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Public Agencies and Investor Compensation: The Agency As Judge or Lawyer?

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PUBLIC AGENCIES AND INVESTOR COMPENSATION: 
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ABSTRACT

This essay compares experiments in investor compensation by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). The Fair Fund provision of Sarbanes-Oxley allows the SEC to distribute penalty amounts to injured investors, acting as “public class counsel.” In contrast, through its longstanding Reparations Program, the CFTC acts as a judge or arbitrator to resolve disputes between private parties. This essay suggests that the Treasury Department’s recent proposal to consolidate financial regulators – including the SEC and CFTC – provides an opportunity to reexamine these programs and ask whether a consolidated financial regulator should act as a judge (like the CFTC) or as a lawyer (like the SEC) when pursuing investor compensation. It proposes reframing the Reparations Program as a potentially valuable source of industry information to the agencies tasked with enforcing the securities and commodities laws. Understanding the program as an information source may help prevent the relatively unglamorous world of the “small claims court” from being overshadowed by higher profile compensation mechanisms.

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INTRODUCTION

When financial regulators get positive press, it is often when they open investigations or recover large sums of money; in other words, when the regulators act in their prosecutorial or counsel role. Similarly, compensation by these regulators hits the headlines when the agency has been the white knight, recovering and distributing funds to injured investors. Rarely do the papers laud financial regulators when they provide the judges in the financial market

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equivalent of small claims court. This essay suggests revisiting the unglamorous business of resolving disputes between customers and brokers and recasting it as a potentially valuable source of industry information to the agencies tasked with enforcing the securities and commodities laws.

Renewed discussion of regulatory consolidation provides an opportunity to reshape the agencies’ involvement in investor compensation. In March 2008, the Department of the Treasury proposed a restructuring of U.S. financial regulators in its *Blueprint for a Modernized Financial Regulatory Structure*.\(^1\) One aim of this proposal is to eliminate distinctions between securities and futures regulation – the regulatory domains of the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC), respectively. In this respect, the Treasury plan is the latest in a series of proposals to consolidate the two agencies and thus resolve a long-standing problem of their overlapping jurisdictions.

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

The essay suggests that designers of a consolidated system consider as part of the cost-benefit mix the fact that, unlike the Fair Funds approach, the Reparations Program has the potential to generate information for the financial regulators. In terms of the judge/lawyer divide, when the agency acts as counsel, it must draw on its traditional sources of information, such as its own compliance inspections and the financial press, to investigate and develop a case. By

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2. Whether consolidation is a good idea in general or whether the Treasury’s ambitious proposal for reorganization is viable is beyond the scope of this essay.
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providing a forum and decisionmaker, it has the potential to draw out information about industry practices or conduct that would not otherwise be available.

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

I.

PROPOSALS TO CONSOLIDATE THE SEC AND CFTC

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

The SEC has jurisdiction to regulate “securities” and options on securities. One court proposed this working definition of “security”: “an undivided interest in a common venture the value of which is subject to uncertainty.” So far, so good; however, the definition of “security” in the securities acts is deliberately broad and inclusive, reaching “any note” or “stock,” but also reaching an “investment contract” – a much-litigated term – and, helpfully, “any interest or instrument commonly known as a ‘security’.” Instruments labeled “stock” and that had

6 883 F.2d 537, 543.
7 33 Act defined security as

“[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.” The Securities Exchange Act 3(a)(10) is so similar that the Supreme Court has announced that it will interpret them together. 471 U.S. 681, 686 n.1; Louis Loss & Joel Seligman, Securities Regulation 3-A-1.
“characteristics usually associated with common stock” provide an example of the relatively easy case. But the definition also reaches “[n]ovel, uncommon or irregular devices” such as assignments of oil leasehold subdivisions and rights in orange groves.

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

Two points complicate the CFTC’s jurisdictional picture. First, “futures,” like securities, are not always straightforward to define. A futures contract can be described as an agreement to buy or sell a commodity for delivery in the future. It grows from agricultural roots in which a typical agreement was for delivery of wheat or corn, for example, at some future date at an agreed upon price.

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8 According to the Supreme Court, the characteristics of common stock are (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.” Landreth Timber Co. v. Landreth, 471 U.S. 681, 686.
9 SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943)
12 7 U.S.C. 2 (“The Commission shall have exclusive jurisdiction … with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an ‘option’, ‘privilege’, ‘indemnity’, ‘bid’, ‘offer’, ‘put’, ‘call’, ‘advance guaranty’, or ‘decline guaranty’), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated or derivatives transaction execution facility registered pursuant to section 7 or 7a of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title.”).
13 Valdez at 42 & n.43.
14 http://www.cftc.gov/educationcenter/glossary/glossary_f.html#futurescontract. The CFTC provides the following qualifications: the agreement must be “(1) at a price that is determined at initiation of the contract; (2) that obligates each party to the contract to fulfill the contract at the specified price; (3) that is used to assume or shift price risk; and (4) that may be satisfied by delivery or offset.” Id.
15 For early U.S. examples of futures contracts, see the Supreme Court’s decisions in Hansen v. Boyd, 161 U.S. 397 (1895), which considered a wheat futures contract and Embrey v. Jemison, 131 U.S. 336 (1888), which considered a cotton futures contract. Their requirement of delivery (or
“Commodity,” however, reaches beyond physical or agricultural commodities to include “all other goods and articles, except onions …, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.” 16 Moreover, although delivery is an alternative, most futures contracts are resolved by cash payout (offset): one party pays the other the difference between contract and market price.

The second complication in interpreting the CFTC’s jurisdiction is that it was granted “exclusive” jurisdiction over futures. 17 This provision can be a tie-breaker in disputes with the SEC: an instrument reasonably characterized as either a security or future may fall into the jurisdiction of the CFTC because that jurisdiction is “exclusive.” 18

As noted above, both securities and futures have an “easy case” or paradigmatic example, but as instruments move away from these examples, distinguishing between futures and securities becomes more and more difficult. Judge Easterbrook described the task of categorizing one such novel instrument as a future or a security as deciding “whether tetrahedrons belong in square or round holes.” 19 Moreover, the target is moving: financial products are continually introduced with, as their very purpose, innovation and difference from the existing products. 20

Stemming in part from the difficulties in determining the line between futures and securities, the agencies have battled over their jurisdictions almost since the CFTC was created. 21 Even before the CFTC began operations, the SEC proposed a competing exclusivity clause that would give the SEC exclusive

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16 7 U.S.C. 2. The onion lobbyists apparently successfully argued that trading in onion futures adversely affected the price of onions. See Board of Trade of City of Chicago v. SEC, 677 F.2d 1137, 1142 n.9.
18 Chicago Mercantile Exchange v. SEC, 883 F.2d 537, 539 (7th Cir. 1989) (“If an instrument is both a security and a futures contract, the CFTC is the sole regulator because [of the exclusive jurisdiction clause].”). See generally Thomas A. Russo & Edwin L. Lyon, The Exclusive Jurisdiction of The Commodity Futures Trading Commission, 6 Hofstra L. Rev. 57 (1977-1978).
19 Chicago Mercantile Exchange v. SEC, 883 F.2d 537 (7th Cir. 1989).
20 Id.
jurisdiction over all “transactions involving a ‘security.’” The SEC and the CFTC clashed in court over jurisdiction over novel products (GNMA options and index participations); the CFTC, aided by its exclusivity clause, prevailed.

The “Commodity Futures Modernization Act of 2000” (CFMA) partially addressed this jurisdictional uncertainty by exempting certain products from the Commodity Exchange Act (CEA), excluding certain products from the definition of ‘security,’ and allowing futures contracts on individual securities, which are acknowledged to be both a security and a futures contract and are jointly regulated by the two agencies. This legislative change, however, did not resolve all jurisdictional issues. Fast forward to 2008, when the Treasury Blueprint blamed these “jurisdictional disputes” for “often hindering the introduction of new products, slowing innovation, and compelling migration of financial services and products to more adaptive foreign markets.” While some commentators and policy makers have downplayed the conflict, focusing on coordinated efforts such as the President’s Working Group on Financial Markets, proponents of consolidation can point to significant evidence of conflict.

In sum, the line between securities and futures has become increasingly difficult to draw as innovative products are introduced that erode their differences. Moreover, because of the difficulty of drawing the jurisdictional line, territorial overlap and conflict has characterized the relationship between the agencies. In

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23 Board of Trade of Chicago v. SEC, 677 F.2d 1137 (7th Cir.), vacated as moot, 459 U.S. 1026 (1982) (GNMA options); Chicago Mercantile Exchange v. SEC, 883 F.2d 537, 539 (7th Cir. 1989) (index participations); see generally Ending the Turf Wars: Support for a CFTC/SEC Consolidation, 36 Vill. L. Rev. 1175, 1185-86 (1991) (tracing the history of the CFTC/SEC jurisdictional dispute).
25 Greene, Rosen, Silverman, Braverman, & Sperber, U. S. Regulation of the International Securities and Derivatives Markets § 14.01 (8th Ed. 2006) (“the CFMA excluded from regulation under the CEA, and accordingly from the prohibition on the trading of products outside a CFTC-regulated trading facility, a wide range of OTC derivatives transactions between qualifying counterparties and so-called "hybrid instruments" (that is, securities or banking products that incorporate the economic features of a futures contract or commodity option).”).
26 Greene, Rosen, Silverman, Braverman, & Sperber, U.S. Regulation of the International Securities and Derivatives Markets § 14.01 (8th Ed. 2006) (noting that the CFMA introduced “individual, and narrow-based indices of, ‘nonexempt’ securities, a new category of product that is both a security and a futures contract that is subject to a unique dual regulatory regime under both the securities laws and the CEA”). Some “individually negotiated swap agreements and other derivatives entered into by qualifying counterparties” were also excluded from the definition of “security.” Id.
28 Treasury Blueprint at 4.
response to these interrelated problems, consolidation of the two agencies has been repeatedly proposed.\textsuperscript{30} The “Markets and Trading Reorganization and Reform Act” was a bill proposed in 1990\textsuperscript{31} and reintroduced in 1995\textsuperscript{32} that proposed merging the two agencies and “establish[ing] a single Federal regulatory body with jurisdiction over securities, options, futures, and related markets and instruments.”\textsuperscript{33}

Consolidation of the SEC and the CFTC has also been proposed as part of a larger consolidation of financial regulators. At one end of the spectrum of possible reorganizations is a proposed single financial regulator.\textsuperscript{34} Commentators and policymakers have one eye on the British experience with the Financial Services Authority (FSA), a single regulator of all financial services established after a review of the UK’s financial regulators in the late 1990s.\textsuperscript{35}

While the recent Treasury proposal does not call for a single financial regulator, it does go beyond a SEC/CFTC merger. The Blueprint calls for three regulators “focused exclusively on financial institutions” as well as a “federal insurance guarantee corporation” and a “corporate finance regulator.”\textsuperscript{36} One of the new proposed regulators of financial firms is the “Conduct of Business Regulatory Agency (CBRA),” which would regulate “all financial products and services,” including those currently within the CFTC’s and the SEC’s jurisdictions. The “corporate finance regulator” (in lower case) would be

\textsuperscript{30} See John D. Benson, \textit{Ending the Turf Wars: Support for a CFTC/SEC Consolidation}, 36 Vill. L. Rev. 1175 (1991); \textit{see also Chicago Mercantile Exchange v. Securities and Exchange Commission}, 883 F.2d 537, 544 (7th Cir. 1989) (“Only merger of the agencies or functional separation in the statute can avoid continual conflict.”).

\textsuperscript{31} 101 HR 4477 (proposing the creation of a new agency called the Markets and Trading Commission);

\textsuperscript{32} 104 HR 718.

\textsuperscript{33} 101 HR 4477 sec. 2; 104 HR 718 Sec 2.

\textsuperscript{34} \textit{See, e.g., Elizabeth F. Brown, E Pluribus Unum-Out of Many, One: Why the United States Needs a Single Financial Services Agency}, 14 U. Miami Bus. L. Rev. 1, 100-01 (2005) (arguing that the United States should consolidate its 115 financial regulatory organizations into a single agency because it would be able to “anticipate and plan for future financial crises, more carefully monitor and regulate financial conglomerates, provide better protection for consumers, operate more effectively in international negotiations, quickly adapt to market innovations and developments, be accountable for market failures, eliminate the duplicative regulations and regulatory gaps, harmonize regulations for financial products and firms competing in the market, and avoid being captured by narrow segments within the financial services industry.”).

\textsuperscript{35} Treasury Blueprint at 3.

\textsuperscript{36} \textit{See The Department of the Treasury, Blueprint for a Modernized Financial Regulatory Structure} 138 (Mar. 2008).
responsible for “general issues related to corporate oversight in public securities markets” including “corporate disclosures, corporate governance, accounting and auditing oversight, and other similar issues” – part of the SEC’s current role.

Although framed as a response to recent front-page concerns with foreign competition and the subprime mortgage crisis, the Treasury’s Blueprint is typical of CFTC/SEC merger proposals in that it asked, in its request for comments, whether “a continued rationale” existed for “distinguishing between securities and futures products and their respective intermediaries” and “having separate regulators for these types of financial products and institutions.” The Treasury Department’s response was a clear “no” to both questions.

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

The rest of this essay focuses on one of these areas. The two agencies have taken very different routes to the same end: investor compensation. As described below, the SEC has a tool that places the Enforcement division in the position of counsel to injured investors, seeking

37 Id. at 138.
38 Id. at 194, Appendix A: Federal Register Notice: Review by the Treasury Department of the Regulatory Structure Associated with Financial Institutions 2.3. The Blueprint pointed out that the “bifurcation between securities and futures regulation was largely established over seventy years ago when the two industries were clearly distinct.” Id. at 2. It pointed to this bifurcation as part of an old-fashioned system “grappling to keep pace with market evolutions and, facing increasing difficulties, at times, in preventing and anticipating financial crises.” Id. at 4.
40 See John D. Benson, Ending the Turf Wars: Support for a CFTC/SEC Consolidation, 36 Vill. L. Rev. 1175, 1194 (1991) (arguing that regulatory similarities would facilitate consolidation); Alan R. Bromberg, Securities Law – Relationship to Commodities Law, 35 Bus. Law. 787, 789 (1979-1980) (noting that courts have drawn on securities cases as precedent for deciding issues under the CEA, including in the areas of “the elements of fraud, the standards for granting an injunction, disgorgement remedies, and aiding and abetting”).
41 Differences that would have to be resolved on consolidation are not limited to the agencies’ compensatory roles, but also include such issues as the approach to pre-emption and state regulation. For instance, the CEA pre-empted state regulation of futures, but, on reauthorization, was revised to allow state attorneys general or other state administrators of securities laws to pursue violators of the CEA as parens patriae for their citizens). See Futures Trading Act of 1978, Pub. L. No. 95-405, 15, 92 Stat. 872 (codified in 7 U.S.C. 13(a-2)) (1978 reauthorization of the CFTC); Guttman at 3 & n.11, 4.
penalties which then may be distributed to investors. In contrast, the CFTC’s longstanding “Reparations Program” uses the CFTC to resolve disputes between private parties (individual shareholders and financial professionals) in a role akin to that of an arbitrator or judge.

II. THE SEC’S COMPENSATORY FUNCTION

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

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

Second, disgorgement has long been available to the SEC as a remedy in judicial or administrative proceedings brought by the Enforcement Division. The basic idea is that the remedy prevents unjust enrichment by forcing the disgorgement of profits (sometimes defined broadly) from violations of the securities laws. Disgorged funds may be distributed to injured investors, although they do not have to be and courts have emphasized that neither identification of harmed investors nor distribution are pre-requisites for imposing


43 SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) (citing cases); SEC v. Texas Gulf Sulphur, 312 F. Supp. 77, 89, 91 (S.D.N.Y. 1970) (first determining that the court had the power to grant the ancillary relief of disgorgement); see also 104 Stat. 931 (1990) (giving the Commission the authority to seek disgorgement in administrative proceedings), codified in Section 9 of the Investment Company Act of 1940, 15 U.S.C. 80a-9(e) (“Authority to Enter an Order Requiring an Accounting and Disgorgement. – In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest.”).

44 See, e.g., SEC v. Blavin, 760 F.2d 706, 713 (6th Cir. 1985) (“The purpose of disgorgement is to force ‘a defendant to give up the amount by which he was unjustly enriched’ rather than to compensate the victims of fraud.” (internal citations omitted)).
the remedy.\textsuperscript{45} Likewise, the appropriate measure is the amount of profit to the violator and not the amount of harm to the investors.\textsuperscript{46}

Finally, since the passage of the Sarbanes-Oxley Act of 2002, the SEC may distribute money penalty amounts to injured investors through “Fair Funds.”\textsuperscript{47} The Fair Fund provision allowed the SEC, at its discretion, to add money collected as a civil penalty (or fine) to a disgorgement fund, which then may be distributed to injured investors. Until 2002 any civil money penalties had been required to be paid into the United States Treasury.\textsuperscript{48} The Federal Account for Investor Restitution Funds (“Fair Fund”) provision of Sarbanes-Oxley allowed penalties paid in enforcement actions to be added – at the SEC’s discretion - to disgorgement funds and distributed to injured investors.\textsuperscript{49} The provision does not distinguish among individuals and groups or between financial institutions and public company misstatements. Time will tell how the SEC chooses to exercise its discretion but, to date, the most obvious effect has been in high profile (Enron, WorldCom) stock-drop cases because of large investor harm and correspondingly large penalties.

III. THE CFTC’S COMPENSATORY FUNCTION

The CFTC is home to its own experiment in investor compensation, the “Reparations Program.”\textsuperscript{50} The agency provides a forum for resolving disputes

\begin{footnotesize}
\begin{enumerate}
\item See id. (“Once the Commission has established that a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged by [defendant’s] fraud.”); Hazen, 3 Treatise on the Law of Securities Regulation 16.2[4][B] & Supp. at 171 (4th ed. 2002 & Supp. 2004) (citing cases).
\item See Remedies Act, Pub. L. 101-429, Sec. 101.
\item Section 308 of Sarbanes-Oxley, codified at 15 U.S.C. § 7246. Section 308 provides, in relevant part, that
\begin{enumerate}
\item Civil penalties added to disgorgement funds for the relief of victims. If in any judicial or administrative action brought by the Commission under the securities laws … the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.
\end{enumerate}
\item 7 USC 18; 17 CFR 12.
\end{enumerate}
\end{footnotesize}
between “futures customers and commodity futures trading professionals.” In contrast to the SEC’s compensatory function described above, the CFTC provides the decisionmaker, akin to a judge or arbitrator, for disputes between private parties.

The Reparations Program grew out of the CFTC’s agricultural roots: before the CFTC came into being, futures regulation was under the auspices of the Department of Agriculture. The Reparations Program is modeled on the Packers and Stockyards program and agriculture legislation. Some legislative history suggests that the program persisted because of perceived problems with arbitration.

For a claim to be eligible for resolution through the CFTC’s Reparations Program, a few prerequisites must be met. The program is designed for the resolution of disputes between customers and futures trading professionals, whether firms or individuals. The violation alleged must be a violation of the Commodity Exchange Act or the CFTC Rules, such as an allegation of fraud, breaches of fiduciary duty, unauthorized trading, misappropriation of funds or churning (excessive trading in an account in order to generate fees). Moreover, the professional must be registered with the CFTC at the time of the violation or at the time the complaint is filed. Finally, a statute of limitations applies: the complaint must be filed within two years of the date the investor knew or should have known of the activity.


52 Marianne Smythe, The Reparations Program of the Commodity Futures Trading Commission: Reducing Formality in Agency Adjudication, 2 Admin. L.J. 39, 42 (1988) (tracing the roots of the CFTC’s reparations program to the CFTC’s roots in the US Agriculture Department, which administered the Packers and Stockyards Act that contained a reparations program); see Abelardo Lopez Valdez, Modernizing the Regulation of the Commodity Futures Markets, 13 Harv. J. on Legis. 35, 60 (1975-1976) (comparing the CFTC’s reparations program to that in the Perishable Agricultural Commodities Act (PACA)). The Packers and Stockyards Act, 1921, 42 Stat. 159, allowed “Any person complaining of anything done or omitted to be done by any stockyard owner, market agency, or dealer” in violation of certain provisions and orders to file a complaint. The defendant must satisfy or answer the complaint, but will be relieved from liability if the defendant “makes reparation” for the alleged injury. 42 Stat. 159, § 309(a).


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

55 Other pre-requisites also apply: foreign residents must file bonds, and respondents must not be in insolvencies proceedings. As detailed below, the Reparations forum may not be available if the claims are also the subject of other investor-initiated proceedings. See infra.
The program provides three routes for aggrieved investors with qualifying claims: the “voluntary proceeding,” the “summary proceeding,” and the “formal proceeding.”

The voluntary proceeding may be elected for any size of claim provided all participants consent. Evidence is submitted in writing and no oral hearing is held. Perhaps most significantly, the decision issued by the Judgment Officer – a CFTC employee, who may or may not be a lawyer – is final and unappealable.

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

Finally, if the claim (or counterclaim) is greater than $30,000, the investor may select a formal proceeding, which is heard by an Administrative Law Judge (ALJ) and accompanied by additional procedural protections and steps, including an oral hearing. As in the summary proceedings, this decision is appealable to the Commission and ultimately to the U.S. Court of Appeals.

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57 17 C.F.R. §§ 12.100 to 12.106 (Subpart C).

58 Id.

59 See Smythe at 57 (noting that the judgment officer is not necessarily a lawyer). The Judgment Officer also may be - but is likely not - an ALJ. See 17 C.F.R. § 12.2 (“Judgment Officer means an employee of the Commission who is authorized to conduct the proceeding and render a decision in a summary decisional proceeding or a voluntary decisional proceeding. In appropriate circumstances, the functions of a Judgment Officer may be performed by an Administrative Law Judge.”);

60 Id. § 12.106(d). Challenges under the Seventh Amendment have not succeeded. See Myron v. Hauser, 673 F.2d 994 (8th Cir. 1982).

61 Id. §§ 12.200 to 12.210 (Subpart D).

62 Id. § 12.206.


64 CFTC, 2007 Performance and Accountability Report (Ann. Rep.) at 70 (noting that the summary and formal proceedings take longer than the voluntary and that the summary “tend to take slightly longer [than the formal], in part because more parties are pro se”).

65 17 C.F.R. §§ 12.300 to 12.315 (Subpart E).

66 17 C.F.R. § 12.314.
Regardless of the label, all of these proceedings are voluntary in that the investor chooses to pursue a claim through the Reparations Program rather than other avenues. Injured investors have the option of pursuing a private lawsuit; a private right of action was implied in Merrill Lynch, Pierce, Fenner & Smith v. Curran, and later codified in the CEA. Moreover, investors may participate in arbitration. Pre-dispute arbitration agreements cannot be required for opening a futures account, but even if customers do enter into such an agreement, CFTC rules require them to include a notice that a customer who signs the agreement agrees to forego private litigation, but will have a 45-day window in which the customer can elect a reparations proceeding. Moreover, the rules provide that institutional customers may enter pre-dispute agreements waiving rights to file a reparations claim. To reduce duplicative actions, the Reparations rules prohibit parallel proceedings that involve claims (or counterclaims) concerning allegations against any of the same respondents based on the same facts. To qualify as a parallel proceeding and thus to foreclose reparations proceedings, the arbitration or court case must be initiated by the investor and be pending when the

\[69\] 17 C.F.R. § 166.5(a)(5) provides that pre-dispute arbitration agreements must include the following language:

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

\[70\] See 7 USC 18(g) ("Predispute resolution agreements for institutional customers. Nothing in this section prohibits a registered futures commission merchant from requiring a customer that is an eligible contract participant, as a condition to the commission merchant's conducting a transaction for the customer, to enter into an agreement waiving the right to file a claim under this section.").
\[71\] A counterclaim in which the investor alleges violations of the CEA or its regulations would also qualify as a parallel proceeding, as would a claim – whether asserted or not – that must be brought or lost under the compulsory counterclaim rules of federal civil procedure. See 17 C.F.R. § 12.24.
\[72\] A counterclaim in which the investor alleges violations of the CEA or its regulations would also qualify as a parallel proceeding, as would a claim – whether asserted or not – that must be brought or lost under the compulsory counterclaim rules of federal civil procedure. See 17 C.F.R. § 12.24.
Reparations complaint is filed. Insolvency proceedings concerning respondents may also qualify as parallel proceedings.\(^73\)

The Reparations Program is focused on individual litigation. In the 1990s, in response to a directive from Congress, the CFTC considered and sought comments on whether it should permit class actions in the reparations forum, however it decided against this expansion.\(^74\) In fact, even modifications to the program that intensify third-party practice have been rejected because of the need to keep the program simple.\(^75\)

The remedies in Reparations proceedings include actual damages caused by the violation.\(^76\) Also, punitive damages up to twice the amount of actual damages are available in the summary and formal proceedings where the actions were “willful and intentional violation in the execution of an order on the floor of a contract market.”\(^77\) An investor must claim actual and punitive damages in the Reparations complaint, prove the actual damages and show that the punitive are appropriate.\(^78\) In keeping with the CFTC’s role as decisionmaker rather than lawyer, the parties bear the costs of collection. This allocation of costs contrasts with the SEC’s practice under Fair Funds in which the SEC bears the burden of collecting what are, at least nominally, civil fines rather than damages.

The CFTC’s involvement in investor compensation is not limited to the Reparations Program and its decisionmaking role. It also pursues enforcement actions in a way similar to the SEC, either in administrative or judicial proceedings, in which it acts in place of counsel to injured investors. Like the SEC, among the available remedies in these adjudicated actions or in settlement

\(^73\) See 17 C.F.R. § 12.24(a)(1)(2) & (3).
\(^75\) Fed. Reg.
\(^76\) 7 U.S.C. § 18(a) (“Petition for actual damages (1) Any person complaining of any violation of any provision of this chapter, or any rule, regulation, or order issued pursuant to this chapter, by any person who is registered under this chapter may, at any time within two years after the cause of action accrues, apply to the Commission for an order awarding— (A) actual damages proximately caused by such violation.”)
\(^77\) See 17 C.F.R. § 12.2; 12.106(b)(3); 12.210(b)(4); 12.314(b)(4). 7 U.S.C. § 18(a)(1)(B) “[I]n the case of any action arising from a willful and intentional violation in the execution of an order on the floor of a registered entity, punitive or exemplary damages equal to no more than two times the amount of such actual damages. ….”).
\(^78\) See 17 C.F.R. § 12.2.
are civil penalties and disgorgement. Furthermore, the CFTC often seeks the equitable remedy of restitution.

The CFTC, like the SEC, has the power to seek penalties. The CEA granted the CFTC the power to impose civil penalties of $100,000 per “violation”.\(^7\)\(^9\) The $100,000 figure does not necessarily capture the potential scope of these penalties. For instance, the CFTC’s post-Enron investigations into misconduct in the energy markets resulted in $130 million in money penalties.\(^8\)\(^0\) These penalties are assessed according to the “gravity of the violation”\(^8\)\(^1\) and are directed to the U.S. Treasury. Unlike the SEC, the CFTC has no statutory authority to distribute funds collected as penalties to injured investors; that is, the statute has not been amended by the equivalent of the Fair Fund provision.\(^8\)\(^2\)

The use of the disgorgement remedy by the CFTC and the SEC is very similar; in fact, securities law precedents about the remedy have been used in the futures context.\(^8\)\(^3\) Again, disgorgement is aimed at preventing unjust enrichment by extracting any profits from the violation. Disgorgement funds either go to the U.S. Treasury or may be distributed to injured investors through a disgorgement fund created by the CFTC (like the SEC) or a court.\(^8\)\(^4\)

Disgorgement is aimed at depriving violators of profit and is measured by the profit. In contrast, the remedy of restitution focuses on the victims and is

\(^7\)\(^9\) See 7 U.S.C. 9. Available remedies are not limited to monetary remedies such as penalties: the CFTC also can seek injunctive relief and suspend or revoke registration and prohibit people from trading on contract markets. See 7 U.S.C. 13a-1; see generally Jerry W. Markham, Investigations Under the Commodity Exchange Act, 31 Admin. L. Rev. 285 (1979).


\(^8\)\(^1\) 7 U.S.C. 9a provides that “[i]n determining the amount of the money penalty assessed under sections 9 and 15 of this title, the Commission shall consider the appropriateness of such penalty to the gravity of the violation.” See also Brenner v. CFTC, 338 F.3d 713 (7th Cir. 2003) (tracing the history of 7 U.S.C. 9a and affirming civil money penalties of $300,000 and $100,000 where the CFTC had considered the gravity of the offense); CFTC, A Study of CFTC and Futures Self-Regulatory Organization Penalties, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26264 at 42220 (CFTC November).


measured by the harm caused.\textsuperscript{85} So, for instance, restitution of almost $10 million was ordered where customers lost at least $10 million due to misrepresentations – brokers had used lines like “How does it feel to be making money?” to a customer whose account was actually losing money.\textsuperscript{86} Relief is not necessarily limited to only one type: as well as combining monetary and non-monetary relief, restitution and money penalties might both be ordered and, in fact, the $10 million restitution order described above was combined with a $6 million penalty.\textsuperscript{87} The CFTC ordered more than $179 million in restitution in 2003 and 2004 combined.\textsuperscript{88} Interestingly, although the remedy of restitution is also available to the SEC, restitution has not played a large role in the SEC’s practices; instead it typically imposes money penalties and disgorgement.\textsuperscript{89} The Fair Funds provision has a restitutitory function – after all, the “FAIR” in “Fair Funds” stands for “Federal Account for Investor Restitution.” Unlike restitution, however, investor harm is not the measure for amounts collected and distributed under this provision or through the disgorgement remedy.

IV. THE INFORMATION ADVANTAGES OF THE AGENCY AS JUDGE

Drawing on the existing Fair Funds and Reparations Programs, this section suggests how a consolidated CFTC and SEC might obtain compensation for injured investors. It suggests that a Reparations Program benefits the agency or agencies by generating information in two ways: eliciting facts about industry practices and conduct (input) and developing law (output). It concludes that this information-generation function should be weighed heavily when considering how limited resources should be allocated between a judicial (Reparations Program) and counsel (Fair Funds) role. It is also a potential advantage of pursuing compensation through agency action rather than other avenues to investor compensation.

\textsuperscript{85} See, e.g., SEC v. Huffman, 996 F.2d 800, 803 (5th Cir. 1993) (“[D]isgorgement is not precisely restitution. … Disgorgement does not aim to compensate the victims of wrongful acts, as restitution does.”).


\textsuperscript{87} Id. at 14.


\textsuperscript{89} Id., Table 1.
The threshold question – before reaching what a compensatory mechanism might look like – is why have any compensatory mechanism at all. The primary objection to investor compensation can be summed up as a concern with circularity. Investors harmed by the conduct may be harmed again by a penalty against a corporation in which they own stock. Moreover, diversified investors may be on both sides of a transaction so that “compensation” for them involves shifting money from one pocket to another, minus administrative costs.90

For a number of reasons, this concern should not foreclose consideration of what compensatory mechanism makes sense. First, commentators have challenged the circularity argument head-on, by, for instance, pointing out that downside losses often exceed upside.91 Second, the category that raises the circularity concern – investors in the secondary market – does not include all possible injured investors and compensatory relief might target the other categories.92 The type of individual cases between brokers and customers covered by the Reparations Program does not raise such concerns. SEC penalties against individuals also potentially avoid the critique, although indemnification and insurance often pass costs along to the corporation and thus to the shareholders. Finally, compensation is likely a political reality, so it makes sense to consider how to go about it, even if critical of it as an independent goal.93

Because the two approaches – judge or lawyer – are not mutually exclusive, a consolidated agency could combine them. As described above, like the SEC, the CFTC has the statutory authority to seek civil penalties. A provision like the Fair Fund provision could reach the CFTC’s money penalties. Likewise, eligibility for the Reparations Program could be enlarged to include matters within the SEC’s current jurisdiction. As things stand, the different approaches track the SEC/CFTC jurisdictional division: Fair Funds applies to matters within the SEC’s jurisdiction and the reparations forum is available for CFTC matters. However, in keeping with the recognition that the line between futures and securities is often difficult to draw,94 the Reparations Program could be a model for broader financial regulation.95 The programs could both apply across the board. Alternatively, one could adopt the divisions among financial regulators suggested by the Treasury’s Blueprint. The CBRA (in charge of regulating financial professionals, whether involved in futures or securities) might administer a Reparations Program, for

94 See supra.
instance, whereas the corporate finance regulator (regulating issuers) might administer a Fair Funds program.

Although the programs could co-exist, the agencies’ limited resources are likely to force choices. The comparison between the SEC’s counsel role and the CFTC’s judicial role lends some support to continuing a program like the Reparations Program. One possibility is that the agencies have more expertise in their judicial role. To the extent that agencies are assigned roles and given powers because of their expertise, a program that builds on an existing structure might make more sense. So, in more concrete terms, both agencies already have a structure of ALJs who hear and resolve administrative cases; a forum for customers may simply be an extension of that developed area. While both agencies have also long had a “counsel” role in one sense – deciding what cases to pursue, and how – in another sense this role has not involved distribution and identification of injured investors to the extent that the Fair Funds program now imposes. The new distribution function has forced the SEC to allocate resources – creating a new office, for instance, as well as taking individual enforcement lawyers’ time. The “expertise” support for a judicial role has limits, however, because expertise is not static and can be developed. The Fair Funds provision can be seen as a directive from Congress to the SEC to become expert in investor compensation.

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

In regards to factual information, when the agency acts as counsel, it must draw on its traditional sources of information to investigate and develop a case. The SEC often looks at market surveillance activities, customer complaints, the financial press, SROs, and its own inspection offices for information.

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96 See, e.g., John D. Ellsworth, Disgorgement in Securities Fraud Actions, at 651 (describing the SEC’s resource constraints).


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

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

As to information about the law, the program generates written opinions that communicate the agencies’ view of futures or securities laws to regulated industry, investors, and the public more generally. Decisions in both the summary and formal reparations proceedings include factual findings supported by references to the record, a legal determination of violation of the CEA or related rules, and the amount of damages. The decision at the initial stages of the reparations process is not binding on the CFTC absent an opinion and an order.

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101 Id. Following spam in the top five complaints was advance fee fraud, manipulation of securities, prices or markets, and problems with account records and transfers. Id.
102 See Jill Fisch, Class Action Reform, Qui Tam, and the Role of the Plaintiff, Law & Contemp. Probs., Autumn 1997, at 195 (noting that “the incentive structure of qui tam is tailored to place a premium on the contribution of original information”); Geoffrey Rapp, Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers, 87 B.U. L. Rev. 91 (proposing a bounty model of rewarding whistleblowers to give them an incentive to come forward with original information).
103 17 C.F.R. § 12.210(b) (content of initial decision in a summary proceeding); 17 C.F.R. § 12.314(b) (content of initial decision in a formal proceeding). In contrast, the voluntary proceeding results in a much more limited final decision that contains a conclusion as to violation and remedy, unaccompanied by factual findings. See 17 C.F.R. § 12.106(b).
(not a summary affirmance) from the Commission on appeal. Nonetheless, the reparations process may generate binding precedent when appealed to the Commission or the federal court. Moreover, a body of written opinions, even if not strictly binding, is likely to serve as guidance for the agency and for those appearing before the agency.

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

Another way the judge/lawyer divide helps us evaluate the two programs is to highlight the problems that arise once a governmental agency “represents” a client. Identifying an agency’s client is never straightforward given the different constituencies within an agency (e.g., enforcement lawyers, Commissioners). Even if an agency is treated as a single unit (so, for instance, the SEC as public class counsel), compensation is only one of the agency’s priorities, competing with other goals such as deterrence and developing positions on novel legal issues. Moreover, agencies provide little representation of injured investors in the sense

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104 17 C.F.R. § 12.406(b) (“Unless the Commission expressly indicates otherwise in its order, an order of summary affirmance does not reflect a Commission determination to adopt the initial decision, including any rationale contained therein, as its opinion and order, and neither initial decision nor the Commission’s order of summary affirmance shall serve as a Commission precedent in other proceedings.”) (emphasis added); see generally Markham, § 20:13 (citing cases about the “precedential effect of ALJ decisions”).


106 The assumption would be that settlements contribute less to development of the law, although the argument made above about the powers of non-binding written precedent might apply equally in the context of the SEC settlements, information about which is readily available on the agency’s webpage. The argument would have to be that the provision allows for increased penalties because compensation either makes corporate penalties more acceptable or because the great degrees of investor harm push the agency to impose higher penalties. Then one would have to speculate about the effects of larger penalties on settlement behavior.
of client voice in whether and how a matter is pursued. For instance, in the Fair Funds context, administrative actions limit the participation of potential claimants to a Fair Fund to the submission of non-binding comments. Likewise, in court actions, courts and the SEC have imposed limits on client participation, reasoning that the compensatory function of disgorgement and of Fair Funds is secondary and incidental to the other purposes of disgorgement and civil penalties, preventing unjust enrichment and promoting deterrence, respectively.

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

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

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107 Rule 1106 of the SEC’s Rules of Practice provides for comments to be submitted as part of the process of approving a Fair Funds distribution plan, but states that “no person shall be granted leave to intervene or to participate or otherwise to appear in any agency proceeding or otherwise to challenge an order of disgorgement or creation of a Fair Fund” or its distribution plan or individual eligibility for disbursements.” U.S. Securities & Exchange Commission, Rules of Practice and Rules on Fair Fund and Disgorgement Plans (Jan. 2006, corrected Mar. 2006).

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

109 See Alicia Davis Evans, The Investor Compensation Fund, 33 J. Corp. L. 223 (2007) (proposing to use Fair Funds as the beginnings of an investor insurance fund).

110 I have suggested elsewhere that such guidelines should focus the SEC on actions that do not duplicate private actions – and thus collection and distribution costs – and that minimize concerns about the circularity of compensation in the secondary market context. Winship, Fair Funds and the Compensation Conundrum, 60 Fla. L. Rev. (forthcoming, Dec. 2008).

111 17 C.F.R. § 166.5(a)(5) (“Three Forums Exist for the Resolution of Commodity Disputes: Civil Court litigation, reparations at the Commodity Futures Trading Commission (CFTC) and arbitration conducted by a self-regulatory or other private organization.”).
The amount of information generated by private securities lawsuits as currently structured is debatable, although some commentators have suggested that they generate little original information. Complaints are often peppered with colorful quotations from the Wall Street Journal, the New York Times, and issuers’ own financial restatements. Although understandable, given that plaintiffs and their counsel are acting without discovery at that stage, to the extent that many actions do not progress far before being settled, this reliance on public sources may signal that these suits have limited information benefits.

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

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

The law-generating aspect of an agency reparations program represents an advantage over arbitration. As described above, the Reparations Program provides written opinions subject to Commission and judicial review. Of course, the flip side of a program of reasoned precedential opinions subject to judicial review is that, as the procedure becomes more judicial, it becomes less useful as an alternative, informal and quick forum for dispute resolution. Moreover, as arbitration changes – for instance, if written opinions become an option – the relative benefits of the Reparations Program may decrease and more pressure is

112 Geoffrey Rapp, Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers, 87 B.U. L. Rev. 91, 136 (“In private securities lawsuits, little new information is typically generated. Instead, class action lawyers use information voluntarily provided by companies or piggy-back on information generated by government investigations in filing their suits.”).
113 Smythe.
114 Id.
115 Jennifer J. Johnson & Edward Brunet, Arbitration of Shareholder Claims: Why Change Is Not Always A Measure of Progress (working paper – check that can cite) (criticizing proposals to arbitrate shareholders’ claims).
put on whether it is worth the cost of the Reparations Program in order to have an arbitrator who is a government employee.\footnote{Marianne Smythe suggested that “the broader utility of such an ADR program for other federal agencies will depend essentially on one question: whether value is ascribed to expert government employees serving as judges of private disputes arising under a federal regulatory program.” Smythe at 83.}

This essay urges policymakers to look at these existing programs and to consider as part of the cost-benefit mix the effects they have on the factual information that gets to the financial regulators and the legal information that the program produces. The Reparations Program is not a fix; throughout its history, it has been unpopular with industry,\footnote{Symposium: New York Stock Exchange, Inc. Symposium on Arbitration in the Securities Industry (November 21, 1994), 63 Fordham L. Rev. 1505, 1523 (1995) (Fowler C. West, former CFTC Commissioner) (“I spent much of my ten years at the CFTC defending the reparations program because the industry disliked it…”).} and the agency and Congress have struggled to combat a backlog of cases by imposing pragmatic limitations to the program’s reach. The history of the Reparations Program lends weight to the critique that the program could make the CFTC a “huge small claims court for the Commodity industry,”\footnote{Valdez at 61, quoting Address by Commissioner Gary L. Seevers before the Regulatory Reform Conference, Washington, D.C., Sept. 11, 1975, at 4.} resulting in a slow system that potentially overwhelms resource-constrained agencies. A large backlog of cases was the impetus for rule revisions in 1984 that introduced pragmatic limitations to the scope of the program.\footnote{See Kenneth M. Raisler & Edward S. Geldermann, The CFTC’s New Reparation Rules: In Search of a Fair, Responsive, and Practical Forum for Resolving Commodity-Related Disputes, 40 Bus. Law. 537 (1985) (describing the perceived problems with the Reparations Program and the responsive rule changes including limiting the eligibility for reparations proceedings).} The revised rules also added the option of a streamlined, quick and unappealable, voluntary process that does not result in binding precedent, and thus does not contribute to generating law in this area.\footnote{See id.}

This difficult history, taken in conjunction with the program’s potential contributions to information-generation, suggests three main avenues of further inquiry. First, the costs of the Reparations Programs need to be tracked and evaluated, particularly if it is expanded to reach a new group of cases. These costs cannot be evaluated in a vacuum; whether the Reparations Program is an appropriate and cost-effective alternative to arbitration may change as arbitration systems change. For instance, if arbitration begins to lead to written explanations, as the NASD proposed in its “explained award proposal,”\footnote{Barbara Black & Jill Gross, The Explained Award of Damocles: Protection or Peril in Securities Arbitration, 34 No. 1 Sec. Reg. L. J. n. 53 (2006).} some of the relative information advantages of the Reparations Program are decreased.
Second, any use of this program by a consolidated agency must develop pragmatic limitations that go beyond the division between futures and securities, which proposed consolidation is designed to overcome. This may be an opportunity to distinguish among types of investors and design a program targeted at the most vulnerable and least likely to pursue a complaint in its absence. For example, the program might identify and define a class of sophisticated investor who may contract out of the Reparations program.122

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

CONCLUSION

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

Building on the assumption that compensation by someone of at least some injured investors is appropriate, this essay makes three arguments: First, the Fair Funds and Reparations approaches could exist side-by-side, but there is no reason to draw the line as it is currently drawn based on the current jurisdiction – essentially over futures versus securities – of the agencies. Second, although a Fair Funds and Reparations program could co-exist, resource-constrained agencies (or Congress when deciding what roles to assign these agencies) are likely to have to make allocative choices. The comparison between the counsel and judicial approaches may aid this choice. An action in which the agency acts as decision-maker (as the CFTC does through its Reparations Program) is potentially information-generating in two ways: aggrieved customers who use the forum furnish facts about industry practices and potential violations that may feed the enforcement efforts of the agency and the decisions that come out of the program develop law in the area. Finally, we should ask whether the agencies – however

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122 In the program’s current structure, even signatories of pre-dispute arbitration agreements have a 45-day window in which to elect the Reparations forum. The current rule allows pre-dispute agreements with sophisticated investors to include waivers of access to the Reparations forum.
configured – should take on any role. This requires a comparison to the alternatives of private actions and arbitration. Although more empirical study of the costs and benefits of the Reparations Program is needed and, as arbitration procedures develop, the need for the Reparations Program may change, its information-generating role should be weighed heavily on the benefit side.