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# Practice in Securities and Exchange Commission Investigatory and Quasi-judicial Proceedings

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# university of miami law review

VOLUME 27

FALL-WINTER 1972

NUMBERS 1-2

## PRACTICE IN SECURITIES AND EXCHANGE COMMISSION INVESTIGATORY AND QUASI-JUDICIAL PROCEEDINGS

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### A. GENERAL CONSIDERATIONS

#### 1. *The Rules of Practice*

In addition to the Administrative Procedure Act,<sup>1</sup> which is designed to provide basic guidelines ensuring procedural due process and basic fairness to those who appear before federal administrative agencies, the United States Securities and Exchange Commission<sup>2</sup> has promulgated two separate and distinct sets of rules to govern the procedures discussed in this paper. These are the Rules of Practice<sup>3</sup> and the Rules Relating to Investigations<sup>4</sup> of the Securities and Exchange Commission.

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1. 5 U.S.C. §§ 551-59, 701-06 (1970).

2. Hereinafter referred to as the Commission.

3. 17 C.F.R. § 201 (1972). Hereinafter in the text and footnotes a rule of practice will be referred to as R.P. Thus, for example, rule of practice number 2(b) will be referred to as R.P. 2(b).

4. 17 C.F.R. § 203 (1972). Hereinafter in the text and footnotes a rule relating to

## 2. *Who May Practice Before the Commission*

Any lawyer admitted to practice before either the highest court in his state, any of the lower federal courts or the Supreme Court of the United States may practice before the Commission.<sup>5</sup> Individuals may appear pro se and corporations and other associations may appear by and through an officer or other authorized person.<sup>6</sup> The Commission has the power to deny the right to practice before it for reasons of misconduct or bad character.<sup>7</sup>

### B. THE DOUBLE-EDGED SWORD OF ENFORCEMENT

#### 1. *The Fifth Amendment—Immunity Swap*<sup>8</sup>

Like most federal regulatory agencies, the Commission has the power to compel witnesses to answer questions or produce documents even though such evidence and testimony may be self-incriminatory.<sup>9</sup> Serious problems have arisen from this statutory grant of power to compel testimony. One quite annoying question is whether the immunity provided in exchange for testimony protects the witness from subsequent prosecution under a state securities statute.<sup>10</sup> Recently, the extent of the privilege thus conferred has been the subject of attack. The statute provides only for immunity against re-use of the compelled testimony. The "immunity swap" statute has been held invalid by several courts on the ground that the granted immunity is not coextensive with the fifth amendment privilege.<sup>11</sup>

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investigations will be referred to as R.R.I. Thus, for example, rule relating to investigations number 5 will be referred to as R.R.I. 5. The parallel citations to R.P. and R.R.I. are from the May 17, 1971, SEC booklet entitled "Rules of Practice and Rules Relating to Investigations and Code of Behavior Governing Ex Parte Communications Between Persons Outside the Commission and Decisional Employees."

5. 17 C.F.R. § 201.2(b) (1972); R.P. 2(b).

6. 17 C.F.R. § 201.2(a) (1972); R.P. 2(a).

7. *Schwebel v. Orrick*, 153 F. Supp. 701 (D.D.C. 1957), *aff'd on other grounds*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958).

8. Prior to December 14, 1970, immunity of witnesses and the privilege against self-incrimination was governed by § 22(c) of the Securities Act of 1933, as amended 15 U.S.C. § 77v(c) (1964), and § 21(d) of the Securities Exchange Act of 1934, as amended 15 U.S.C. § 78u(d) (1964). However, the Organized Crime Control Act of 1970 repealed those subsections and now governs the topic. 18 U.S.C. §§ 6001-05 (1970). Nonetheless, prior decisional law will most likely continue to be applicable, as the new provisions are quite similar to those they replaced.

9. 18 U.S.C. § 6002 (1970). *See also* *Shapiro v. United States*, 335 U.S. 1 (1948) (citing 26 statutes conferring such powers on various federal agencies); *Brown v. Walker*, 161 U.S. 591 (1896).

10. *See* *Feldman v. United States*, 322 U.S. 487 (1944); *United States v. Murdock*, 284 U.S. 141 (1931); *McNaughton, Self Incrimination under Foreign Law*, 45 VA. L. REV. 1299 (1959), and the subsequent commentaries on all of these authorities in *Murphy v. Waterfront Comm'n*, 378 U.S. 52 (1964). *Murphy* and *Adams v. Maryland*, 347 U.S. 179 (1954), make it certain that the compelled testimony cannot be used elsewhere. But see note 17 *infra* and accompanying text.

11. *In re Kinoy*, 326 F. Supp. 407 (S.D.N.Y. 1971); *see also In re Korman*, 449

There is no formal procedure which must be followed in claiming the privilege before the Commission.<sup>12</sup> It may be claimed informally before the witness has been sworn to testify.<sup>13</sup> However, there are important conditions which must be met before the immunity takes effect and important limitations as to the privilege which creates the immunity.

Immunity does not follow from the mere fact of testifying as to matters which are, in fact, incriminating:

The statute is plain and unambiguous. It requires that a claim of privilege against self-incrimination must be made by an individual, *and* that, thereafter, the individual *must be compelled* to testify or to produce records for inspection by the legislative body.<sup>14</sup>

Therefore, testimony given without a claim of privilege against self-incrimination under the fifth amendment, and given without compulsion, creates no immunity from prosecution for the witness.<sup>15</sup>

The immunity provisions apply only insofar as the witness has a constitutional privilege to assert; that is, the immunity is coterminous with the privilege.<sup>16</sup> The privilege does not extend to corporations or to officers of corporations insofar as the corporate books and records are concerned.<sup>17</sup> The only papers protected by the privilege are those that are the private property of the person claiming the privilege, or at least those that are in his possession in a purely personal capacity.<sup>18</sup>

The federal law as to partnerships is somewhat unsettled. The courts have upheld the privilege as to a member of a partnership, but have also indicated that members of large partnerships, having both special and general partners, might not be entitled to the privilege.<sup>19</sup>

The immunity is applicable to a person compelled to testify orally as to matters contained in corporate books or other records, but not to one

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F.2d 32 (7th Cir. 1971). If a "transactional" immunity statute existed, with language similar to "in any criminal case" as in 18 U.S.C. § 6002 (1970), an argument founded upon the supremacy clause could be made in favor of a total, nationwide immunity, and thus bar prosecutions under state securities statutes.

12. *United States v. Eisele*, 52 F. Supp. 105 (D.D.C. 1943); *United States v. Goodner*, 35 F. Supp. 286 (D. Colo. 1940).

13. *United States v. Goodner*, 35 F. Supp. 286 (D. Colo. 1940).

14. *United States v. Abrams*, 357 F.2d 539, 549 (2d Cir. 1966).

15. *Shaw v. United States*, 131 F.2d 476 (9th Cir. 1942). The fact that immunity provisions are expressly conditioned upon claiming the privilege makes the rule the same as that which applies to the fifth amendment itself. *See, e.g., Rogers v. United States*, 340 U.S. 367 (1951).

16. *Shapiro v. United States*, 335 U.S. 1 (1948). It must be noted, however, that the refusal to testify in noncriminal proceedings has been used to support an inference that had the witness testified, such testimony would have been adverse to his position. *See, e.g., N. Sims Organ & Co. v. SEC*, 293 F.2d 78 (2d Cir. 1961).

17. *Wilson v. United States*, 221 U.S. 361 (1911).

18. *See, e.g., Essgee Co. of China v. United States*, 262 U.S. 151 (1923); *In re Verser-Clay Co.*, 98 F.2d 859 (10th Cir. 1938), *cert. denied*, 306 U.S. 639 (1939).

19. *United States v. Linen Serv. Council*, 141 F. Supp. 511 (D.N.J. 1956), provides a good review of the cases in this area.

asked merely to authenticate such books and records.<sup>20</sup> And while a witness might personally have a privilege that can be exchanged for immunity, his privilege does not extend to accounting work papers owned by his accountant.<sup>21</sup> The attorney-client privilege, of course, is honored, but no accountant-client privilege is recognized,<sup>22</sup> regardless of underlying state law. Neither a privilege between broker and customer<sup>23</sup> nor between banker and depositor<sup>24</sup> is available for immunity purposes. The practice is to honor priest-penitent, doctor-patient, and husband-wife confidential communications, but foreign bank secrecy laws and related secrecy statutes will offer no protection from the production of records relating to securities transactions within the United States.<sup>25</sup>

Since the federal perjury laws apply to testimony given before the Commission,<sup>26</sup> client candor is particularly important so that counsel will have the best information from which to determine whether to claim the privilege for his client before allowing him to testify.

It should be noted that while the SEC has the power to compel a witness to testify by granting immunity, in the author's experience the SEC attorney taking the deposition is not given the power to grant such immunity.

## 2. *The Subpoena Power*

The Commission has the power to issue subpoenas requiring sworn testimony and the production of books, records and other documents which the Commission deems relevant or material to the subject matter under inquiry.<sup>27</sup> This power applies both to named parties to a proceeding and to third persons.<sup>28</sup>

To validly issue subpoenas, the Commission need not show violations or even probable violations of the securities laws.<sup>29</sup> And the breadth of a subpoena duces tecum will not affect its validity so long as it indicates the subject matter of the inquiry and describes the documents or other records so that they may be readily identified.<sup>30</sup> The determination of the relevancy, materiality and necessity of evidence and of the need for issu-

20. *United States v. Austin-Bagley Corp.*, 31 F.2d 229 (2d Cir.), *cert. denied*, 279 U.S. 863 (1929). *See also* *Essgee Co. of China v. United States*, 262 U.S. 151 (1923).

21. *In re Rashba & Pokart*, 271 F. Supp. 946 (S.D.N.Y. 1967).

22. *Id.*

23. *McMann v. SEC*, 87 F.2d 377 (2d Cir.), *cert. denied*, 301 U.S. 684 (1937).

24. *See, e.g., Galbraith v. United States*, 387 F.2d 617 (10th Cir. 1968).

25. *Fontaine v. SEC*, 259 F. Supp. 880 (D.P.R. 1966).

26. *United States v. Batten*, 226 F. Supp. 492 (D.D.C. 1964), *cert. denied*, 380 U.S. 912 (1965).

27. 15 U.S.C. § 78u(b) (1970); 17 C.F.R. § 201.14(b)(1) (1972); R.P. 14(b)(1).

28. *McGarry v. SEC*, 147 F.2d 389 (10th Cir. 1945).

29. *Mines & Metals Corp. v. SEC*, 200 F.2d 317 (9th Cir. 1952); *Consolidated Mines v. SEC*, 97 F.2d 704 (9th Cir. 1938). *See also* *Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186 (1946).

30. *See, e.g., SEC v. Vacuum Can Co.*, 157 F.2d 530 (7th Cir. 1946), *cert. denied*, 330 U.S. 820 (1947).

ing a subpoena may be delegated to an employee of the Commission.<sup>31</sup> This power to issue and enforce subpoenas has been held consistent with the fourth amendment guarantee against unreasonable search and seizure.<sup>32</sup>

Any party to a quasi-judicial proceeding may request the officer conducting the proceeding to issue a subpoena, which request will be granted unless patently oppressive or unreasonable.<sup>33</sup> However, the officer may require that the party requesting the subpoena advance the reasonable costs of transporting any documents subpoenaed.<sup>34</sup> A party whose request for the issuance of a subpoena has been denied by the officer may appeal to the Commission.<sup>35</sup> A witness subpoenaed by a party may move the Commission's hearing officer either to quash or to modify a subpoena.<sup>36</sup>

In the event of a witness's refusal to respond to a subpoena, the Commission may apply for enforcement of the subpoena to the federal district court within the jurisdiction in which the witness is found or resides.<sup>37</sup> Generally, in such an enforcement action, the district court will grant full remedial relief to the Commission.<sup>38</sup> The failure to obey the court's order is then punishable as contempt.<sup>39</sup> It has been held to be an abuse of discretion for a district court to only fine a disobedient witness and to fail to grant any coercive relief designed to force compliance with the subpoena.<sup>40</sup> A witness may not appeal to a federal court to quash a Commission subpoena, except by way of defending an enforcement proceeding brought against him by the Commission.<sup>41</sup>

## C. INVESTIGATIONS

### 1. *Nature and Scope of the Power*

The power of the Commission to conduct investigations is similar to that of a grand jury:

It has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or contro-

31. *Woolley v. United States*, 97 F.2d 258 (9th Cir.), *cert. denied*, 305 U.S. 614 (1938).

32. *Newfield v. Ryan*, 91 F.2d 700 (5th Cir.), *cert. denied*, 302 U.S. 729 (1937); *McMann v. SEC*, 87 F.2d 377 (2d Cir.), *cert. denied*, 301 U.S. 684 (1937). Of course, a subpoena could be so oppressive as to violate the fourth amendment. *See Hale v. Henkel*, 201 U.S. 43 (1906); *SEC v. Bourbon Sales Corp.*, 47 F. Supp. 70 (W.D. Ky. 1942).

33. 17 C.F.R. § 201.14(b)(1) (1972); R.P. 14(b)(1).

34. *Id.*

35. *Id.*

36. 17 C.F.R. § 201.14(b)(2) (1972); R.P. 14(b)(2).

37. The enforcement section of the Securities Act of 1933 is § 22(b), 15 U.S.C. § 77v(b) (1970).

38. *Id.*; *SEC v. Brigadoon Scotch Distrib. Co.*, CCH FED. SEC. L. REP. ¶ 94,017 (2d Cir. 1973).

39. Securities Act of 1933 § 22(b), 15 U.S.C. § 77v(b) (1970).

40. *Penfield Co. v. SEC*, 330 U.S. 585 (1947).

41. *SEC v. Isbrandtsen*, 245 F. Supp. 518 (S.D.N.Y. 1965).

versy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties are delegated by statute to an administrative body, it, too, may take steps to inform itself as to whether there is probable violation of the law.<sup>42</sup>

Only the Commission has the power to initiate and conduct investigations of matters under its jurisdiction. No court may make such an investigation, and a court is without power to direct the Commission, at the instance of a private petitioner or on its own motion, to initiate an investigation.<sup>43</sup> No court has injunctive power over any Commission proceeding or the power to control the conduct of a Commission investigation.<sup>44</sup> However, the Commission is subject to judicial power when it oversteps its jurisdiction or attempts to extend its power beyond that provided by law.<sup>45</sup> The Commission's decision to undertake an investigation is merely interlocutory and, thus, is not reviewable in the courts.<sup>46</sup>

## 2. Procedure and Practice

There are various sources which may alert the Commission to possible violations of the federal securities acts. These sources include inquiries and complaints of investors and the general public, surprise inspections of the books and records required to be kept by those dealing in securities, and the general surveillance and analysis of fluctuations in particular stocks which appear not to be the result of known developments affecting the issuing company or of general market trends.<sup>47</sup> Investigations are primarily conducted by the regional offices of the Commission.<sup>48</sup> If there is an indication of a violation of the law, the regional office or the appropriate division of the Commission staff will open an investigation file and assign a two-man team to investigate the matter.<sup>49</sup>

42. *United States v. Morton Salt Co.*, 338 U.S. 632, 642-43 (1950). This language, although written about the Federal Trade Commission, is an excellent statement of the nature of agency investigatory power.

43. *Crooker v. SEC*, 161 F.2d 944 (1st Cir. 1947); *Webster Eisenlohr, Inc. v. Kalodner*, 145 F.2d 316 (3d Cir. 1944), *cert. denied*, 325 U.S. 867 (1945).

44. *SEC v. Harrison*, 80 F. Supp. 226 (D.D.C. 1948). An exception to this rule should be applied where the Commission has sought an injunction in a district court and then, during the pendency of such action, tries to initiate a private investigation into matters raised by the Commission's complaint. The district court should require the Commission to discover only in compliance with the Federal Rules of Civil Procedure. Such a protective order was entered in *SEC v. Glenn W. Turner Enterprises, Inc.*, 348 F. Supp. 766 (D. Ore. 1972).

45. *See Newfield v. Ryan*, 91 F.2d 700 (5th Cir.), *cert. denied*, 302 U.S. 729 (1937), and cases cited therein at 703-04.

46. *SEC v. Andrews*, 88 F.2d 441 (2d Cir. 1937).

47. 11 H. SOWARDS, *BUSINESS ORGANIZATIONS [SECURITIES REGULATION]* § 1.03[2][b] (1971) [hereinafter cited as SOWARDS].

48. *Id.*

49. 11A E. GADSBY, *BUSINESS ORGANIZATIONS [SECURITIES REGULATION]* § 9.02[1][a] (1973) [hereinafter cited as GADSBY].

The first stage of investigation is informal. No process is issued, no witnesses are sworn, and no testimony is taken. Witnesses are interviewed by the investigators of the Commission, who make notes and sometimes take notarized statements.<sup>50</sup> In this informal stage, neither the person who complained to the Commission nor those complained of are apprised of the existence or scope of the investigation.<sup>51</sup> Even when a formal investigation is commenced, all proceedings are private.<sup>52</sup> This policy of secrecy is intended to protect those who, although not guilty of any actionable misconduct, would be seriously injured if it became publicized that they were somehow involved in a Commission investigation, and also to obtain the best results. It is the Commission's experience that private inquiry is more effective, since witnesses will be more candid if they know that their statements will be kept in strictest confidence.<sup>53</sup>

Commission examinations in investigations at first may appear to raise severe *Miranda*<sup>54</sup> problems. However, one circuit court of appeals has held that such testimony is exempt from the formal warning requirements because it is not given while the individual is "in custody."<sup>55</sup> Nevertheless, should the Commission formalize a "warning" procedure, failure to comply with such a rule could lead to suppression of the testimony.<sup>56</sup>

In addition to the power of secrecy, the Commission also has the equally effective power to make all such information public.<sup>57</sup> As a rule, however, the Commission does not make any information public until quasi-judicial proceedings are brought. A Commission employee will not honor any request, even through a subpoena, to furnish information obtained in an investigation, unless the release of such information has been expressly authorized by the Commission.<sup>58</sup> This right to refuse to divulge information has been upheld in the federal courts.<sup>59</sup>

If, as a result of the informal inquiry, the investigators obtain evidence that, in their opinion, indicates the presence of a violation of the securities laws, they will submit their information to the Commission with a recommendation that a formal investigation be instituted. If the Commission concurs in this decision, it will issue a formal order authorizing a formal investigation.<sup>60</sup> The purpose of a formal investigation is to both

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50. *Id.*

51. *Id.*

52. 17 C.F.R. §§ 203.2, 203.5 (1972); R.R.I. 2 and 5.

53. Levenson, *Administrative Procedures in Connection with Investigations and Hearings Under the Securities Act of 1933*, in SECURITIES LAWS & REGULATIONS INSTITUTE 109, 114-15 (H. Sowards ed. 1967) [hereinafter cited as Levenson].

54. *Miranda v. Arizona*, 384 U.S. 436 (1966).

55. *Dosek v. United States*, 405 F.2d 405 (8th Cir. 1968); see also *SEC v. Dott*, 302 F. Supp. 169 (S.D.N.Y. 1969).

56. See *United States v. Heffner*, 420 F.2d 809 (4th Cir. 1970) (IRS).

57. 17 C.F.R. § 203.5 (1972); R.R.I. 5.

58. SOWARDS, *supra* note 47, at § 10.02[1].

59. Appeal of SEC, 226 F.2d 501 (6th Cir. 1955). But see *NLRB v. Capitol Fish Co.*, 294 F.2d 868 (5th Cir. 1961).

60. SOWARDS, *supra* note 47, at § 10.02[1].



determine whether there has been a violation of the law and to gather evidence as to the violation's existence.<sup>61</sup>

The formal order defines the scope of the inquiry by specifying which questions of fact and law are to be investigated.<sup>62</sup> It also designates the members of the Commission's staff who will be empowered to conduct the proceedings, issue subpoenas, place witnesses under oath, and take testimony.<sup>63</sup> This formal order is not served upon those under investigation. However, the rules provide that any witness in a formal investigation may examine the order upon a request made to the Commission.<sup>64</sup> Unless unusual circumstances can be shown, no one outside the Commission is allowed to retain a copy of this formal order.<sup>65</sup>

An official transcript and record are made of the proceedings. Such proceedings are nonpublic, and the record is confidential.<sup>66</sup>

A person subpoenaed to appear in these proceedings has the right to counsel.<sup>67</sup> If a witness appears without counsel, the officer in charge of the proceeding will instruct the witness of his right to have counsel, and the witness will be allowed to obtain counsel if he so desires before he is sworn in and examined. However, a witness cannot demand that the Commission furnish him with counsel.<sup>68</sup>

The witness's right to counsel is limited to the following: counsel may advise the witness before, during and after the examination; counsel may ask his client questions at the conclusion of the examination to clarify any of the answers given; and counsel may make summary notes during the examination solely for the use of his client.<sup>69</sup> Counsel for the witness does not have the right to object to questions, to cross-examine any other witnesses, or even to be present when other witnesses are testifying.<sup>70</sup>

The Commission's formal investigatory procedures apparently measure up to due process requirements. In *Hannah v. Larche*,<sup>71</sup> the United States Supreme Court explained that, pursuant to *Greene v. McElroy*,<sup>72</sup> questions of procedural due process in administrative proceedings were to be resolved through a two-step analysis: (1) Did the President or Congress authorize the procedures being employed? If so, (2) are such procedures consistent with the due process clause of the fifth amendment? In

61. *Id.* at §§ 1.03[2][c], 10.02[1]. See *Woolley v. United States*, 97 F.2d 258 (9th Cir.), *cert. denied*, 305 U.S. 614 (1938), to the effect that this SEC function resembles that of a grand jury.

62. GADSBY, *supra* note 49, at § 9.02[2].

63. *Id.* at § 9.02[1][b].

64. 17 C.F.R. § 203.7(a) (1972); R.R.I. 7(a).

65. *Id.*

66. 17 C.F.R. §§ 203.2, 203.5 (1972); R.R.I. 2 and 5.

67. 17 C.F.R. § 203.7(b) (1972); R.R.I. 7(b).

68. *Boruski v. SEC*, 340 F.2d 991 (2d Cir.), *cert. denied*, 381 U.S. 917 (1965).

69. 17 C.F.R. § 203.7(c) (1972); R.R.I. 7(c).

70. 17 C.F.R. § 203.7(b)-(c) (1972); R.R.I. 7(b)-(c); *SEC v. Isbrandtsen*, 245 F. Supp. 518 (S.D.N.Y. 1965).

71. 363 U.S. 420 (1960).

72. 360 U.S. 474 (1959).

*Hannah*, the Court analyzed the investigative procedures of the Civil Rights Commission, which did not provide a right of cross-examination. After answering the threshold question of authorization affirmatively, the Court proceeded to find no due process limitations, based upon a distinction between *adjudicative* proceedings and *investigative* proceedings. In holding that all of the due process essentials of an adjudicatory proceeding were not necessary in a mere *investigatory* proceeding, the Court, in the strongest possible dictum, placed the stamp of approval on the Commission's investigative procedures:

Another regulatory agency which distinguishes between adjudicative and investigative proceedings is the Securities and Exchange Commission. . . . Although the Commission's Rules provide that parties to adjudicative proceedings shall be given detailed notice . . . and a right to cross-examine witnesses . . . those provisions of the Rules are made specifically inapplicable to investigations. . . .<sup>73</sup>

However, in an appendix to *Hannah* in which the Supreme Court delineated the investigative procedures of the various agencies, the Court stated:

It should be noted, however, that the Securities and Exchange Commission, unlike the Civil Rights Commission, is an adjudicatory body, and it may use the information gathered through investigative proceedings to initiate 'administrative proceedings . . . injunction proceedings . . . [or] criminal prosecution.'<sup>74</sup>

Despite the formal strictures placed on counsel, as a matter of practice the Commission allows the counsel for a witness to state objections to questions and his reasons for same. Furthermore, especially if a witness testified to matters which may result in liability, his counsel is allowed a reasonable opportunity to produce any additional explanatory testimony or documentary evidence.<sup>75</sup>

The right to counsel in a formal investigation is further limited by the "sequestration of witnesses" rule.<sup>76</sup> All witnesses are sequestered during the examinations, and, unless permitted in the discretion of the officer in charge, no witness or counsel is permitted to be present during the examination of any other witness.<sup>77</sup> The officer in charge has the power to exclude counsel from representing a particular witness if such representation would infringe on the sequestration rule.<sup>78</sup> These rules have created considerable controversy.

While an official Commission position on sequestration cannot defi-

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73. *Hannah v. Larche*, 363 U.S. 420, 446-47 (1960).

74. *Id.* at 461, 463.

75. Levenson, *supra* note 53, at 121.

76. 17 C.F.R. § 203.7(b) (1972); R.R.I. 7(b).

77. *Id.*

78. *United States v. Steel*, 238 F. Supp. 575 (S.D.N.Y. 1965).

nately be stated, one high-ranking Commission official states the rationale for the rule to be as follows:

This rule was designed to minimize the relaying of testimony from one witness to another witness. For example, an employee may be reluctant to testify fully when the employer, who is involved in the investigation, provides the same counsel for all employees. There was concern that choice of counsel by the employee would be dictated by fear of employer disfavor if counsel other than that of the employer was retained. . . .

This rule was not promulgated to infringe upon a witness's right to counsel. The rule was adopted primarily to permit the Commission to obtain the truth in investigations. Violations of the securities laws are often difficult to detect and require extensive investigation. It may be necessary to determine whether or not individuals are acting in concert. Investigations frequently are sought to be frustrated by non-cooperation and even subornation of perjury. The purpose of sequestration could be defeated by an attorney advising witnesses as to the testimony which had been given by others. This rule is also regarded as a form of regulation of the practice of the Commission bar.<sup>79</sup>

This rule has been upheld as not denying a witness the right to counsel of his choice, so long as the rule is applied reasonably.<sup>80</sup> In *SEC v. Higashi*,<sup>81</sup> the appellate court laid down this "rule of reasonableness," while finding that the Commission's investigation officer had exceeded his discretion by prohibiting the counsel who represented a company and certain of its directors from representing another director.

A witness who is compelled to submit data or other evidence or testimony has the absolute right to inspect his testimony, and may request and receive, upon payment of the cost thereof, a transcript of his testimony. However, the Commission, for good cause, may deny his request for a copy of his testimony.<sup>82</sup> A staff attorney usually notifies counsel for the witness when his testimony has been transcribed, so that the witness may review the testimony and submit any corrections or additions thereto. This addendum is then made a part of the record.<sup>83</sup>

79. Levenson, *supra* note 53, at 118-19.

80. *SEC v. Higashi*, 359 F.2d 550 (9th Cir. 1966); *United States v. Steel*, 238 F. Supp. 575 (S.D.N.Y. 1965).

81. 359 F.2d 550 (9th Cir. 1966).

82. 37 Fed. Reg. 25165 (1972), *amending* 17 C.F.R. § 203.6 (1972). Whether the Commission will deny a witness's request to purchase a copy of his transcript will depend upon whether the Commission feels that the copy of the testimony will be used to defeat the discovery of essential facts in the investigation, *e.g.*, the transcript being made available to the persons whose activities are the subject of the investigation. *Id.* The Commission's denial is authorized by the Administrative Procedure Act, 5 U.S.C. § 555(c) (1970), and was upheld in *Commercial Capital Corp. v. SEC*, 360 F.2d 856 (7th Cir. 1966).

83. Levenson, *supra* note 53, at 123; GADSBY, *supra* note 49, at § 9.02[1][b].

## D. QUASI-JUDICIAL PROCEEDINGS

1. *General Procedure*

The Commission, after a review of the investigation proceedings, may issue an order for an administrative hearing.<sup>84</sup> In this hearing, the division of the Commission which conducted the investigation seeks to establish violations of law against individuals or companies and to have administrative sanctions imposed against such offenders.<sup>85</sup> This hearing is conducted like a nonjury trial, with each party having the right to present evidence and testimony and to cross-examine all witnesses.<sup>86</sup>

Notice of the hearing, along with a copy of the order, is given to each respondent named in the order. The order must contain a short and simple statement of the matters of fact and law to be determined at the hearing.<sup>87</sup> This order and the notice of hearing, unless otherwise ordered by the Commission,<sup>88</sup> are given general circulation by release to the public press.<sup>89</sup> Although all quasi-judicial proceedings are public<sup>90</sup> unless otherwise ordered by the Commission,<sup>91</sup> when all respondents request that the hearing be public the Commission has no power to conduct the hearing in private.<sup>92</sup>

The hearing is usually held in Washington, D.C. A respondent may obtain a change of location by application to the Commission if great inconvenience can be demonstrated.<sup>93</sup> Hearings involving common issues of fact or law may be consolidated on motion of the parties.<sup>94</sup> If one case is then dismissed, the hearing continues as to the other cases, subject to a motion to strike irrelevant and immaterial evidence.<sup>95</sup>

The hearings are conducted by a hearing officer, a Commission employee who has the title of "administrative law judge" and who serves in-

84. The Commission is also empowered, either as an alternative to an administrative hearing or in addition thereto, to bring an action in federal district court to enjoin violations of the securities statutes, or may transmit its evidence to the United States Attorney General who may, in his discretion, institute criminal proceedings. Securities Act of 1933, 15 U.S.C. § 77t(a)-(b) (1970); Securities Exchange Act of 1934, 15 U.S.C. §§ 78u(a), (e) (1970).

85. SOWARDS, *supra* note 47, at § 1.03[2][c].

86. 17 C.F.R. § 201.14(a) (1972); R.P. 14(a).

87. 17 C.F.R. § 201.6(a) (1972); R.P. 6(a). The copy of the order is routinely provided as a matter of practice, although the rule does not require it.

88. 17 C.F.R. § 201.6(c) (1972); R.P. 6(c).

89. *Id.* In certain proceedings parties may request that the notice and other papers be kept confidential, and the Commission, in its discretion, may grant the request. 17 C.F.R. § 201.25 (1972); R.P. 25.

90. *Id.*

91. 17 C.F.R. § 201.11(b) (1972); R.P. 11(b).

92. 17 C.F.R. § 201.25 (1972); R.P. 25.

93. 17 C.F.R. § 201.6(b) (1972); R.P. 6(b). Additionally, judicial relief from unreasonable subpoenas can be obtained. *E.g.*, *Bank of America v. Douglas*, 105 F.2d 100 (D.C. Cir. 1939).

94. 17 C.F.R. § 201.10 (1972); R.P. 10. *John A. Kaye*, 22 S.E.C. 632 (1946).

95. *Charles A. Massie*, 22 S.E.C. 857 (1946).

dependently of the office or division responsible for prosecuting the case.<sup>96</sup> The hearing officer passes on all interlocutory motions and on the admissibility of evidence.<sup>97</sup> He may certify an interlocutory question to the Commission for its review only under specified circumstances.<sup>98</sup>

## 2. *Who May Participate in the Hearing*

Any party respondent must file notice of appearance with the Commission within 15 days after service of the order or be considered in default.<sup>99</sup> Where a default occurs, the matter contained in the order may be taken as established and findings of fact and law may be entered.<sup>100</sup>

In addition to the original parties (*i.e.*, the division of the Commission which is prosecuting and the named respondents), any person who may be affected by an order may request the privilege to intervene and to be heard. The determination of whether a person should be allowed to intervene is at the complete discretion of the Commission and may not be appealed to the federal courts.<sup>101</sup> However, any interested governmental agency—local, state, or federal—is entitled to become a party to such proceedings merely by filing a notice of appearance.<sup>102</sup> The conduct of the case, regardless of any intervention, remains within the control of the original named parties.<sup>103</sup> If the intervenor, upon written application, can demonstrate to the Commission's satisfaction that leave to be heard is inadequate and that his full participation is in the public interest, he may be permitted to participate as a party.<sup>104</sup> The Commission may at any time review the order of the hearing officer allowing intervention, and modify it in any way it sees fit.<sup>105</sup>

In addition to allowing intervention, the hearing officer may allow a person who has not filed for intervention to state his views at the hearing.<sup>106</sup> However, such statements are not considered independently as evidence unless offered and admitted as evidence of the truth of the statements therein made.<sup>107</sup>

96. 17 C.F.R. § 201.11(b) (1972); R.P. 11(b). This rule was amended on September 27, 1972, changing the designation of "hearing examiner" to that of "administrative law judge." 37 Fed. Reg. 23826 (1972), *amending* 17 C.F.R. § 201.11(b) (1972).

97. 37 Fed. Reg. 23826 (1972), *amending* 17 C.F.R. § 201.11(e) (1972).

98. 17 C.F.R. § 201.12(a) (1972); R.P. 12(a).

99. 17 C.F.R. § 201.6(e) (1972); R.P. 6(e).

100. *Id.*

101. 17 C.F.R. § 201.9(c) (1972); R.P. 9(c); *Okin v. SEC*, 143 F.2d 960 (2d Cir. 1944).

102. 17 C.F.R. § 201.9(a) (1972); R.P. 9(a); *see, e.g.*, *The Middle West Corp.*, 11 S.E.C. 355 (1942).

103. 17 C.F.R. § 201.9(d) (1972); R.P. 9(d).

104. 17 C.F.R. § 201.9(e) (1972); R.P. 9(e).

105. 17 C.F.R. § 201.9(h) (1972); R.P. 9(h).

106. 17 C.F.R. § 201.9(f) (1972); R.P. 9(f).

107. *Id.*

### 3. *Discovery by the Parties*

The parties are allowed to preserve testimony either by oral deposition<sup>108</sup> or by written interrogatory,<sup>109</sup> upon a showing to the hearing officer that the witness may not or will not be able to attend the hearing, that his testimony is material to the proceeding, and that in the interest of justice his deposition should be taken.<sup>110</sup> The request to take a deposition must be in writing and must specify the matters to which the witness will testify, and the time and place proposed for the taking of the deposition.<sup>111</sup>

Formerly, a party was provided no right to discover any part of the Commission's case.<sup>112</sup> Now, however, the hearing officer may, at his discretion, and either at the request of any party or sua sponte, order the interested division to furnish any or all of the following: An outline of its case or defense, the legal theories upon which it will rely, the identity of witnesses who will testify on its behalf, and copies of or a list of the documents which it intends to introduce at the hearing.<sup>113</sup> In a proceeding involving more than one respondent the administrative law judge may, at his discretion, require the Commission staff to indicate the respondent against whom evidence will be presented, and this must be done at least one day prior to the presentation of that evidence.<sup>114</sup>

After a witness who has been called by the interested division has given direct testimony, any party may request and obtain the production of any statement of such witness pertaining to his direct testimony which is in the possession of the interested division.<sup>115</sup> It should be noted, however, that even this right to review statements is strictly limited to matters covered in the witness's direct testimony before the hearing officer and applies only after the witness has testified.<sup>116</sup>

### 4. *Pleadings*

A respondent is *not* required to answer the order of the Commission unless the order specifically directs that an answer be made.<sup>117</sup> If an

108. 17 C.F.R. § 201.15(a) (1972); R.P. 15(a).

109. 17 C.F.R. § 201.15(g) (1972); R.P. 15(g).

110. 17 C.F.R. § 201.15(a) (1972); R.P. 15(a).

111. *Id.*

112. *Steadman Security Corp. v. SEC*, [1972-73 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,735 (D.D.C. 1973). The court held that the documents requested by plaintiffs, who were respondents in an administrative proceeding before the Commission, were investigatory files compiled for law enforcement purposes and therefore exempt from disclosure under the Freedom of Information Act. The district court also held that it had no jurisdiction to review the administrative law judge's denial of plaintiffs' request for disclosure.

113. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.8(d) (1972).

114. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.11(d) (1972).

115. 17 C.F.R. § 201.11.1 (1972); R.P. 11.1. This right is further expressly limited by all of the applicable provisions of the Jencks Act, 18 U.S.C. § 3500 (1970).

116. 17 C.F.R. § 20.11.1 (1972); R.P. 11.1.

117. 17 C.F.R. § 201.7(a) (1972); R.P. 7(a).

answer is required, it must be filed within 15 days after service of the order upon the respondent.<sup>118</sup> The answer must admit, deny, or state that the party does not have and is unable to obtain sufficient information to admit or deny, each allegation in the order.<sup>119</sup> A statement of lack of information is taken as a denial,<sup>120</sup> and any allegation which is not denied is taken as admitted.<sup>121</sup> Failure to timely file a required answer results in the respondent being deemed to be in default.<sup>122</sup> The proceeding then may be determined against him by the Commission upon consideration of the order alone, the allegations of which may be deemed to be true.<sup>123</sup>

While a party has had the right to file a motion for a more definite statement of specified matters of fact or law to be considered or determined,<sup>124</sup> a review of the Commission's decisions reveals that in the past the chances for getting a more definite statement were almost nonexistent.<sup>125</sup> However, the Rules of Practice have been amended to make it clear that the hearing officer may, in appropriate cases, require pretrial discovery.<sup>126</sup> The Commission's position has been that a respondent is entitled to be sufficiently informed of the charges against him so that he may adequately prepare his defense, but that he is not entitled, as a matter of right, to disclosure of evidence in advance of the hearing.<sup>127</sup> In its release announcing the amendment to Rule 8(d),<sup>128</sup> the Commission indicated that it now favors a more liberal treatment of parties' motions for more definite statements under Rule 7(d).<sup>129</sup>

It should be noted that, for all the suggestive language in its release, the Commission declined to *require* pre-hearing disclosure by the parties, and the Commission also failed to implement in its administrative proceedings the pre-hearing disclosure of exculpatory evidence, as required in the federal trial courts under the rules of *Brady v. Maryland* and *Giles v. Maryland*.<sup>130</sup>

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118. 17 C.F.R. § 201.7(b) (1972); R.P. 7(b). The period may be altered by rule or by order. *Id.*

119. 17 C.F.R. § 201.7(c) (1972); R.P. 7(c).

120. *Id.*

121. *Id.*

122. 17 C.F.R. § 201.7(e) (1972); R.P. 7(e).

123. 17 C.F.R. § 201.7(e) (1972); R.P. 7(e). *E.g.*, Diversified Sec. Corp., SEC Securities Exchange Act Release No. 7489 (Dec. 23, 1964).

124. 17 C.F.R. § 201.7(d) (1972); R.P. 7(d).

125. 3 L. LOSS, SECURITIES REGULATION 1904 (2d ed. 1961). *See, e.g.*, Sterling Sec. Co., 37 S.E.C. 825 (1957); Charles C. Wright, 1 S.E.C. 482 (1936).

126. *See* note 109 *supra* and accompanying text.

127. Charles M. Weber, 35 S.E.C. 79 (1953); Michael J. Meehan, 1 S.E.C. 238 (1935).

128. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.8(d) (1972).

129. 17 C.F.R. § 201.7(d) (1972).

130. 373 U.S. 83 (1963); 386 U.S. 66 (1967). Such pre-hearing disclosure has been advocated by the Administrative Conference of the United States, DISCOVERY IN AGENCY ADJUDICATION, 1 RECOMMENDATIONS AND REPORTS OF THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, January 8, 1968-June 30, 1970, Recommendation No. 21, at 571 (1971), and by the practicing securities bar, Mathews, *A Practitioner's Comments on SEC Enforcement Policies, Practices and Procedures*, in CHANGES IN SECURITIES LAW ENFORCEMENT AND LITIGATION 89, 100-06 (N.Y.L.J. 1972).

The hearing officer, for cause shown, may grant a motion for an amendment to the matters to be considered at the hearing at any time after the commencement of the hearing and prior to the filing of an initial decision, or, if no initial decision is to be filed, prior to the time fixed for the filing of final briefs with the Commission.<sup>131</sup> The Commission may, at any time, allow an amendment to the matters to be considered.<sup>132</sup> As a general rule, the Commission staff will file a motion to amend with the hearing officer when the proposed new matter is within the framework of the original order for proceedings issued by the Commission. If the amendment seeks to add new matter which is not within the scope of the original order, the staff will submit its motion to amend to the Commission.<sup>133</sup> In the opinion of one authority, the possibility of unfair surprise due to this liberal amendment procedure is softened by the Commission's practice of granting continuances where bona fide surprise to a party results from an amendment.<sup>134</sup>

### 5. Settlements

At any time during the course of the proceedings, a party may submit an offer of settlement, in writing, to the interested division of the Commission. The interested division presents the offer of settlement to the Commission when its recommendation is favorable. However, when the recommendation is unfavorable, it will present the settlement offer to the Commission only if the party making the offer so requests. If the interested parties agree and so request, the hearing officer may express his views regarding the appropriateness of any settlement offer. The request for such an expression of opinion by the hearing officer constitutes a waiver by the parties of any right to claim prejudice by the hearing officer based upon the views he expresses. The hearing officer has the discretion as to whether to express his views on a settlement offer. The Commission, if it deems it appropriate, may allow the party making the offer the opportunity to make an oral presentation to the Commission on the offer. When the Commission rejects a settlement offer, the offer is deemed

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131. 37 Fed. Reg. 23827 (1972), amending 17 C.F.R. § 201.6(d) (1972).

132. *Id.*

133. *Id.*

134. GADSBY, *supra* note 49, at § 9.02[2][a][i]. Extension of Time and Adjournments, 17 C.F.R. § 201.13 (1972), was amended on Sept. 27, 1972, as follows: paragraph (b) was deleted, and paragraph (c) was redesignated as paragraph (b) and was amended to read:

(b) *Limitations on postponements and adjournments.* A hearing before a hearing officer shall begin at the time and place ordered by the Commission, provided that, within the limits provided by statute, the hearing officer may for good cause postpone the commencement of the hearing for a reasonable period of time or change the place of hearing. Any convened hearing may be adjourned to such time and place as may be ordered by the Commission or by the hearing officer. It is the policy of the Commission that such postponements or adjournments should normally not exceed 30 days. If the hearing officer orders a postponement or an adjournment for a period exceeding 30 days, the reasons for so doing shall be stated in his order.

37 Fed. Reg. 23827, 23829 (1972), amending 17 C.F.R. § 201.13 (1972).



withdrawn, and the offer and any document relating thereto is not included in the record of the proceedings. The acceptance by the Commission of an offer of settlement is not final unless it is made in its formal findings and opinion issued on the proceedings.<sup>135</sup>

### 6. *Proof and Evidence*

The hearing officer rules on all matters of admissibility of evidence.<sup>136</sup> The common law rules of evidence have only limited application to the hearing.<sup>137</sup> While immaterial and irrelevant material should be excluded by the hearing officer, the admission of such evidence does not constitute grounds for reversal of a finding of fact or law made by him if, on the whole, the order was based on and supported by such relevant and material evidence as a "reasonable mind might accept as adequate to support a conclusion."<sup>138</sup> However, the administrative findings may not be based exclusively on uncorroborated hearsay.<sup>139</sup>

### 7. *The Hearing Officer's Order and Commission Review*

A motion to dismiss the Commission's case may be made at the end of the Commission's staff's case or at the end of the proceedings.<sup>140</sup>

At the end of the hearing, the hearing officer consults with the parties and determines the period in which the parties will have to file proposed findings of fact and conclusions of law for the hearing officer's consideration.<sup>141</sup> These proposed findings and conclusions, supported by citations to authority and by argument, are usually required to be filed within 30 days after the conclusion of the hearing.<sup>142</sup> The parties' proposed findings and conclusions may be accepted or rejected, in whole or in part, by the hearing officer, or not considered at all in arriving at his opinion.

The record of the hearing is served upon the hearing officer promptly after the end of the period allowed for the filing of the party's proposed findings and conclusions.<sup>143</sup> The hearing officer must file his initial decision with the Secretary of the Commission within 30 days after service

135. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.8(a) (1972).

136. 3 L. LOSS, *SECURITIES REGULATION* 1908 (2d ed. 1961).

137. *FTC v. Cement Institute*, 33 U.S. 683 (1948); *Archer v. SEC*, 133 F.2d 795 (8th Cir.), *cert. denied*, 319 U.S. 767 (1943).

138. *Willaport Oysters, Inc. v. Ewing*, 174 F.2d 676, 691 (9th Cir.), *cert. denied*, 338 U.S. 860 (1949) *quoting* *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938).

139. *American Natural Gas Co.*, 36 S.E.C. 387 (1955). *See also* *Bridges v. Wixon*, 326 U.S. 135 (1945).

140. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.11(e) (1972).

141. 17 C.F.R. § 201.16(d)-(e) (1972); R.P. 16(d)-(e).

142. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.16(e) (1972). This amendment eliminated the 60 day maximum time within which the hearing officer could allow the first filing, substituting a recommended 30 days with discretion to allow any additional time, provided the officer recites his reasons in the order setting the time for briefs.

143. 17 C.F.R. § 201.16(f) (1972); R.P. 16(f).

upon him of the hearing record.<sup>144</sup> During the 30-day period in which the hearing officer has to write his opinion, the parties may request, or the hearing officer may request of the parties, additional oral argument on the subject matter of the hearing, which takes place at his discretion.<sup>145</sup>

The hearing officer's initial decision must include findings and conclusions, with the reasons therefor, upon all material issues of fact, law and discretion presented in the record. The decision must also contain an appropriate order and a statement of the rules governing appeals from the order.<sup>146</sup>

The initial decision may be reviewed by the Commission either upon petition filed by a party within 15 days of service of the decision on the party,<sup>147</sup> or upon the Commission's own order, made within 30 days after service of the decision on all parties.<sup>148</sup> A petition for review must contain specific exceptions to the findings and conclusions of the hearing officer's order and state the reasons for such exceptions.<sup>149</sup> Any exception omitted from the petition is waived and may be disregarded by the Commission on review.<sup>150</sup> The Commission may decline to grant a petition for review.<sup>151</sup>

The petitioner and those other parties supporting reversal or modification of the decision must file briefs with the Commission within 30 days after the Commission's order granting review.<sup>152</sup> All other parties must file their reply briefs within 30 days after service of the original briefs.<sup>153</sup> When the Commission orders review on its own motion, all briefs are due within 30 days of service of the order of review.<sup>154</sup> Any reply briefs must be filed within 30 days after service of the brief replied to.<sup>155</sup>

144. *Id.*

145. 17 C.F.R. § 201.16(g) (1972); R.P. 16(g).

146. 17 C.F.R. § 201.16(a) (1972); R.P. 16(a).

147. 17 C.F.R. § 201.17(b) (1972); R.P. 17(b). "Substantial compliance" with time periods is required. *Breeze Corps.*, 3 S.E.C. 709 (1949).

148. 17 C.F.R. § 201.17(c) (1972); R.P. 17(c).

149. 17 C.F.R. § 201.17(b) (1972); R.P. 17(b). Lack of specificity and failure to file a satisfactory petition will result in the affirmance of the original decision. *See, e.g.*, *Broadwall Sec., Inc.*, SEC Securities Exchange Act Release No. 7556 (Mar. 12, 1965).

150. 17 C.F.R. § 201.17(b) (1972); R.P. 17(b).

151. 17 C.F.R. § 201.17(d) (1972); R.P. 17(d). However, this rule provides that review will be ordered where the initial decision involves: suspension, denial or revocation of a broker-dealer registration; suspension, denial or withdrawal of any registration; suspension or expulsion of a member of a national exchange; or suspension of trading.

Review will also be ordered if the petition makes a reasonable showing (1) of prejudicial error, or (2) that the initial decision embodies (a) a clearly erroneous finding or conclusion of a material fact, or (b) an erroneous legal conclusion, or (c) an act of discretion or decision of importance that should be reviewed. *Id.*

152. 17 C.F.R. § 201.17(e)(1) (1972); R.P. 17(e)(1). The briefs may exceed sixty pages in length only with permission of the Commission. 37 Fed. Reg. 23827 (1972), *amending* 17 C.F.R. § 201.22(d) (1972).

153. 17 C.F.R. § 201.17(e)(1) (1972); R.P. 17(e)(1).

154. 17 C.F.R. § 201.17(e)(2) (1972); R.P. 17(e)(2).

155. *Id.* Untimely filed briefs will be received only upon special permission of the Commission. 17 C.F.R. § 201.18 (1972); R.P. 18.

The scope of the Commission's review is limited to the matters specified in the order for review.<sup>156</sup> However, the Commission, with appropriate notice to the parties, may revise that order and raise and determine any other matters which it deems material. The parties are afforded sufficient opportunity to brief and prepare for argument on such additional points.<sup>157</sup> The Commission will generally grant oral argument on review upon the written request of any party.<sup>158</sup>

After the Commission renders an opinion and order in the matter reviewed, any party can move for a rehearing within 10 days from the entry of the Commission's order and opinion.<sup>159</sup>

### 8. *Appeal from Commission Orders*

Any party<sup>160</sup> who considers himself aggrieved by a Commission order may appeal from that order to the federal court of appeals either in the circuit in which the party resides or in the District of Columbia.<sup>161</sup> The petition for appeal must be filed within 60 days after entry of the Commission order complained of or within 60 days after entry of an order by the Commission denying a petition for rehearing.<sup>162</sup> This appeal time is jurisdictional and may not be extended by the federal court.<sup>163</sup>

The order of the Commission appealed from must be a final order, as that term is used in the federal rules of civil procedure. Thus, orders initiating preliminary investigations and the like do not sufficiently "aggrieve" parties so as to make appeal proper, regardless of adverse publicity and loss of time resulting from such orders.<sup>164</sup> In considering the appeal, the court of appeals will use such well-established principles of administrative law as the "substantial evidence" rule, the "relevance of administrative history and practice" rule, and the "right of an agency to select its own remedy" rule.<sup>165</sup>

156. 17 C.F.R. § 201.17(g)(1) (1972); R.P. 17(g)(1).

157. *Id.*

158. 17 C.F.R. § 201.21(a) (1972); R.P. 21(a).

159. 17 C.F.R. § 201.21(e) (1972); R.P. 21(e). Specificity in the petition as to matter sought to be reheard is essential. *Id.*

160. *Wallach v. SEC*, 206 F.2d 486 (D.C. Cir. 1953). No one has the right to appeal unless he has been a party respondent to the proceedings.

161. 15 U.S.C. § 78y(a) (1970).

162. *Samuel B. Franklin & Co. v. SEC*, 290 F.2d 719 (9th Cir. 1961), *construing* § 25(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78y(a) (1970).

163. *Columbia Oil & Gas Corp. v. SEC*, 134 F.2d 265 (3d Cir. 1943).

164. *Stardust, Inc. v. SEC*, 225 F.2d 255 (9th Cir. 1955); *Okin v. SEC*, 143 F.2d 943 (2d Cir. 1944). *But see* *Medical Committee for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970) (appeal proper where Commission action dispositive of proceeding without formal order).

165. *Capital Funds, Inc. v. SEC*, 348 F.2d 582 (8th Cir. 1965); *Archer v. SEC*, 133 F.2d 795 (8th Cir. 1943); *GADSBY*, *supra* note 49, at § 9.02[2][c].

## E. CONCLUSION

In its report dated June 1, 1972, the Advisory Committee on Enforcement Policies and Practices, which was appointed to review and evaluate the Commission's enforcement policies and practices, made several recommendations designed to afford persons under investigation by the Commission an opportunity, through formal procedures, to present their position to the Commission prior to the authorization of an enforcement proceeding.<sup>166</sup> The Committee's recommendations, in general, would have required that a prospective defendant or respondent be given notice of the Commission staff's charges and proposed enforcement recommendation, and be given an opportunity to submit a written statement to the Commission which would accompany the staff's recommendation. While the Securities Act of 1933<sup>167</sup> and the Securities Exchange Act of 1934<sup>168</sup> provide that the Commission, in its discretion, can require or permit a person under investigation to file a written statement concerning the matter under investigation, the Commission and its staff generally elect to keep secret the subject matter of the investigation and the persons under investigation. The objective of the recommended procedure was to allow the Commission the benefit of both the staff's and the adverse party's contentions concerning the matters involved in the staff's enforcement recommendation, prior to the Commission's authorizing an enforcement proceeding. While the Commission agreed with the objective of the recommendations, it declined to adopt formal rules embodying the Committee's recommendations, stating that "it believes it necessary and proper that the objective be attained, where practicable, on a strictly informal basis in accordance with procedures which are now generally in effect."<sup>169</sup>

Under present procedure, the decision as to whether or not to inform persons under investigation as to the nature of the charges against them is left to the discretion of the Commission staff. The Commission should incorporate the Committee's recommendations into its rules, since such a procedure would provide the Commission with a more complete presentation of the matter prior to its having to decide whether to authorize an enforcement proceeding.

The Committee also recommended to the Commission that it adopt the practice of notifying a person who is the subject of an investigation and against whom no further action is contemplated, that the staff has concluded its investigation of the matters referred to in the investigative order and has determined that it will not recommend the commencement

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166. REPORT OF THE SEC'S ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES (June 1, 1972), in CHANGES IN SECURITIES LAW ENFORCEMENT AND LITIGATION 7, 48 (N.Y.L.J. 1972).

167. 15 U.S.C. § 77t(a) (1970).

168. 15 U.S.C. § 78u(a) (1970).

169. SEC Securities Act Release No. 5310, at 2 (Sept. 27, 1972).

of an enforcement proceeding against him.<sup>170</sup> The Commission declined to adopt a rule requiring such a procedure in every case, but has instructed its staff that they have sole discretion to advise a person under investigation that the formal investigation has been terminated if such advice is deemed appropriate.<sup>171</sup> The Commission has emphasized that such a notice should not be construed as indicating that the party has been exonerated or that no action will ever be brought as a result of the staff's investigation of that particular matter.

The area in most urgent need of revision is that of pre-hearing disclosure by the parties of witness lists, copies of documents to be offered into evidence, copies of witnesses' statements and exculpatory evidence. In light of the severe sanctions which may be imposed upon respondents as a result of the Commission's quasi-judicial proceedings, the Commission should implement rules requiring such pre-hearing disclosure. Under the present rules, where no such disclosure is required, a respondent is severely limited in his ability to defend against the Commission's staff's charges. Such pre-hearing disclosure would not only insure that the person charged would receive a fair chance to defend himself, but would also enhance the probability that the full facts of the case would be brought out in the hearing. Pre-trial disclosure of evidence has proven to be a great aid to the fair and efficient administration of justice in the federal courts in both civil and criminal cases, and it is submitted that such pre-hearing disclosure in SEC proceedings would have the same beneficial effect.

The decision as to whether or not to advise a client who has been subpoenaed to give testimony in an investigation to invoke his fifth amendment privilege against self incrimination must be made only after a careful review by counsel of the client's knowledge of the matter under investigation, the apparent extent of his involvement, and his status as a registered broker, dealer or representative under the federal securities acts. Counsel must seek the fullest disclosure from his client concerning the facts known to the client, since the subpoena to which the witness must respond states only the name of the persons or companies which are the subject of the investigation, and then speculate as to the nature of the suspected objections. The client must be strongly advised that the purpose of the deposition is to gather evidence as to the existence of violations of the securities laws, which evidence may well be used in a subsequent criminal prosecution. A special problem is present when the client is registered as a broker, dealer or representative under the securities acts, since failure to cooperate in the SEC investigation or the invoking of the client's fifth amendment right to silence may well jeopardize his securities license. While the authors, in practice, generally recommend that the client who is not licensed under the securities acts invoke the fifth

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170. REPORT OF THE SEC'S ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES (June 1, 1972), in *CHANGE IN SECURITIES LAW ENFORCEMENT AND LITIGATION*, 7, 36 (N.Y.L.J. 1972).

171. SEC Securities Act Release No. 5310, at 4 (Sept. 27, 1972).

amendment in an investigation, it has been their experience that, in many cases, the licensed client will choose to take the calculated risk of criminally incriminating himself in order to attempt to preserve his securities license. Indeed, the securities salesman or broker who is subpoenaed to testify in an investigation is placed between the proverbial "rock and a hard place." Thus, it appears that the SEC rules governing investigations and quasi-judicial proceedings are in need of revision to insure that the rights of persons involved are adequately protected.