairness in allowing Ponzi scheme investors to recover); David A. Gradwohl & Karin Corbett, *Equity Receiverships for Ponzi Schemes*, 34 SETON HALL LEGIS. J. 181, 183 (2010) (proposing powers of equity receiverships to recover funds for victims of Ponzi scheme are limited).

⁶⁶ See Stephen P. Harbeck, *Stockbroker Bankruptcy: The Role of the District Court and the Bankruptcy Court Under the Securities Investor Protection Act*, 56 AM. BANKR. L.J. 277, 285 (1982) ("[A] SIPC Proceeding is largely governed by the Bankruptcy Code."). This is important because a major issue in both receiverships has been whether to claw back payments that were received by early investors. The SEC has argued that these payments should not be retrieved.

⁶⁷ See Stanford Receiver Order, *supra* note 65, at 6 (granting receiver "exclusive power" to petition for relief under Bankruptcy Code). For the receiver's account of developments in the Stanford case, see *What Happened and General Receivership Information*, STANFORD FINANCIAL GROUP RECEIVERSHIP, (last updated Feb. 22, 2009), http://www.stanfordfinancialreceivership.com/documents/General_Receivership_Information_022709.pdf.

⁶⁸ See, e.g., Pozza et al., *supra* note 65, at 120–21 (describing receiver's dispute with SEC over clawback efforts in Stanford receivership).

⁶⁹ It is possible that general principles will emerge in the SEC receiverships, much as they did with the evolution of railroad receiverships in the nineteenth century. But the railroad receiverships filled a clear need. With the SEC receiverships, by contrast, the SEC is trying to remake existing regulatory options under circumstances where the need is much less evident.

historical focus on public shareholders and bondholders, SEC influence may mean a bias toward public investors and against other kinds of creditors. It also would replace the transparency of bankruptcy with a more opaque insolvency resolution mechanism. Fortunately, there is some evidence that courts may limit the SEC's efforts to establish its own bankruptcy remote proceedings in the Ponzi scheme cases.⁷⁰

VI. THE FUTURE?

I do think it may be possible to carve out a limited but meaningful role for the SEC in bankruptcy cases. The key, in my view, is to stick with the kinds of things the SEC already does outside of bankruptcy, particularly its role in overseeing disclosure, and to steer clear of responsibilities that are already handled by others. Two areas that might benefit from additional SEC expertise are disclosure statements and securities offerings made when a company exits chapter 11.⁷¹ Bankruptcy judges could be given the option of soliciting an opinion on the securities aspects of a proposed disclosure statement, for instance, and the SEC might play a rulemaking role with the rights offerings that many firms now conduct as they exit from chapter 11.⁷² I also think that the SEC's efforts to police securities-related fraud committed by individual wrongdoers—including by challenging third party releases in connection with a chapter 11 reorganization—is often defensible.⁷³

Particularly given the SEC's increasing interest in substantive intervention, as reflected in its Ponzi scheme receiverships, the new Dodd-Frank Act could have nefarious implications for the SEC's perception of its role in bankruptcy. Under Dodd-Frank's new resolution rules, the SEC will itself be appointed as receiver if a systemically important investment bank falls into financial distress.⁷⁴ At the moment, we do not have any systemically important investment banks, since Bear Stearns, Merrill Lynch and Lehman Brothers have disappeared, and Goldman Sachs and Morgan Stanley turned themselves into bank holding companies. But Goldman and Morgan may "de-bank" at some point, and other investment banks may emerge.

In an investment bank resolution, the SEC would play the most substantive of possible roles. It would decide which claims get assumed and which do not, and generally dictate the terms of the resolution—just as the FDIC does in a bank

⁷⁰ See *SEC v. Byers*, 592 F. Supp. 2d 532, 539–40 (S.D.N.Y. 2008) (striking language from Receiver Order which permitted court to remove case from bankruptcy proceedings), *aff'd*, 609 F.3d 87 (2d Cir. 2010).

⁷¹ Under 11 U.S.C. § 1125 (2006), a plan proponent is required to provide a detailed disclosure statement when it proposes a reorganization plan. If the reorganization will provide for an issuance of new securities, section 1145 currently exempts the issuance from otherwise applicable securities law. 11 U.S.C. § 1145 (2006).

⁷² See generally Colin Diamond, *Rights Offerings as a Means of Financing Exits from Chapter 11*, 18 AM. BANKR. INST. L. REV. 615 (2010).

⁷³ See, e.g., Bambach & Maizel, *supra* note 22, at 109 (noting SEC challenges to third party releases).

⁷⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 204, 124 Stat 1376, 1454–56 (2010).

resolution. My fear is that this might encourage the SEC to think of its place in bankruptcy and insolvency more generally in substantive terms as we move into a more regulatory era. This would augur an unfortunate resurrection of the most problematic elements of the SEC's former role in bankruptcy.

The SEC's involvement in bankruptcy has been a long, strange trip. The fact that the SEC is once again concerned about the bankruptcy process is a promising development in at least one respect. It is strong evidence that the artificial boundaries between corporate law and bankruptcy have seriously eroded. But there is a real danger that the SEC will creep back into the kinds of oversight that proved so problematic prior to the 1978 Code.

We are entering into a new regulatory era that harkens back to the heyday of regulation during and just after the New Deal. My hope is that the SEC will back off a little, focus on what it does well, and learn from the mistakes that were made in its bankruptcy glory days.