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Implications of the 1984 Insider Trading Sanction Act: Collateral Estoppel and Double Jeopardy

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COMMENTS

Implications of the 1984 Insider Trading Sanction Act: Collateral Estoppel and Double Jeopardy*

I. INTRODUCTION

On August 10, 1984, President Reagan signed the Insider Trading Sanctions Act of 1984 (ITSA).[1] ITSA provides the Securities and Exchange Commission (SEC) with a treble civil penalty[2] enforcement sanction to use against corporate insiders who trade securities in violation of rule 10b-5[3]—a rule prescribed by the SEC in accordance with section 10(b) of the Securities Exchange Act (Exchange Act).[4] The treble penalty supplements existing SEC sanctions[5]

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1. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified as amended at 15 U.S.C.A. §§ 78c, 78o, 78t, 78u, 78ff (West Supp. 1985)). ITSA became effective upon enactment, August 10, 1984. 15 U.S.C.A. § 78c (West Supp. 1985).

2. 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985). "[The] court shall have jurisdiction to impose . . . a civil penalty . . . [that] shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale . . . ." *Id.* ITSA also increases the criminal penalty for all violations of the Securities Exchange Act from $10,000 to $100,000, 15 U.S.C.A. § 78ff (West Supp. 1985) (amending § 32 of the Exchange Act, ch. 404, 73 Stat. 904 (1934)), to adjust for inflationary erosion of the fine's deterrent effect.

3. A rule 10b-5 violation occurs when a corporate insider "trad[es] in securities based on nonpublic confidential or proprietary information." T. HAZEN, THE LAW OF SECURITIES REGULATION 480 (Law. ed. 1985); *see infra* notes 12-19, and accompanying text (defining inside information and inside trading).

4. Rule 10b-5 allows the SEC to bring enforcement actions under the Exchange Act against insiders who fraudulently exploit inside information. 17 C.F.R. § 240.10b-5 (1984). Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . .
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> . . . .
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1982).

Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
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> (1) to employ any device, scheme, or artifice to defraud,
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> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
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> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1984).

Establishing a 10b-5 violation is a prerequisite to the assessment of the treble penalty. *The*

and is designed to deter insider trading,[6] thereby protecting investor confidence and the integrity of the securities market.[7] Although ITSA bolsters the SEC enforcement sanctions, it does not alter the underlying substantive law of insider trading; accordingly, the courts, not ITSA, define what conduct constitutes a 10b-5 violation.[8]

This Comment identifies and assesses two problematic consequences of ITSA. ITSA adds significant factors to a trial judge's decision whether to allow the use of offensive nonmutual collateral estoppel by a plaintiff in a private action following a successful SEC treble penalty action.[9] This Comment reviews these factors, concluding that collateral estoppel should be available to a private plaintiff following an SEC treble penalty action. Another consequence of ITSA is the possibility of placing a violator in jeopardy twice for the same offense. After a review of double jeopardy doctrine, the Comment concludes that the combination of a criminal prosecution and an SEC treble penalty action would compel an insider to defend two "essentially criminal"[10] lawsuits for the "same offense,"[11] thereby violating the double jeopardy clause of the Constitution.

Insider Trading Sanctions Act of 1983: Hearings on H.R. 559 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 98th Cong., 2d Sess. 72, 74, 107-08 (1984) [hereinafter cited as *Senate Hearings*].

5. ITSA amends § 21 of the Securities Exchange Act of 1934, ch. 404, 73 Stat. 886. 15 U.S.C.A. § 78u (West Supp. 1985). Section 2(A) of ITSA provides that an action seeking the treble penalty "may be brought in addition to any other actions that the Commission or the Attorney General are entitled to bring." 15 U.S.C.A. 78u(d)(2)(A) (West Supp. 1985). The legislative history corroborates the need for a treble penalty. *Senate Hearings, supra* note 4, at 5, 10, 72, 116; *Insider Trading Sanctions and SEC Enforcement Legislation: Hearings on H.R. 559 Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 98th Cong., 1st Sess. 13-14, 26-27, 56, 60 (1983) [hereinafter cited as *House Hearings*]; H.R. REP. No. 355, 98th Cong., 1st Sess. 8, 16, 20 (1983) [hereinafter cited as H.R. REP.]; 130 CONG. REC. S8913 (daily ed. June 29, 1984) (statement of Sen. D'Amato).

6. *Senate Hearings, supra* note 4, at 2, 3; *House Hearings, supra* note 5, at 12, 16, 59; H.R. REP., *supra* note 5, at 8, 18, 24; 130 CONG. REC. S8914 (daily ed. June 29, 1984) (statement of Sen. Sarbanes); 129 CONG. REC. H7012 (daily ed. Sept. 19, 1983) (statement of Rep. Wirth).

7. *Senate Hearings, supra* note 4, at 1, 11, 95, 115, 147; *House Hearings, supra* note 5, at 16, 35, 36; H.R. REP., *supra* note 5, at 23; 130 CONG. REC. S8914 (daily ed. July 29, 1984) (statement of Sen. Sarbanes); 130 CONG. REC. H7757, 7759 (daily ed. July 25, 1984) (statements of Rep. Dingell and Rep. Wirth); 129 CONG. REC. H7012 (daily ed. Sept. 19, 1983) (statement of Rep. Wirth).

8. *Senate Hearings, supra* note 4, at 72, 74, 95; H.R. REP., *supra* note 5, at 9, 13 n.20, 14, 31, 32; 130 CONG. REC. H7758, (daily ed. July 25, 1984) (statement of Rep. Dingell); *see* 130 CONG. REC. S8912-13 (daily ed. June 29, 1984) (statement of Sen. D'Amato) (expressing desirability of statutory definition of insider trading but noting that such definition not included in ITSA).

9. For information on collateral estoppel, see generally C. WRIGHT, THE LAW OF FEDERAL COURTS 682-88 (1983) (description and explanation of collateral estoppel).

10. *See infra* note 185 and accompanying text.

11. *See infra* note 185 and accompanying text.

II. BACKGROUND

A. *The Law of Insider Trading*[12]

ITSA is applicable only when a 10b-5[13] insider trading violation can be established. There are two essential elements of a 10b-5 violation: a fiduciary relationship between the defendant and the parties with whom the defendant transacts and fraudulent conduct by the defendant.[14]

A fiduciary duty arises from the relationships between corporate insiders—directors, officers, and other persons within the corporation who have access to confidential corporate information—and shareholders of the corporation.[15] This fiduciary duty requires insiders either to disclose nonpublic, confidential information relevant to a decision to buy or sell or to abstain from trading in the company's stock. This requirement is known as the duty to "disclose or abstain."[16] Fraudulent conduct is a breach of the corporate insider's fiduciary duty. The purchase or sale of securities by anyone knowingly in possession of material,[17] nonpublic information—"inside" information—is fraudulent.[18] Fraudulent conduct also may arise outside the purchase or sale context if an insider tips material, nonpublic information to another trader.[19]

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12. For commentary on insider trading, see Barry, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307 (1981); Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322 (1979); Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53 (1960); Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1 (1980); Fleischer, Mundheim & Murphy, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. PA. L. REV. 798 (1973); Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051 (1982); Hazen, *Corporate Insider Trading: Reawakening the Common Law*, 39 WASH. & LEE L. REV. 845 (1982).

13. *See supra* note 4. Rule 10b-5 was promulgated by the SEC pursuant to an express authorization in § 10(b) of the Exchange Act. As a result, rule 10b-5 has the force of a statutory provision. T. HAZEN, *supra* note 3, at 12 & n.3.

In addition to 10b-5, there are other statutory provisions prohibiting insider trading. Section 17(a) of The Securities Act of 1933, 15 U.S.C. § 77a-77bbbb (1982), contains substantially the same language as rule 10b-5 and applies to the primary distribution of securities. Section 16(b) of the Exchange Act, *id.* § 78p(b), proscribes "unfair use of information" by insiders. It allows the issuer to recover any profits made by an insider "from any purchase and sale or any sale and purchase, . . . within any period of less than six months." *Id.* Finally, rule 14e-3, 17 C.F.R. § 240.14e-3 (1984), created pursuant to an express authorization in § 14e of the Exchange Act, prohibits fraudulent use of inside information in the context of tender offers and has the force of a statutory provision. *See* T. HAZEN, *supra* note 3, at 362.

14. Dirks v. SEC, 103 S. Ct. 3255, 3261 (1983); Chiarella v. United States, 445 U.S. 222, 231 (1980); *Senate Hearings*, *supra* note 4, at 75-76; *House Hearings*, *supra* note 5, at 113.

15. Moss v. Morgan Stanley, Inc., 719 F.2d 5, 10 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984); *Senate Hearings*, *supra* note 4, at 75; *House Hearings*, *supra* note 5, at 16-17. The fiduciary duty extends not only to shareholders from whom the insider is buying, but also to potential shareholders to whom the insider is selling. *See* Chiarella v. United States, 445 U.S. 222, 227 n.8 (1980); Gratz v. Claughton, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951).

16. Chiarella v. United States, 445 U.S. 222, 229-31 (1980). *See* Hazen, *supra* note 12, at 850.

17. The materiality requirement necessitates that the inside information be a factor in the investment decision. *In re* Investors Management, 44 S.E.C. 633 (1971); *Senate Hearings*, *supra* note 4, at 110-11, 116.

18. Rule 10b-5 expressly requires that the fraudulent conduct be "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (1984); *supra* note 4. Scienter also is an element of a rule 10b-5 violation. Aaron v. SEC, 446 U.S. 680, 691 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

19. *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961) (The SEC determined that a tip of inside

A company president who buys stock from shareholders of the company or on the open market without disclosing that the company has made a major mineral find has violated 10b-5.[20] The result is the same when a broker-dealer sells stock on the basis of information obtained from an insider.[21] In both instances, the president's conduct constitutes fraud and a breach of the duty to disclose or abstain. In contrast, a printer who, while working on galleys, obtains material, nonpublic information about an impending tender offer and purchases stock in the target company probably has not violated 10b-5.[22] Similarly, a stock analyst who, possessing material, nonpublic information that an insurance company is engaging in fraud, passes this information to a number of investors probably has not violated 10b-5.[23] Both the printer and stock analyst are outsiders and owe no duty to disclose or abstain to the corporation's shareholders.[24]

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information from an insider to a broker-dealer who passed the information on to his clients "at least violated [rule 10b-5(3)] as a practice which operated as fraud or deceit upon the purchasers [of the securities sold by the tippees]."). *Id.* at 913; Hazen, *supra* note 12, at 848. Examples of fraudulent conduct covered by 10b-5 include the sale or purchase of stock in a face-to-face transaction or on the open market without disclosing nonpublic information that the company will increase in value because of a merger, tender offer, mineral find, or any other fact that a reasonable investor would weigh in making an investment decision. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849-52 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). Passing on nonpublic information about an impending dividend reduction in a publicly traded stock is another example of fraudulent conduct. *Cady, Roberts*, 40 S.E.C. at 907.

20. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852 (2d Cir. 1968), *cert. denied*, 394 U.S. 476 (1969).

21. *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

22. Chiarella v. United States, 445 U.S. 222 (1980).

23. Dirks v. SEC, 103 S.Ct. 3255 (1983). *Senate Hearings, supra* note 4, at 75-76. *See* Moss v. Morgan Stanley, Inc., 719 F.2d 5, 10 n.8 (2d Cir. 1983), *cert. denied*, 404 S. Ct. 1280 (1984).

24. Moss v. Morgan Stanley, Inc., 719 F.2d 5, 10 n.8 (2d Cir. 1981), *cert. denied*, 404 S. Ct. 1280 (1984); *Senate Hearings, supra* note 4, at 76-78. The SEC, however, has advanced alternative theories under which it can bring actions against outsiders who trade with, or tip material, nonpublic information. *See Senate Hearings, supra* note 4, at 76-78. Creation of these theories is an attempt to circumvent the Supreme Court's requirement of a fiduciary obligation as a prerequisite to a 10b-5 violation. *Id.* One theory purports to treat outsiders as insiders, thereby justifying the imposition of the 10b-5 duty. *See, e.g.*, Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (bank employees owed duty of disclosure to Ute Indians when employees were purchasing shares in a tribal trust fund without disclosing the existence of another market in which the shares could be sold for a higher price); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) (investment advisor owed clients duty of disclosure when he purchased stock for his own account immediately prior to publishing a recommendation that his clients buy the stock); *see also* Zweig v. Hearst Corp., 594 F.2d 1261 (9th Cir. 1979) (financial columnist committed 10b-5 violation by purchasing a security prior to publishing a buy recommendation); Lewelling v. First California Co., 564 F.2d 1277 (9th Cir. 1977) (brokerage firm committed 10b-5 violation by failing to disclose to purchaser that the transactions were part of a scheme to resell insiders' securities to enable such insiders to bail out of failing corporation). The Supreme Court has been willing to impose a 10b-5 duty on outsiders who have a special relationship of trust and confidentiality with the seller or issuer of the securities. *See, e.g.*, Dirks v. SEC, 103 S. Ct. 3255, 3261 n.14 (1983); *Moss*, 719 F.2d at 11.

A second theory, called the misappropriation theory, extends the scope of 10b-5 to outsiders based on an outsider's breach of a duty owed an employer in procuring the information. Some lower federal courts have accepted the misappropriation theory. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 104 S. Ct. 193 (1983); SEC v. Lund, 570 F. Supp. 1397 (C.D. Cal. 1983); O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179 (S.D.N.Y. 1981). Commentators advocating a statutory definition of "insider trading" have contended that the misappropriation theory has a tenuous future and may not suffice to put outsiders within the scope of 10b-5. *Senate Hearings, supra* note 4, at 76-78; *House Hearings, supra* note 5, at 114-17. Under a strict reading of Chiarella v. United States, 445 U.S. 222 (1980), the United States Court of Appeals for the Second Circuit recently rejected the misappropriation theory as a basis for an outsider's duty of disclosure to open market investors. *Moss*, 719 F.2d at 13, 15, 16. Under the misappropriation

B. *Pre-ITSA Enforcement Remedies*

Prior to the enactment of ITSA, the SEC's arsenal of enforcement sanctions did not include a civil penalty.[25] The primary sanction had been an injunction against future violations of the security laws and disgorgement of illicit profits.[26] An injunction is appropriate when the "defendant's past conduct indicates . . . that there is a reasonable likelihood of further violation in the future."[27] A defendant who violates the terms of an injunction may be subject to criminal fines and imprisonment.[28] Disgorgement, in contrast to the payment of damages, is not designed to compensate an injured party; instead, it is intended to force "a defendant to give up the amount by which he was unjustly enriched."[29] The disgorged profits are placed in an escrow account and distributed to private parties who can demonstrate losses incident to the defendant's illegal trading.[30] Other SEC equitable enforcement sanctions have included requiring the defendant to disclose previously withheld or omitted information, correct misleading reports, or add independent directors to corporate boards.[31] These pre-ITSA

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theory, a printer who surreptitiously deciphers confidential information about an impending tender offer and subsequently purchases stock in the target company has violated 10b-5 by fraudulent conduct in breach of a duty owed his or her employer. The defendant in *Chiarella* would have been in violation of 10b-5 had the misappropriation theory been applied. *See Chiarella*, 445 U.S. at 239, 240 (comments of Justices Brennan and Burger in support of the misappropriation theory); *House Hearings*, *supra* note 5, at 114. It is not necessary to show the breach of a fiduciary duty owed the shareholders. Although the Supreme Court has not decided on the viability of the misappropriation theory, the Court has placed a proviso on the theory, requiring that an outsider who tips the confidential information receive a direct or indirect benefit as a precondition of a 10b-5 violation. *Dirks*, 103 S. Ct. at 3264; T. HAZEN, *supra* note 3, at 489.

25. *See House Hearings*, *supra* note 5, at 13-14 (list of pre-ITSA sanctions that have been issued).

26. *Senate Hearings*, *supra* note 4, at 95; *House Hearings*, *supra* note 5, at 12; H.R. REP., *supra* note 5, at 7, 24; 130 CONG. REC. H7759 (daily ed., July 25, 1984) (statement of Rep. Wirth).

27. SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 99 (2d Cir. 1978) (quoting 3 L. LOSS, SECURITIES REGULATIONS 1976 (1961)). *See* SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 18 (2d Cir.1977); SEC v. Universal Major Indus., 546 F.2d 1044, 1048 (2d Cir. 1976), *cert. denied*, 434 U.S. 834 (1978); Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 394 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); SEC v. Everest Management Corp., 466 F. Supp. 167, 175 (S.D.N.Y. 1979); 15 U.S.C. § 78u(d) (1982).

28. 15 U.S.C. § 78u(d) (1982); H.R. REP., *supra* note 5, at 7.

29. SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 102 (2d Cir. 1978). Disgorgement is viewed as an equitable remedy, justifying denial of a jury trial right in an SEC disgorgement action. "[T]he court is not awarding damages to which plaintiff is legally entitled but is exercising the chancellor's discretion to prevent unjust enrichment." *Id.* at 95.

30. H.R. REP., *supra* note 5, at 25. *See* Dent, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865, 932 n.302 (1983); Hazen, *Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Methods*, 31 HASTINGS L.J. 427, 446 (1979). *See also* SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 96 (2d Cir. 1978) ("SEC makes proceeds of disgorgement available to injured investors.").

31. In addition to its equitable sanctions, the SEC has the authority to commence an administrative proceeding pursuant to rules 15b-4 and 15c-4 against a broker-dealer or any person subject to the reporting requirements of §§ 12, 13, and 15(b) of the Exchange Act. The term "dealer" includes "any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. § 776(12) (1982). Persons violating the reporting requirements have been ordered by the SEC to make more complete disclosures and to comply in the future. Other sanctions against broker-dealers have included "censure, limitations on activities, and suspension or revocation of the registration of a broker-dealer or person associated with a broker-dealer." H.R. REP, *supra* note 5, at 7. These administrative SEC orders, however, do not have the

sanctions are still in effect and can be used by the SEC in conjunction with ITSA enforcement provisions.

In addition to government enforcement sanctions, a defendant who violates 10b-5 also may be subject to suit by a private plaintiff for damages.[32] To establish a private action against a defendant for inside trading, a private plaintiff must prove that the defendant violated 10b-5 and must show reliance, causation, and damages.[33] The SEC's enforcement remedies, in contrast, are available against inside traders merely upon a showing that the defendant violated 10b-5. To avoid exposing an insider to excessively burdensome liability, the courts have placed restrictions on the class of private plaintiffs to whom the insider may be liable and on the type of damages allowed.[34] To recover, the private plaintiff must be a member of the class of persons to whom the defendant owes a fiduciary duty.[35]

Private actions pursuant to 10b-5 have been successful when controlling shareholders, directors, or officers possessing material, nonpublic information enter into face-to-face transactions with existing shareholders.[36] This conduct by corporate insiders not only violates 10b-5, it also imposes on the insider a duty to disclose, the breach of which provides the basis for a private action brought by the shareholder trading with the insider.[37] Insiders trading on the open market, however, are less susceptible to private actions.[38] Even though insiders trading on the open market are vulnerable to SEC 10b-5 enforcement actions, courts have hesitated to extend an insider's duty to disclose or abstain beyond face-to-face transactions because such an extension could expose insiders to overly burdensome liability.[39] Courts that deny liability also point to the difficulty in determining which investors on the open market actually were in-

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same enforcement effect as injunctions, because a defendant who disregards an order is not subject to a criminal contempt proceeding. *Id.* Defendants engaging in willful violations of the Exchange Act have also been subject to fines up to $10,000 and imprisonment in criminal actions brought by the Justice Department. 15 U.S.C. § 78ff (1982).

32. *House Hearings, supra* note 5, at 118-20; Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (recognized implied private actions pursuant to 10b-5). Later, the Supreme Court expressly allowed private actions pursuant to 10b-5. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Superintendent of Ins. v. Banker's Life & Casualty Co., 404 U.S. 6 (1971); Mill v. Electric Auto-Lite Co., 396 U.S. 375 (1970); Hazen, *Symposium Introduction: The Supreme Court and the Securities Laws: Has the Pendulum Slowed?* 30 EMORY L.J. 5, 11-17 (1981); Hazen, *Implied Private Remedies Under Federal Statutes: Neither A Death Knell Nor a Moratorium—Civil Rights, Securities Regulation, and Beyond*, 33 VAND. L. REV. 1333, 1340-42 (1980).

33. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 325 n.2 (1979); SEC v. Management Corp., 475 F.2d 1236, 1240 (2d Cir. 1972); Hazen, *supra* note 30, at 456; Pickholz & Brodsky, *An Assessment of Collateral Estoppel and SEC Enforcement Proceedings After* Parklane Hosiery Co. v. Shore, 28 AM. U.L. REV. 37, 50 (1978).

34. *See, e.g.*, Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977) (Trading by insiders on the open market ordinarily does not cause any legally recognizable loss to plaintiffs trading on the open market who would have traded in any event.).

35. *See* Hazen, *supra* note 12, at 852. In a face-to-face securities transaction, an insider owes a duty of disclosure to the party with whom he or she trades. *Id.*

36. *See, e.g., In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

37. *See* Hazen, *supra* note 12, at 852.

38. *Id.* at 852-53.

39. *Id.*; *see* Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir 1976).

jured by the inside purchases or sales.[40]

C. *The Need for Potent Sanctions*

Congress is concerned about the effects of insider trading for several reasons. First, insider trading undermines investor confidence. "Capital formation and our nation's economic growth and stability depend on investor confidence in the fairness and integrity of our capital market."[41] Second, insider trading injures specific people: "[M]arket makers and specialists, so necessary to the liquidity of the market, have suffered extreme financial losses . . . ."[42] Although 10b-5 transgressors have been subject to injunctions, disgorgement, criminal fines, imprisonment, civil suits by defrauded parties, disbarment, license revocation, loss of employment, payment of legal fees, and social opprobrium,[43] these sanctions did "not serve as a real deterrent when compared to the vast profits which can be gained so rapidly by trading with inside information."[44] According to Congress, ITSA's substantial sanctions were needed to deter insider trading, thereby effectuating the policy goals of protecting investor confidence and preventing injury to market professionals.[45]

Pre-ITSA sanctions alone are an inadequate deterrent for a number of reasons. First, the difficulty in meeting the burden of proof beyond a reasonable doubt in cases almost exclusively based on circumstantial evidence renders the criminal law penalties ineffective.[46] Second, the real enforcement power behind

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40. *House Hearings*, *supra* note 5, at 118. Presently, the courts are split on whether a private action exists when an insider defendant trades at an informational advantage on the open market. The United States Court of Appeals for the Sixth Circuit has determined that such an action "does not ordinarily cause any loss to open market traders who would have traded in any event." Fridrich v. Bradford, 542 F.2d 307, 318-19 (6th Cir. 1976). Allowing damages in such cases would create "a windfall for those fortuitous enough to be aware of their nebulous legal rights, and [impose] what essentially must be considered punitive damages almost unlimited in their potential scope." *Id.* at 321. The United States Court of Appeals for the Second Circuit has reached the opposite result, concluding that a private action exists "in favor of all investors who traded in the market contemporaneously with the insider trader before the information was disclosed." Elkind v. Ligget & Myers, Inc., 635 F.2d 156, 165-68 (2d Cir. 1980); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 236 (2d Cir. 1974); *House Hearings*, *supra* note 5, at 119. A plaintiff need only demonstrate that "the market price was affected by the misstatement or omission and the plaintiff's injury is due to a purchase or sale at the then fraudulently induced market price"—the fraud on the market approach. T. HAZEN, *supra* note 3, at 465. The United States Court of Appeals for the Second Circuit resolved the problem of potentially burdensome liability by limiting a defendant's liability to disgorgement of profits. *Elkind*, 635 F.2d at 173; *House Hearings*, *supra* note 5, at 118-20.

41. H.R. REP., *supra* note 5, at 2.

42. *Id.* at 5.

43. *House Hearings*, *supra* note 5, at 13-14.

44. *Id.* at 11.

45. *Id.* at 35-37 (statements of Rep. Wirth and John Fedders, director of SEC enforcement).

46. *Senate Hearings*, *supra* note 4, at 39-40 (testimony of John Fedders, director of SEC enforcement) ("Now when you go into the criminal forum you meet the burden of proof beyond a reasonable doubt, and to take circumstantial evidence and meet that burden is difficult for criminal prosecution. That's why I think . . . the civil penalty is correct. We know that it is going to continue to be the circumstantial evidence that we act on. We're going to meet the preponderance of evidence test."); *House Hearings*, *supra* note 5, at 63. *See also* H.R. REP., *supra* note 5, at 30-31 ("Most insider trading cases are . . . based largely on circumstantial evidence."); Hazen, *supra* note 30, at 435 (Because of the "constitutional and procedural safeguards that accompany criminal trials," criminal prosecutions are seldom pursued.).

To successfully prosecute an insider, the Justice Department must prove beyond a reasonable

an injunction rests in a possible criminal contempt proceeding, which is available only if the defendant repeats the illegal conduct.[47] An injunction, therefore, will deter repeat violations because a previously enjoined defendant faces the risk of a criminal contempt proceeding for subsequent violations. An injunction, however, does not penalize a defendant for the immediate, illegal conduct and thus provides only an inconsequential deterrent against initial violations.[48] Third, disgorgement merely returns a defendant to his or her financial position prior to the illegal trading.[49] By failing to threaten potential violators with significant negative consequences, disgorgement is an insufficient deterrent.[50] Fourth, changes in the securities market have multiplied the opportunities for an investor with inside information to make huge profits on a minimal investment.[51] The increase in mergers and tender offers, as well as the growth of the options market, has "fundamentally altered the risk-reward equation with respect to potential insider trading."[52] Tender offers and mergers frequently result in quick, sweeping price movements in the target company's stock, creating a strong temptation for persons possessing inside information to purchase stock in the target company. Persons with inside information of an impending tender offer, for example, may be tempted by the options market, where a small investment in options in the target company's stock can yield significant profits when the information becomes public and the underlying stock increases in value. Because of these market conditions, pre-ITSA sanctions were inadequate to offset

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doubt that the defendant knowingly and willfully violated 10b-5. 15 U.S.C. § 78 ff(a), (c)(1) (1982). *See* Hazen, *supra* note 30, at 435. As a result, "criminal proceedings utilize far more governmental resources." *Id.* at 432. Before a criminal action is commenced, the SEC refers the case to the Attorney General. *See Senate Hearings*, *supra* note 4, at 41-42 (letter to members of Senate Subcommittee on Securities from Director of SEC indicating that SEC investigations result in either informal reports or formal referrals to the Department of Justice or a grant of access for the Department of Justice to SEC files). Ultimately, the Justice Department and the SEC work together to prepare the criminal case. Hazen, *supra* note 30, at 435.

As of June 1, 1984, the SEC had instituted 61 civil actions against insiders for 10b-5 violations since 1981. *Senate Hearings*, *supra* note 4, at 41. The SEC formally referred seven cases to the Justice Department and granted access to SEC files in nineteen other cases. *Id.* Twenty-two criminal actions ultimately were brought, with seventeen resulting in criminal penalties, five of which were prison sentences. *Id.* at 42. For a synopsis of each criminal action, see *id.* at 42-51. For other comments concerning criminal prosecution of insiders who violate 10b-5, see *Senate Hearing*, *supra* note 4, at 39, 112; *House Hearings*, *supra* note 5, at 60-71; 130 CONG. REC. H7757 (daily ed. July 25, 1984) (statement of Rep. Dingell that criminal charges are rare); Hazen, *supra* note 30, at 434-35.

47. H.R. REP., *supra* note 5, at 7. An injunction "serves only a remedial function . . . ." *Id. See Senate Hearings*, *supra* note 4, at 32; Dent, *supra* note 30, at 930; Hazen, *supra* note 30, at 444; Comment, *Scienter and SEC Injunction Suits*, 90 HARV. L. REV. 1018, 1023-24 (1977); Note, *SEC Enforcement Actions to Enjoin Violations of Section 10(b) and Rule 10b-5: The Scienter Question*, 5 HOFSTRA L. REV. 831, 833-35 (1977).

48. *See Senate Hearings*, *supra* note 4, at 95; H.R. REP., *supra* note 5, at 7.

49. SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 95 (2d Cir. 1978); *House Hearings*, *supra* note 5, at 12; H.R. REP., *supra* note 5, at 7. *See* Porter v. Warner Holding Co., 328 U.S. 395, 400-02 (1946); 5 J. MOORE, FEDERAL PRACTICE ¶ 38.24[2] (1977).

50. *House Hearings*, *supra* note 5, at 12; H.R. REP., *supra* note 5, at 7.

51. *Senate Hearings*, *supra* note 4, at 17; *House Hearings*, *supra* note 5, at 18-20; H.R. REP., *supra* note 5, at 5, 6, 21; 130 CONG. REC. H7759 (daily ed. July 25, 1984) (statement of Rep. Wirth); 129 CONG. REC. H7012 (daily ed. Sept. 19, 1983) (statement of Rep. Oxley).

52. *Senate Hearings*, *supra* note 4, at 20.

the increased temptation to violate the securities laws.[53] Finally, the risk to a violator of detection is slight.[54] When coupled with insubstantial sanctions, a low rate of detection exacerbates the deterrence problem.

Beyond its desire to bolster deterrence, Congress sought harsher sanctions to punish insiders who violate 10b-5 as a matter of principle. ITSA's legislative history is embellished with references to such insiders as "thieves."[55] John Shad, Chairman of the SEC, promised to come down on them with "hobnail boots."[56] The pre-ITSA sanctions, in Congress' view, were not commensurate with the magnitude of the wrong committed.[57]

III. LEGISLATIVE RESPONSE TO THE INSIDER TRADING PROBLEM

Congress enacted ITSA to effectuate the policy goals of protecting investor confidence, preventing injury to market professionals, and preserving the efficiency and integrity of the securities market. ITSA augments the "risk-reward equation"[58] and makes the penalties for insider trading more commensurate with the magnitude of the temptation and potential profit, thereby restraining would-be transgressors with the threat of substantial, even financially crippling, fines.

Although ITSA provides additional enforcement sanctions, it does not define "insider trading,"[59] leaving the courts to determine the scope of 10b-5.

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53. *See Senate Hearings, supra* note 4, at 40; *House Hearings, supra* note 5, at 2, 31; 130 CONG. REC. H7757 (daily ed. July 25, 1984) (statement of Rep. Dingell).

54. *Senate Hearings, supra* note 4, at 39, 40.

55. *Senate Hearings, supra* note 4, at 1, 39; *House Hearings, supra* note 5, at 1, 65; 130 CONG. REC. H7757 (daily ed. July 25, 1984) (statement of Rep. Dingell); *id.* at S8912 (daily ed. June 29, 1984) (statement of Sen. D'Amato).

56. *House Hearings, supra* note 5, at 2.

57. *Senate Hearings, supra* note 4, at 39, 40, 147; *see House Hearings, supra* note 5, at 70; 130 CONG. REC. H7757, H7759 (daily ed. July 25, 1984) (statements of Rep. Dingell and Rep. Wirth). Representative Dingell commented that insiders who violate 10b-5 "are thieves and the current law is the equivalent of making a bank robber return the loot and then proceed on his merry way after signing a promise not to steal anymore—without having to admit he stole in the first place." *Id.* at H7757. Representative Wirth asserted that pre-ITSA sanctions "merely [restore] an unscrupulous trader to his original position without extracting a real penalty for his illegal behavior." *Id.* at H7759. Representative Bates sought "much tougher criminal sanctions. We have been toughening up [penalties for] burglaries and robberies, and armed robbery . . . . Drunk driving is starting to get some attention, and yet the white collar crimes, we are just getting around to . . . ." *House Hearings, supra* note 5, at 70.

58. *Senate Hearings, supra* note 4, at 21.

59. *See supra* note 8. Although the vast majority of commentators, members of Congress, and SEC staff members were in favor of supplementing the SEC enforcement sanctions with the treble penalty, a substantial debate transpired over whether the treble penalty alone, without an expanded definition of "insider trading," would be effective. *Senate Hearings, supra* note 4, at 32-33, 38, 66, 67-86, 99, 106-07, 116, 147; *House Hearings, supra* note 5, at 14-15, 49-56, 89-90, 98-99, 106-07, 112, 144-45, 174-98, 234-35. Many members of Congress and several commentators argued for an expanded definition of "insider trading." *Senate Hearings, supra* note 4, at 1-2, 66, 67-86, 96, 146; *House Hearings, supra* note 5, at 52, 106, 112, 144, 174-98. Proponents of this view envisioned a definition that would remove the fiduciary duty requirement from the case law definition of "insider trading," allowing 10b-5 to reach outsiders who base their trading on, or tip material, nonpublic information. *Senate Hearings, supra* note 4, at 1-2, 8-10, 68-86, 147; *House Hearings, supra* note 5, at 174-96. The Senate hearings incorporated an alternative draft of ITSA, developed by Milton Freeman and presented by Senator D'Amato, which expressly disallowed "unfair trading." *Senate Hearings, supra* note 4, at 8-10. Supporters of the draft argued that the fraud requirement of a 10b-5

ITSA amends section 21 of the Securities Exchange Act of 1934 to give the SEC the authority to seek a civil penalty of up to three times the amount of profit gained or loss avoided by one "purchasing or selling a security while in possession of material information."[60] At its discretion, the SEC may seek an injunction, disgorgement, the treble penalty, or any combination of these sanctions.[61] Furthermore, the SEC has the authority to seek the treble penalty from any or all persons within the scope of the Act.[62] Thus, the payment of a treble penalty by one person does not extinguish the liability of another person.[63] To establish an insider's liability, the SEC need only meet the burden of proof applicable in SEC injunction actions and private civil suits—a preponderance of the evidence.[64]

In addition to bolstering SEC enforcement ability, ITSA increases from $10,000 to $100,000 the maximum criminal fine for all violations of the Securities Exchange Act.[65] Because the civil penalties and the criminal punishments

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violation prevents SEC enforcement against outsiders who make transactions based on nonpublic information. *Id.* at 2, 68-86, 95, 147; *House Hearings, supra* note 5, at 174-96. These traders have information unavailable to the public, giving them an unfair advantage over even diligent investors. *See Senate Hearings, supra* note 4, at 68-86; *House Hearings, supra* note 5, at 174-96. "Unfair trading" of this nature erodes investor confidence and was viewed as reprehensible. *See Senate Hearings, supra* note 4, at 32-33, 68-86, 147; *House Hearings, supra* note 5, at 174-96. For these reasons, an expanded definition of "insider trading" was viewed as essential to effecting ITSA's policy goals.

The SEC staff and a number of commentators were opposed to including a statutory definition of insider trading. *Senate Hearings, supra* note 4, at 38, 107; *see House Hearings, supra* note 5, at 98-99. Their main objection was that the inclusion of such a definition would delay passage of ITSA. *Senate Hearings, supra* note 4, at 36-38; *see* 130 CONG. REC. S8912-13 (daily ed. June 29, 1984) (statement of Sen. D'Amato). The SEC maintained that the misappropriation theory would become accepted law, resulting in the proscription of at least some types of unfair trading over which Senator D'Amato expressed concern. *Senate Hearings, supra* note 4, at 33; *see supra* note 24 (misappropriation theory explained). Ultimately, Senator D'Amato acquiesced and came out in favor of ITSA, believing that immediate passage of ITSA was more important than the inclusion of the definition. 130 CONG. REC. S8411, S8913 (daily ed. June 29, 1984).

Advocates of a statutory definition could point to studies of deterrence in the criminal context which indicate that certainty of conviction (high rates of detection and prosecution) provides more deterrence than increased penalties. *See* F. MCCLINTOCK & E. GIBSON, ROBBERY IN LONDON 30 (1961); UNITED STATES DEPARTMENT OF JUSTICE, SUMMARY REPORT, THE DETERRENT EFFECTIVENESS OF CRIMINAL SANCTION STRATEGIES 18, 34 (Sept. 1972); F. ZIMRING & G. HAWKIN, DETERRENCE 3 (1973). If this principle were applicable to insider trading, then a statute which includes "unfair trading" in the category of prohibited trading would increase the SEC's rate of successful enforcement actions and would provide both a strong deterrent and an excellent complement to the existing treble penalty.

60. 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985). To satisfy a judgment for a treble penalty, the defendant pays the specified amount to the United States Treasury. *Id.*

61. *House Hearings, supra* note 5, at 27; H.R. REP., *supra* note 5, at 8; 130 CONG. REC. S8913 (daily ed. June 29, 1984) (statement of Sen. D'Amato). *See House Hearings, supra* note 5, at 14, 50.

62. *House Hearings, supra* note 5, at 14; 130 CONG. REC. H7758 (daily ed. July 25, 1984) (statement of Rep. Dingell). There were comments, however, that the combined amount of the penalty could be "astronomical." *Senate Hearings, supra* note 4, at 146.

63. *House Hearings, supra* note 5, at 14; 130 CONG. REC. H7758 (daily ed. July 25, 1984) (statement of Rep. Dingell).

64. H.R. REP., *supra* note 5, at 9, 15, 16, 27, 30, 31. Given the punitive nature of the treble penalty, it was pointed out that "a clear and convincing" standard might be more appropriate. *Senate Hearings, supra* note 4, at 109, 111-13; *House Hearings, supra* note 5, at 205. The SEC, however, contended that because actions brought against insiders who violate 10b-5 are based on circumstantial evidence, a higher standard of proof would impede the SEC's ability to bring successful treble penalty actions, undermining the deterrent effect of ITSA. *House Hearings, supra* note 5, at 46.

65. 15 U.S.C.A. § 78ff (West Supp. 1985) (amending § 32(a) of the Exchange Act). The crimi-

are not mutually exclusive,[66] the harshest repercussion of insider trading would be a triple action attack: an SEC injunction, disgorgement, and treble penalty action; a criminal action seeking a $100,000 fine and imprisonment; and a civil action brought by private plaintiffs.[67]

Given the potential for harsh results incident to the use of the treble penalty, either alone or in conjunction with other sanctions, Congress limited the applicability of the treble penalty. First, a court is not required to issue the full treble penalty in all cases in which the SEC seeks the penalty. Instead, the court has "discretion to determine the amount of the penalty . . . in light of the facts and circumstances."[68] A court may consider the defendant's level of awareness and the strength of the evidence as part of the "facts and circumstances."[69] Second, the treble penalty applies only against persons "most directly culpable in insider trading violations."[70] No person is subject to the treble penalty solely for "aiding and abetting" a 10b-5 violation unless that person communicates material, nonpublic information.[71] Thus, secondary liability under ITSA is limited to tippers who violate 10b-5; a broker who merely executes the trade is not subject to the treble penalty.[72] Classes excluded from the application of the treble penalty, however, are still subject to the pre-ITSA enforcement remedies.[73] Third, no person will be subject to the treble penalty solely for employing another person who is liable under ITSA.[74] Fourth, in establishing a mechanism for measuring the amount of the treble penalty under ITSA, Congress uses the phrase "profit gained or loss avoided" to mean "the difference between the purchase or sale price of the security and . . . the trading price of that security a reasonable period after public dissemination of the nonpublic information."[75] Compared to a method that measures the difference between the

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nal fine is not limited to insider trading violations; it applies when reporting companies, regulated entities, or individuals engage in "willful" violations of the Exchange Act. H.R. REP., *supra* note 5, at 7 (reporting companies), 10 (broker-dealers), 21 (individuals); 129 CONG. REC. H7013 (daily ed. Sept. 19, 1983) (statement of Rep. Oxley).

66. H.R. REP., *supra* note 5, at 10. John Fedders, former director of SEC enforcement, noted that with the advent of the treble penalty the Justice Department may shy away from criminal prosecutions because the defendant is now vulnerable to substantial SEC sanctions. *House Hearings*, *supra* note 5, at 70-71.

67. *See House Hearings*, *supra* note 5, at 10.

68. H.R. REP., *supra* note 5, at 8-9; *see* 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985). The judge determines the amount of the penalty. *House Hearings*, *supra* note 5, at 46-47; H.R. REP., *supra* note 5, at 16, 31.

69. H.R. REP., *supra* note 5, at 9.

70. *Id.* at 7; 130 CONG. REC. S8913 (daily ed. June 29, 1984) (statement of Sen. D'Amato); *see* 15 U.S.C.A. § 78u (West Supp. 1985); H.R. REP., *supra* note 5, at 10, 11, 28, 29.

71. 15 U.S.C.A. § 78u(d)(2)(B) (West Supp. 1985); H.R. REP., *supra* note 5, at 9-10, 28-29; *see* 130 CONG. REC. S8913 (daily ed. June 29, 1984) (statement of Sen. D'Amato).

72. H.R. REP., *supra* note 5, at 9-10. *See* 15 U.S.C.A. § 78u(d)(2) (West Supp. 1985); *House Hearings*, *supra* note 5, at 91; H.R. REP., *supra* note 5, at 27-29; 130 CONG. REC. S8913 (daily ed. June 29, 1984) (statement of Sen. D'Amato); *see also* 130 CONG. REC. H7758 (daily ed. July 25, 1984) (statement of Rep. Dingell) (Violation of the case law construction of rule 10b-5 is a necessary ingredient of a treble penalty action.).

73. H.R. REP., *supra* note 5, at 9-10, 28-29.

74. 15 U.S.C.A. § 78u(d)(2)(B) (West Supp. 1985); *House Hearings*, *supra* note 5, at 43-45; H.R. REP., *supra* note 5, at 9, 28.

75. 15 U.S.C.A. § 78u(d)(2)(C) (West Supp. 1985); H.R. REP., *supra* note 5, at 11, 29; *see House Hearings*, *supra* note 5, at 91.

purchase and sale price of the actual securities traded, the method applicable under ITSA restricts an insider's total liability.[76] Fifth, ITSA contains a statute of limitations precluding recovery of the treble penalty more than five years after the date of the purchase or sale giving rise to a violation.[77] Sixth, ITSA only applies to transactions "on or through the facilities of a national securities exchange or from or through a broker or dealer."[78] Public offerings by a securities issuer, as a general rule, are not covered by ITSA.[79] Last, ITSA only extends to actions instituted by the SEC under the Exchange Act.[80]

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76. H.R. REP., *supra* note 5, at 29. *See House Hearings*, *supra* note 5, at 42-44. The United States Court of Appeals for the First Circuit has rejected an attempt by the SEC to measure the amount to be disgorged as the difference between the purchase price and the sale price of the actual securities traded. SEC v. MacDonald, 699 F.2d 47 (1st Cir. 1983).

77. 15 U.S.C.A. § 78u(d)(2)(D) (West Supp. 1985); H.R. REP., *supra* note 5, at 12.

78. 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985); H.R. REP., *supra* note 5, at 26.

79. 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985); H.R. REP., *supra* note 5, at 26 & n.51.

80. *See* 15 U.S.C.A. § 78u(d)(2)(A) (West Supp. 1985); H.R. REP., *supra* note 5, at 1, 25. In addition to these enacted limitations on the use of the treble penalty, other limitations were suggested. First, some commentators argued for the adoption of the "clear and convincing" standard of proof. *Senate Hearings*, *supra* note 4, at 109, 111-13; *House Hearings*, *supra* note 5, at 121, 205. "[S]ince the penalty may exceed the insider trader's actual or theoretical gain (or avoidance of loss), the penalty takes on significance as a quasi-criminal punishment, thereby suggesting that a higher standard of proof may be appropriate." *Id.* at 121; *see also id.*, *supra* note 5, at 39, 50 (SEC recognized that some commentators favor a higher standard of proof due to the severity of the penalty); *id.* at 63 (SEC director of enforcement would accept higher standard because of the "extraordinary burden" of the treble penalty, provided that the high burden did not spill over into other enforcement actions). *But see Senate Hearings*, *supra* note 4, at 40; *House Hearings*, *supra* note 5, at 46, 65; H.R. REP., *supra* note 5, at 9, 15, 16, 30, 31 (rejects higher proof standard that would hamper SEC's enforcement of securities law). Ultimately, Congress' intent was to use the preponderance of the evidence standard. *Id.* The amount of proof, however, is a factor in determining the appropriate magnitude of the penalty. H.R. REP., *supra* note 5, at 9.

Second, it was suggested that the treble penalty apply only to those who knowingly caused the transaction in question. *Senate Hearings*, *supra* note 4, at 128; *House Hearings*, *supra* note 5, at 204, 215. *See also House Hearings*, *supra* note 5, at 15 (issue of degree of knowledge raised). Requiring that a defendant "knowingly cause" a transaction would eliminate liability for recklessness and would provide a defendant with a protection often available in a criminal action. *See id.* at 215. This may be appropriate given the punitive nature of the treble penalty. Congress, however, intended the level of awareness required for an injunctive action to be applicable in a treble penalty action. H.R. REP., *supra* note 5, at 9. As with the amount of proof, the level of awareness is a factor in determining the appropriate amount of the penalty. *Id.*

Third, it was suggested that a jury instead of a judge determine the existence of a violation and the amount of the penalty. *House Hearings*, *supra* note 5, at 106; *see also id.* at 15 (issue raised). Congress intended the judge to determine the amount of the penalty. *Id.* at 47; H.R. REP., *supra* note 5, at 16, 31. The issue of whether a defendant has a right to a jury trial to decide the question of liability was reserved for the courts. *House Hearings*, *supra* note 5, at 92; H.R. REP., *supra* note 5, at 16, 31.

Fourth, one commentator suggested the use of either a fixed penalty or a specific standard by which the courts could determine the appropriate amount of the penalty: "It is not appropriate, and it may indeed be subject to constitutional question, for the courts to be granted unfettered power to set their own multiple of a penalty on no specified bases." *House Hearings*, *supra* note 5, at 176.

Fifth, many commentators objected to the language of ITSA that describes a violation in terms of "in possession of" material, nonpublic information. *Senate Hearings*, *supra* note 4, at 99, 109-111, 116, 127; *House Hearings*, *supra* note 5, at 177, 178, 196, 197; *see also id.* at 15 (issue raised). *But see id.* at 49, 50, 71, 72 (preferred "on the basis of" language). These commentators contended that the case law description of a violation was phrased in terms of trading "on the basis of" inside information; therefore, the "in possession of" language erroneously describes the violation. *Senate Hearings*, *supra* note 4, at 111, 116, 127; *House Hearings*, *supra* note 5, at 177, 178, 196, 197. *See* Chiarella v. United States, 445 U.S. 222 (1980) (duty "does not arise from the mere possession of the nonpublic market information"); *In re* Investors Management, 44 S.E.C. 633 (1971) (inside information must be at least a factor in the investment decision for a violation to exist). The concern with

IV. COLLATERAL ESTOPPEL

A. *Overview*

ITSA's addition of the treble penalty raises the question whether a plaintiff in a private action should be able to use offensive nonmutual collateral estoppel to preclude a defendant previously adjudged liable in an SEC treble penalty action from relitigating the issue of a 10b-5 violation. The doctrine of collateral estoppel operates to preclude relitigation of issues in a second action that were "actually litigated and necessary to the outcome of the first proceeding."[81] According to an earlier mutuality requirement, collateral estoppel was available only when the parties to the second action were the same as the parties to the first action.[82] The modern, prevailing view is that mutuality is not required.[83] Thus, collateral estoppel may be available to a party who was not a party to the first action. When the nonparty to the first action is the defendant in the second action, collateral estoppel is employed defensively, precluding the plaintiff from relitigating the issue.[84] When the nonparty is the plaintiff in the second action, collateral estoppel is employed offensively, precluding the defendant from relitigating an issue.[85]

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the "in possession of" language was that it "could result in a *de facto* shift in the burden of proof." *Senate Hearings, supra* note 4, at 110-11. Congress ultimately used the "in possession of" language, but also made clear that ITSA was not intended to change the case law definition of insider trading. 15 U.S.C.A. § 78u (West Supp.1985); *see supra* note 8 and accompanying text.

81. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 n.5 (1979); 1 J. MOORE, FEDERAL PRACTICE ¶ 0.405[1], at 178-88 (2d ed. 1974); *see, e.g.*, Lawlor v. National Screen Serv. Corp., 349 U.S. 322, 326 (1955); Commissioner v. Sunnenm, 333 U.S. 591, 597 (1948).

82. *See, e.g.*, Bigelow v. Old Dominion Copper Mining and Smelting Co., 225 U.S. 111, 127 (1912). For commentary on the mutuality doctrine, see Callen & Kadue, *To Bury Mutuality, Not to Praise It: An Analysis of Collateral Estoppel After* Parklane Hosiery Co. v. Shore, 31 HASTINGS L. J. 755 (1980); Currie, *Civil Procedure: The Tempest Brews*, 53 CALIF. L. REV. 25 (1965); Currie, *Mutuality of Collateral Estoppel: Limits of the* Bernhard *Doctrine*, 9 STAN. L. REV. 281 (1956); Moore & Currier, *Mutuality and Conclusiveness of Judgments*, 35 TUL. L. REV. 301 (1961); Overton, *The Restatement of Judgments, Collateral Estoppel, and Conflict of Laws*, 44 TENN. L. REV. 927 (1977); Note, *Nonmutuality: Taking the Fairness out of Collateral Estoppel*, 13 IND. L. REV. 563 (1980).

83. *E.g.*, Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326-28 (1979); Blonder-Tongue Laboratories, Inc. v. University of Ill. Found., 402 U.S. 313, 320-29 (1971); Zdanok v. Glidden Co., 327 F.2d 944, 953-57 (2d Cir.1964), *cert. denied*, 377 U.S. 934 (1964); Bernhard v. Bank of Am. Nat'l. Trust & Savings Ass'n, 19 Cal. 2d 807, 812, 122 P.2d 892, 895 (1942).

84. *See* Note, *Collision Course: Collateral Estoppel and the Seventh Amendment*: Parklane Hosiery Co. v. Shore, 57 DEN. L.J. 115, 118-19 (1979) [hereinafter cited as Note, *Collision Course*]; *see also* Blonder-Tongue Laboratories, Inc., v. University of Illinois Found., 402 U.S. 313, 329-30 (1971) (defensive nonmutual collateral estoppel less objectionable than offensive nonmutual collateral estoppel); Note, *Collision Course, supra*, at 118-19 ("The Supreme Court is more inclined to allow a stranger the use of a prior judgment as a shield rather than a sword."); Note, *supra* note 82, at 563 (some courts allow defensive use of nonmutual collateral estoppel only). For cases limiting collateral estoppel to only defensive use, see, *e.g.*, Standage Ventures, Inc. v. State, 114 Ariz. 480, 484, 562 P.2d 360, 364 (1977); Spettigue v. Mahoney, 8 Ariz. App. 281, 288, 445 P.2d 557, 564 (1968); Tezak v. Cooper, 24 Ill. App. 2d 356, 363, 164 N.E.2d 493, 496 (1960); Albernaz v. City of Fall River, 346 Mass. 336, 339-40, 191 N.E.2d 771, 772-73 (1963).

85. Two reasons have been advanced to show that offensive and defensive collateral estoppel should be treated differently: (1) offensive collateral estoppel may not promote judicial economy to the same extent as defensive use, and (2) offensive collateral estoppel may be unfair to the defendant. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 330 (1979). Some commentators are reluctant to sanction offensive use. Semmel, *Collateral Estoppel, Mutuality and Joinder of Parties*, 68 COLUM. L.

B. *Purposes of the Collateral Estoppel Doctrine*

The primary purpose of collateral estoppel is to avoid unnecessary relitigation.[86] "Avoiding relitigation achieves underlying goals of preventing parties from having more than one day in court, protecting parties from the burden of relitigation, and reducing court time in the interest of judicial economy."[87] Needless relitigation detracts from the efficient administration of justice.[88] By precluding relitigation of an insider's 10b-5 violation in a subsequent private action, collateral estoppel would promote judicial efficiency.[89]

Furthermore, collateral estoppel, like stare decisis, is of substantial utility in the ordering of extra-judicial relations.[90] Stare decisis establishes legal norms that are determinative in similar fact situations.[91] These legal norms provide citizens with guidance as to their legal rights. Similarly, collateral estoppel provides finality in the resolution of factual questions by allowing parties to rely on a judicial determination and to plan their out-of-court decisions accordingly.[92] Additionally, it is essential for a judicial system based on rational decisionmaking to maintain the appearance of rationality in factfinding, exemplified by the use of the "clearly erroneous test for appellate factual review."[93] To categorically reject the use of collateral estoppel in a second action after the issues have been adjudicated suggests that "the process by which the first action was decided is itself seriously in need of reform."[94] By providing factfinding finality, collateral estoppel helps preserve the integrity of the judicial process.

REV. 1457 (1968); Note, *The Impacts of Defensive and Offensive Assertion of Collateral Estoppel by a Nonparty*, 35 GEO. WASH. L. REV. 1010, 1054 (1967); Note, *supra* note 82, at 563, 574.

The Supreme Court allows offensive collateral estoppel and accounts for the potential negative effects of offensive use by granting the trial judge "broad discretion to determine when it should be applied." *Parklane*, 439 U.S. at 331. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 88 reporter's note (Tentative Draft No. 2, 1975) (suggests de-emphasizing distinction between offensive and defensive collateral estoppel and stressing whether the party against whom estoppel is sought could have joined). The suggestion made by the RESTATEMENT is discussed in *Parklane*, 439 U.S. at 330 n.13, 331 n.16.

86. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979); Note, *supra* note 82, at 570. Other litigation-saving devices include counterclaims, intervention, interpleader, and joinder. *See* FED. R. CIV. P. 18-22, 24; Note, *supra* note 82, at 570.

87. Note, *supra* note 82, at 570. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979).

88. Maryland v. Capital Airlines, Inc., 267 F. Supp. 298, 304 (D. Md. 1967); Note, *supra* note 82, at 572 ("Society has a right to the efficient administration of justice . . . ."). Needless litigation is a particularly serious problem in light of the rising caseloads in some urban courts. *See* Note, *Collision Course*, *supra* note 84, at 117.

89. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979); Note, *supra* note 82, at 572. Application of collateral estoppel would save time in the context of securities litigation. Note, *Mutuality of Estoppel and the Seventh Amendment: The Effect of* Parklane Hosiery, 63 CORNELL L. REV. 1002, 1013-14 (1979).

90. Callen & Kadue, *supra* note 82, at 812. *See* George, *Sweet Uses of Adversity*: Parklane Hosiery *and the Collateral Class Action*, 32 STAN. L. REV. 655, 685 (1980).

91. George, *supra* note 90, at 685. *See* Dworkin, *Hard Cases*, 88 HARV. L. REV. 1057, 1094-95 (1975).

92. Callen & Kadue, *supra* note 82, at 763-64; George, *supra* note 90, at 685.

93. George, *supra* note 90, at 765.

94. Callen & Kadue, *supra* note 82, at 765.

C. *Prerequisites for the Application of Collateral Estoppel*

There are three preliminary requirements for the application of collateral estoppel: (1) the issue decided in the prior adjudication must have been identical to the issue presented in the subsequent action; (2) the party against whom collateral estoppel is asserted must have been "a party or in privity with a party to the prior adjudication";[95] and (3) the prior adjudication must have produced a final judgment on the merits.[96] Meeting these prerequisites triggers the second phase of the analysis: whether the defendant had a "full and fair" opportunity to litigate the issue in the prior proceeding.[97] The party seeking to employ collateral estoppel has the burden of proving that the prerequisites are satisfied.[98] Should this party meet the burden of proof, the party to be estopped then has the burden of proving that the initial opportunity to litigate the issue was less than full and fair.[99]

Because the standards for establishing a 10b-5 violation are the same for private and SEC actions,[100] there is an identity between the violation issues in both actions. A private plaintiff bringing a claim following a treble penalty action in which the SEC prevailed on the merits should be able to employ collateral estoppel to preclude the insider from relitigating the issue of the insider's 10b-5 violation, unless the insider demonstrates that under the circumstances the application of collateral estoppel would be unfair.

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95. Due process prohibits application of collateral estoppel against a nonparty to the first action, unless the nonparty is in privity with a party to the first action. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 327 (1979); Hansberry v. Lee, 311 U.S. 32, 40 (1940) (findings are binding only on parties who have had an opportunity to participate in the litigation).

96. Blonder-Tongue Laboratories, Inc. v. University of Ill. Found., 402 U.S. 313, 323-324 (1971); Bernhard v. Bank of Am. Nat'l. Trust & Sav. Ass'n, 19 Cal. 2d 807, 813, 122 P.2d 892, 895 (1942); Note, *Collateral Estoppel Effect of Prior Equitable Determinations in SEC Actions Upon Subsequent Private Legal Actions Does Not Violate the 7th Amendment*: Parklane Hosiery v. Shore, 10 CUM. L. REV. 619, 623 (1979) [hereinafter cite as Note, *Collateral Estoppel*]; *see* Note, *supra* note 82, at 576.

97. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 328, 333 (1979); Blonder-Tongue Laboratories, Inc. v. University of Ill. Found., 402 U.S. 313, 329 (1971); *see* Rachal v. Hill, 435 F.2d 59, 62 (5th Cir. 1970); Maryland v. Capital Airlines, Inc., 267 F. Supp. 298, 304 (D. Md. 1967); Note, *supra* note 82, at 576-77.

98. *See* Schwartz v. Public Administrator, 24 N.Y.2d 65, 73, 246 N.E.2d 725, 729, 298 N.Y.S.2d 955, 961 (1969); Callen & Kadue, *supra* note 82, at 774 (citing *Schwartz*).

99. Callen & Kadue, *supra* note 82, at 774. *See* Maryland v. Capital Airlines, Inc., 267 F. Supp. 298, 304 (D. Md. 1967); B.R. DeWitt, Inc. v. Hall, 19 N.Y.2d 141, 146-47, 225 N.E.2d 195, 198, 278 N.Y.S.2d 596, 600-01 (1967); Note, *supra* note 82, at 577. Numerous factors are relevant to the fairness determination: (1) the defendant's incentive to fully litigate the issue in the first suit (*see* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 330, 332 (1979); Pickholz & Brodsky, *supra*, note 33, at 54; Note, *supra* note 89, at 1011-12. Note, *Collision Course*, *supra* note 84, at 120; Note, *supra* note 82, at 581); (2) the ease with which the defendant could have joined in the first action (*see Parklane*, 439 U.S. at 331-32; Callen & Kadue, *supra* note 82, at 785; Note, *Collision Course*, *supra* note 84, at 118; Note, *supra* note 89, at 1011; Note, *supra* note 82, at 581, 584-86; *see also* Callen & Kadue, *supra* note 82, at 779-85 (discussion of the impact of offensive nonmutual collateral estoppel on the incidence of joinder in the initial action)); (3) judicial economy (*see Parklane*, 439 U.S. at 330; Callen & Kadue, *supra* note 82, at 780-85; Note, *Collateral Estoppel*, *supra* note 96, at 631 (referring to judicial economy); Note, *supra* note 82, at 572-75, 584; *supra* note 85); (4) the adequacy of the procedural opportunities of the first suit (Callen & Kadue, *supra* note 82, at 777; Note, *Collision Course*, *supra* note 84, at 122; Note, *supra* note 82, at 577-79; *see Parklane*, 439 U.S. at 332.). Ultimately, the court in its discretion determines whether it would be fair to apply collateral estoppel in any particular case. *See supra* text accompanying note 97.

100. *See infra* notes 108-09 and accompanying text.

The elements of an SEC 10b-5 action and a private 10b-5 action have not always been the same. Before the Supreme Court's 1980 decision in *Aaron v. SEC*,[101] courts were split on whether the level of awareness required to establish a defendant's 10b-5 violation in an SEC action corresponded to that required in a private action.[102] In a 1978 decision, *Ernst & Ernst v. Hochfelder*,[103] the Supreme Court held that a private plaintiff must show scienter[104] to establish a 10b-5 violation.[105] The Court left open the question whether scienter must be proved in an SEC action.[106] In United States courts of appeal in which scienter was not required in an SEC 10b-5 action, a private plaintiff theoretically could not employ collateral estoppel because there would be no identity of the elements of the two actions.[107]

The Supreme Court in *Aaron*, however, held that scienter was also a requirement for an SEC 10b-5 action.[108] The Court noted that "scienter" refers to the same level of awareness as the term connoted in *Hochfelder*.[109] Hence, the defendant's level of awareness in both private and SEC actions is the same, facilitating issue identity and thus the use of collateral estoppel. As in *Hochfelder*, the Supreme Court in *Aaron* expressly refrained from deciding "whether, under some circumstances, scienter may also include reckless behavior."[110] Since *Hochfelder*, however, the courts of appeal have agreed that "recklessness" is a sufficient level of awareness on which to base a 10b-5 action, at least when the

101. 446 U.S. 680 (1980).

102. *See* Hazen, *supra* note 30, at 454-55 (pre-*Aaron* discussion of requisite culpability); Pickholz & Brodsky, *supra* note 33, at 53; Note, *Judgments—Res Judicata—Estoppel—Right to Trial By Jury*, 48 CIN. L. REV. 611, 620-21 (1979). Although scienter was required in private actions, most United States courts of appeal before *Aaron* did not require scienter in SEC injunction actions. *E.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963); SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1167 (D.C. Cir 1978) (SEC not required to prove scienter under § 13(d)(1)); SEC v. American Realty Trust, 586 F.2d 1001, 1006-07 (4th Cir. 1978) (SEC not required to prove scienter under § 17(a)(2)); SEC v. World Radio Mission Inc., 544 F.2d 535 (1st Cir. 1976) (SEC not required to prove scienter under § 17(a)); SEC v. Universal Major Indus. Corp., 546 F.2d 1044 (2d Cir. 1976) (SEC not required to prove scienter under § 5), *cert. denied*, 434 U.S. 834 (1977); SEC v. Spectrum Ltd., 489 F.2d 535 (2d Cir. 1973). *But see* SEC v. Blatt, 583 F.2d 1325 (5th Cir. 1978) (SEC must prove scienter in § 10(b) action).

103. 425 U.S. 185 (1976).

104. Scienter refers to "a mental state embracing intent to deceive, manipulate, or defraud." *Hochfelder*, 425 U.S. at 193 n.12. Scienter is a higher level of awareness than negligence. *See generally* Lowenfels, *Scienter or Negligence Required for SEC Injunctions Under 10(b) and Rule 10b-5: A Fascinating Paradox*, 33 BUS. LAW. 789 (1978) (discussing scienter requirements under 10(b) and 10b-5 as developed by federal courts).

105. *Hochfelder*, 425 U.S. at 212-14.

106. *Id.* at 193 n.12.

107. SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 96-97 n.4 (2d Cir. 1978); Pickholz & Brodsky, *supra* note 33, at 52-53; Note, *supra* note 102, at 620; *see* Hazen, *supra* note 30, at 455. For the scienter issue to be given preclusive effect in a subsequent private action, the level established in the SEC action must have been necessary to the result reached. *See* Pickholz & Brodsky, *supra* note 33, at 53. Scienter was not a necessary element of an SEC 10b-5 action in jurisdictions which allowed a mere showing of negligence. *See, e.g.*, *White v. Abrams*, 495 F.2d 724, 734 (1974) (flexible duty standard); *Myzel v. Fields*, 386 F.2d 718, 735 (8th Cir. 1967) (negligence sufficient), *cert. denied*, 390 U.S. 951 (1968); *Kohler v. Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963) (knowledge not required). Thus, even when scienter was established in an SEC 10b-5 action, collateral estoppel was inapplicable in a subsequent private action.

108. 446 U.S. at 695.

109. *Id.* at 686 n.5.

110. *Id.*

action is brought by a private plaintiff.[111] The question arises whether recklessness also will be a sufficient basis for liability in an SEC treble penalty action.

Given the severity of the treble penalty, some commentators contended during the legislative process that ITSA should apply only to persons who "knowingly cause" the transaction in question.[112] Congress, however, clearly refused to make this strict definition of "scienter" a requirement for the treble penalty: "The legislation is not intended to change current law with respect to the level of awareness required of a violator."[113] In expressly rejecting "knowingly cause" as the required level of awareness, Congress implicitly recognized and sanctioned the inclusion of "recklessness" in the scope of scienter for the purposes of an SEC treble penalty. Even if the courts of appeal or the Supreme Court were to differentiate between private and SEC treble penalty actions and disallow recklessness as a sufficient basis for an SEC treble penalty action, collateral estoppel would be available to a private plaintiff. The requirement that the SEC demonstrate an extra quantum of awareness should not negate the establishment of a lesser-included level of awareness; thus, establishing scienter would suffice to prove recklessness.

D. *Fairness in The Application of Collateral Estoppel*

1. Incentive to Fully Litigate

If an SEC treble penalty action ends with a judgment on the merits and the issue identity prerequisite of collateral estoppel is satisfied, a court then must decide whether it would be fair to preclude the same defendant from relitigating the issue of a 10b-5 violation in a subsequent private action.[114] Fairness is determined by reference to many factors, one of which is whether the defendant had an adequate incentive in a prior adjudication to fully litigate the issue of a 10b-5 violation.[115] When a defendant has not had an adequate incentive "to fully and

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111. Pegasus Fund, Inc. v. Laraneta, 617 F.2d 1355 (9th Cir. 1980); Healey v. Catalyst Recovery of Pennsylvania, Inc., 616 F.2d 641 (3d Cir. 1980); Broad v. Rockwell Int'l Corp., 614 F.2d 418 (5th Cir. 1980); Keirnan v. Homeland, Inc., 611 F.2d 785 (9th Cir. 1980); Mclean v. Alexander, 599 F.2d 1190 (3d Cir. 1979); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979); Hoffman v. Estabrook & Co., Inc., 587 F.2d 509 (1st Cir. 1978); Nelson v. Serwold, 576 F.2d 1332 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); Rolf v. Blyth, Eastmany, Dillon & Co., Inc., 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); Coleco Indus., Inc. v. Berman, 567 F.2d 569 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978). One court noted that:

> "Reckless conduct may be defined as . . . highly unreasonable (conduct) involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."

Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir.) (quoting Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719, 724 (W.D. Okla. 1976)), *cert. denied*, 434 U.S. 875 (1977). Presumably, recklessness also will be a sufficient basis for liability in an SEC treble penalty action.

112. *See supra* note 80.

113. H.R. REP., *supra* note 5, at 9.

114. *See supra* note 97 and accompanying text.

115. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 330, 332 (1979); Pickholz & Brodsky, *supra* note 33, at 54 (1978); Note, *supra* note 89, at 1011-12; Note, *Collision Course*, *supra* note 84, at 120; Note, *supra* note 82, at 588.

vigorously"[116] litigate an issue in a prior adjudication, collateral estoppel is inapplicable.[117] If one party is uninterested in the resolution of a particular issue, a basic element of the adversary system is missing—the balance afforded by the vigorous presentation of both sides of an issue—and the issue will not be fully litigated. In such a case, fairness dictates the denial of collateral estoppel.

In determining the incentive to litigate, "[c]ourts must look to tangible indicators, such as the amount of damages, the seriousness of the allegations, and the foreseeability of future suits to determine whether a defendant was motivated to defend vigorously."[118] Because a defendant in an SEC treble penalty action faces significant monetary liability and the likelihood of future private actions,[119] a court in a subsequent private action should conclude that the defendant had adequate incentive to litigate the 10b-5 violation. In *Parklane Hosiery Co. v. Shore*,[120] the Supreme Court held that an SEC injunction action was sufficiently serious to motivate a defendant to fully litigate the issue whether a proxy statement issued by the defendant "was materially false and misleading."[121] The Court added that a subsequent action by a private party was foreseeable "in light of the serious allegations made in the SEC's complaint . . . as well as the foreseeability of subsequent private suits that typically follow a successful Government judgment . . . ."[122]

Under *Parklane*, the treble penalty, which is clearly a more severe remedy than an injunction, would be viewed as sufficiently serious to motivate a defendant to litigate the case vigorously, and a private action following an SEC treble penalty action would be foreseeable. Furthermore, the defendant is motivated to strongly contest an SEC lawsuit to avoid the negative publicity of an adverse judgment.[123]

2. Joinder

Another factor in the fairness determination is the ease with which the party asserting collateral estoppel could have joined in the prior action.[124] When parties capable of joining decide to await the outcome of the action before bringing a separate action, the number of suits litigated increases and the policy

116. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 332 (1979).

117. Pickholz & Brodsky, *supra* note 33, at 54; Note, *supra* note 82, at 581. The Supreme Court has expressly noted that a defendant in an SEC injunction action is afforded a "full and fair opportunity" to litigate. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 332 (1979).

118. Note, *supra* note 82, at 581-82; *see also* Note, *Collision Course supra* note 84, at 120 (collateral estoppel inoperative when the recurrence of an issue was unforeseeable during the initial action).

119. In terms of establishing a 10b-5 violation and determining whether a subsequent private action is foreseeable, an SEC injunction and treble penalty action are synonymous. A private action is clearly foreseeable following a SEC injunctive action; in fact, "[o]ne purpose of an SEC injunctive action is to alert potential plaintiffs to securities law violations." Pickholz & Brodsky, *supra* note 33, at 54 ("SEC defendants are unlikely to be surprised by subsequent damage actions.").

120. 439 U.S. 322 (1979).

121. *Id.* at 325, 333.

122. *Id.* at 332.

123. *See* Bialkin, *The Impact of* Parklane Hosiery: *A Change in Litigation Strategy*, NAT'L L.J., Feb. 26, 1979, at 22, col. 4; Hazen, *supra* note 30, at 453; Note, *supra* note 89, at 1012-1013 n.46.

124. *See Parklane*, 439 U.S. at 331-32; Callen & Kadue, *supra* note 82, at 785; Note, *supra* note 89, at 1011; Note, *Collision Course*, *supra* note 84, at 118; Note, *supra* note 82, at 581, 584-86.

goal of judicial economy is undermined.[125] Because the primary purpose of collateral estoppel is to promote judicial economy, courts hesitate to apply the doctrine when it runs contrary to that purpose.[126] In contrast to defensive collateral estoppel, offensive collateral estoppel induces a nonparty capable of joining to adopt a "wait and see" posture, awaiting the outcome of one or more suits against the defendant with the hope that a necessary issue will be decided against the defendant, thereby allowing the "wait and see" plaintiff to prevail on that issue with minimal effort in a subsequent action against the same defendant.[127] Recognizing this danger, the Supreme Court has determined that "if a nonparty plaintiff could easily have joined" in the prior action, collateral estoppel is not available in a subsequent action.[128]

Section 78u(g) of the Exchange Act precludes joinder by a private plaintiff in an SEC action unless the SEC consents to the consolidation.[129] Because the SEC generally is opposed to consolidation, joinder of a nonparty is unlikely.[130] Thus, the statute and SEC policy prevent a private plaintiff from easily joining an SEC treble penalty action. Insofar as the opportunity to join bears on the application of collateral estoppel, a private plaintiff should be able to use collateral estoppel following an SEC treble penalty action.

3. Judicial Economy

Because the primary purpose of collateral estoppel is to promote judicial efficiency, the availability of collateral estoppel in a private action is partly contingent on whether it will promote this goal. The judicial economy in avoiding relitigation of a defendant's 10b-5 violation must be weighed against any increase in litigation resulting from the use of collateral estoppel.[131] Collateral estoppel can increase litigation in three ways. First, it can increase litigation within the original suit: "[L]itigants may feel bound to fight a case to the utmost

125. *See Parklane*, 439 U.S. at 329-30; Nevarov v. Caldwell, 161 Cal. App. 2d 762, 767-68, 327 P.2d 111, 115 (1958); Reardon v. Allen, 88 N.J. Super. 560, 571-72, 213 A.2d 26, 32 (Law Div. 1965); Note, *supra* note 82, at 575-76.

126. *See supra* notes 85 & 88. Defensive collateral estoppel "induces joinder by its application because a plaintiff threatened by future estoppel is motivated to join all of his defendants." Note, *supra* note 82, at 584; *see Parklane*, 439 U.S. at 329-30. The availability of defensive collateral estoppel thus decreases not only litigation in actions in which it is asserted (issue preclusion), but also the number of separate suits litigated.

127. *Parklane*, 439 U.S. at 330; Callen & Kadue, *supra* note 82, at 784-85; Note, *supra* note 82, at 584.

128. *Parklane*, 439 U.S. at 331.

129. 15 U.S.C. § 78u(g) (1982) provides in part: "[N]o action for equitable relief instituted by the [Securities and Exchange] Commission . . . shall be consolidated or coordinated with other actions not brought by the Commission, even though such other actions may involve common questions of fact, unless such consolidation is consented to by the Commission." *See* Note, *supra* note 89, at 1011.

130. *See* Amicus Brief of SEC at 30-31, *Parklane* (commissioners concern with consolidation of private actions and injunctions). This brief states: "Private actions . . . may consume years for pretrial discovery alone. The Commission's ability to protect the public during that period would be seriously impaired if injunctive proceedings were postponed at the request of private litigants or delayed by requests for jury trials." *Id.*; *see also* SEC v. Everest Management Corp., 475 F.2d 1236, 1240 (2d Cir. 1972) (Intervention by private plaintiffs in SEC enforcement actions would substantially increase the SEC workload, complicate the cases, and possibly discourage consent decrees.).

131. *See* Callen & Kadue, *supra* note 82, at 780.

in both trial and appellate courts which [they] would treat rather casually if its sole effect were on the immediate adversaries."[132] The availability of collateral estoppel, however, does not cause an increase in litigation in the original suit when the suit itself threatens the defendant with serious consequences.

Second, collateral estoppel can increase litigation within the subsequent suit: "Rather than engage in relitigation of issues, parties will contest the application of nonmutual collateral estoppel . . . ."[133] Any additional litigation within a subsequent suit incident to the application of collateral estoppel, however, is more than offset by the economy in not relitigating issues common to both suits.[134] This is particularly true for cases in which the resolution of the issues in dispute is a lengthy and complicated process, such as establishing an insider's 10b-5 violation.[135] In addition, because the elements of a 10b-5 violation are the same for both an SEC and a private action,[136] the prerequisites of collateral estoppel should be met easily and quickly in the subsequent private action, leaving only the determination of whether it would be fair in that case to apply collateral estoppel. Unless an SEC treble penalty case contains facts sufficiently unusual to warrant special attention by a judge making the fairness determination, the stare decisis effect from early collateral estoppel cases should substantially limit the judicial energy expended on the fairness determination, probably by way of a partial summary judgment.

Third, the availability of offensive nonmutual collateral estoppel can increase the number of suits brought.[137] The increase can occur in two ways: (1) "wait and see plaintiffs," who usually would join in the initial action were it not for the availability of collateral estoppel, can await the outcome of that action before bringing a second action hoping to use collateral estoppel,[138] and (2) "reluctant plaintiffs,"[139] who usually would forego the opportunity to sue at all, bring an action because they can use the findings of the prior action.[140] Practically speaking, "wait and see plaintiffs" do not exist in the context of a 10b-5 private action because their existence is contingent upon the availability of joinder in the initial action. The statutory obstacle to joinder in an SEC action negates any causal relationship between the availability of collateral estoppel and an increase in the number of suits brought by "wait and see plaintiffs."

The "reluctant plaintiff," however, is another matter. Assuming the advent of the treble penalty increases the number of SEC actions in which a defendant is found to have violated 10b-5, the use of collateral estoppel following an SEC

132. R. FIELD & B. KAPLAN, MATERIALS FOR A BASIC COURSE ON CIVIL PROCEDURE 859 (3d. ed. 1973), *quoted in* Note, *supra* note 82, at 572.

133. Note, *supra* note 82, at 573.

134. Callen & Kadue, *supra* note 82, at 784-85.

135. Note, *supra* note 89, at 1013-14. *See* Amicus Brief of SEC at 2 n.1, *Parklane*; *see also* SEC v. Everest Management Corp., 475 F.2d 1236, 1240 (2d Cir. 1972) (security cases are "complicated").

136. *Supra* text accompanying note 100.

137. *See supra* note 85 and text accompanying notes 125-28.

138. *See supra* note 127 and accompanying text.

139. Callen & Kadue, *supra* note 82, at 779.

140. *Id.*; Note, *supra* note 102, at 620.

treble penalty action could induce plaintiffs, who otherwise would not sue, to bring a private action.[141] Any increase in litigation, however, must be weighed against the positive consequences of compensating injured investors and achieving deterrence through enforcement of the securities laws.[142] In sum, the benefits of judicial economy in avoiding relitigation of a defendant's 10b-5 violation, combined with the benefits of increased deterrence and compensation, all incident to the availability of collateral estoppel to a plaintiff in a private action, clearly outweigh any increase in the number of suits initiated.

4. Procedural Opportunities

Also relevant to the fairness determination are the procedural opportunities afforded an insider in an SEC treble penalty action.[143] Without full and fair procedural opportunities to litigate in the original suit, a court will deny collateral estoppel.[144] Fullness of opportunity is measured by comparing the original and subsequent suits.[145] If the subsequent suit affords procedural opportunities unavailable in the original suit, then the procedural opportunities in the original suit may have been less than full.[146] Fairness connotes the lack of procedural disadvantages in the original suit.[147] Because cases should be decided on their merits, any procedural rule that gives one party an advantage over the other or that prevents a decision on the merits may constitute unfairness.[148] Slight procedural disadvantages, however, will not provide a sufficient basis to deny collateral estoppel; only when the disadvantages "could readily cause a different result" should collateral estoppel be denied.[149]

The availability of jury trial[150] and compromise verdicts[151] also bear on

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141. Note, *supra* note 102, at 620

142. *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 382 (1970); J.I. Case Co. v. Borak, 377 U.S. 426, 430-34 (1964); Note, *supra* note 102, at 620 (private actions supplement SEC enforcement actions and provide an additional deterrent against violations of the securities laws); Note *supra* note 89, at 1013.

143. Callen & Kadue, *supra* note 82, at 777; Note, *Collision Course*, *supra* note 84, at 122; Note, *supra* note 82, at 577-79; *see Parklane*, 434 U.S. at 332.

144. Note, *supra* note 82, at 577; *see supra* notes 97 & 99 and accompanying text.

145. Note, *supra* note 82, at 577.

146. *Id.*; *see also Parklane*, 439 U.S. at 330-31 (It may be unfair to apply offensive collateral estoppel when a second action affords the defendant procedural opportunities that were unavailable in the first action but that could readily cause a different result.).

147. *See Parklane*, 439 U.S. at 328; Blonder-Tongue Laboratories, Inc. v. University of Ill. Found., 402 U.S. 313, 329 (1971); Callen & Kadue, *supra* note 82, at 777; Note, *supra* note 82, at 577.

148. *See* Foman v. Davis, 371 U.S. 178, 181-82 (1982). One commentator has listed several factors that courts consider in deciding whether a prior opportunity to litigate was procedurally fair, including

> [c]hoice of forum, availability of jury trial, differences between administrative and civil proceedings, differences in evidentiary rules, availability of procedural devices such as discovery and counterclaims, adequacy of representation, availability of new evidence, opportunity to call witnesses, length of trial, jury prejudice, compromise verdicts, and differences in available law.

Note, *supra* note 82, at 578.

149. *Parklane*, 439 U.S. at 331; *see* Note, *Collision Course*, *supra* note 84, at 122.

150. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 88 comment d (Tent. Draft No. 3, 1976) (suggests that availability of jury trial in second action is a "fuller procedural opportunity"); Note,

whether an insider was afforded a "full and fair" opportunity to litigate in an SEC treble penalty action. Collateral estoppel can have the effect of denying a party the right to a jury trial.[152] Generally, the right to a jury trial is available when a party seeks damages, but is unavailable when a party seeks only equitable relief.[153] Issues resolved in an equitable action, however, could be raised in a subsequent damage action, causing the use of collateral estoppel to conflict with a party's right to a jury trial.[154] In this situation collateral estoppel may be available, even though it may deprive the party against whom it is asserted the right to a jury trial on the issues previously litigated.[155] In *Parklane Hosiery Co. v. Shore*,[156] the Supreme Court held that a defendant in a private action following an SEC injunction action did not have a sufficient basis for contesting the application of collateral estoppel, despite the resulting loss of the right to a jury trial on the issues common to both proceedings.[157]

The legislative history of ITSA indicates that in an SEC action the judge will determine the amount of the penalty,[158] and the evolving case law will determine whether the defendant has a right to a jury trial under the seventh amendment on the issue of an alleged 10b-5 violation.[159] If defendants are denied a jury trial in SEC actions, the application of collateral estoppel in a subsequent private action will deprive them of the right to a jury trial in a suit for damages. *Parklane*, however, suggests that this loss of the right to a jury trial is not a sufficiently serious procedural disadvantage to deny application of collateral estoppel.[160]

Indications of a compromise verdict in the prior action may preclude application of collateral estoppel in a subsequent action.[161] A compromise verdict is a damage award that is substantially less than the amount requested, suggesting that the court was both uncertain on the issue of the defendant's liability and uncomfortable about denying the plaintiff compensation.[162] Another explanation for a minimal award is that the court, after resolutely ascertaining the defendant's liability, awarded damages based solely on the extent of the plaintiff's injury. When the minimal award is a compromise verdict, collateral estoppel should be denied in a subsequent action because the defendant's liability remains

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supra note 82, at 578-79. *But see Parklane*, 439 U.S. at 332 n.19 (presence or absence of jury as factfinder is basically neutral). *See generally* Note, *supra* note 82, at 578-81 (discussion of procedural opportunities and risk of unfairness).

151. *See* Taylor v. Hawkinson, 47 Cal. 2d 893, 896-97, 306 P.2d 797, 799 (1957); Note, *supra* note 82, at 578-79.

152. *See Parklane*, 439 U.S. at 332 n.19.

153. *See* Pernell v. Southall Realty, 416 U.S. 363, 375 (1974); SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 95 (2d Cir. 1978).

154. *See, e.g., Parklane*, 439 U.S. at 324-25.

155. *Id.* at 334-35, 337.

156. 439 U.S. 322 (1979).

157. *Id.*

158. *House Hearings*, *supra* note 5, at 46-47; H.R. REP., *supra* note 5 at 31.

159. *House Hearings*, *supra* note 5, at 92; H.R. REP., *supra* note 5, at 16, 31.

160. *See Parklane*, 439 U.S. at 337.

161. *See, e.g.*, Taylor v. Hawkinson, 47 Cal. 2d 893, 896-97, 306 P.2d 797, 799 (1957).

162. *See id.*

in question.[163] Collateral estoppel should be available, however, when the minimal award reflects the court's honest assessment of the extent of the injury. Instead of leaving a court to decide between these two competing explanations, fairness dictates that a defendant be allowed to relitigate the alleged liability whenever the initial judgment could be the result of a compromise verdict.

A judge in an SEC treble penalty action has broad discretion to determine the appropriate amount of the penalty "in light of the facts and circumstances."[164] The issue of a compromise verdict could arise if the judge orders the defendant to pay only the slightest proportion of the illicit profits—a nominal penalty—rather than the full treble penalty.[165] Theoretically, establishing a 10b-5 violation is a prerequisite to assessing even a nominal penalty. The determination of a 10b-5 violation and the amount of the penalty are separate inquiries constituting a two step process for applying the treble penalty. The amount of the penalty is determined only if a 10b-5 violation is found. Thus, any successful SEC treble damage action, regardless of the magnitude of the penalty, should indicate that the defendant violated 10b-5, justifying application of collateral estoppel in a subsequent private action. In practice, however, a nominal penalty might indicate that the judge was uncertain of the defendant's liability and rendered a compromise verdict. The possibility that a nominal penalty is a result of a compromise verdict arguably is a sufficient basis to deny collateral estoppel in a subsequent private action because any doubts as to whether an issue has been litigated fully and fairly should be resolved in favor of the party against whom collateral estoppel is asserted. Denying collateral estoppel merely forces the private plaintiff to prove a basic element of the case—that the defendant violated 10b-5. Applying collateral estoppel, however, leaves the defendant unable to contest the allegation of wrongful conduct; the defendant can argue only that the violative conduct did not cause the plaintiff's injury.

Furthermore, the award of a nominal penalty should be interpreted in light of other disadvantages a defendant faces when contesting an SEC action. The superior resources and favorable image of the SEC work to the defendant's disadvantage.[166] "[T]he SEC may succeed in establishing securities violations where private litigants would fail."[167] The expertise of SEC lawyers, combined with the SEC's substantial financial resources, rarely can be matched by private litigants.[168] In addition, the SEC is perceived as representing the public interest,[169] whereas private litigants are perceived as seeking a financial gain. "As a result, fact-finders may subconsciously give greater weight to allegations and

163. *See id.*; Note, *supra* note 82, at 578-79.

164. H.R. REP., *supra* note 5, at 9; *see supra* note 68.

165. The judge has discretion to impose any penalty that does not exceed three times the amount of the illicit profits. 15 U.S.C.A. § 78u(d)(2)(A)(ii) (West Supp. 1985). Accordingly, a judge might require the defendant to pay only a slight fraction of the amount of illicit profits.

166. *See* Note, *supra* note 89, at 1014 n.55.

167. *Id.* at 1014.

168. *See* Merrifield, *Investigation by the Securities and Exchange Commission*, 32 BUS. LAW. 1583, 1627 n.160 (1977) (remarks of Kenneth Bialkin, ABA Annual Convention); Note, *supra* note 89, at 1014 n.55; *The Supreme Court, 1978 Term*, 93 HARV. L. REV. 219, 225 n.50 (1979).

169. Note, *supra* note 89, at 1014 n.55.

evidence presented by the SEC."[170] Ultimately, when an action is brought by the SEC, a lesser measure of culpability may be required to establish a 10b-5 violation than when the action is brought by a private plaintiff.[171]

Thus, any doubts whether a nominal penalty accurately indicates a 10b-5 violation are compounded by both the probable predisposition of the courts to find a violation on a lesser margin of culpability in an SEC action and by the superior resources of the SEC. Given the disproportionate impacts of applying versus denying collateral estoppel, these doubts should be resolved in favor of the party against whom collateral estoppel is sought. Therefore, a nominal penalty in an SEC treble penalty action is inadequate evidence that the issue of a defendant's alleged 10b-5 violation has been fully and fairly litigated.

E. *Policy Considerations*

The conflicting policy goals of enhancing deterrence and avoiding coerced settlements also are important considerations in determining whether collateral estoppel is appropriate. When a defendant is vulnerable to both SEC sanctions and private money damages, the risks associated with detection are significantly increased. One purpose of SEC injunction actions, in fact, is "to alert potential private plaintiffs to securities law violations."[172] The availability of collateral estoppel increases both the number and success rate of private actions, thus furthering deterrence.[173]

The policy goal of avoiding coerced settlements[174] conflicts with the use of

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170. *Id.*

171. *Id.*

172. Pickholz & Brodsky, *supra* note 33, at 54.

173. *See* Note, *supra* note 102, at 620; Note, *supra* note 89, at 1013.

174. *See* Bialkin, *supra* note 123, at 22; Note, *supra* note 89, at 1014; *see also* Brodsky, *Collateral Estoppel in SEC Injunctive Actions*, 179 N.Y.L.J. 1 (1978) (Offensive collateral estoppel threatens SEC defendants with the loss of the right to a jury trial in a private damage action and thus induces settlement.); Hazen, *supra* note 30, at 450 ("collateral estoppel effect that might apply to fully litigated injunction order does not attach to a consent decree"); Pickholz & Brodsky, *supra* note 33, at 60 (availability of offensive collateral estoppel puts pressure on SEC defendants to settle); Note, *supra* note 102, at 621 (availability of offensive collateral estoppel will encourage consent judgments in SEC actions because consent judgments "are not final judgments and therefore not subject to collateral estoppel"); *See generally* Dent, *supra* note 30, at 946-50 (discussion of consent decrees).

The policy of avoiding coerced settlements is evidenced in the antitrust area; the finding of an antitrust violation in a government enforcement action is only prima facie evidence of a violation in a subsequent private action. 15 U.S.C. § 16(a) (1982) (Clayton Act § 5(a)). According to a majority of courts, collateral estoppel is unavailable in private antitrust actions that follow government enforcement actions. North Carolina v. Charles Pfizer & Co., 537 F.2d 67, 73-74 (4th Cir.), *cert. denied*, 429 U.S. 870 (1976); Purex Corp. v. Procter & Gamble Co., 308 F. Supp. 584, 589-90 (C.D. Cal. 1970), *aff'd*, 453 F.2d 288 (9th Cir. 1971), *cert. denied*, 405 U.S. 1065 (1972); United States v. Grinnel Corp., 307 F. Supp. 1097, 1098-99 (S.D.N.Y. 1969); *see* Note, *supra* note 89, at 1015 n.57. For a source supporting the majority view, see Note, *Section 5(a) of the Clayton Act and Offensive Collateral Estoppel in Antitrust Damage Actions*, 85 YALE L.J. 541 (1976) [hereinafter cited as Note, *Section 5(a) and Antitrust Damage Actions*]. Some courts and commentators interpret § 5(a) as not preempting the common law, but rather as setting a minimum standard; accordingly, they believe that collateral estoppel should be available in private treble damage actions. *See* Fleer Corp. v. Topps Chewing Gum, Inc., 415 F. Supp. 176, 185-86 (E.D. Pa. 1976); ANTITRUST COMMISSION REPORT, 80 F.R.D. 509, 593 (1979) (majority of the National Commission for the Review of Antitrust Laws and Procedures recommended amending § 5(a) of the Clayton Act to make clear that collateral estoppel is available following government action); Comment, *The Use of Government*

collateral estoppel in private actions.[175] As the risks associated with an unfavorable judgment increase, the incentive to avoid the judgment becomes greater. To a defendant in an SEC action, the threat of issue preclusion and of the loss of the jury trial right in a subsequent private action magnifies the risks associated with an unfavorable judgment in an SEC action.[176] Thus, even before ITSA, the SEC had the power to persuade defendants to enter into consent judgments, "which are not final judgments and therefore are not subject to collateral estoppel."[177] By entering into a consent judgment, an SEC defendant could "preserve his jury trial right in a subsequent private action"[178] and "force private plaintiffs to prove independently the elements of their damage claim."[179]

Although consent judgments promote judicial economy,[180] a contrary policy concern is that nonculpable defendants may be coerced into entering consent judgments.[181] Even before ITSA, a nonculpable SEC defendant might agree to a consent judgment based on a cost-benefit analysis of the alleged trading.[182] To the extent that the fear of collateral estoppel in subsequent private actions accounts for coerced consent judgments, public policy disfavors the application of collateral estoppel in subsequent private actions.

The enactment of ITSA, however, renders the risk of collateral estoppel a secondary consideration to the risk of a potentially enormous fine. An SEC defendant's willingness to enter into a consent judgment is primarily contingent on

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Judgments in Private Antitrust Litigation: Clayton Act Section 5(a), Collateral Estoppel, and Jury Trial, 43 U. CHI. L. REV. 338, 374-75 (1976); Note, *Section 5(a) of the Clayton Act and the Use of Collateral Estoppel by a Private Plaintiff in a Treble Damage Action*, 8 U.S.F.L. REV. 74, 89 (1973) [hereinafter cited as Note, *Section 5(a) and the Use of Collateral Estoppel*].

Although the combined litigation risks to SEC and antitrust defendants are roughly equivalent, the power to coerce a defendant into a consent judgment is greater in the antitrust context. An antitrust defendant's primary concern is to avoid paying treble damages in a private action. The availability of collateral estoppel figures strongly in an antitrust defendant's assessment of whether to enter a consent judgment, which explains courts' reluctance to apply collateral estoppel in this context. To an SEC defendant, however, the availability of collateral estoppel is of secondary importance in the assessment of whether to enter a consent judgment. An SEC defendant's chief concern is not with the risks inherent in a subsequent private action but with the risk of paying a treble penalty in the SEC action. Because the analogy between SEC and antitrust actions is imperfect, the policy goal of avoiding coerced settlements does not justify categorically denying the application of collateral estoppel in the SEC context in the same way that it jusitifies such a denial in the antitrust context. However, a judge in a private action following an SEC action under ITSA should take this policy goal into account in determining whether to grant the plaintiff the benefit of collateral estoppel.

175. *See* Note, *supra* note 89, at 1014-15.

176. *See Parklane*, 439 U.S. at 355-56 (Rehnquist, J., dissenting); Brodsky, *supra* note 174, at 1; Pickholz & Brodsky, *supra* note 33, at 60; Note, *supra* note 89, at 1014-15.

177. Note, *supra* note 102, at 621; *see Parklane*, 439 U.S. at 355-56 (Rehnquist, J., dissenting); Lawlor v. National Screen Serv. Corp., 349 U.S. 322, 326-27 (1955); R. JENNINGS & H. MARSH, SECURITIES REGULATIONS 1258 (5th ed. 1982); Dent, *supra* note 30, at 948-49; Hazen, *supra* note 30, at 450; Merrifield, *supra* note 168, at 1627; Note, *supra* note 89, at 1014 n.53.

178. Note, *supra* note 102, at 621.

179. Note, *supra* note 89, at 1014-15; *see* Merrifield, *supra* note 168, at 1627.

180. *See* SEC v. Everest Management Corp., 475 F.2d 1236, 1240 (2d Cir. 1972) ("The SEC can bring the large number of enforcement actions it does only because in all but a few cases consent decrees are entered."); *see also* Dent, *supra* note 30, at 949 (Enforcement proceedings are "lengthy"; consent judgments are "quick.").

181. *See supra* note 174.

182. *See supra* note 174.

the extent to which the SEC will make concessions on the amount of the penalty. If the risks of issue preclusion and the loss of defendant's jury trial rights were sufficiently serious to cause pre-ITSA nonculpable defendants to enter consent judgments, the additional risk of paying a treble penalty renders ITSA defendants practically powerless to refuse settlement opportunities. This is particularly true when the SEC agrees to impose only a small penalty. To the extent that the treble penalty increases the SEC's power to coerce consent judgments and to dictate the terms of the judgments, public policy weighs against the use of collateral estoppel in private actions. Denying collateral estoppel would reduce some of the litigation risks to an SEC defendant, decreasing the SEC's bargaining power to coerce nonculpable defendants to enter consent judgments.

F. *Summary of Collateral Estoppel*

Judicial precedent indicates that collateral estoppel will be available to a private plaintiff following an SEC treble penalty action.[183] On balance, application of collateral estoppel in a private action would be fair—(1) an SEC defendant, confronted with the risk of paying a treble penalty, would have a sufficient incentive to vigorously litigate the issue of the alleged 10b-5 violation; (2) potential private plaintiffs can not "easily join" in an SEC treble penalty action; (3) application of collateral estoppel would promote judicial economy; (4) the procedural opportunities afforded an SEC defendant, except in cases ending with compromise verdicts, would be full and fair; and (5) the danger of an increase in the number of coerced settlements is offset by the increase in judicial economy, the primary policy goal of collateral estoppel.

Collateral estoppel, however, should not be applied indiscriminately. An SEC defendant faces the procedural disadvantages not only of confronting the resources and status of the SEC, but also of losing the right to a jury trial in a subsequent private action. Hence, before applying collateral estoppel, a judge in a private action should ascertain whether an SEC defendant has encountered other procedural disadvantages. When in doubt, the judge should deny the application of collateral estoppel, particularly when the SEC treble penalty action ended with a compromise verdict.

V. DOUBLE JEOPARDY

A. *Overview*

A second major issue arising from the enactment of ITSA is whether subjecting an inside trader to both a treble penalty action and a criminal prosecution, regardless of the sequence in which the two suits are brought, violates the double jeopardy clause of the fifth amendment. The fifth amendment prohibits placing a defendant in jeopardy twice for the same offense.[184] Whether an inside

183. *Parklane*, 439 U.S. at 331; *see* R. JENNINGS & H. MARSH, *supra* note 177, at 1258.

184. The fifth amendment of the U.S. Constitution provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment by a grand jury, except in cases arising in the land or naval

trader can successfully invoke the double jeopardy clause depends on the satisfaction of two requirements: (1) the criminal prosecution and the treble penalty action must involve the "same offense"; and (2) the SEC treble penalty action must be "essentially criminal."[185] The following factors strongly suggest that an inside trader will be able to satisfy these requirements: the purposes behind the double jeopardy clause,[186] the punitive nature of the treble penalty,[187] the intent of Congress,[188] and considerations of fairness.[189]

B. *The Purposes of the Double Jeopardy Clause*

> The double jeopardy clause is intended to afford a defendant finality.[190]
>
> [It is] designed to protect an individual from being subjected to the hazards of trial and possible conviction more than once for an alleged offense . . . . [The] underlying idea . . . is that the State with all its resources and power should not be allowed to make repeated attempts to convict an individual for an alleged offense, thereby subjecting him to embarrassment, expense and ordeal and compelling him to live in a continuing state of anxiety and insecurity, as well as enhancing the possibility that even though innocent he may be found guilty.[191]

Thus, the double jeopardy clause is designed to protect a defendant not only from double conviction, but also from the anxieties and risks incident to a second prosecution. Hence, the clause forbids a second prosecution regardless of whether the initial prosecution resulted in a conviction or acquittal.[192] This limitation on the state assumes that courts will punish offenders fully in the initial trial.[193]

Another purpose of the double jeopardy clause is to protect people from

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> forces, or in the militia, when in actual service in time of war or public danger; *nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb*; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

U.S. CONST. amend. V (emphasis added).

185. Breed v. Jones, 421 U.S. 519, 528 (1975) (quoting Helvering v. Mitchell, 303 U.S. 391, 398 (1938)). *See* One Lot Emerald Cut Stones v. United States, 409 U.S. 232, 237 (1972) (per curiam); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-49 (1943); see also J. SIGLER, DOUBLE JEOPARDY 60-62 (1969).

186. *See infra* text accompanying notes 295-97. For statements concerning the purposes behind the double jeopardy clause, see Green v. United States, 355 U.S. 184, 187 (1957); Note, *A Definition of Punishment for Implementing the Double Jeopardy Clause's Multiple Punishment Prohibition*, 90 YALE L.J. 632 (1981).

187. *See generally infra* text accompanying notes 253-93 (discussing the application of the treble penalty as a punitive sanction).

188. *See infra* text accompanying notes 265-79.

189. *See infra* text accompanying notes 292 & 298.

190. *See* Missouri v. Hunter, 459 U.S. 359, 365 (1983); United States v. Scott, 437 U.S. 82, 92 (1978); Green v. United States, 355 U.S. 184, 187 (1957); J. SIGLER, *supra* note 185, at 39; Note, *supra* note 186, at 634.

191. Green v. United States, 355 U.S. 184, 187-88 (1957).

192. North Carolina v. Pearce, 395 U.S. 711, 717 (1969); *see* United States v. Candelaria, 131 F. Supp. 797 (S.D. Cal. 1955); Note, Missouri v. Hunter *and the Legislature: Double Punishment Without Double Jeopardy*, 37 ARK. L. REV. 1000, 1002 (1984).

193. Note, *supra* note 186, at 637-38.

punishment that is not commensurate with their degree of culpability.[194] Accordingly, the clause places restrictions on a court's authority to punish a defendant. A court cannot impose a sanction not authorized by the legislature;[195] and as a general rule, a court cannot increase the severity of a punishment once a defendant has begun to serve a sentence.[196] In the event a defendant succeeds in vacating a conviction and subsequently is reconvicted and resentenced for the same offense, a court must credit fully the time that the defendant already has served against the length of any new sentence.[197]

The double jeopardy clause does not fully insulate defendants from punishment that may be incommensurate with their level of culpability.[198] Assuming that the legislature's ability to effectively punish and deter is at least partly contingent on its authority to prescribe more than one statutory violation for the same act, a defendant's interest in avoiding multiple violations for the same act and thus excessive punishment clashes with society's interest in punishment and deterrence. The Supreme Court has handled this policy clash merely by preventing courts from punishing defendants more severely than was intended by the legislature.[199] By prescribing several overlapping statutory offenses, the legislature, therefore, can enable the government to prosecute defendants under more than one statutory provision for the same act, thereby subjecting them to multiple punishments, provided that the punishments result from the same trial and that the legislature intended such an outcome.[200] This recent, restrictive interpretation of the protections afforded by the double jeopardy clause reflects an emphasis on society's interest in punishment and deterrence and arguably allows the government to subject insiders who violate 10b-5 to both the treble penalty and the 10b-5 criminal sanctions, provided that these punishments are issued in one trial and are consistent with the legislative intent.[201]

C. *The Same Offense Requirement*

To invoke the protections of the double jeopardy clause, a defendant must

194. *Id.* at 637.

195. *Id.* at 639; *see* Missouri v. Hunter, 459 U.S. 359, 366 (1983).

196. United States v. Benz, 282 U.S. 304, 307 (1931); M. FRIEDLAND, DOUBLE JEOPARDY 52 (1969); Note, *supra* note 186, at 637.

197. Note, *supra* note 186, at 636; *see* North Carolina v. Pearce, 395 U.S. 711, 717-19 (1969) (crediting prison term served after initial trial against sentence imposed in second trial); Culp v. Bounds, 325 F. Supp. 416, 419 (W.D.N.C. 1971) (crediting prison sentence for time spent in pretrial confinement).

198. *See* J. SIGLER, *supra* note 185, at 40.

199. Missouri v. Hunter, 459 U.S. 359, 366 (1983); *see* People v. Moore, 143 Cal. App. 2d 333, 299 P.2d 691 (1956); J. SIGLER, *supra* note 185, at 40.

200. *See* Missouri v. Hunter, 459 U.S. 359, 367-68 (1983); Note, *supra* note 192, at 1000.

201. Dicta in *Ex parte* Lange, 85 U.S. (18 Wall.) 163 (1873), indicates that the double jeopardy clause at one time precluded imposition of multiple sentences in a single trial. *Id.* at 170; *see* Note, *supra* note 192, at 1003. As late as 1969, the Supreme Court stated that the double jeopardy clause "protects against a second prosecution for the same offense after acquittal, . . . against a second prosecution for the same offense after conviction, . . . [and] against multiple punishment for the same offense." North Carolina v. Pearce, 395 U.S. 711, 717 (1969). Missouri v. Hunter, 459 U.S. 359 (1983), restricts this notion of the scope of the double jeopardy clause by removing a defendant's protection from multiple punishments for the same offense within the same trial. *Id.* at 368-69.

demonstrate that a 10b-5 criminal violation is the "same offense" as a 10b-5 civil violation.[202] The test for determining whether two statutory provisions constitute the same offense "is whether each provision requires proof of a fact which the other does not"[203]—the "same evidence test."[204] Conspiracy to import marijuana and conspiracy to distribute marijuana, for example, are different offenses because each requires proof of a criminal element that the other does not.[205] In contrast, lesser-included offenses of a primary offense do not require proof of an additional criminal element and are deemed to be the "same offense" as the primary offense.[206] Manslaughter, for example, is a lesser-included offense of murder; as a result, acquittal or conviction of murder bars a retrial for manslaughter.[207] The same evidence test has been expanded to include greater-included offenses. An acquittal or conviction for manslaughter, therefore, should bar a retrial for murder.[208] Conceptually, greater and lesser-included offenses merge with the primary offense, thereby becoming the "same offense."[209]

A 10b-5 criminal violation is clearly the same offense as a 10b-5 civil violation. Fraudulent conduct in connection with the use of material, nonpublic information and a breach of fiduciary duty are necessary elements of both a criminal and civil 10b-5 violation.[210] The only distinction is the requisite levels of awareness: criminal sanctions are imposed for "willful" violations, whereas the civil treble penalty is imposed upon a showing of scienter.[211] A willful violation entails a showing of "knowingly wrongful misconduct";[212] scienter, in contrast, has been interpreted to include "recklessness."[213] Thus, willfulness connotes a higher degree of awareness and culpability; a showing of willfulness necessarily proves scienter. Accordingly, a civil 10b-5 violation is a lesser-included offense of a criminal 10b-5 violation, and a 10b-5 criminal violation is a greater-included offense of a civil 10b-5 violation. Using the same evidence test, criminal sanctions and the civil treble penalty, therefore, would be the "same offense."

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202. *See* U.S. CONST. amend. V (reprinted *supra* note 184).

203. Blockburger v. United States, 284 U.S. 299, 304 (1932); *see* Missouri v. Hunter, 459 U.S. 359, 366 (1983); Whalen v. United States, 445 U.S. 684, 688 (1980); J. SIGLER, *supra* note 185, at 66; Kirchheimer, *The Act, the Offense, and Double Jeopardy*, 58 YALE L.J. 513, 527-34 (1949).

204. J. SIGLER, *supra* note 185, at 66; Kirchheimer, *supra* note 203, at 527.

205. Albernaz v. United States, 450 U.S. 333, 339 (1981).

206. J. SIGLER, *supra* note 185, at 66; *see, e.g.*, Whalen v. United States, 445 U.S. 684, 693 (1980) (rape found to be a lesser-included offense of murder committed "in the course of the rape"); Brown v. Ohio, 432 U.S. 161, 168 (1977) (joyriding a lesser-included offense of auto theft); Note, *supra* note 192, at 1008 n.53; *see also* Kirchheimer, *supra* note 203, at 528 ("[O]nly if the purpose of the second indictment could have been reached under the first indictment would double jeopardy attach.").

207. J. SIGLER, *supra* note 185, at 66.

208. *See* Brown v. Ohio, 432 U.S. 161, 168 (1977) (greater offense of auto theft same offense as the lesser-included offense of joyriding for double jeopardy purposes).

209. BLACK'S LAW DICTIONARY 892 (5th ed. 1979).

210. *See supra* note 14 and accompanying text.

211. *See supra* notes 108-11 and accompanying text.

212. United States v. Chiarella, 688 F.2d 1358, 1371 (2d Cir. 1978), *rev'd on other grounds*, 445 U.S. 222 (1980).

213. *See supra* note 111 and accompanying text.

D. *Requirement that the Treble Penalty Be "Essentially Criminal"*

1. The Remedial/Punitive Test

To claim double jeopardy, a defendant must establish that both a civil treble penalty action and a criminal prosecution put a defendant in "jeopardy."[214] Jeopardy refers to the risks that traditionally arise from a criminal prosecution.[215] Labelling a suit "civil," however, is insufficient to deny application of the double jeopardy clause.[216] The test is whether the proceeding is "essentially criminal."[217] Courts have been reluctant to categorize civil actions as essentially criminal.[218] In deciding whether an action is essentially criminal, the primary consideration is whether the legislature intended the provision to be punitive or remedial.[219]

Historically, only the most severe punishments provided a defendant the protection of the double jeopardy clause.[220] Today, courts do not require that a defendant literally be twice in jeopardy of "life or limb."[221] When the potential consequences of a sanction include a criminal stigma and the deprivation of liberty or property, the proceeding may be sufficiently punitive to trigger the double jeopardy clause.[222] Fines and money penalties have been held to be puni-

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214. *See* U.S. CONST. amend. V (reprinted *supra* note 184).

215. Breed v. Jones, 421 U.S. 519, 528 (1975); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-49 (1943).

216. Breed v. Jones, 421 U.S. 519, 529 (1975).

217. *See supra* note 185 and accompanying text.

218. *See, e.g.*, One Lot Emerald Cut Stones v. United States, 409 U.S. 232, 235-37 (1972) (civil proceeding to forfeit undeclared imports that occurred after defendant's criminal acquittal on smuggling charge remedial in nature and hence not barred by double jeopardy clause); Rex Trailer Co. v. United States, 350 U.S. 148, 148-52 (1956) (circuit prosecution following nolo contendere plea in criminal action not double jeopardy); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 545-46 (1943) (civil prosecution following nolo contendere plea in criminal action not double jeopardy); Helvering v. Mitchell, 303 U.S. 391, 402-04 (1937) (acquittal of tax evasion charge does not bar imposition of "remedial sanction" of one-half the unpaid tax); United States v. Naftalin, 606 F.2d 809 (8th Cir. 1979) (criminal conviction for scheme to defraud in violation of Securities Act of 1933 not double jeopardy despite prior disciplinary action by SEC); United States v. Hall, 559 F.2d 1160, 1162-63 (9th Cir. 1977), *cert. denied*, 435 U.S. 942 (1978) (civil forfeiture procedure under Tariff Act would not preclude subsequent criminal prosecution because protection of double jeopardy clause only triggered by multiple criminal punishments). *But see* Breed v. Jones, 421 U.S. 519, 529-31 (1974) (label of "civil" on a juvenile court proceeding insufficient to prevent application of the double jeopardy clause in a subsequent criminal prosecution); United States v. La Franca, 282 U.S. 568, 575-76 (1931) (civil penalty under National Prohibition Act disallowed following a criminal prosecution for the same offense).

219. *See* Helvering v. Mitchell, 303 U.S. 391, 397-98 (1938); United States v. Ben Grunstein & Sons, Co., 127 F. Supp. 907, 912 (D.N.J. 1955); J. SIGLER, *supra* note 185, at 60; Note, *White-Collar Crime: Second Annual Survey of Law*, 19 AM. CRIM. L. REV. 173, 231 (1981). A remedial action is one "which is brought to obtain compensation or indemnity." BLACK'S LAW DICTIONARY 1162 (5th ed. 1979). A punitive action, in contrast, has "the character of punishment or penalty." *Id.* at 1110.

220. J. SIGLER, *supra* note 185, at 5, 39.

221. *Id.* at 39; *see Ex parte* Lange, 85 U.S. (18 Wall.) 163, 169-75 (1873) (threat of death or mutilation eliminated as requirement of double jeopardy); Note, *supra* note 186, at 641.

222. Note, *supra* note 186, at 649; *see* Breed v. Jones, 421 U.S. 519, 529 (1975) (juvenile is put in jeopardy if possible consequences of proceeding include stigma and loss of liberty for many years); North Carolina v. Pearce, 395 U.S. 711, 718 n.12 (1969) (recognizing imprisonment and fines as criminal punishments for double jeopardy purposes).

tive for the purposes of the double jeopardy clause.[223] On the other hand, compensatory damages,[224] injunctions,[225] revocations of licenses voluntarily granted,[226] and forfeitures[227] have been viewed as remedial.

Although a fine issued in a criminal prosecution will be characterized as punitive, a penalty of the same severity issued in a government civil action usually is characterized as remedial.[228] In government civil actions, damages clearly in excess of actual damages, for example, have been found to be remedial.[229] The courts have based these decisions on legislative intent to classify civil penalties as nonpunitive sanctions.[230] Three rationales are used to support a court's conclusion that a legislature intended a civil penalty to be viewed as nonpunitive. First, criminal punishments are intended "to vindicate public justice,"[231] whereas civil penalties are intended only to vindicate private justice.[232] Second, by providing civil penalties, the legislature intended merely to afford complete indemnification to the government for investigatory and other hidden costs.[233] Last, by providing both a civil forum and procedure to adjudicate the appropriateness of a penalty, the legislature indicated its intention to attribute noncriminal characteristics to the penalty.[234]

In *Helvering v. Mitchell*,[235] the Supreme Court held that a civil fifty per cent "tax" for fraudulent tax evasion was remedial.[236] The Court reasoned that the additional tax was intended to provide "a safeguard for the protection of . . . revenue" and to fully indemnify the government for investigatory ex-

223. *See, e.g.*, North Carolina v. Pearce, 345 U.S. 711, 718 n.12 (1969); United States v. La Franca, 282 U.S. 568, 572 (1931); Note, *supra* note 186, at 633, 641.

224. Rex Trailer Co. v. United States, 350 U.S. 148, 154 (1956); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-52 (1943).

225. Murphy v. United States, 272 U.S. 630, 632 (1926); *see* United States v. La Franca, 282 U.S. 568, 572-73 (1931).

226. Helvering v. Mitchell, 303 U.S. 391, 399 & n.2 (1938).

227. *Id.* at 400; *see, e.g.*, One Lot Emerald Cut Stones v. United States, 409 U.S. 232, 235-37 (1972) (civil proceeding to require forfeiture of undeclared imports after defendant's criminal acquittal on smuggling charge remedial in nature).

228. *See* United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-51 (1943) (Criminal prosecution under False Claims Act resulting in $54,000 fine is "clearly criminal in nature," whereas $315,000 in double damages and fines resulting from a civil action against the same defendant is remedial.).

229. *See, e.g.*, Rex Trailer Co. v. United States, 350 U.S. 148, 153-54 (1956) ($10,000 in penalties for violations of the Surplus Property Act held not to be a criminal penalty); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 540, 549 (1943) ("We cannot say that [$315,000 in double damages and fines] will do no more than afford the government complete indemnity for the injuries done it.").

230. Helvering v. Mitchell, 303 U.S. 391, 398-99 (1938); Note, *supra* note 186, at 642; *see also* United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 549 (1943) ("question is one of statutory construction in determining whether statute imposes a criminal sanction").

231. Breed v. Jones, 421 U.S. 519, 529 (1975) (quoting United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-49 (1943)); *see* Comment, *Punitive Damages and Double Jeopardy: A Critical Perspective of the Taber Rule*, 56 IND. L.J. 71, 86 (1980).

232. Comment, *supra* note 231, at 86; *see* United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 548-50 (1943); *see also* Rex Trailer Co. v. United States, 350 U.S. 148, 151 (1956) (emphasizing that government contract rights and remedies are the same as those of private persons).

233. *See* Rex Trailer Co. v. United States, 350 U.S. 148, 153 (1956); United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 549 (1943); Helvering v. Mitchell, 303 U.S. 391, 401 (1938).

234. Helvering v. Mitchell, 303 U.S. 391, 402 (1938).

235. 303 U.S. 391 (1938).

236. *Id.* at 401.

penses.[237] The tax was viewed "as [a] civil [incident] of the assessment and collection of the income tax."[238] In discussing legislative intent, the Court emphasized that Congress had provided a civil procedure for the collection of the tax and, therefore, "intended a civil, not a criminal, sanction."[239]

When the assessment of a civil penalty arises from fraudulent conduct in the creation or performance of government contracts, the Supreme Court has emphasized that the penalties are intended to indemnify the government and are not punitive. Thus, a $2,000 penalty for each violation of the antifraud provision of the Surplus Property Act of 1944[240] was not viewed as "so unreasonable or excessive that it transformed what was clearly a civil remedy into a criminal penalty."[241] Analogizing the penalty to a liquidated damages clause, the Supreme Court stated that the penalty was merely the equivalent of a recovery in a private contract action.[242]

To avoid application of the double jeopardy clause in the civil setting, the Supreme Court has expanded the concept of remedial beyond its literal meaning. A literal application of the remedial/punitive test would render all civil penalties in excess of actual injury or losses punitive penalties. Applying such a literal definition, the Supreme Court in *United States v. La Franca*[243] held a double tax on the unlawful sale of intoxicating liquor under the National Prohibition Act[244] to be punitive and dispelled the fiction of calling the assessment of a double tax a "tax":

> A tax is an enforced contribution to provide for the support of government; a penalty . . . is an exaction imposed by statute as punishment for an unlawful act. . . . No mere exercise of the art of lexicography can alter the essential nature of an act or thing; and if an exaction be clearly a penalty it cannot be converted into a tax by the simple expedient of calling it such.[245]

The Court explained that "remedial" connoted a preventive sanction, such as an

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237. *Id.*

238. *Id.* at 405.

239. *Id.* at 402.

240. Surplus Property Act of 1944, ch. 479, § 26, 58 Stat. 765, 780-81, *repealed by* Act of June 30, 1949, ch. 209, § 602(a)(1), 63 Stat. 399.

241. Rex Trailer Co. v. United States, 350 U.S. 148, 154 (1956).

242. *Id.* at 151, 153; *see also* Cotton v. United States, 52 U.S. (11 How.) 229, 231 (1850) (United States capable of making contracts).

The same reasoning was used in a government civil action under the False Claim Act of 1863, ch. 67, 12 Stat. 696 (current version at 31 U.S.C. § 3729 (1982)), in which defendant, after paying a $54,000 criminal fine, was held liable for double damages and fines totaling $315,000. United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 540, 545 (1943). The Court decided that the $54,000 criminal fine was "not intended to compensate the government" because it was "clearly criminal in nature." *Id.* at 548. The $315,000 civil penalty, however, was viewed as remedial—brought to protect the government from financial loss, *id.* at 548-49,—as opposed to an action intended to vindicate public justice. The court even stated that it was within Congress' power to provide the government a treble damages remedy in such actions. *Id.* at 550.

243. 282 U.S. 568, 572 (1931).

244. National Prohibition Act, ch. 85, 41 Stat. 305 (1919), *repealed by* Liquor Law Repeal and Enforcement Act, ch. 740, 49 Stat. 872 (1935).

245. *La Franca*, 282 U.S. at 572.

injunction to abate a nuisance.[246] In refusing to impose civil liability, the Court emphasized that the defendant had already undergone a criminal prosecution;[247] thus, a retrial, even in a civil proceeding,[248] was barred by the double jeopardy clause.[249] Despite the persuasiveness of this literal approach to the remedial/punitive test, the Supreme Court has largely ignored *La Franca* and instead has adopted a more relaxed definition of remedial.

Four policy reasons explain the judiciary's reluctance to extend the double jeopardy clause across the civil/criminal jurisdiction line. First, if courts labelled a civil penalty or a double tax as punitive, they implicitly would concede that the civil courts are an appropriate forum in which to mete out criminal punishment. Congress, however, does not have the authority to punish criminally in a civil proceeding;[250] if it did have this authority, the protection afforded a defendant in a criminal forum, such as requiring proof beyond a reasonable doubt, could be easily circumvented. Thus, to maintain an appearance of rationality in the issuance of punishment, the courts are apt to label sanctions available in a civil proceeding as "civil" or "remedial." Second, to label a civil sanction as punitive would threaten the government's ability to prosecute criminals; once jeopardy attached to a civil action, a criminal prosecution against the same defendant for the same offense would be barred. Third, if any two statutory provisions exposed a defendant to double prosecution for the same offense and, consequently, were deemed to violate the double jeopardy clause, a court would be forced to determine whether these statutes were unconstitutional.[251] In turn, this could lead to a time-consuming overhaul of many state statutes. Fourth, Congress' ability to deter socially detrimental conduct may be contingent on its ability to provide civil penalties. For example, the requirement of proof beyond a reasonable doubt renders criminal law punishments ineffective in cases against insiders who violate 10b-5 because such cases are based almost exclusively on circumstantial evidence.[252] Because the burden of proof is less onerous in civil proceedings, civil sanctions provide the enforcement device needed to bolster deterrence. Labelling civil sanctions as punitive, however, eliminates this means of achieving deterrence because the double jeopardy clause would limit the government to either a civil or a criminal action. These policy considerations have encouraged courts to pay lip service to legislative intent while concluding that a clearly punitive provision is remedial.

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246. *Id.* at 573.

247. *Id.*

248. The Court stated that "the word 'prosecution' is not inapt to describe" such a civil action. *Id.* at 575.

249. *Id.* at 574.

250. *Mitchell*, 303 U.S. at 402 n.6.

251. *See, e.g.*, Simpson v. United States, 435 U.S. 6 (1978). In *Simpson* the defendant was charged under the Federal Bank Robbery Act and felony firearms statute. *Id.* at 9. The Court avoided constitutional analysis of statutes by applying a "rule of lenity" and by interpreting legislative ambiguity in defendant's favor. *Id.* at 15; *see also La Franca*, 282 U.S. at 574-75 (Court considered whether the potential for double jeopardy created by the Willis-Campbell Act and the National Prohibition Act undermined the validity of the two statutes).

252. *See supra* note 46.

2. Application of the Remedial/Punitive Test to the Treble Penalty

Even under the current interpretation of the remedial/punitive test, courts would find it difficult to categorize the SEC treble penalty as remedial. The treble penalty has all the characteristics of a criminal punishment and virtually none of the characteristics of the civil penalties that courts have classified as remedial. The treble penalty was not designed to vindicate private justice; instead, the treble penalty, as evidenced by ITSA's legislative history, was designed to effect the criminal law goals of punishment and deterrence and to protect investor confidence and the integrity of the capital markets.[253] The legislative history of ITSA clearly indicates that Congress was attempting to resolve the broad societal problem of insider trading.[254] The penalty is paid not to the injured investors, but to the United States Treasury,[255] indicating that the action is brought on behalf of the public as a whole.

Unlike government tax and contract actions seeking civil penalties, the treble penalty is not intended to indemnify the government. When the government seeks to penalize a defendant for tax evasion or for fraudulent conduct in contracting with the government, the government can be likened to a private party having a monetary stake in the defendant's assets.[256] Private parties may be entitled to punitive damages or damages in excess of actual damages as a result of a liquidated damages clause.[257] The government is entitled to similar remedies.[258] When the government sues to collect a tax or to enforce a contract, a penalty in excess of the actual claim is similar to a private recovery,[259] designed to reimburse the government for expenses incident to the investigation and collection of the amount owed.[260] The treble penalty, in contrast, is not attached to a prior government monetary claim against the defendant. The government suffers no specific monetary losses from the insider's conduct. It would be unreasonable, therefore, to view the treble penalty as indemnifying the government.

The inaccuracy of labelling the treble penalty as remedial also is apparent from a comparison of the treble penalty and the injunctive sanction. An injunction squarely meets the definition of remedial because it is designed to prevent a

253. *See supra* note 7 and accompanying text.

254. *See supra* notes 41-57 and accompanying text. "The broad point is that the public policy goal we are after is to achieve fairness in the market place . . . ." *House Hearings, supra* note 5, at 35-36 (statement of Rep. Wirth).

255. *See supra* note 60.

256. *See* United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 549-51 (1943); *see also* Rex Trailer Co. v. United States, 350 U.S. 148, 151 (1956) (government recovery of $10,000 penalty comparable to private parties' recovery under a liquidated damage clause).

257. United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 550 (1943).

258. *Id.* at 549-50.

259. *Id.* at 550 (The government, "when spending its money has the same interest in protecting itself from fraudulent practices as it has in protecting any citizen from frauds which may be practiced upon him.").

260. *Mitchell*, 303 U.S. at 401 ("[S]anctions imposing additions to a tax . . . are provided primarily as safeguard . . . of the revenue . . . [and] to reimburse the Government for heavy expenses of investigation.").

second violation by the defendant.[261] However, because an injunction does not deter an initial violation, Congress believed it to be an inadequate sanction.[262] Representative Wirth asserted that pre-ITSA sanctions "merely [restore] an unscrupulous trader to his original position without extracting a real penalty for his illegal behavior."[263] The treble penalty stands in stark contrast to the injunctive sanction, representing Congress' effort to provide a "real penalty."[264]

More importantly, Congress did not intend the treble penalty to be remedial.[265] In applying the remedial/punitive test, courts purportedly look to legislative intent.[266] However, it is difficult to accurately discern the legislature's intention in creating a sanction.[267] Not all sanctions available in the civil or criminal arenas are sufficiently punitive to trigger the double jeopardy clause;[268] only sanctions that are intended to effect the traditional purposes of the criminal law are deemed sufficient.[269] The courts and commentators are divided on the question of whether sanctions instituted to rehabilitate defendants are "essentially criminal."[270] Sanctions designed for punishment and deterrence, however, clearly are criminal in nature.[271] Congress devised the treble penalty to deter insider trading and to punish violators, something Congress felt the pre-ITSA sanctions could not do adequately.[272] Thus, the underlying purposes of the treble penalty are identical to the purposes typically associated with criminal punishments.

The enacted and proposed limitations on application of the treble penalty further indicate Congress' recognition of the punitive nature of the treble penalty. Enacted limitations include a statute of limitations, prohibition of respondeat superior, restrictions on liability for aiding and abetting, and conferal on the trial court of discretion not to issue the full treble penalty.[273] In addition, Congress enacted a defendant-favorable restrictive formula for calculating the base figure used to determine a defendant's total liability.[274] A proposal that would have heightened the standard of proof required to impose the treble penalty was strongly considered but ultimately rejected.[275]

Comments made during the legislative process also reflect an awareness of the treble penalty's punitive nature. John Fedders, former head of SEC enforce-

261. *See supra* notes 47-48 and accompanying text.
262. *See supra* notes 41-54 and accompanying text.
263. 130 CONG. REC. H7759 (daily ed. July 25, 1984) (statement of Rep. Wirth); *see supra* note 57.
264. *See* 130 CONG. REC. H7757, H7759 (daily ed. July 25, 1984) (statement of Rep. Wirth).
265. *See id.*
266. *See supra* note 219 and accompanying text.
267. Note, *supra* note 186, at 646.
268. *Id.* at 640 n.32.
269. *See supra* notes 214-15 and accompanying text; Note, *supra* note 186, at 646-47.
270. Note, *supra* note 186, at 647.
271. *See id.* at 646 nn.61-62.
272. *See supra* note 55 and accompanying text.
273. For discussion of and citations to the enacted and proposed limitations, see *supra* notes 68-80 and accompanying text.
274. *See supra* notes 75-76 and accompanying text.
275. *See supra* note 80.

ment, described the treble penalty as an "extraordinary burden."[276] One participant stated that "since the penalty may exceed the inside trader's actual or theoretical gain (or avoidance of loss), the penalty takes on significance as a quasi-criminal punishment."[277] Representative Rinaldo asked whether "a higher burden of proof, such as proof by clear and convincing evidence, [should] be applied in the special circumstances of treble damages actions under [ITSA] in light of the potentially severe penalties."[278] Furthermore, in discussing whether a definition of "insider trading" should accompany ITSA, Rinaldo stated that "when you go from the *remedial stage to the punitive stage*, . . . there should be a definition, but that definition should apply only to . . . the [treble penalty]."[279] Along with the enacted and proposed limitations on the applicability of the treble penalty and the sanction's criminal law purposes, these comments clearly demonstrate that the treble penalty was intended as a punitive sanction.

3. Comparison of the Treble Penalty With Punitive Damages

Punitive damages "consist of an additional sum, over and above the compensation of the plaintiff for the harm which he has suffered, which are awarded to him for the purpose of punishing the defendant, of admonishing him not to do it again, and of deterring others from following his example."[280] The treble penalty fits this definition, with the exception that it is paid to the government instead of to a private plaintiff.[281] First, as with punitive damages, the treble penalty is aimed at deterrence. Second, as with a payment in excess of compensatory damages, any payment in excess of an amount already disgorged would be punitive. In other words, a defendant, after disgorging profits, is returned to his or her financial position prior to the illicit transaction.[282] A payment of three times that amount must be viewed as punitive. That the treble penalty is analogous to punitive damages suggests that it is punitive for the purposes of the double jeopardy clause.

The majority of courts, however, will award punitive damages even though the defendant has been prosecuted criminally for the same act.[283] Treble damages awarded to private plaintiffs under the Racketeer Influenced and Corrupt Organizations Act (RICO)[284] and the Clayton Act,[285] for example, will not bar

276. *House Hearings*, *supra* note 5, at 63.
277. *Id.* at 121.
278. *Id.* at 39.
279. *Id.* at 52 (emphasis added).
280. W. PROSSER & J. WADE, CASES AND MATERIALS ON TORTS 1076 (1971).
281. *See supra* note 60.
282. *See supra* note 49 and accompanying text.
283. *See* W. PROSSER & J. WADE, *supra* note 280, at 1076.
284. 18 U.S.C. § 1963 (1976); Note, *Use of Collateral Estoppel in Private Civil Actions Under RICO: The Procedural Benefits of* Parklane Hosiery Co. v. Shore, 52 U. CIN. L. REV. 490, 490 (1983); *see also* Note, *supra* note 219, at 230 ("[T]he provision for both criminal and civil sanctions under the same act does not constitute double jeopardy.").
285. Herald Co. v. Harper, 410 F.2d 125, 129-30 (8th Cir. 1969); Comment, *supra* note 231, at 79, 92; *see also* Note, *supra* note 219, at 230 ("[T]he provision for both criminal and civil sanctions under the same act does not constitute double jeopardy.").

a subsequent criminal prosecution. At first glance, this would support the view that the double jeopardy clause should not apply to the treble penalty. Because the government in a civil action is entitled to the rights and remedies of a private plaintiff,[286] a private plaintiff's authority to seek punitive damages without the risk of a double jeopardy defense should allow the government to sidestep the double jeopardy clause when bringing a civil treble penalty action. This argument, however, is not convincing.

Some states do not permit punitive damages, believing that only the government has the authority to punish a defendant.[287] Thus, because they view punitive damages as a criminal punishment, the treble penalty, at least in these states, will be considered a criminal punishment. Consistent with this view, other states have suggested that punitive damages should be paid to the state's treasury[288]—another indication that punitive damages constitute criminal punishment. Indiana, for example, rejects punitive damages when the defendant is subject to a criminal prosecution for the same act.[289] The rationale for this view is that the spirit of the double jeopardy clause should protect a defendant from double punishment, regardless of whether one source of the punishment is contained within a private civil action.[290] In recognizing that the combination of a private punitive damages action and a criminal prosecution would constitute two "essentially criminal" actions against a defendant for the same offense, Indiana's treatment of punitive damages supports the argument that a defendant should be protected from the combination of a treble penalty and a criminal prosecution. Thus, the government can not rely on the analogy between punitive damages and the treble penalty to argue that a combination of a treble penalty action and a criminal prosecution should be outside the scope of the double jeopardy clause.

Even in jurisdictions allowing punitive damages in a criminal prosecution, the analogy between punitive damages and the treble penalty does not compel the conclusion that the treble penalty should be outside the scope of the double jeopardy clause. Although similar in many respects, the treble penalty and punitive damages are distinguishable. One difference is that some statutorily authorized forms of punitive damages, such as treble damages under RICO and the Clayton Act, have a remedial purpose. By increasing the percentage of injured persons who are ultimately recompensed, treble damages serve a remedial purpose.[291] This distinguishes treble damages from criminal sanctions and arguably

286. *See supra* note 258 and accompanying text.

287. W. PROSSER & J. WADE, *supra* note 280, at 1076.

288. *Id.* at 1077.

289. Wabash Printing & Publishing Co. v. Crumrine, 123 Ind. 89, 21 N.E. 904 (1889); Taber v. Hutson, 5 Ind. 332 (1854); Moore v. Waitt, 157 Ind. App. 1, 298 N.E.2d 456 (1973); W. PROSSER & J. WADE, *supra* note 280, at 1076; Comment, *supra* note 231, at 72.

290. Taber v. Hutson, 5 Ind. 332, 335-36 (1854); Comment, *supra* note 231, at 73.

291. Although the treble penalty provides private plaintiffs an incentive to litigate and thus promotes deterrence, Congress also intended to effect redress for injuries suffered. *See* Note, *Section 5(a) and the Use of Collateral Estoppel*, *supra* note 174, at 74; *see also* W. PROSSER & J. WADE, *supra* note 280, at 1077 (One justification for punitive damages is to provide "an incentive to bring into court and redress a long array of petty cases of outrage and oppression . . . which a private individual would otherwise find not worth the trouble and expense of a lawsuit.").

justifies insulating treble damages in RICO and Clayton Act cases from the reach of the double jeopardy clause.

The ITSA treble penalty, in contrast, is not designed to encourage private actions. Instead, the penalty is sought by and paid to the government and therefore will not increase the percentage of recompensed, injured investors. Accordingly, unlike RICO and Clayton Act treble damages, the ITSA treble penalty has no remedial purpose that would justify removing it from the scope of the double jeopardy clause.

In addition, some courts, in refusing to apply the double jeopardy clause to punitive damages, have characterized punitive damages as vindicating "the interests of an individual who has been the victim of a malicious wrong."[292] This characterization distinguishes punitive damages from criminal punishments that are designed to vindicate public justice.[293] Arguably, the government also is vindicating private justice when it sues to rectify an isolated occurrence, such as a breach of a government contract. In these situations, awarding the government punitive damages, without the attachment of "jeopardy" to the action, may be appropriate because the government can be viewed as any other injured plaintiff. In bringing the ITSA treble penalty action, however, the government is not redressing a personal, isolated grievance with a defendant; rather, the government is attempting to effect the criminal law purposes of deterrence and punishment. Thus, the treble penalty falls within the scope of the double jeopardy clause.

4. Policy Considerations

Despite the policy reasons behind classifying sanctions issued in civil courts as remedial, the legislative intent approach to the remedial/punitive test would lose any sense of rationality if courts attributed a remedial purpose to a sanction so clearly punitive as the treble penalty. Congress should not be able to change the nature of a sanction merely by shifting the sanction into the civil forum. In fact, the argument for protecting an individual is stronger when one of two punitive actions is initiated in a civil forum because a defendant loses the protections afforded by the criminal procedures. For example, the government need only prove its case by a preponderance of the evidence to prevail in a civil enforcement action. Thus, rationality, fairness, and constitutional considerations dictate that Congress not infringe on a citizen's criminal procedure rights and double jeopardy protections merely by transferring a criminal penalty to a civil forum.

The purposes of the double jeopardy clause also favor its application following either a civil treble penalty action or a 10b-5 criminal prosecution. The primary purpose of the double jeopardy clause is to provide a defendant with finality in the litigation of essentially criminal prosecutions. Because insiders are currently subject to the full barrage of SEC enforcement sanctions, a criminal

292. Comment, *supra* note 231, at 86.
293. *Id.* at 85-86.

prosecution, and private actions, they have an acute interest in resolving any risks of punishment in one prosecution. In recognition of this interest, punitive damages are disallowed in private actions against insiders.[294]

The second purpose of the double jeopardy clause is to prevent punishment that is incommensurate with a defendant's level of culpability. Under ITSA, an insider who violates 10b-5 is subject to an injunction, disgorgement, a treble penalty, a $100,000 criminal penalty, imprisonment, and payment of compensatory damages in private actions.[295] The combined effect of these measures is disproportionate to the insider's level of culpability. John Fedders, former head of SEC enforcement, predicted a decline in criminal prosecutions with the advent of the treble penalty.[296] Fedders predicted that once a defendant has disgorged illicit profits, paid an additional treble penalty, and received an injunction prohibiting future violations the Department of Justice would decline the opportunity to pursue further sanctions.[297]

In calculating the amount of the treble penalty, courts have the authority to triple "the difference between the purchase or sale price of the security and the trading price of that security a reasonable period after public dissemination of the nonpublic information."[298] This base figure from which the treble penalty is calculated has only a tenuous connection with a defendant's level of culpability; yet, it has a substantial effect on the amount of the penalty. The magnitude of the base figure depends far more on fortuitous fluctuations in the market price of the stock than on the defendant's level of culpability. Two defendants, both knowingly trading on the basis of material, nonpublic information and breaching a fiduciary duty, may wind up with great differences in their respective liabilities. In addition, an insider's base figure could be astronomical if the release of the inside information results in a substantial change in the price of the stock. By basing a defendant's liability in part on shifts in the securities market, Congress has created the potential for harsh and unjust results. Because of this, the application of the double jeopardy clause to prevent the addition of criminal fines and imprisonment to the already harsh treble penalty is consistent with the clause's purpose of protecting a defendant from disproportionate punishment.

5. Criticism of the Legislative Intent Approach

Although the courts are reluctant to extend the double jeopardy clause across the civil/criminal jurisdictional line,[299] the legislative intent approach to the remedial/punitive test nevertheless results in a classification of the treble penalty as punitive. The courts look to legislative intent to decide whether a civil sanction is remedial or punitive.[300] This approach emphasizes society's in-

294. *See* T. HAZEN, *supra* note 3, at 471.

295. *See supra* notes 59-67 and accompanying text.

296. *House Hearings*, *supra* note 5, at 70-71.

297. *Id.*

298. H.R. REP., *supra* note 5, at 11; *see* 15 U.S.C.A. § 78u (d)(2)(c) (West Supp. 1985); *House Hearings*, *supra* note 5, at 91; H.R. REP., *supra* note 5, at 29.

299. *See supra* note 218 and accompanying text.

300. *See supra* note 219 and accompanying text.

terest in effecting punishment and deterrence while circumventing the double jeopardy clause by imputing a remedial purpose to a punitive sanction.[301] The legislative intent approach also ignores the effect a sanction has on a defendant.[302] Regardless of legislative intent, a penalty in excess of compensatory damages is punitive.[303] A court cannot change the objective nature of a sanction merely by imputing a remedial purpose to it.[304] One student commentator has recommended that the courts look instead to the effect a sanction has on the defendant in determining whether the sanction is punitive or remedial.[305] Clearly, the treble penalty would be viewed as punitive under this effects approach.

The effects approach, however, ignores the policy reasons behind the legislative intent approach. If every civil penalty, regardless of amount, was viewed as sufficient to bar a subsequent criminal prosecution for the same offense, the government's ability to effect deterrence and punishment would be undermined. For example, civil penalties for tax fraud would bar a subsequent criminal prosecution.[306] Particularly when the civil penalty is mild, the government's interest in law enforcement must outweigh a defendant's interest in avoiding the second of two punitive actions. In balancing these competing interests, a court should assess whether the civil punishment is sufficiently severe to warrant the protection of the double jeopardy clause. In this way, courts could avoid both the inquiry into legislative intent and the contrived definition of remedial. This approach is justified on the principle that the double jeopardy clause is applicable only to serious punishments.[307] If a penalty were deemed severe enough to warrant the protection of the double jeopardy clause, the legislature would not be able to modify this determination by making the penalty available in a civil forum. Thus, a defendant would not be subject to double prosecution merely because of a change in forum. Under this proposed approach, ITSA's treble penalty would be considered severe enough to warrant granting the defendant the protection of the double jeopardy clause.

E. *Legislative Recommendations*

Based on the foregoing assessment of the double jeopardy clause, a defendant should be protected from the second of the two punitive government 10b-5 actions. To avoid losing the combined effect of the treble penalty and the criminal sanctions, Congress should add the treble penalty to the criminal sanctions. Because the double jeopardy clause has been construed to limit double prosecu-

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301. *See supra* note 229.

302. *See* Note, *supra* note 186, at 648 & n.67.

303. *La Franca*, 282 U.S. at 572; *see also* W. PROSSER & J. WADE, *supra* note 280, at 1076 (definition of "punitive damages" being the amount of damages in excess of compensation for harm caused.).

304. *See La Franca*, 282 U.S. at 572.

305. Note, *supra* note 186, at 648-50.

306. *Id.* at 645 n.58.

307. Although the threat of death or mutilation has been removed as a necessary element of double jeopardy, courts can rely on this historical application of the double jeopardy clause to hold penalties slightly in excess of actual damages as falling short of the clause's intended reaches.

tion but not multiple punishment within one trial,[308] adding the treble penalty to the available criminal sanctions would enable the government to seek both in one trial. The government would have the option of seeking either the civil treble penalty alone or the criminal treble penalty, imprisonment, and $100,000 fine. Additionally, the civil treble penalty would be available in the event the government determined that it could not prevail in a criminal prosecution due to the circumstantial nature of the evidence, the requirement of showing a willful violation, or the criminal burden of proof. Thus, insider trading could be deterred without violating the double jeopardy clause. Furthermore, the total punishment to which a defendant would be exposed would be contingent on the level of culpability. A defendant committing willful violations would be subject to the same total punishment as he or she would be if the government were allowed to bring both a civil treble penalty action and a criminal prosecution.

F. *Summary of Double Jeopardy*

The double jeopardy clause should protect an insider from the combination of an SEC treble penalty action and a criminal prosecution. The treble penalty action and the 10b-5 criminal prosecution both seek to administer essentially criminal punishments against an insider for the same offense, triggering the double jeopardy clause. The treble penalty is sufficiently punitive to constitute criminal punishment. Furthermore, the treble penalty was designed by Congress to serve the criminal law purposes of deterrence and punishment.

VI. CONCLUSION

As a general rule, the doctrine of collateral estoppel will enable a plaintiff in a private action to preclude an SEC defendant from relitigating issues previously adjudicated in an SEC treble penalty action. Collateral estoppel, however, should not be applied indiscriminately. An SEC defendant faces the procedural disadvantages not only of confronting the resources of the SEC, but also of losing the right to a jury trial in a subsequent private action. Therefore, before applying collateral estoppel, a judge in a private action should ascertain the extent to which an SEC defendant has encountered other procedural disadvantages. When in doubt, the judge should deny collateral estoppel, particularly when the SEC treble penalty action ended with a compromise verdict.

The double jeopardy clause will protect an insider from the combination of an SEC treble penalty action and a criminal prosecution. To avoid losing the combined effect of the treble penalty and the criminal sanctions, Congress should add the treble penalty to the current criminal sanctions.

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308. *See supra* notes 198-201 and accompanying text.