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# A Lack of Fair Procedures in the Administrative Process: Disciplinary Proceedings at the Stock Exchanges and the Nasd

Lewis D. Lowenfels

# A LACK OF FAIR PROCEDURES IN THE ADMINISTRATIVE PROCESS: DISCIPLINARY PROCEEDINGS AT THE STOCK EXCHANGES AND THE NASD

*Lewis D. Lowenfels*†

"Procedural fairness and regularity are of the indispensable essence of liberty."
*Mr. Justice Jackson*[1]

## INTRODUCTION

The average American is much more directly and frequently affected by the administrative process than by the judicial process. Utility, airline, and railroad rates and services, air and water pollution, adulteration of food, unfair labor practices, false advertising, industrial plants in residential areas, fraud in the sale of securities—these are but a small sampling of areas governed in large part by the administrative process.

This Article addresses one small but vital portion of that administrative process: disciplinary proceedings involving broker-dealers and their personnel before the three major self-regulatory organizations of the securities industry—the New York[2] and American Stock Exchanges[3] and the National Association of Securities Dealers, Inc. (NASD).[4] The thesis of this Article is that

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† Member of the New York Bar; A.B. 1957, LL.B. 1961, Harvard University. Many of the observations expressed herein are based upon the author's experience as a practicing securities lawyer since 1961. The author wishes to thank Fern Lowenfels, Leslie Susser, Esq., and Roger A. Tolins, Esq., for their helpful suggestions in connection with the preparation of this Article.

[1] Shaughnessy v. United States *ex. rel.* Mezei, 345 U.S. 206, 224 (1953) (dissenting opinion).

[2] Disciplinary proceedings before the New York Stock Exchange are governed by NYSE CONST. art. XIV, 2 NYSE GUIDE (CCH) 1091 to 1103-3 (1978), and NYSE RULES OF BOARD OF DIRECTORS 345, 475, 2 NYSE GUIDE (CCH) 3589-2 to 3590, 4031-32 (1978).

[3] Disciplinary proceedings before the American Stock Exchange are governed by AM. STOCK EX. CONST. art V, 2 AM. STOCK EX. GUIDE (CCH) 2153-65 (1978), and RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 1-13, 2 AM. STOCK EX. GUIDE (CCH) 3403-07 (1975).

[4] Disciplinary proceedings before the NASD are governed by NASD BY-LAWS art. VII, NASD MANUAL (CCH) ¶¶ 1503-05 (1973), by NASD RULES OF FAIR PRACTICE arts. IV-V, NASD MANUAL (CCH) ¶¶ 2201-2303 (1975-76), and by NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS §§ 1-27, NASD MANUAL (CCH) ¶¶ 3001-26 (1973).

the procedures employed by these institutions in implementing their disciplinary responsibilities under the self-regulatory structure mandated by the federal securities laws[5] are seriously deficient. A paucity of procedural guidelines, a lack of adherence to such guidelines as exist, an excess of discretionary power vested in staff personnel, arbitrary decisions, and a generally haphazard approach—these characteristics permeate the disciplinary proceedings of the two major exchanges and the NASD. The result is a lack of fairness for defendants and a gap in the protections ostensibly accorded to the investing public. In evaluating self-regulatory procedures, this Article eschews two standards traditionally applied to administrative agencies—constitutional due process and the scope of statutory authority. Digressions into these areas become nebulous and theoretical. In any event, judges dealing with questions of due process enforce only minimum requirements, and legislators granting statutory authority supply only broad frameworks.

The thrust of this Article is pragmatic. Specific problems are identified and dissected; specific solutions are suggested. And perhaps certain of these problems and solutions will have meaning and applicability beyond the comparatively limited area of securities law. In a very real sense, unless proper procedures are introduced into many areas of the administrative process, the ever-expanding bureaucracies will continue to chip away at the individual liberties which are the very core of our society.

## I

## THE PROBLEMS

### A. *The Investigatory Stage*

There are many ways in which investigations by the two major exchanges and the NASD for violations of the securities laws may be stimulated. Each of these self-regulatory agencies employs computers to monitor stock prices and trading volumes in its jurisdiction. When trading in a particular security exceeds

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[5] Self-regulation is mandated by the Securities Exchange Act of 1934, §§ 6, 15A, 15 U.S.C. §§ 78f, 78o-3 (1976). Associations that qualify as self-regulatory must enforce among their members the provisions of the 1934 Act, rules and regulations promulgated thereunder, and the internal rules of the association. *Id.* §§ 6(b)(1), 15A(b)(2), 15 U.S.C. §§ 78f(b)(1), 78o-3(b)(2).

the established parameters, an inquiry is launched. Alternatively, such inquiries may result from reports filed with the regulatory authorities, from newspaper articles or from rumors. Disgruntled former employees or colleagues, as well as competitors, often stimulate investigations by playing the role of informant. Often, a perfectly reasonable explanation is readily apparent; at other times, a more searching, full-scale investigation must be pursued. It is at this crucial crossroads that the absence of established procedures first invites unfair practices. Through excessive zeal, narrow perspective, sheer momentum, inertia, or even personal animosity on the part of the compliance staff, a preliminary inquiry may blossom into a full-scale investigation involving depositions, examinations of records, and interviews of third parties. The rules promulgated for and by the exchanges and the NASD supply neither guidance for nor restraint upon this exercise of discretion by agency personnel.

It requires little insight to conclude that this system is open to real abuse. Over the years, close relationships develop between the staff compliance personnel and certain of the regulated persons or entities. Those members of the industry who take the time and trouble to cultivate the staff regulators are much less likely to be the subject of a full-scale investigation than those members of the industry who neglect these duties. New firms, younger people, and others who are outside of this "inner circle" are prime candidates for formal, in-depth investigations. And if one of the important staff compliance personnel has a deep-seated animosity toward a particular firm or individual, one full-scale investigation can follow another in what amounts to an endless sequence. To the extent that the "inner circle" receives unwarranted immunity, the investing public suffers. To the extent that "outsiders" are subjected to precipitate investigations, they suffer unwarranted expense and injury to reputation.

In certain infrequent situations, as when a scandal of major proportions appears to be surfacing, the regulatory staffs of the exchanges or the NASD may bear some degree of responsibility for transgressions.[6] This responsibility may range from an innocent failure to discover violations of the securities laws at a sufficiently early stage, all the way to actual complicity in misdeeds.

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[6] *Cf. id.* § 19(h), 15 U.S.C. § 78s(h) (governing sanctions for self-regulatory organizations).

The responsibility may involve only low-level personnel, or it may extend into the highest echelons of the compliance department. To permit the self-regulators in such cases to conduct the investigation themselves could lead to "scapegoating" or to the suppression of embarrassing information. Yet the procedures of the exchanges and the NASD make no allowance for situations where potential conflicts of interest cast doubt upon the objectivity of the investigators.

Once a formal investigation is launched, the procedures used to conduct the investigation are heavily weighted in the regulators' favor. The staff examines records, takes formal depositions, and has endless time and resources to exploit in preparing its case. One particular problem that invariably surfaces during this period is that the exchanges and the NASD lack a procedure whereby the target of an investigation may refuse to testify on grounds of self-incrimination without risking expulsion from the exchange.[7] This type of compelled testimony can engender particularly dire consequences when it is turned over, as it may be, to federal or state authorities for their review.[8] The irony is that these same

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[7] The constitution of the New York Stock Exchange provides:

> Failure to Testify or Produce Records Sec. 9. Whenever it is adjudged in a proceeding under this Article that a member, allied member or approved person has been required by the Board or any committee, officer or employee of the Exchange authorized thereby to submit his books and papers or the books and papers of his firm or of any employee thereof or the books and papers of the member corporation in which he is a stockholder, or of any employee thereof to the Board or any such committee, officer or employee or to furnish information to or to appear and testify before or to cause any such employee to appear and testify before the Board or any such committee, officer or employee and has refused or failed to comply with such requirement, such member or allied member may be suspended or expelled and such approved person may have his approval withdrawn.

NYSE CONST. art. XIV, § 9, 2 NYSE GUIDE (CCH) 1095-96 (1978). The American Stock Exchange has an analogous provision in AM. STOCK EX. CONST. art. V, § 4(k), 2 AM. STOCK EX. GUIDE (CCH) 2161 (1978). Similarly, NASD RULES OF FAIR PRACTICE, art. IV, § 5, NASD MANUAL (CCH) ¶ 2205 (1975), empowers certain governing bodies to require members to furnish information pursuant to investigations. By resolution of the Board of Governors (NASD MANUAL (CCH) ¶ 2205, at 2112-13 (1974)), the president of the NASD is authorized to suspend the membership of any member who refuses to furnish the requested information.

[8] The defendant's testimony may be used against him in an SEC proceeding to withdraw his broker-dealer license (see Securities Exchange Act of 1934, § 6(d)(1), 15 U.S.C. § 78f(d)(1) (1976), which requires national securities exchanges to keep records in disciplinary proceedings, and *id.* § 21(b), 15 U.S.C. § 78u(b), which gives the SEC access to such records for investigations and other proceedings), in a civil injunction action brought by the SEC (same), or in a criminal action brought by the United States Attorney's Office (*see* FED. R. CRIM. P. 17(c)).

state and federal authorities could not obtain this testimony directly if the target chose to assert his constitutional right against self-incrimination. Regardless of its constitutionality,[9] administrative compulsion of incriminating testimony is an unfair practice which the exchanges and the NASD should eliminate.

Once the compliance staff has finished taking testimony and examining records, a decision must be made either to initiate a disciplinary proceeding or to close the file without recommending further action. No formal procedure exists, however, to expose the people who will participate in making this critical decision to a presentation describing and summarizing the case from the viewpoint of the potential defendant.[10] This deficiency has unfortunate results both for individuals under investigation and for the investing public. First, a defendant may be called to answer unwarranted charges based upon a one-sided version of the facts. Second, the absence of formal input encourages potential defendants and their counsel to informally exert pressure upon higher officials of the exchanges and the NASD to abort intended proceedings. Where close personal or professional relationships exist between the regulator and the regulated, these illegitimate channels of influence erode the protections promised investors by the disciplinary process.

### B. *Filing the Complaint*

The filing of a formal complaint by the exchanges and the NASD precipitates a new set of problems. First, despite agency rules requiring reasonable specificity,[11] the complaint is often too vague to communicate to the defendant precisely what transgressions he is accused of committing. Second, exactly who the

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[9] At least one court has held that admissions made during an interrogation by the New York Stock Exchange, and subsequently used by the government to convict the defendant for creating and maintaining false books and records in violation of § 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(q)(a) (1976), and related regulations, did not violate the defendant's fifth amendment privilege against self-incrimination. United States v. Solomon, 509 F.2d 863 (2d Cir. 1975).

[10] By contrast, the Securities and Exchange Commission developed a procedure six years ago requiring "that a prospective defendant or respondent be given notice of the staff's charges and proposed enforcement recommendation and be accorded an opportunity to submit a written statement to the Commission which would accompany the staff recommendation." SEC Securities Act Release No. 5310 (Sept. 27, 1972).

[11] *See* NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1098 (1978); AM. STOCK EX. CONST. art. V, § 1(b)(4), 2 AM. STOCK EX. GUIDE (CCH) 2154 (1978); NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS § 4, NASD MANUAL (CCH) ¶ 3004 (1973).

defendants are is often a matter of some mystery. There have been instances on the exchanges, for example, where specialist units as entities, rather than individuals, have been named as defendants. Some of these units comprise over ten individuals. Which, if any, of these persons is responsible for a particular violation is often left unspecified. Third, the confusion of vague allegations against unspecified individuals may be compounded by the legal standard applied to defendants' conduct. Although some complaints allege particularized violations of federal laws or agency rules, other complaints call the defendant to account under broad ethical standards such as "just and equitable principles of trade."[12]

Fourth, even the specification of deeds and violations in the complaint does not guarantee that the hearing will follow this outline. Both the exchanges and the NASD are notorious for introducing a certain "flexibility" into hearings whereby evidentiary digressions, or even new charges, suddenly manifest themselves. This may substantially prejudice the defendant, who has prepared his defense to Charge A and finds himself, at the last minute, facing Charge B. Only the American Exchange has a rule guaranteeing a "reasonable continuance" to enable the defendant to meet new evidence.[13] The constitution of the New York Exchange

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[12] The American Stock Exchange Constitution provides:

> A member, member organization or director of a member corporation who or which shall be adjudged guilty in a proceeding under this Article of a violation of the Constitution of the Exchange, of a violation of a rule adopted pursuant to the Constitution, of a violation of a resolution of the Board regulating the conduct or business of members or member organizations, or of conduct or proceeding inconsistent with just and equitable principles of trade, may, if a member or member organization, be suspended or expelled from membership or, if an approved person have his approval withdrawn, unless the offense is the violation of a provision, rule or resolution for which a different penalty has been provided, in which case such other penalty may be imposed.

AM. STOCK EX. CONST. art. V, § 4(h), 2 AM. STOCK EX. GUIDE (CCH) 2160 (1978). The New York Stock Exchange has a similar provision in NYSE CONST. art. XIV, § 6, 2 NYSE GUIDE (CCH) 1095 (1978). The NASD admonition is even more nebulous. It states, simply: "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." NASD RULES OF FAIR PRACTICE art. III, § 1, NASD MANUAL (CCH) ¶ 2151 (1973).

[13] If during the course of a hearing it shall appear to the chairman that proffered evidence relates to matters outside the scope of the charges or the answer but that a proper resolution of the issues involved requires consideration of such evidence by the Panel, he may permit amendment of the charges or the answer, or both, by the respective parties. In such event, the chairman shall grant a reasonable continuance to enable the objecting party to meet such evidence.

permits evidence only upon facts put into issue by the original complaint and answer,[14] but this salutary precept is often ignored in practice. NASD rules not only permit the parties to submit "any relevant material,"[15] they also fail to provide for extra time to respond.

A final problem occurring at the complaint stage results from the inordinate delay that often intervenes between the events in question and the filing of a complaint. Firms or entities have been dissolved, records have been misplaced or destroyed, potential witnesses have died or moved away, memories of specific actions and motives are vague or nonexistent—any or all of these elements can substantially prejudice the defense. Unlike the federal securities laws,[16] or indeed any other body of civilized law, no statute of limitations governs the compliance departments of the exchanges or the NASD.

### C. *Selecting a Panel*

Shortly after the complaint has been filed, the defendant receives in the ordinary course of business an innocent looking document advising him as to who will constitute the hearing panel. At this point, one of the most important stages of the entire disciplinary proceeding has been passed and the defendant is often only dimly aware of its significance. The prosecutor at the NASD or a member of the staff hierarchy at the exchanges has exercised his power to choose the hearing panel.[17] This power

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RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 7, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

> [14] The Hearing Officer [panel chairman] shall determine the specific facts put into issue by the charge or charges and the answer, and with respect to those facts only, the person or persons making the charge or charges may produce witnesses and any other evidence . . .; the accused may also present such testimony or other evidence with respect to the facts so designated by the Hearing Officer as well as such testimony, defense or explanation as the accused may deem proper with respect to the charge or charges.

NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1098 (1978).

[15] NASD BY-LAWS art. VII, § 4, NASD MANUAL (CCH) ¶1504 (1973).

[16] *See* Securities Act of 1933, § 13, 15 U.S.C. § 77m (1976); Securities Exchange Act of 1934, §§ 9(e), 18(c), 15 U.S.C. §§ 78i(e), 78r(c) (1976); Trust Indenture Act of 1939, § 323(a), 15 U.S.C. § 77www(a) (1976).

[17] At the NASD, original jurisdiction over complaints is vested in a District Business Conduct Committee. CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS § 2, NASD MANUAL (CCH) ¶ 3004 (1979). In practice, original jurisdiction is exercised by a panel chosen from among the full Committee, pursuant to NASD rules, with the full Committee taking only final action. *See id.* § 22, NASD MANUAL (CCH) ¶ 3021 (1979). Although there is no formal procedure governing the choice of this disciplinary panel, in

provides the regulators with an extraordinary and often insuperable advantage. Most of the cases to be heard by these disciplinary panels are not unique; they involve fact situations which have arisen and been decided in the past. The individuals choosing the panel know who among the eligible panelists will be sympathetic to the NASD or exchange position and who will be unsympathetic. The particular case, moreover, may be only one of a series of identical cases initiated against different defendants. It is not uncommon for panelists deciding earlier cases to serve again in subsequent cases, if the prosecutor so desires. Even at the exchanges the prosecutor often advises the exchange employee who selects the panel. Thus, the regulatory authorities in general and the prosecutors in particular have enormous power to tailor the panel to achieve a desired result.

Once the panel has been chosen, other problems begin to surface. The panel chairman is not generally trained in the law; he is an industry member (in the American Exchange) or an exchange employee (in the New York Exchange).[18] Nevertheless, he must rule on the admissibility of evidence, the eligibility of witnesses, adjournments for additional preparation, and a myriad of other complex matters. He may consult with the panel—several members of the industry who sit for a limited period on a part-time basis.[19] Although usually well-intentioned, these people are often unsure of themselves in this unfamiliar setting.[20] In

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practice, the NASD prosecutor selects the panel from among the industry members who constitute the Committee. Panels customarily consist of three members.

At the New York Stock Exchange the Chairman of the Exchange appoints hearing officers, from among staff officers and employees of the Exchange, to serve as chairmen of hearing panels. The choice of a chairman for a particular panel depends upon who is available when the panel is being chosen. The remainder of the panel is composed of at least two members or employees of members chosen by an exchange employee from boards of eligible individuals selected by the Chairman of the Exchange. *See* NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1097 (1978).

The Chairman of the American Stock Exchange chooses a chairman for a particular panel from a group of Exchange Officials—industry members not employed by the Exchange—originally selected by him. The chairman of the panel is then empowered to choose the remaining two to four members of the panel from a group of eligible members or allied members originally selected by the Chairman of the Exchange. *See* AM. STOCK EX. CONST. art. V, § 1(b)(1), 2 AM. STOCK EX. GUIDE (CCH) 2153 (1978); RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 1-3, 2 AM. STOCK EX. GUIDE (CCH) 3403-04 (1975).

[18] *See* note 17 *supra.*

[19] *See* note 17 *supra.*

[20] The sole exception to this generalization is the chairman of the New York Exchange hearing panel who is part of the staff hierarchy of that exchange. The chairman of an American Exchange panel, although nominally an "Exchange Official," is in fact an industry member not employed by the Exchange. *See* note 17 *supra.*

this type of situation, the influence of the experienced prosecutor is enormous. He has probably tried dozens of similar cases and the panel knows it. When the prosecutor makes a suggestion or raises an objection, the panel often tends to overlook the adversary nature of the proceeding and views the prosecutor as some sort of advisor or moderator. This reliance upon the prosecutor, which begins in the procedural area, often imperceptibly merges into substantive considerations and can result in substantial prejudice to the defendant.

Unlike a jury in the judicial process, the panelists often are not strangers to the defendant. The panelists and the defendant may have known each other in a business environment for years. Old prejudices and rivalries sometimes lurk in the background. Existing competitive considerations may be a subconscious factor in reaching decisions. A clever prosecutor will not overlook the human element when selecting a panel and presenting his case.

The rules of the American Exchange recognize and attempt to deal with both problems outlined above. When selecting a panel, the panel chairman for the American Exchange

> shall, to the extent practicable, choose individuals whose background, experience and training qualified them to consider and make determinations regarding the subject matter to be presented to the Panel. He shall also consider such factors as the availability of individual hearing officers, the extent of their prior service on Disciplinary Panels and any relationship between individual hearing officers and the accused which might make it inappropriate for such hearing officer to serve on the Panel.[21]

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[21] RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 3, 2 AM. STOCK EX. GUIDE (CCH) 3404 (1975). Rule 3 goes on to state:

> Promptly after the selection of the hearing officers, the chairman of the Panel shall cause written notice thereof to be given to the accused. If any person involved in the disciplinary proceeding shall have knowledge of a relationship between himself and any hearing officer selected for service on the Panel which might result in such hearing officer being unable to render a fair and impartial decision, he shall give prompt written notice thereof to the chairman of the Panel, specifying the nature of such relationship and the grounds for contesting the qualification of such hearing officer to serve on the Panel. The decision of the chairman of the Panel shall be final and conclusive with respect to the qualification of any hearing officer to serve on the Panel.

*Id.* The official comment to rule 3 adds:

> In determining the number of hearing officers to serve on a Disciplinary Panel, the chairman of the Panel shall consider such factors as the complexity of the disciplinary matter to be heard, whether it presents novel questions concerning the interpretation and application of Exchange rules or of the securities

The efforts of the American Exchange highlight the failures of the New York Exchange and the NASD. NASD procedures offer a modicum of protection against the more tangible causes of bias:

> No member of the [NASD adjudicatory bodies] . . . shall in any manner, directly or indirectly, participate in the determination of any complaint affecting his interest or the interests of any person in whom he is directly or indirectly interested. In any case where such an interest is involved, the particular member shall disqualify himself, or shall be disqualified by the Chairman of any such Board or Committee.[22]

Although the NASD formulation appears more forceful because of its mandatory language, it may not as readily extend beyond immediate professional interests to reach the lasting effects of old rivalries. Moreover, the NASD provision does not recognize experience or training as an important factor in the selection of panel members. Yet the NASD fares better at this stage than the New York Exchange, which provides the defendant no formal protection from the inexperience of the panel or from its consideration of illegitimate factors.

D. *Preparing a Defense*

Once the complaint has been filed and a panel has been convened, the defendant must focus upon the specific details of the prosecution's case. Only if he can obtain and analyze these specific details can the defendant properly prepare his defense. Vital documents, statements of witnesses, opinions of experts—all of these sources may contain evidence which will lead ultimately to conviction or exoneration of the defendant. Amazingly enough, the defendant in a disciplinary hearing before a major exchange or the NASD has no formal rights of discovery. He is completely at the mercy of the prosecution; he gets what the prosecutor chooses to give him. The prosecutor, on the other hand, has unlimited time and resources to assemble and analyze every shred of evidence prejudicial to the defendant. Moreover, during the course of his investigation, the prosecutor will undoubtedly have uncovered at least some evidence that favors the defense. Under

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laws and whether it appears that substantial questions of fact or law must be resolved.

Commentary .01, *id.*

[22] NASD BY-LAWS art. VII, § 5, NASD MANUAL (CCH) ¶ 1505 (1973).

existing procedures, however, this evidence need never be presented.[23]

If there are multiple defendants, each faces the same problems vis-à-vis the others as vis-à-vis the prosecution. Without rights of discovery, one defendant's presentation at the hearing can completely surprise and prejudice another defendant. This may be substantively unjust as well as procedurally unfair, because prehearing discovery of damaging evidence might have led the defendant to additional exculpatory evidence or theories of refutation.

Depending upon the nature of the case, expert witnesses may be indispensable to the defendant.[24] The retaining of competent experts, however, is inhibited by two basic problems—money and time. The defendant, already saddled with substantial legal fees, may simply be unable to afford vital but expensive expert assistance.[25] Even if sufficient money is available, however, the time required for a proper expert analysis may be lacking. Once the complaint is filed, the prosecutor wishes to move as expeditiously as possible to a hearing and a sanction. The prosecution's case is assembled and ready; delay favors only the defense. Any attempts by the defense to obtain time for experts to survey and analyze relevant data encounter vigorous, and usually successful, opposition by the prosecutor.

Finally, one of the most difficult problems for the defendant is that exchange and NASD rules do not provide him with access to recorded agency precedents. Without such guidelines, the defendant can only speculate upon the possible interpretations and applications of the standards against which his conduct will be judged. He is unable to prepare his case with a view to showing why the transgressions which the prosecutor must prove have not been satisfactorily established. The prosecutor, on the other hand, has a complete file of all previously recorded decisions together with a complete record of all previous hearings.

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[23] In contrast, a criminal prosecutor must, upon request, disclose to a defendant any exculpatory evidence he uncovers during the course of his investigation. Brady v. Maryland, 373 U.S. 83 (1963).

[24] For example, charges alleging manipulation may rest solely upon statistical analysis of trading patterns and, in the absence of eyewitnesses, can be successfully defended only by relying in large part upon expert testimony.

[25] In a recent case in which the author was involved, the cost of preparing a single statistical report for defendants was in excess of $20,000.

E. *Scheduling the Hearing*

As soon as he files the complaint, the prosecutor is virtually prepared to try his case. The prosecutor has finished taking the defendant's deposition. He has completed interviewing potential witnesses. He has carefully examined the relevant documents. He has consulted experts and analyzed their findings. He has researched the relevant precedents and formulated his legal theories. He has discussed, analyzed, and dissected the case with his colleagues in the compliance department. The prosecutor is ready.

The defendant, by comparison, is unprepared. He may have had his deposition taken a long time ago or supplied a few requested records to the regulatory personnel. He may be aware that colleagues or competitors have been interviewed or asked to supply records. However, in the heavily regulated securities industry, such events are commonplace. Moreover, these activities occurred a long time ago and the defendant has probably presumed that whatever problems existed have long since been laid to rest. Now, suddenly, the defendant is served with a complaint and given, at most, three weeks to respond.[26] He must consult with his lawyer, who is not always immediately accessible. He must search his own records and files and attempt to refresh his memory with respect to incidents which occurred many months or even years ago. He must reread his deposition to remember what he said to the regulatory authorities a number of months ago. He must think, analyze, attempt to recall, and contact witnesses who may be helpful. The defendant is not ready to present his case; he needs time.

In the judicial process this vital factor of time is administered in a comparatively impartial manner by the court. The administrative process, however, is completely different. If the prosecutor at the American or New York Exchange will not consent to a postponement, the decision is left to a supposedly impartial panel

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[26] The NASD allows defendants 10 business days to respond. A defendant missing this deadline is given a second notice and five additional business days to respond. Failure to meet this second deadline may be treated as an admission of the allegations in the complaint. NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS § 7, NASD MANUAL (CCH) ¶ 3007 (1973). Including nonbusiness days, a defendant could have up to three weeks before his nonresponse would be held against him.

Both exchanges allow defendants 20 calendar days to respond. NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1098 (1978); AM. STOCK EX. CONST. art. V, § I(b)(4), 2 AM. STOCK EX. GUIDE (CCH) 2154 (1978).

assistant or panel chairman, respectively.[27] As a practical matter, however, these persons are exchange employees who, by virtue of their position, work closely with the prosecutors on a daily basis. Their job is to move the cases through the hearing process as expeditiously as possible. While some degree of consideration for defendants' rights is present, these exchange employees are not disposed to grant lengthy postponements. The NASD does not even bother with the facade of an impartial panel assistant. Here, defendants must negotiate with and seek the consent of the prosecutor. The court of last resort with respect to postponements is the panel itself. The panel, however, composed not of practicing lawyers but of industry personnel, is rarely sensitive to the determinative role that time plays in disciplinary hearings. Therefore, the panel, like the prosecutor and the panel assistant or panel chairman, is usually disposed to move the case as rapidly as possible.

There is a certain amount of sophisticated maneuvering in the scheduling process which is often engaged in by the prosecutors. First, there may be a number of virtually identical cases pending against different defendants. Here the prosecutor will attempt to bring the weakest defendant to a quick hearing and use a favorable result to bludgeon the stronger defendants into settlement. Second, there may be two different cases—one comparatively stronger for the prosecution on the facts and the law—pending against the same defendant. Here the prosecutor may attempt to bring the stronger case to an early hearing and use a favorable result to compel a settlement in his weaker case. Third, there may be two different cases pending against the same defendant, one involving a serious violation and one a lesser violation. Here the prosecutor may expedite the latter case, obtain a favorable decision with respect to a minor transgression, and use this one black mark as a springboard to a draconian sanction in the more serious case. Possible variations on the above themes are limited only by the prosecutor's imagination because, in the final analysis, it is the prosecutor who controls the scheduling of the hearing.

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[27] Although in practice decisions on extensions in the American Exchange are often made by panel assistants appointed under RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 6, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975), the Rules place that authority in the panel chairman. RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 7, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

F. *The Hearing*

The defendant in an exchange or NASD disciplinary hearing begins at a substantial disadvantage. In most cases the panel, composed of industry personnel, has some degree of independent knowledge regarding the case. In many instances, the entire set of factual circumstances surrounding the hearing represents a major scandal already trumpeted by the media. The ripple effects of the scandal may even have reached members of the panel in varying degrees. Most panel members assume that if the staff of the exchanges or the NASD goes to the extreme of initiating charges, the defendant must have done something wrong. Among persons not trained in law, this combination—a general perception of wrongdoing coupled with a habit of relying upon staff judgments—is likely to create a presumption of guilt which is very difficult to overcome.

The hearing itself is largely unstructured, and this favors the prosecutor. Except for the statement of charges, the defendant often has no idea what to expect. Unlike a judicial proceeding the prosecutor is not obliged to furnish the defendant with a list of witnesses or with the documentary evidence which the prosecutor intends to introduce at the hearing. Legal issues have not been narrowed; facts have not been stipulated. The positions of other defendants may be a complete surprise. This freewheeling atmosphere provides a tremendous advantage to the prosecutor who has meticulously prepared his case and knows exactly what proof he must introduce.

As the hearing progresses, the defendant faces additional problems. As at any trial, many disputed questions arise during the course of the proceedings. The competence of letters or affidavits from people not present at the hearing, the admissibility of inflammatory testimony, requests for adjournments to give one side or the other additional time to prepare, the interpretation of relevant sections of the securities laws—each of these areas may involve a myriad of hotly disputed, and often crucial, questions upon which the panel or the panel chairman must rule.[28] The

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[28] In an American Exchange hearing, the panel chairman rules "on all questions of admissibility, relevancy and materiality of evidence" and generally "prescribe[s] the time within which all documents . . . or other written materials must be filed with the Panel." RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 7, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975). In a New York Exchange hearing, the panel chairman "shall determine the specific facts put into issue by the charge or charges and the answer,

same problem confronts the defendant at this stage as at the scheduling stage: The lay panel at the NASD and the panel chairmen at the exchanges are likely to view these interim disputes from the vantage point of the prosecution.

The most difficult obstacle confronting the defendant, however, is the close interaction between the prosecutor and the panel. This begins with the choice of the panel, continues up to and throughout the hearing, and extends to posthearing procedures. During adjournments from the hearing, the prosecutor will often mix with the panel on an informal basis. If the hearing is being held, as it sometimes is, in a city that is far from the home bases of the panel and the prosecutor, they may well have flown to the hearing together in the same airplane, will often stay at the same hotel, will take at least some of their drinks and meals together, and may discuss and resolve outstanding business unrelated to the hearing. These circumstances create a significant and gratuitous risk of impermissible influence upon the judgment of the panel.

### G. *Procedures After the Hearing*

After the hearing has been completed, the panel must render its decision. Although it is the panel which deliberates and concludes, it is the prosecutor at the NASD who actually writes the panel's opinion.[29] A number of undesirable consequences follow from this procedure. First, the panel avoids an important facet of the intellectual discipline essential to a reasoned decision. Judges often make determinations immediately after a hearing on the merits and then modify their initial determinations in the course of writing their opinions. The process of careful reasoning required to draft an opinion is a substantial factor in achieving a fair and just result. In certain instances, it will represent a substantial safeguard for the rights of the defendant. It diminishes the role that whim, prejudice, emotion, and intellectual laziness play in reaching a conclusion. Second, the content of the panel's

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and with respect to those facts only, [the parties] ... may produce witnesses and any other evidence...." NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1098 (1978). NASD rules do not specifically authorize any member of the panel to rule on evidentiary questions. *See* NASD BY-LAWS art. VII, § 4. NASD MANUAL (CCH) ¶ 1504 (1973).

[29] The practice at the exchanges is to have the panel work together with the panel assistant (at the American Exchange) or the panel chairman (at the New York Exchange) to draft the panel's opinion. No formal provision governing this practice is contained in either the NASD or the exchange rules governing disciplinary proceedings.

written opinion may have important ramifications for the defendant. The NASD panel's decision is only the first step in a four-tier process.[30] The appellate tribunals that ultimately resolve the case will be influenced in great part by the reasoning and language of the initial panel's opinion. A crucial word placed in a strategic position, a premise leading to a vital conclusion, the omission of an important counterargument, the entire structure of reasoning and organization which supports the initial decision—any of these factors may play a crucial role in an appellate decision. And, at the NASD, all of these factors are controlled by the prosecutor when he composes the initial panel's opinion. Third, the initial panel's opinion, as expressed by the NASD prosecutor, may reach conclusions with respect to issues of fact which could conceivably bind the defendant in judicial proceedings initiated by private plaintiffs seeking money damages.[31]

In addition to drafting the panel's opinion, the prosecutor at the NASD, unlike the exchange prosecutors, has a degree of discretion in determining when and if the panel's decision officially becomes final. This results from an NASD requirement that the panel's decision be reviewed and approved by the District Business Conduct Committee.[32] A prosecutor who has other investigations pending against a particular defendant may delay submission to the District Committee of a panel decision in favor of that defendant to avoid undermining the momentum of his other inquiries.[33] Moreover, the prosecutor is present when the District Committee reviews the panel's determination, but the defendant

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[30] After the NASD panel has rendered its decision, the defendant may appeal to the Board of Governors of the NASD. If the defendant chooses not to appeal, the Board of Governors has the authority to call any decided case before it for review on its own motion. NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS §§ 15-17, NASD MANUAL (CCH) ¶ 3014-16 (1973).

A final decision rendered by the Board of Governors of the NASD may be reviewed by the Securities and Exchange Commission "on its own motion, or upon application by any person aggrieved thereby." Securities Exchange Act of 1934, § 19(d)(2), 15 U.S.C. § 78s(d)(2) (1976). After a final order has been rendered by the Securities and Exchange Commission, "[a] person aggrieved by a final order of the Commission ... may obtain review of the order in the United States Court of Appeals." *Id.* § 25(a)(1), 15 U.S.G. § 78y.

[31] *Cf.* United States v. Utah Constr. & Mining Co., 384 U.S. 394, 422 (1966) ("When an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have bad an adequate opportunity to litigate, the courts have not hesitated to apply *res judicata* to enforce repose.").

[32] NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS § 22(a), NASD MANUAL (CCH) ¶ 3021 (1973).

[33] NASD rules do not require the prosecutor to submit the panel's decision to the District Business Conduct Committee within a stated period of time. *See id.*

and his counsel are excluded.[34] Theoretically, the prosecutor is present only to respond to questions, but there is always the chance that a prejudicial answer, a passing comment, a facial expression, or even a tone of voice may influence a close decision.

After a decision has been reached on the merits by an exchange or NASD panel, and in the latter case approved by the District Committee, the initial decision normally goes to the governing board of the exchange or the Board of Governors of the NASD for review.[35] At this point, if the case is sufficiently important, the enforcement division of the Securities and Exchange Commission will informally make known its views regarding the panel's decision. Invariably, these views will be expressed only if the government feels that the decision or sanctions erred on the side of leniency for the defendant. Rarely will the self-regulators ignore the SEC. In this type of situation the panel decision will be reexamined by the governing board of the exchange or the Board of Governors of the NASD with a view to increased severity.[36] This type of procedure seems unfair to the defendant who has just completed a full hearing on the merits before a tribunal of his peers in complete accordance with the mandate for self-

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[34] This procedure has evolved through practice; it is not required by NASD rules.

[35] Any accused member, allied member, approved person, member firm or member corporation or the party bringing the charges or any member of the Board of Directors of the Exchange may require a review by the Board of any determination or penalty, or both, imposed by a Hearing Panel.

NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1099 (1978).

Any member, member organization or approved person determined to he guilty of a charge or charges before an Exchange Disciplinary Panel pursuant to this Article may require a review of such determination or of any penalty imposed by the Disciplinary Panel, or of both the determination and the penalty. Upon the request of any four members of the Board of Governors, any determination hy a Disciplinary Panel pursuant to this Article or any penalty imposed by such Disciplinary Panel, or both, shall be subject to review as hereinafter provided.

AM. STOCK EX. CONST. art. V, § 1(b)(5), 2 AM. STOCK EX. GUIDE (CCH) 2155 (1978). NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS §§ 15-17, NASD MANUAL (CCH) ¶ 3014-16 (1973). *See* note 30 *supra.*

[36] In this respect the American Exchange more closely approaches fairness than does the New York Exchange or the NASD. Both the Board of Directors of the New York Stock Exchange and the Board of Governors of the NASD may increase, decrease, cancel, or affirm any penalty imposed by the panel. NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1099 (1978); NASD CODE OF PROCEDURE FOR HANDLING TRADE PRACTICE COMPLAINTS § 16, NASD MANUAL (CCH) ¶ 3015 (1973). At the American Stock Exchange, however, the Board of Governors may only decrease, cancel or affirm any penalty imposed by the panel. The penalty may be increased at the American Stock Exchange only by the disciplinary panel itself upon remand from the Board of Governors. AM. STOCK EX. CONST. art. V, § 1(b)(5), 2 AM. STOCK EX. GUIDE (CCH) 2155 (1978).

regulation contained in the federal securities laws.[37] Moreover, this procedure seems particularly unfair when one considers that the SEC, under specific provisions of the Securities Exchange Act of 1934, has the power to hear the entire case on review after it has been finalized at the highest levels of the self-regulatory organizations.[38]

## II

## Some Suggested Solutions

Reasonable, practical, and relatively simple solutions exist for some of the problems described in the preceding sections. For others, solutions are more elusive. And, for a few of these problems, there are no solutions at all.

One innovation in particular would alleviate unfairness at a number of stages in the disciplinary process. The exchanges and the NASD should employ a group of genuinely independent panel administrators to oversee hearings in a quasi-judicial capacity. These panel administrators would be trained lawyers who are completely independent from the prosecutorial staff. Their salaries and advancement within the organization would be determined by persons having no responsibility for compliance. The panel administrator would not be a member of the panel and would not vote on ultimate rulings. He would, however, assist in selecting the panel, in monitoring discovery, and in scheduling the hearing. In addition, the panel administrator would attend the hearing, render interim evidentiary and procedural rulings, and help the panel compose its final written opinion.

### A. *The Investigatory Stage*

With respect to the problem of a routine initial inquiry imperceptibly blossoming into a full-scale investigation, a standing subcommittee of the governing boards of the exchanges or the Board of Governors or District Business Conduct Committees of the NASD could be empowered to review routine inquiries and either authorize or veto full-scale investigations. After the comple-

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[37] *See* note 5 *supra.*

[38] Securities Exchange Act of 1934, § 19(d)(2), 15 U.S.C. § 78s(d)(2) (1976). *See* note 30 *supra.*

tion of its initial inquiry, the staff should be required to submit a report to this subcommittee outlining the alleged violations, the evidence supporting these allegations, and a staff recommendation with respect to a course of action. The subcommittee would then determine whether to terminate the inquiry or to proceed further. With relatively little cost or delay, and with expedited measures for emergencies, this procedure could provide the dispassionate judgment and broader perspective which are needed at an important crossroads in the investigatory stage.[39]

In the rare situation where it initially appears that the regulatory staff of the exchanges or the NASD may bear some responsibility for transgressions, the governing board should retain a completely independent law firm to conduct the investigation from inception to conclusion.[40] The staff should have no role in this investigation; it should be conducted entirely by independent counsel reporting directly to the governing board.

Finally, once a full-scale investigation has been completed, but before formal charges are issued, a prospective defendant should be given notice of the staff's allegations and proposed enforcement recommendation and afforded an opportunity to submit a written statement summarizing the case from his viewpoint. The written positions of the staff and of the prospective defendant should then be placed before a subcommittee of the governing board which will determine whether or not to issue formal charges. By providing the defendant with a healthy, legitimate outlet for reasoned opposition to the issuance of charges, this procedure should protect him from allegations based upon a one-sided version of events and should protect the investing public from the effects of improper, informal pressure upon the self-regulators.[41]

### B. *Filing the Complaint*

With respect to improving the procedures surrounding the filing of the complaint, one must assume that broad legal-ethical standards[42] will continue to govern the conduct of exchange and

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[39] The SEC has employed a similar procedure for years. *See* Lowenfels, *Securities and Exchange Commission Investigations: The Need for Reform,* 45 ST. JOHN'S L. REV. 575, 576-77 (1971).

[40] This law firm should not be the institution's regular outside counsel.

[41] The SEC adopted a similar procedure six years ago and it has worked reasonably well. *See* note 10 *supra.*

[42] *See* note 12 and accompanying text *supra.*

NASD members. These standards have served as the heart of the disciplinary procedures of these institutions for too long a period and have become embedded in too many precedents for one to harbor any realistic hopes for change at this late date. As regards specificity with respect to charges and defendants, however, meaningful improvements are easily implemented. The complaint should clearly describe specific allegations, as the organizations' own rules require.[43] Where possible, schedules should be annexed to the complaint which list the details of the offending transactions on an item-by-item basis.[44] Specific individuals should be charged with specific transgressions. Only in the rare cases where circumstances offer no alternative should units or groups of individuals be luped ogether as defendants. In short, each defendant should receive clear notice of the specific charges against him so that he may take all proper measures to defend himself.

The exchanges and the NASD should adopt statutes of limitations to govern the initiation of formal complaints. It is unfair to require a person to defend himself against charges issued years after the events giving rise to the allegations occurred.[45] Precedent for a time bar exists in other areas of the administrative process. For example, the National Labor Relations Act contains a six-month statute of limitations for unfair labor practice complaints.[46] A statute of limitations is particularly justified in the securities industry where individuals and firms consummate a plethora of intricate, detailed transactions in relatively short periods of time.

Finally, the exchanges and the NASD must become more sensitive to the problems attendant upon amending charges at the last minute. A conscientious defendant and his counsel will have expended substantial time, effort, and money to answer and defend against specific allegations. They will have searched records, interviewed witnesses, and retained experts. An eleventh-hour change may mean that new records will have to be studied, new

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[43] *See* note 11 *supra.*

[44] Annexing schedules, currently done on an occasional basis, should become the rule rather than the exception.

[45] In one recent case in which the author was involved, the charges were initiated more than four years after the violations were alleged to have occurred. The firm involved had been out of business for over three years and most of its records had been lost. The result was that the defendant had no records upon which he could base his defense.

[46] 29 U.S.C. § 160(b) (1976).

witnesses located, and a different set of experts hired. Only in extraordinary situations should the self-regulators permit a last-minute change in the substance of the charges. Normally, if the prosecutor wishes to alter his charges in a material way, the disciplinary proceeding should be recommenced from inception. This will not only insure that the defendant has a fair opportunity to defend himself, but also will discourage the prosecutor from initiating charges before he has carefully and meticulously analyzed his case.[47]

C. *Selecting a Panel*

There is no reason to permit the regulatory authorities to choose the hearing panel unilaterally when an equitable and accepted alternative exists. When a matter is submitted to the American Arbitration Association for arbitration proceedings, each of the parties receives an identical list of proposed arbitrators selected from standing panels.[48] In certain situations, the list may consist solely of persons having expertise in the subject matter of the arbitration. Each of the parties is then directed: "[I]ndicate by number your order of preference upon this list of proposed Arbitrators. You may strike out names that are not acceptable but please leave as many names as possible."[49] This list is then returned to the Tribunal Administrator who matches the relative choices of the respective parties.[50] A similar procedure could be employed by the exchanges and the NASD.[51] Each of these organizations has standing panels of members eligible to serve on hearing panels. Identical lists of eligible panelists could be submitted to prosecutor and defendant at the same time and their respective choices could be matched as closely as possible.

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[47] At the very least, the NASD and the New York Exchange should formally provide for a continuance to meet new evidence, as the American Exchange has done. *See* note 13 *supra.*

[48] AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES § 12.

[49] AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES, List Submitted to the Parties.

[50] AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES § 12.

[51] It may be argued that different procedures are called for in the quasi-criminal proceedings of the self-regulatory organizations than in the arbitration of competing private claims. Yet the existence of a relatively small and constant pool of potential panelists, from which only two or three are chosen, makes the self-regulatory process analogous to arbitration in this respect. Further, even in criminal trials the defendant normally receives one or more peremptory challenges—a protection not furnished by the exchanges or the NASD.

Such an innovation would prevent the regulatory authorities from tailoring the panel to achieve a desired result.

The problem of the inexperienced panel giving undue deference to the experienced prosecutor can be alleviated by requiring members to remain eligible for service on hearing panels for longer periods of time.[52] The result will be that these eligible members will obtain more experience and perspective by serving on more hearing panels. Problems that appear difficult when first considered are often more easily solved when they have been dealt with on prior occasions. Moreover, as members serve on more panels during their extended terms of eligibility, there will be no need to have more than one novice on any hearing panel.

The problem of old prejudices and rivalries lurking below the surface of a hearing can never be entirely eliminated. Giving the defendant an equal voice in choosing the panel, however, will substantially diminish the frequency and influence of this all too human factor.

### D. *Preparing a Defense*

The lack of formal rights of discovery for defendants in self-regulatory proceedings is one problem for which a reasonable, practical, and relatively simple solution exists. In the words of the Administrative Conference of the United States: "[F]airness requires that private parties have equal access to all relevant unprivileged information at some point prior to the hearing."[53] Prior to every hearing, the self-regulatory organization should hold at least one conference at which all sides must exchange their evidentiary exhibits and witness lists. In addition, these agencies should institute rules guaranteeing the defendant's right to take depositions, propound interrogatories, and obtain from

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[52] At the exchanges, the panel members presently serve "at the pleasure of the [governing board] or until the next annual election of the Exchange and their successors are appointed and take office." NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1097 (1978); AM. STOCK EX. CONST. art. V, § 1(b)(1), 2 AM. STOCK EX. GUIDE (CCH) 2153 (1978).

At the NASD, "[e]ach regularly elected member of a District Committee shall hold office for a term of three (3) years, and until his successor is elected and qualified, or until his death, resignation or removal." NASD BY-LAWS § 11, NASD MANUAL (CCH) ¶ 1411 (1973). As a practical matter, the term of office of a District Committee member is spent almost entirely on the District Business Conduct Committee.

[53] 1 ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, RECOMMENDATIONS AND REPORTS OF THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, Recommendation 21, at 571 (1968-70).

the prosecutor documentary evidence and prospective witnesses' prior statements. In short, there should be few surprises at the hearing. The prosecutor has been unfettered in preparing his case; each defendant deserves equivalent rights to discover evidence held by the prosecutor and any other defendants. In addition, if in the course of his investigation the prosecutor has uncovered evidence favorable to the defendant, the prosecutor should be required to furnish this evidence to the defendant for examination before the hearing.[54] These procedures would enable the defendant to prepare a proper defense, would minimize the competitive "game" elements of what should be a responsible search for the truth, and by enabling the parties to gauge their respective strengths and weaknesses prior to the hearing, may encourage prehearing settlements or other resolutions less burdensome than a formal hearing.

Problems of money and time arising in connection with expert witnesses are soluble. Defendants may fairly be required to bear initial outlays for expert studies. If, however, initial expert analysis reveals serious flaws in the prosecution's case, perhaps, in some situations, the exchanges or the NASD should bear the costs of any further studies. This might be appropriate, for example, if the defendant's expert identifies gaps in the coverage of exchange or NASD surveillance techniques. After all, these are members who are being prosecuted, and it seems unfair to tax a few defendants with the entire expense of an in-depth study that, once serious questions have been raised, at least in part is being conducted for the benefit of the institution itself. As regards sufficient time for expert studies, there is no reason to be niggardly. Defendants should be given whatever time is reasonably necessary to retain experts and analyze their completed studies.

Finally, in order to comprehend the legal and ethical standards against which his conduct will be judged, the defendant needs access to precedents. The exchanges and the NASD should require that carefully reasoned opinions accompany panel decisions. These opinions could then be catalogued by subject matter and made available to defendants charged with similar transgressions. Such an innovation would give defendants the opportunity to organize their facts and expert studies to prove that the factors judged to be determinative in past violations had not been established in the case at bar.

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[54] *See* note 23 *supra.*

E. *Scheduling the Hearing*

There is no panacea for the problem of time. There are, however, a number of steps which may be taken to lessen the advantages which the time factor gives to the prosecution. First, the NASD and the exchanges presently grant defendants three weeks or less to answer formal charges.[55] These time periods should be extended to a full thirty days. Second, the disinterested panel administrator described earlier should be empowered to control the timing of the hearing. It is reasonable to expect that a trained lawyer, specifically hired to function in a genuinely independent, quasi-judicial capacity, will be relatively sensitive to the time problems facing a defendant. Moreover, placing the power to schedule hearings in the hands of a disinterested panel administrator should eliminate some of the more sophisticated stratagems employed by prosecutors to gain advantages over defendants. Third, the adoption of a statute of limitations to govern the institution of formal complaints by the exchanges and the NASD, as suggested earlier, should help to neutralize the time factor as a prosecutorial weapon.[56] It is the charge filed when witnesses, records, and memories have long since disappeared that normally requires the most time for a proper defense preparation.

F. *The Hearing*

Certain of the solutions already suggested in connection with other problems will have a salutary impact upon the problems that arise at the hearing itself. The introduction of rights of discovery—the right to take depositions, to obtain a list of witnesses together with their previous statements, to submit interrogatories and to examine documentary evidence—will narrow the issues and focus both sides upon the key legal and factual problems in the case. Each side will be informed with respect to his adversary's position and will be prepared to organize his own presentation accordingly. The result should be a more structured hearing with less emphasis upon the element of surprise. The problems presented by important interim rulings dealing with admissibility of evidence, temporary adjournments, and complex

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[55] *See* note 26 *supra.*

[56] *See* text accompanying note 45 *supra.*

legal questions will be alleviated by the presence of a genuinely independent panel administrator who is a trained lawyer.

The de facto presumption of guilt arising from the combination of publicity concerning the alleged transgressions and the panel's tendency to rely upon staff judgments will prove difficult to neutralize. Yet, given the quasi-criminal nature of the disciplinary process, fairness demands that the defendant initially be presumed innocent. One partial solution might be to require the panel administrator to address the panel at the opening of the hearing, forcefully emphasizing the presumption of innocence and the prosecutor's burden of proof. The panel administrator should repeat this statement at the close of the hearing in the form of a judge's charge to the jury. How much weight a panel would accord to this admonition, however, must remain an open question.

Similarly, it is equally difficult to neutralize the prosecutor's influence upon a panel through informal interaction. Although institutional rules could prohibit fraternization between the parties and the panel during the course of a hearing, there are many subtle and informal influences which may be introduced before or after the hearing.

### G. *Procedures After the Hearing*

Here again, solutions suggested previously with respect to other problems may tend to improve the posthearing procedures. First, the NASD should eliminate the prosecutor's role in the writing of panel opinions. The panel's opinion should be composed by the panel and the independent panel administrator working together. The panel should focus upon findings of fact while the panel administrator, a trained lawyer, should assist in applying precedents to the panel's findings. The panel administrator also should be responsible for advising the panel regarding previous sanctions in similar cases. This procedure will impose upon the panel an element of intellectual discipline which should help to prevent careless or arbitrary action. As Judge Jerome Frank wrote in a similar setting:

> It is sometimes said that the requirement that the trial judge file findings of fact is for the convenience of the upper courts. While it does serve that end, it has a far more important purpose—that of evoking care on the part of the trial judge in ascertaining the facts .... Often a strong impression that, on

> the basis of the evidence, the facts are thus-and-so gives way when it comes to expressing that impression on paper.[57]

Moreover, eliminating the role of the NASD prosecutor in composing the panel's opinion will prevent an adversary from structuring that opinion in such a way as to evoke a decision favorable to the prosecution in an appellate tribunal.[58]

Regarding the NASD procedure of permitting the prosecutor to time the submission of the panel's decision to the District Business Conduct Committee and to be present on an ex parte basis when that decision is discussed,[59] the independent panel administrator should perform these functions. This will prevent the NASD prosecutor from timing his submission to obtain advantages in other pending matters and will deliver him from one temptation to surreptitiously influence the disciplinary process.

Finally, the SEC or the exchanges and the NASD should prohibit the SEC enforcement staff from intervening, directly or indirectly, in a case pending before a self-regulatory organization. The statutory ladder[60]—from hearing panel to governing board to the SEC and, ultimately, to a federal court of appeals—has been carefully constructed. The tribunal at each step in the administrative process must be allowed to function independently if defendants are to receive the full procedural protection provided by the Securities Exchange Act of 1934.

## CONCLUSION

The thrust of this Article has been directed at the lack of fair procedures in a particular area of discipline under the federal securities laws. The problems analyzed in this Article, however, are not endemic to this area of the administrative process. As a response to these problems, certain solutions have been suggested. And these proposed solutions, hopefully, are not unique to the securities industry. To a majority of our citizens, the face of justice in our contemporary society is seen through the administrative process. Relatively few Americans become involved in full-dress court proceedings, but many of our citizens obtain licenses,

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[57] United States v. Forness, 125 F.2d 928, 942 (2d Cir.), *cert. denied*, 316 U.S. 694 (1942).

[58] *See* notes 30-31 and accompanying text *supra*.

[59] *See* text accompanying notes 33-34 *supra*.

[60] *See* notes 30 & 35 *supra*.

contest zoning regulations, and seek to maintain job tenures. One of the great challenges of our contemporary legal system is to ensure that these administrative proceedings, which affect so many of our citizens on a day-by-day basis, are conducted fairly. Fairness, however, is not the equivalent of due process of law because due process is really a minimum standard.[61] Fairness in an administrative proceeding requires that each side be given a relatively equal opportunity to present its case in a rational, open manner, and that an honest, impartial, reasoned adjudication be rendered. To achieve fairness, however, there must be proper procedures, for without these guidelines the tyranny of the bureaucracy is free to work its will. Without proper procedures, the administrative process becomes a haven for the meddlesome, the misinformed, the incompetent, and the corrupt to achieve their ends undetected and unchecked.[62] Certain of the more advanced agencies, such as the SEC in the securities field, do have a core of procedures which serve to guarantee defendants a degree of fairness throughout the administrative proceeding.[63] Today's challenge is to extend these procedures to the backward agencies—to the exchanges and the NASD in the securities field and to the parole boards, the zoning boards, the tenure panels and a host of other administrative bodies that dominate our contemporary jurisprudence. This Article attempts to chart a modest move in this direction.

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[61] *See* K. DAVIS, ADMINISTRATIVE LAW TEXT § 13.06, at 265 (3d ed. 1972).

[62] Justice Jackson used similar words to denounce unfairness in another administrative context. *See* United States *ex rel.* Knauff v. Shaughnessy, 338 U.S. 537 (1950) (dissenting opinion).

[63] The SEC's Rules of Practice and Conduct, contained in scattered setions of 17 C.F.R. §§ 200-203 & 231.1934 (1977), are collected in 4 FED. SEC. L. REP. (CCH) ¶¶ 66,101-66, 528 (1976).