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Investor Rights Symposium

Introduction
The Elusive Balance Between Investor Protection and Wealth Creation

Barbara Black* and Jill Gross**

The enactment of federal securities legislation in the 1930s codified the principle that investors should be shielded from securities fraud, but scholars and policymakers continue to debate the appropriate balance between protecting investors and encouraging capital formation. Congressional activity of the past decade reflects this tension. In the 1990s, Congress enacted two major pieces of legislation to restrict securities fraud class actions because of its belief that frivolous class actions were a drain on entrepreneurism.[1] In 2002, after the Enron/WorldCom et al. corporate scandals, reflecting perhaps a sense that the earlier legislation had tipped the pendulum too far, Congress passed the Sarbanes-Oxley Act (SOX) with its wide-ranging reforms to improve corporate reporting and investor decision-making.[2]

The Pace Investor Rights Project (PIRP), launched in the fall of 2003[3] as an expansion of Pace Law School's ground-breaking Securities

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1. Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737; Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227.

2. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 15 U.S.C. §§ 7201-7266 (2005) (Public Company Accounting Oversight Board and Corporate Responsibility).

3. In the spring of 2003, New York State Attorney General Eliot Spitzer settled an enforcement action brought under the Martin Act, New York's securities statute, involving allegations of "IPO spinning" against a chief executive officer of a public company. *See* Press Release, Office of New York State Attorney General, Telecom

Arbitration Clinic,[4] seeks to foster increased scholarly interest on topics related to investor justice in the regulatory, arbitral and judicial arenas. The Project thus produced the Investor Rights Symposium, which took place on the grounds of the Judicial Institute at Pace Law School on March 31 and April 1, 2005, to bring together academics, regulators, practitioners, investors' advocates and students to explore the precarious balance between investor protection and wealth creation. The scholarship that follows in this volume reflects the academic and critical thoughts of six authors who explore through different lenses the various obstacles to optimal investor protection in the securities industry.

Securities Regulation

Professor David S. Ruder[5] kicked off the Symposium with a keynote speech presenting his thoughts on the SEC's dual role of protecting investors and facilitating wealth creation by maintaining the

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Executive Agrees to Give Up IPO Profits (May 13, 2003), http://www.oag.state.ny.us/press/2003/may/may13b_03.html. As part of the settlement, the CEO agreed to donate $200,000 to Pace University School of Law to support programs of the Securities Arbitration Clinic (SAC). Pace's SAC used this grant money to launch PIRP, an expansion of the clinic designed to promote advocacy, research and educational programs in the area of investor justice. *See* Press Release, Pace Law School, Pace Law School Received $200,000 Grant to Launch the Pace Investor Rights Project (Sept. 8, 2003), http://www.law.pace.edu/news/2003/SAC-Sept-2003.html. We conceived and implemented PIRP due to our perception that no organization advocated for the legal rights of small, individual investors.

4. In the fall of 1997, Professor Black founded SAC, the first such clinic in the nation, in response to an initiative by then Securities and Exchange Commission (SEC) Chairman Arthur Levitt to provide free representation to small investors who had arbitrable disputes with their brokerage firms and could not otherwise obtain representation due to the small size of their claims. Press Release, SEC, SEC Announces Pilot Securities Arbitration Clinic to Help Small Investors—Levitt Responds to Concerns Voiced at Town Meetings (Nov. 12, 1997), http://www.sec.gov/news/press/pressarchive/1997/97-101.txt. Chairman Levitt's focus on investor protection alerted him to the lack of fairness in arbitration because small investors, whose claims were too small to make it cost-effective for a lawyer to take the case, were faring poorly without legal representation. He concluded that one solution was to use the vehicle of the law school clinic to deliver legal services to these small investors. *Id.* The authors currently are co-directors of the clinic. Since it opened its doors, SAC has represented more than 30 clients, and has obtained recoveries for its clients through awards and settlements totaling more than $300,000. For a more extensive description of the history and early years of Pace's clinic, see Barbara Black, *Establishing a Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000).

5. William W. Gurley Memorial Professor of Law, Northwestern University School of Law. Professor Ruder was Chair of the SEC from 1987-89.

integrity of the capital markets.[6] Professor Ruder examined in detail whether the SEC accounts for and appropriately balances these competing considerations in the performance of its various functions, including its rulemaking, enforcement, oversight of securities self-regulatory organizations (SROs), market regulation and investor education functions.[7] He concluded that the SEC's pursuit of investor protection is aligned with the interests of capital formation because "honest" markets are the best markets.[8] If investors know they will not be defrauded, the cost of capital will be lower as there will be no reason to discount for potential dishonesty.

Professor Thomas R. Hurst[9] examined the recent regulatory approach to investor protection by reviewing the noteworthy reforms implemented by the SEC in the wake of the mutual funds scandals of 2003 and 2004,[10] but concluded that much remains to be done.[11] Mutual fund expenses remain high, and disclosure of mutual fund expenses is obtuse and incomplete. Low-cost index funds constitute only about ten percent of mutual fund assets, despite widespread publicity about their benefits.

Professor James J. Fishman[12] commented that most mutual fund abuse is in the asset-gathering phase rather than the trading decision phase, so the greatest need for investor education is in the area of choosing funds wisely. He suggested more standardized presentations of criteria such as costs, performance, and allocations.

These criticisms confirm our own observations in the Securities Arbitration Clinic, where we have noted that many of our small-investor clients are placed in a variety of expensive mutual funds. We suspect this demonstrates the conflict of interest between customer suitability and brokers' incentives to sell certain products. In fact, Professor Hurst called for sales practice reform requiring brokers to disclose *all*

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6. David S. Ruder, *Keynote Speech: Balancing Investor Protections and Capital Market Operation*, 26 PACE L. REV. 39 (2005).

7. *Id.*

8. *Id.*

9. Sam T. Dell Research Scholar Professor, University of Florida, Fredric G. Levin College of Law.

10. These scandals included allegations of late-trading and market-timing in enforcement actions brought by the SEC and the New York State Attorney General's Office against several mutual fund companies.

11. Thomas R. Hurst, *The Unfinished Business of Mutual Fund Reform*, 26 PACE L. REV. 133 (2005).

12. Professor of Law, Pace University School of Law.

compensation they receive from selling funds.[13] In our opinion, many investors would be better served if, rather than seeking the services of a broker-dealer, they consulted a fee-paid investment adviser and purchased low-cost funds on their own. As Professor Hurst wondered, how can regulators increase the pressure on broker-dealers to make better mutual fund selections for their customers?[14]

Securities Arbitration

As for the arbitration arena, Professor Ruder thought the SEC was on the "wrong side" of the Supreme Court's landmark decision in *Shearson/American Express, Inc. v. McMahon*,[15] overruling long-standing precedent and holding that federal securities law claims were arbitrable.[16] However, he noted that there has been considerable reform of the SRO securities arbitration process to protect investors,[17] including the development of a strong claimants' bar.[18] As a result, Professor

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13. Hurst, *supra* note 11.

14. *Id.*

15. 482 U.S. 220 (1987). In *McMahon*, the SEC filed a brief as *amicus curiae* urging reversal of the Court of Appeals' holding that federal securities law claims were not arbitrable. The SEC argued that the 1975 amendments to the Securities Exchange Act of 1934 gave it extensive authority to ensure the fairness of securities arbitration. *Id.* at 233-34.

16. For a more extensive discussion of the significance of *McMahon*, see Barbara Black & Jill I. Gross, *Making It Up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991 (2002). Justice Harry A. Blackmun wrote the dissenting opinion; for an assessment from the vantage point of his law clerk at the time, see James A. Fanto, *Justice Blackmun and Securities Arbitration:* McMahon *Revisited*, 71 N.D. L. REV. 145 (1995).

17. Many of the reforms have been the result of Professor Ruder's work in chairing an Arbitration Policy Task Force appointed by the National Association of Securities Dealers (NASD) in 1994, which resulted in the report widely known as the "Ruder Report." *See* SECURITIES ARBITRATION REFORM: REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. (1996).

18. The Public Investors Arbitration Bar Association (PIABA) is "a national bar association whose member attorneys are dedicated to the representation of investors in disputes with the securities industry." PIABA Home Page, https://secure.piaba.org/piabaweb/html/index.php (last visited Sept. 7, 2005).

> The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process, such as those associated with document production and discovery; making securities and commodities arbitration as just and fair as systematically possible; and creating a level playing field for the public investor in securities and commodities arbitration.

See About PIABA, https://secure.piaba.org/piabaweb/html/modules.php?op=modload

Ruder believes that securities arbitration currently is fair to investors.[19] He did express concerns, however, that arbitration awards lack precedential value,[20] and thus the law governing broker-dealers' duties to their customers has not been developing since *McMahon*.[21]

Certain investors' advocates have challenged Professor Ruder's view that securities arbitration is fair to investors and have called for changes in the process.[22] Some of those views were expressed to a House of Representatives subcommittee who, about the time of the Symposium, conducted a hearing to review the securities arbitration process.[23] In addition, the SROs are continually reviewing their arbitration procedures and proposing rule changes to improve the process for investors.[24]

At our Symposium, two scholars presented proposals for securities arbitration reform. Professor Sarah Rudolph Cole[25] presented her

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&name=Sections&file=index&req=viewarticle&artid=56&page=1 (last visited Nov. 18, 2005).

19. *See* David S. Ruder, *Elements of a Fair and Efficient Securities Arbitration System*, 40 ARIZ. L. REV. 1101, 1108 (1998) (arguing that securities arbitration "provides clear and significant advantages over the civil litigation system"); David S. Ruder, *Securities Arbitration in the Public Interest: The Role of Punitive Damages*, 92 NW. U. L. REV. 69, 74 (1997) ("[A]ctive SEC oversight of the SRO arbitration system . . . is an essential ingredient in assuring a securities arbitration system in the public interest."); *see also* Barbara Black, *The Eighth James D. Hopkins Lecture: Is Securities Arbitration Fair to Investors?*, 25 PACE L. REV. 1 (2004) (concluding that securities arbitration is a fair alternative to courts for investors).

20. *See, e.g.*, IDS Life Ins. Co. v. SunAmerica Life Ins. Co., 136 F.3d 537, 543 (7th Cir. 1998) ("[A]rbitrators' decisions are not intended to have precedential effect even in arbitration unless given that effect by contract, let alone in the courts.").

21. *See* Black & Gross, *supra* note 16, at 1013-26.

22. *See, e.g.*, *A Review of the Securities Arbitration System: Hearing Before the U.S. H. Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises*, 109th Cong. (Mar. 17, 2005) (testimony of William Francis Galvin), http://financialservices.house.gov/media/pdf/031705wfg.pdf.

23. *See A Review of the Securities Arbitration System: Hearing Before the U.S. H. Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises*, 109th Cong. (Mar. 17, 2005), http://financialservices.house.gov/hearings.asp?formmode =detail&hearing=362&comm=1 (speakers included representatives of the NASD and NYSE arbitration forums and the securities industry, investors' advocates, and academics).

24. *See, e.g.*, Self-Regulatory Organizations; National Association of Securities Dealers; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3 and 4 Thereto to Amend NASD Arbitration Rules for Customer Disputes, 70 Fed. Reg. 36,442 (June 23, 2005) (soliciting public comment on proposed rule change to revise arbitration code governing customer disputes to make code more understandable for investors).

25. Professor of Law, The Ohio State University, Michael E. Moritz College of Law.

analysis that securities arbitration entails state action and thus requires due process protections,[26] while Professor Peter Bowman Rutledge[27] proposed to eliminate arbitrators' immunity.[28] Professor Cole's analysis is constitutionally-based and advocates reforms that more closely equate arbitration with a judicial proceeding, while Professor Rutledge proposes a market-based solution that equates arbitrators with professionals with an interest in marketing their services.

Both scholars' reformist idealism necessarily is tempered a bit by practical realities. Although Professor Cole's state action argument is more persuasive when applied to intra-industry arbitrations; as a practical matter, if her argument prevails, the same due process protections are likely to be added for customer arbitrations as well, since neither SRO could justify a fairer procedure just for the industry. Moreover, as Professor Maureen Arellano Weston[29] commented, while Professor Rutledge accurately points out that the lack of arbitrator accountability is a serious problem, especially with the explosive growth of arbitration, she does not believe that contractual immunity is workable as investors have no negotiation power. She thus advocated for qualified immunity of arbitrators, allowing liability only for gross negligence.[30]

Finally, both reform proposals share a common laudable goal—to provide incentives for arbitrators to exercise more care in deciding cases. In particular, Professors Cole and Rutledge both advocate reasoned awards[31] and favor NASD's recent rule proposal to require arbitrators to provide reasons for their awards at the request of the customer.[32] While we have serious reservations about NASD's proposal, Professor Cole supplies the most compelling argument for reasoned awards through her

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26. Sarah Rudolph Cole, *Fairness in Securities Arbitration: A Constitutional Mandate?*, 26 PACE L. REV. 73 (2005).

27. Assistant Professor, The Catholic University of America, Columbus School of Law.

28. Peter B. Rutledge, *Market Solutions to Market Problems: Re-Examining Arbitral Immunity as a Solution to Unfairness in Securities Arbitration*, 26 PACE L. REV. 113 (2005).

29. Associate Professor, Pepperdine University School of Law.

30. Maureen Weston, *Reexamining Arbitral Immunity in an Age of Professional and Mandatory Arbitration*, 88 MINN. L. REV. 449 (2004).

31. *See* Cole, *supra* note 26; Rutledge, *supra* note 28.

32. *See* NASD, *Proposed Rule Change to Provide Written Explanations in Arbitration Awards Upon the Request of Customers or Associated Persons, Amendment No. 1*, File No. SR-NASD-2005-032, http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013542 (last visited Sept. 7, 2005). For customer disputes, industry parties will not have the same right to request arbitrators to include written explanations in their awards.

discussion of the cognitive psychology-based thought processes of arbitrators.[33]

In a robust defense of the NASD forum, George H. Friedman[34] respectfully disagreed with Professor Cole's theory that there is state action in securities arbitration. He also argued that, even if there were state action, the forum contains all requisite due process protections and NASD-DR arbitration is fair as a matter of law and fact. He does recognize that more empirical data is necessary to determine whether parties want more professional arbitrators[35]—and to confirm his view that securities arbitration is a fair process.[36] The authors have embarked on just such a study, with results expected in early 2006.[37]

Common Law

Focusing on investor rights in the judicial arena, Professor Francis J. Facciolo[38] traced the complex and somewhat contingent origins of the duty of best execution,[39] noting that it evolved largely through SEC activism in creating the shingle theory.[40] Professor James A. Fanto[41]

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33. Cole, *supra* note 26, at 107-08. For a fuller explanation of our reservations about the NASD's "explained awards" proposal, see Comment Letter from Jill Gross, Barbara Black & Melanie Serkin, PIRP, to Jonathan Katz, Secretary, SEC (Aug. 5, 2005), http://www.sec.gov/rules/sro/nasd/nasd2005032/bblack6853.pdf.

34. Executive Vice President and Director of Dispute Resolution of NASD Dispute Resolution, Inc. ("NASD-DR").

35. *See* Barbara Black, *Do We Expect Too Much From NASD Arbitrators?*, 2004 SEC. ARB. COMMENTATOR No. 7, 1 (Oct. 2004).

36. *See* George H. Friedman, *The Level Playing Field*, XI SEC. ARB. COMMENTATOR No. 12, 1 (July 2001).

37. Specifically, in response to a 2002 recommendation by Michael A. Perino, Professor of Law, St. John's University School of Law (*see* Michael A. Perino, Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations, at 5 (Nov. 2, 2002), http://www.sec.gov/pdf/arbconflict.pdf), the Securities Industry Conference on Arbitration (SICA) has commissioned us to conduct an empirical study of the fairness of securities arbitration. Our study will explore, in particular, investors' perceptions of the fairness of arbitration and whether arbitrators appear competent to resolve their customer disputes. *See* Thirteenth Report of the Securities Industry Conference on Arbitration, at 8 (Oct. 2005), http://www.nyse.com/pdfs/SICA2005.pdf.

38. Assistant Professor, St. John's University School of Law.

39. The duty of best execution refers to the duty by a broker to seek out the best price, time and market for his or her client's trade.

40. Francis J. Facciolo, *A Broker's Duty of Best Execution in the Nineteenth and Early Twentieth Centuries*, 26 PACE L. REV. 155 (2005).

41. Professor and Associate Director, Center for the Study of International Business Law, Brooklyn Law School.

astutely observed that the SEC's successful performance as a "legal entrepreneur" should send signals to the private bar about available legal theories that investors' advocates can pursue to protect investors' rights. In the end, Professor Fanto noted, it will take a combination of government regulation and increased court receptivity to novel (and not so novel) legal theories to maximize investors' rights.

Unfortunately, in our view, the reality is that judges have not made it easy for investors to sue their investment professionals for misconduct.[42] Courts impose a heavy burden on investors to demonstrate that they acted reasonably and thus were entitled to trust their broker.[43] Moreover, since *McMahon*, there are few opportunities for a reform-minded judge to advance investor protection in this area, thus making it unlikely that such court receptivity is forthcoming.

Investor Backlash

With the perspective of several months, the Investor Rights Symposium seems very well timed. By the spring of 2005, it was abundantly clear that a backlash against investor protection efforts was underway. The corporate community was strident in its insistence that SOX reforms to improve financial reporting were too costly to implement and were forcing some issuers to opt out of the public market.[44] The expensing of stock options, a major initiative of the Public Company Accounting Oversight Board, was stalled.[45] The SEC was subjected to ongoing criticism, including from two of its own Commissioners,[46] and litigation[47] over two of its reforms—the

42. *See* Black & Gross, *supra* note 16, at 1035-47; Marc I. Steinberg, *Securities Arbitration: Better for Investors Than the Courts?*, 62 BROOK. L. REV. 1503 (1996).

43. *See* Black & Gross, *supra* note 16, at 1037-38.

44. *See, e.g.*, Karen Richardson & Diya Gullapalli, *Next SEC Chief Faces Full Plate of Issues*, WALL ST. J., June 2, 2005, at A4 ("[C]ompanies of all stripes have railed against the time and expense of preparing internal-control reports, even as hundreds of companies have identified deficiencies in the systems they have in place to prevent accounting shenanigans.").

45. *Id.* ("[M]any companies, particularly those in Silicon Valley, still argue against options expensing, and they have a number of Washington politicians on their side."); *see also* Jonathan Weil, *Companies Get Reprieve on Expensing Options*, WALL ST. J., Apr. 13, 2005, at C3.

46. *See, e.g.*, Letter from Commissioners Glassman and Atkins re: Staff Report on the Exemptive Rule Amendments of 2004: The Independent Chair Condition (Apr. 29, 2005), http://www.sec.gov/news/speech/spch050205cagpsa.htm (criticizing SEC staff report because it provides no justification for the independent chair rule); Paul A. Atkins, Speech by SEC Commissioner: Remarks Before the SIA Industry Leadership Luncheon

registration of advisers to private hedge funds[48] and the requirement that mutual funds have boards with no less than 75% independent directors and independent chairs.[49] A modest SEC proposal to allow shareholders the power to nominate directors in limited circumstances[50] was declared "dead" in the face of assertions that it would cause disruption within corporate boardrooms.[51] Finally, the concerns of investors' advocates intensified with the ominous resignation of SEC Chair William Donaldson and President Bush's nomination of Representative Christopher Cox, who, it is widely reported,[52] played an important role in the enactment of PSLRA.

The backlash did not play out simply in the political arena. The consensus among federal appeals courts[53] is that the longer statute of

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(June 8, 2005), http://www.sec.gov/news/speech/spch060805psa.htm (referring to the hedge fund and the independent chair rules as reflecting "a puzzling willingness to undertake sweeping regulatory actions without adequate justification"). Another Commissioner, Roel Campos, was quoted as wondering: "Is it possible to have reform—in terms of regulation—if it affects and hurts a particular industry that has significant lobbying power? Can any regulation or reform survive under our system?" *See* Richard Hill, *Campos Considers Viability of Rules in Era of Lobbying*, SEC. L. DAILY, Mar. 18, 2005.

47. The U.S. Chamber of Commerce sued the SEC asserting it had no authority to adopt the independent chair rule. In June 2005 the D.C. Circuit held that the SEC had the authority to promulgate the rule, but its failure to consider the costs of the rule violated the Administrative Procedure Act. Chamber of Commerce of the United States of America v. SEC, 412 F.3d 133 (D.C. Cir. 2005). On Chair Donaldson's last day at the SEC, it voted, again by a 3-2 vote, not to modify the rule. Press Release 2005-99, SEC, *SEC Votes to Adopt Securities Act Rule Reform and Shell Company Regulations; Considers Matters Remanded by the Court of Appeals* (July 1, 2005), http://www.sec.gov/news/press/2005-99.htm. The U.S. Chamber of Commerce sued again. *See* Chamber of Commerce of the United States of America v. SEC, 2005 LEXIS 19602 (D.C. Cir. 2005) (denying petition for a rehearing); *see also* Richardson & Gullapalli, *supra* note 44, at A4 (reporting that hedge funds have sued the SEC over the rule requiring registration of hedge fund advisers).

48. Rule 203(b) (3)-2, 17 C.F.R. § 203(b) (3)-2.

49. Investment Company Governance, 69 Fed. Reg. 46,378 (Aug. 2, 2004).

50. Security Holder Director Nominations, 68 Fed. Reg. 60,784 (Oct. 23, 2003).

51. *See, e.g.*, Detailed Comments of Business Roundtable on the "Proposed Election Contest Rules" of the U.S. Securities and Exchange Commission, http://www.sec.gov/rules/proposed/s71903/brt122203.pdf (last visited Sept. 7, 2005); *see also* Brett Ferguson, *Snow Says SEC Proxy Access Rule 'More Likely to Backfire' Than Help*, SEC. L. DAILY, May 24, 2005 (reporting that "industry experts have called the proposal 'dead'").

52. *See, e.g.*, Deborah Solomon, Michael Schroeder, David Rogers & Diya Gullapalli, *Cox's Nomination to Run SEC Signals a Regulatory Shift*, WALL ST. J., June 3, 2005, at A1.

53. *See* Enter. Mortg. Acceptance Co., LLC, Sec. Litig. v. Enter. Mortg. Acceptance Co., 391 F.3d 401 (2d Cir. 2004); Foss v. Bear Stearns & Co., 394 F.3d 540

limitations for securities fraud private actions, the only provision of SOX that directly improves investors' remedies for securities fraud, is not to be applied retroactively, thus depriving many investors of the opportunity to recover for injuries incurred because of the corporate scandals that led to SOX's enactment. The U.S. Supreme Court reversed the conviction of Arthur Anderson for witness tampering in connection with the government's investigation of the Enron scandal.[54] While the conviction was overturned because of faulty jury instructions, many blamed the Department of Justice for the demise of the accounting firm.[55] Finally, while the government has been successful in achieving convictions in some well-publicized cases of corporate officers and securities professionals for corporate looting or other misconduct,[56] other prosecutions were unsuccessful[57] and call into question the ability of the jury system to handle these complex cases.[58]

(7th Cir. 2005); In re ADC Telecomms., Inc., 409 F.3d 974 (8th Cir. 2005); *cf.* Tello v. Dean Witter Reynolds, Inc., 410 F.3d 1275 (11th Cir. 2005) (suggesting that extension could be applicable, but declining to decide the question until a more developed record determined when class members had inquiry notice).

54. Arthur Andersen LLP v. United States, 125 S. Ct. 2129 (2005).

55. *See, e.g.*, Editorial, *Arthur Andersen's 'Victory,'* WALL ST. J., June 1, 2005, at A20.

56. *E.g.*, Andrew and Lea Fastow (Enron); John and Timothy Rigas (Adelphia Communications); L. Dennis Kozlowski and Mark Swartz (Tyco); Bernard Ebbers (Worldcom); Martin Grass (Rite Aid); Jamie Olis (Dynegy); and Frank Quattrone (CSFB). *See Executives on Trial: Guilty, Not Guilty, Mistrial*, WALL ST. J. ONLINE, June 21, 2005, *available at* http://online.wsj.com/article_print/0,SB110995911259970823,00.html (some of these are currently on appeal; it is suggested that, in light of the reversal of Arthur Andersen's conviction, Quattrone's conviction may be set aside since the jury instructions were similar).

57. Most notably, a jury acquitted Richard M. Scrushy, former CEO of HealthSouth Corp., of participating in a $2.7 billion accounting fraud, despite testimony from several former HealthSouth executives about Scrushy's involvment as well as tape recordings that implicated him. *See* Dan Morse, Chad Terhune & Ann Carrns, *HealthSouth's Scrushy is Acquitted*, WALL ST. J., June 29, 2005, at A1. A few weeks earlier, New York Attorney General Eliot Spitzer's failure to win a conviction of Theodore Sihpol was viewed by some as a cautionary tale of prosecutorial over-zealousness. *See* Kara Scannell & Arden Dale, *Sihpol Verdict Deals a Blow to Spitzer*, WALL ST. J., June 10, 2005, at A1 (describing acquittal as a "high-profile setback for Mr. Spitzer . . .").

58. Kozlowski and Swartz were each convicted of 22 counts in June 2005 after their first trial, which began in October 2003, resulted in a mistrial in April 2004. *See* Mark Maremont & Chad Bray, *Tyco Trial Jurors Say Defendants Weren't Credible*, WALL ST. J., June 20, 2005, at A1. Scrushy was acquitted of 36 charges, including the first charge brought under SOX reporting requirements, after a trial that lasted six months, where one juror was replaced for health reasons after deliberations had begun and the jury frequently communicated to the judge that it was deadlocked. *See* Morse, Terhune & Carrns, *supra* note 57.

Investor Education

Many investors are remarkably unaware of the degree to which they are responsible for their investment choices, even if those choices were influenced by their broker, and they are even less aware of basic principles such as the need for diversification, the degree of risk involved in equity investing and the lack of a broker's duty to monitor the investor's account on an ongoing basis absent special circumstances.[59] The high level of investor ignorance coupled with the mounting investor backlash suggests that the greatest hope for investor protection lies in investor education efforts. The Investor Rights Project has been tackling, in small ways, the need for more investor education, especially with respect to conduct that may affect investors' legal rights and responsibilities. Through grass-roots efforts at local libraries, community centers and AARP chapter meetings, our staff attorneys have been presenting seminars to individual investors, mostly elderly, on their legal rights and responsibilities when opening and maintaining a brokerage account at a securities firm.

Despite our investor education efforts and our desire to continue them, we have reservations about their efficacy. Professor Fanto, ever a passionate observer, despaired from the Symposium audience that after studying investor education efforts,[60] he too doubted their effectiveness. Instead, adopting a regulatory model of "conservative paternalism" looked better and better to him as the only solution to investor ignorance and abuse. It is significant to us that the Global Analyst Research Settlement, touted by the regulators and the industry as a panacea for investor education deficiencies,[61] has led to nothing but political

59. *See* Applied Research & Consulting LLC, NASD INVESTOR LITERACY RESEARCH (2003), *available at* http://www.nasdfoundation.org/surveyexecsum.pdf (last visited Sept. 7, 2005) (reporting on results of 2003 survey of 1086 investors showing remarkable lack of knowledge regarding basics of investing). This ignorance is not limited to unsophisticated investors. *See* Peter G. Gosselin, *Experts Are at a Loss on Investing*, L.A. TIMES, May 11, 2005; De Kwiatkowski v. Bear Stearns & Co., Inc., 306 F.3d 1293 (2d Cir. 2002) (reversing finding of liability of commodities broker whose currency trades on behalf of sophisticated investor lost hundreds of millions of dollars).

60. *See* James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105 (1998).

61. Joint Press Release, SEC, NASD, NYSE, NYSAG & NASAA, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking—Historic Settlement Requires Payments of Penalties of $487.5 Million, Disgorgement of $387.5 Million, Payments of $432.5 Million to Fund Independent Research, and Payments of $80 Million to Fund Investor Education and Mandates Sweeping Structural Reforms (Apr. 28, 2003), http://www.

infighting, institutional paralysis, and what appears to be a tremendous waste of time and money.[62] In particular, the Investor Education Fund has disbursed high fees to lawyers and industry personnel to service a now-defunct entity that accomplished nothing, dollars that could otherwise have been spent in the trenches, convincing investors—one at a time if necessary—that securities industry players may not have their best interests at heart, despite their rhetoric, advertising, and fancy titles. The complete failure of the SEC's Investor Education Fund crystallizes the lack of consensus on the best way to help investors.

In light of this backlash, the ideals of the Symposium—to improve investor justice by highlighting the interplay of private and public law in areas impacting investors—seem ever more elusive. Only with persistent investor rights advocacy, through groups such as the Investor Rights Project, will the voices of average, individual investors be heard.

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sec.gov/news/press/2003-54.htm.

62. *See, e.g.*, Deborah Solomon, *What's the Best Way to Invest in Teaching the U.S. to Invest?*, WALL ST. J., May 26, 2005, at C1 (reporting on the dispute between federal and state securities regulators on how to spend the $55 million in investor education funds set aside by the analyst settlement); Randall Smith & Ian McDonald, *Frustrating Venture: SEC Education Fund to Lose Top Figures*, WALL ST. J., Mar. 23, 2005, at C1 (reporting on resignation of leaders of SEC's investor education entity set up with analyst settlement funds); *see also* Application of Plaintiff SEC for Order Approving New Investor Education Plan, 03 Civ. 2937 (WHP) (on file with authors) (seeking approval from federal district court to dissolve SEC's Investor Education Fund and to instead utilize already-existing NASD Investor Education Foundation to administer investor education monies, and notifying court of need to reimburse Investor Education Fund for its expenses).