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Book Review

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REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA, by Roberta S. Karmel, Simon & Schuster, New York 1982, 400 pp.

When Roberta Karmel was appointed to the Securities and Exchange Commission (SEC) in 1977, the press emphasized that this New York lawyer was the first woman on the SEC. Karmel's gender, as it turns out, was probably the least interesting part of her tenure at the regulatory agency. A member from 1977 to 1980, Karmel was in almost constant conflict with her fellow commissioners and was often a lone dissenter. She derived delight from a quotation that she framed and placed on her Washington office wall. It stated, "I'm just not ready to assume that merely because a government official suggests something, it's automatically in the public interest." What makes the quotation unusual is that its author was Roberta Karmel herself.

After Karmel returned to New York to be a law partner with the firm Rogers and Wells, she wrote *Regulation by Prosecution,* which was influenced by her experience as both a government regulator and a Wall Street lawyer. Assailing enforcement practices at the SEC, Karmel perpetuates her role as an adamant dame of dissent by belaboring her argument that too much regulation constitutes a serious drawback to corporate capital accumulation, a deduction clearly reflected in the book's subtitle, "The Securities and Exchange Commission vs. Corporate America." The main theme of the book is that the SEC should stick to the basics — protecting investors from corporate deception and Wall Street chicanery —

and should forget about wrenching confessions out of corporations on overseas bribes, perquisites, and failures to comply with other agencies' rules. These activities, according to Karmel, may be ethically repugnant, but they are simply of passing concern to the public investors. Thus, beset with philosophical incompatibilities while a commissioner, Karmel continues to wield the harpoon at Stanley Sporkin, the former SEC chief enforcement officer, whose emphasis on regulatory conformity brought some merit to him and the Commission.

Karmel, the daughter of Jewish immigrants who were Socialists until they lent their allegiance to Franklin D. Roosevelt, describes herself as a "child of the New Deal" who didn't even know a Republican until she went away to Radcliff, she has continued to be an ardent Democrat. During an earlier stint as a staff attorney in the SEC's New York regional office, she accepted the Commission's party line that "we are the good guys and those we are chasing were the bad guys." Only later did she come to realize that the SEC often won cases that were poorly prepared or based on questionable legal arguments.

The Commission allowed its staff to vent a self-righteous reaction to the evils of Watergate. Karmel found that with this attitude staff members sometimes acquired an arrogance intolerable in a democratic government. As long as the country enjoyed a succession of prosperous years, society "could afford the luxury of government regulation that is legalistic, adversarial, and concerned with equity instead of efficiency." But in a troubled economic climate such as the present one, "it is becoming increasingly apparent that Government regulation . . . is not working well, because it has been ignoring, and even destroying, economic values."

When Karmel began working with the SEC enforcement office in New York, she realized that the government did not appear as she had idealized it. Her daily contact with that system transformed it "from a neoclassic temple where godlike creatures dispensed justice to a dingy government building where faceless bureaucrats coped as well as they could with a faceless horde of miscreants." She was further disillusioned by the Watergate incident. Although some liberals may have been eager to expose the scandal ridden Nixon administration, Karmel was horrified to learn that the federal government would try to undermine democratic values. The SEC itself became severely sullied when the public learned that Nixon's aides had pressured Bradford Cook, the agency chairman, into quashing certain aspects of the investigation of Robert Vesco, the itinerant financier and Nixon's political contributor. This whole sordid experience prompted Karmel to conclude that "the burden was on government to justify its objectives and procedures when taking action."

During her twenty-eight months as commissioner, she found that SEC lawyers apparently entertained the opposite reaction. Many SEC staffers preferred to maintain a self-righteous determination to show the public that "the business world was as corrupt as government." Frequently, these official regulators trampled on the rights of the accused.

Karmel believes that some of her controversial views, especially on the stultifying effect of government overregulation, will eventually gain acceptance. The ideas that first shook the SEC's foundation in 1977 are now orthodox in Washington. Her views are particularly relevant today because other "questioning liberal[s]" will similarly experience her apostasy from a New Deal Democrat to "a wholly corporatized regulator," the label uncharitably given to her by Ralph Nader.

While recognizing that the SEC, a small and independent agency, cannot be at the center of the government or the economy, Karmel regrets that "the federal agency most concerned with public securities markets has neither a clear statutory directive nor a tradition that encourages the agency to promote investment." Although she does not dispute that exorbitant bribes from domestic corporations to corrupt foreign officials are properly a matter of national concern, Karmel contends that the SEC's "puritanical witch-hunts," culminating in some 400 confessions of corporate bribery and questionable payments, were merely a reaction to the Watergate incident. She doubts the agency's role of self-appointed guardian of corporate morals and whether business practices are rightly the "concern of an independent agency responsible for financial disclosure to investors." Most investors, after all, care primarily about capital appreciation and dividends.

In this respect, Karmel sounds the same cadence as Milton Friedman, an advocate of the free market and the 1976 Nobel laureate in economics. Both Karmel and Friedman believe that the duty of corporate executives is to make money for their stockholders rather than to consider the social consequences of their actions. Such social awareness in a democratic society would be fundamentally subversive of free enterprise. It would involve the adoption of the Socialist view that exhortations and policies of political leaders, rather than market forces, are better able to determine the allocation and uses of society's scarce resources. Thus, according to Karmel, the Commission should "stop worrying about how to improve corporate morality and social responsibility and start worrying about how to encourage the public to put dollars into savings and investment instead of consumption."

Fundamentally, the SEC succeeded in controlling corporate boardrooms because its enforcement division gradually took over and established Commission policy. Such "regulation by prosecution" ironically coincided with a massive defection in the ranks of individual investors during the 1970s. Karmel also indicts the SEC's allies in Congress. For example, she suspects that the congressional mandate for a national securities market in 1975 was motivated more by political inducements than by economic criteria of efficiency or equity. Coincidentally, the consumer movement was then reaching its zenith; "the possibility that such a trading system could impair the viability of the stock exchanges . . . was not only countenanced but welcomed."

Although this rather thick volume constitutes a valuable and highly interesting addition to a reference shelf, Karmel nonetheless fails to convince her audience that the mission of the SEC is to promote the nation's economic growth and capital accumulation. The suggestion that Congress should give the SEC a new responsibility, that of boosting productivity and capital formation, is also perplexing. Karmel, the "questioning liberal," apparently wants to return to her days as a child of the New Deal, seeking governmental solutions to economic problems that a regulatory agency may be poorly equipped to address. If the SEC took on this new charge, it could not devote adequate attention to investor protection because of the limited resources at hand. This new task could decrease confidence in the market place and could greatly hamper the capital markets themselves. While lowering the barriers of regulation to assist the formation of capital can be a laudable design, many dangers lurk in the commingling of regulatory responsibility and corporate schemes. Also, the Commission's top priority under any set of conditions should not be the sales promotion of corporate securities.

Equally disturbing is Karmel's suggestion that the Commission be relieved of its status as an independent agency and placed under the wing of the White House. This change, according to Karmel, would allow the Commission's policies to be "integrated into an overall plan for the national economy." Yet, securities regulation should not be subservient to presidential policies.

Karmel is unduly cautious in her description of the decision making process at the SEC. For example, Karmel does not explain how Stanley Sporkin, SEC chief enforcement officer, prevailed in many controversial enforcement cases and rulemaking proceedings. Karmel also depicts the SEC staff as blindly self-righteous, but then praises the Commission in a perfunctory way for its intelligence and dedication.

Regulation by Prosecution will be of keen interest to students of federal regulation. Though it lacks in firsthand reminiscences, it excels in examining critical issues. To call this a lawyer's book is not to say that others, such as economists, accountants, historians, and the securities industry in general, will not find it immensely compelling and stimulating. The lawyerly style of writing and exposition, however, will probably intimidate many general readers. One can quibble also with the use of undefined terminology and some redundancies. Indeed, the book turns out less readable than it could have been because of an apparently light editorial touch. This is unfortunate because the book focuses on a question critical to our time — how should government interact with business enterprises? Both critics and defenders of the SEC will find it difficult to ignore this book. One may already hear the cheers reverberating through the corridors of Wall Street.

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