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REPLY TO LOWENFELS*

Norman S. Poser†

Mr. Lowenfels makes serious charges against the nation's two leading stock exchanges and the only national securities association. He claims that the procedures they employ in fulfilling their self-regulatory obligations are deficient and unfair, and he implies strongly that the members and employees of these organizations allow personal, rather than professional, considerations to guide them in the discharge of their duties. If these charges were true, it would be a serious situation indeed. Fortunately, they are not.

Before dealing with the specifics of the Article, it is necessary to understand the regulatory scheme in which the self-regulatory organizations (SROs) play an important role. In enacting the Securities Exchange Act of 1934 (Exchange Act),¹ Congress declared that transactions in securities in organized markets are "affected with a national public interest which makes it necessary to provide for regulation and control of such transactions."² The SEC was established to administer the Act³ and given direct regulatory power in a number of areas,⁴ but a major portion of the day-to-day regulation of the markets was left to the SROs⁵ to perform, subject to SEC oversight.⁶

* *Editor's Note:* The *Review* invited the American Stock Exchange, the New York Stock Exchange, and the National Association of Securities Dealers, Inc. (NASD) to respond to the preceding Article. Mr. Norman S. Poser submitted this reply. Mr. Frank J. Wilson, Vice-President and General Counsel of the NASD, submitted a manuscript providing some of the authority cited in the footnotes of this reply.

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¹ Ch. 404, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78111 (1976)).

² Securities Exchange Act of 1934, § 2, 15 U.S.C. § 78b (1976).

³ *Id.* § 4, 15 U.S.C. § 78d.

⁴ *See, e.g., id.* §§ 8-11, 21, 23, 15 U.S.C. §§ 78h-78k, 78u, 78w.

⁵ *See, e.g., id.* §§ 6, 15A, 15 U.S.C. § 78f (national securities exchanges), 78o-3 (national securities associations).

⁶ The exchanges and the NASD are not historically analogous. The 1975 Amendments to the Exchange Act (Securities Acts Amendments of 1975, Pub. L. No. 94-29, secs. 4, 12, 16, §§ 6(b)(7), 15A(b)(8), 19(d), (e), 89 Stat. 97 (codified at 15 U.S.C. §§ 78f(b)(7) (exchange proceedings), 78o-3(b)(8) (association proceedings), 78s(d), (e) (SEC oversight of SROs) (1976))) subject exchange enforcement proceedings to the same statutory requirements and SEC review power as has applied to the NASD since its incorporation in 1939 (*see* Act of June 25, 1938, ch. 677, sec. 1, § 15A(h), 52 Stat. 1070 (codified at 15 U.S.C. § 78o-3(h) (1976) (as amended))); NASD MANUAL (CCH) ¶ 101 (1977)). *See* note 21 *infra*. Thus, NASD proceedings have a longer history of SEC oversight.

The Act required the SROs to have rules for the disciplining of members for conduct inconsistent with "just and equitable principles of trade,"⁷ a phrase that includes but is not limited to violations of the Exchange Act and SEC rules.⁸ The courts soon held that the duty to have disciplinary rules carried with it an implied duty to enforce them.⁹

Two assumptions underlay the decision of Congress to rely to a large degree on industry self-regulation, rather than exclusively on direct government regulation, to carry out the purposes of the Act. First, the expertise of participants in the securities industry would make possible a more speedy and responsive regulatory process than could be expected from a more remote government agency.¹⁰ Second, the SROs could enforce compliance with "ethical standards beyond those any law can establish,"¹¹ as well as

⁷ Securities Exchange Act of 1934, §§ 6(b)(5), 15A(b)(6), 15 U.S.C. §§ 78(b)(5), 78o-3(b)(6) (1976).

⁸ See, e.g., *id.* §§ 6(d)(1)(B), 15A(h)(1)(B), 15 U.S.C. §§ 78f(d)(1)(B), 78o-3(h)(1)(B).

⁹ *Baird v. Franklin*, 141 F.2d 238, 244 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944).

¹⁰ SECURITIES AND EXCHANGE COMM'N, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess., pt. 4, at 693-94 (1963) [hereinafter cited as SPECIAL STUDY]. The Report of the Senate Committee on Banking, Housing and Urban Affairs, discussing the proposed 1975 amendments to the Exchange Act, stated:

These bodies do not act just like Government agencies, whose procedures and functions are derived from, and often prescribed by, statutes rather than from the decisions of those who choose to become members, and the Committee believes the distinction is essential to the concept of self-regulation. This does not mean that the decision-making processes of the self-regulatory bodies cannot be improved. Quite to the contrary, but in the Committee's view it would be self-defeating to saddle the self-regulatory organizations with the wholly [*sic*] panoply of Governmental administrative procedure.

One of the advantages of self-regulation is the flexibility and informality of its decision-making procedures. Further, self-regulatory organizations differ as to their membership, regulatory responsibilities, and economic power. It would be difficult to prescribe a single "proper" decision-making procedure appropriate to the circumstances of every self-regulatory organization, and it is doubtful that any such formal procedure would better serve the goal of effective securities regulation than the present practice of encouraging each organization to develop procedures which best serve its needs and those of public investors.

S. REP. NO. 75, 94th Cong., 1st Sess. 28-29 (1975).

The SEC itself has recognized the purposeful informality of NASD proceedings: "When Congress provided for self-regulatory associations of securities dealers such as the NASD, it clearly did not intend to create formalistic tribunals akin to courts or even to this Commission. Self-regulation or cooperative regulation necessarily calls for informality." Sumner B. Cotzin, Securities Exchange Act Release No. 10850 (June 12, 1974), 4 SEC DOCKET 420, 422 (1974).

¹¹ SPECIAL STUDY, *supra* note 10, at 694 (quoting address given by Justice William O. Douglas when Chairman of SEC).

with "legal standards in a complex and changing industry."¹² From the viewpoint of SRO members, effective self-regulation is important not only because they and their customers may be victims of misconduct, but also because the confidence of investors is essential to preserving healthy securities markets.¹³

Over the years, procedures have evolved at the SROs for fulfilling the statutory duty to discipline members in appropriate cases. Originally, the industry members themselves handled most or all phases of disciplinary actions in an informal way. A member or a member's employee suspected of misconduct would be brought swiftly before a committee of members and given an opportunity to make his defense. Representation by counsel was not permitted at any stage of the proceeding,¹⁴ and little, if anything, would be put in writing. The committee hearing the case would come quickly to a decision and notify the accused of it. At the exchanges, unlike the National Association of Securities Dealers, Inc. (NASD), there was no appeal to the Securities and Exchange Commission.¹⁵ The premise that these were not judicial proceedings but simply peer review according to trade standards justified the informality with which they were conducted.

As the securities industry has grown more complex, disciplinary procedures have evolved along more formal and "legalistic" lines, and functions previously performed by members have increasingly been taken over by the staffs of the SROs. Nevertheless, SRO proceedings remain different from those of courts and governmental agencies such as the SEC. In the first place, SRO disciplinary proceedings are based on a contractual arrangement between the member and the SRO, not on the sovereign power of the government. Every exchange or NASD member, at the time he joins, agrees to be bound by the SRO's rules and procedures,

¹² *Id.* at 693 (quoting Justice Stewart's dissenting opinion in *Silver v. New York Stock Exchange*, 373 U.S. 341, 371 (1963)); see *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 514 (1934).

¹³ In 1941, the public governors of the Amex advocated public disclosure of disciplinary hearings and stated: "A National Securities Exchange has a definite public service to perform. That service is to maintain a free market for the sale and purchase of securities. If this service functions properly, business enterprise will be aided by the flow of capital into industry." SPECIAL STUDY, *supra* note 10, at 541-42.

¹⁴ In 1972, the American Stock Exchange Constitution was amended to expressly permit the assistance of counsel. AM. STOCK EX. CONST. art. V, § 1(a), 2 AM. STOCK EX. GUIDE (CCH) 2153 (1978). Presently, the New York Stock Exchange and the National Association of Securities Dealers allow counsel. See NYSE CONST. art. XIV, § 23, 2 NYSE GUIDE (CCH) 1103 (1978); NASD BY-LAWS art. VII, § 4, NASD MANUAL (CCH) ¶ 1504 (1973).

¹⁵ SPECIAL STUDY, *supra* note 10, at 664-65, 704.

which must be approved by the SEC.¹⁶ Second, the advantages of the self-regulatory system—expertise, speed, and the enforcement of ethical as well as legal standards—are as vital today as they were in 1934. If SRO disciplinary proceedings were to become merely a copy of those of the SEC, an important justification for having a system of self-regulation would disappear.

This is not to say that fundamental concepts of fairness should not be adhered to in SRO disciplinary proceedings. For the most part—Lowenfels' unsubstantiated charges to the contrary—these proceedings are fair. They are conducted within the framework of the Exchange Act,¹⁷ as amended in 1975¹⁸ to add new procedural protections and to formalize others that had previously been introduced by the SROs themselves.

In any disciplinary proceeding, the Exchange Act requires the SRO to bring specific written charges, give proper notice of the charges to the member, give him an opportunity to defend himself, and keep a record of the proceedings.¹⁹ In addition, any determination to impose a disciplinary sanction must be accompanied by a statement specifying the objectionable act or practice, the specific provisions or rules violated, the sanctions imposed, and the reasons therefor.²⁰ Furthermore, the respondent may appeal the SRO's decision to the SEC²¹ and ultimately to the

¹⁶ NYSE CONST. art. IX, § 8, 2 NYSE GUIDE (CCH) 1076 (1978); AM. STOCK EX. CONST. art IV, § 1(a)(3), 2 AM. STOCK EX. GUIDE (CCH) 2134-35 (1978); NASD BY-LAWS art. 1, § 4(a)(1), NASD MANUAL (CCH) ¶ 1104 (1974).

¹⁷ The Securities Exchange Act of 1934, §§ 6(b)(7), 15A(b)(8), 15 U.S.C. §§ 78f(b)(7), 78o-3(b)(8) (1976), requires the SRO rules to

provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the [SRO] of any person with respect to access to services offered by the [SRO] or a member thereof.

¹⁸ See Securities Acts Amendments of 1975, Pub. L. No. 94-29, secs. 4, 12, §§ 6(d)(1)-(3), 15A(h)(1)-(3), 89 Stat. 97 (codified at 15 U.S.C. §§ 78f(d)(1)-(3), 78o-3(h)(1)-(3) (1976)).

¹⁹ Securities Exchange Act of 1934, §§ 6(d)(1), 15A(h)(1), 15 U.S.C. §§ 78f(d)(1), 78o-3(h)(1) (1976).

²⁰ *Id.*

²¹ *Id.* § 19(d), 15 U.S.C. § 78s(d). Section 19 of the Exchange Act (15 U.S.C. § 78s (1976)) sets forth the oversight responsibilities of the SEC with respect to SROs. It requires that all rules, policies, practices and interpretations must be filed with the SEC for approval. Under these provisions, the SEC may abrogate, add to, or delete such rules as it deems necessary to insure the fair administration of the organization consistent with the requirements of the Act. Section 19 requires that every SRO comply with the provisions of the Act and its own rules and, absent reasonable excuse or justification, enforce compliance by its members and their associates with such provisions. The SEC is authorized to suspend or revoke the registration of an SRO, or to censure or impose limitations upon its activities, functions and operations upon finding that the SRO has violated, or is unable to comply

courts.²²

Within this statutory framework, the American Stock Exchange (Amex) has established detailed procedures for the conduct of disciplinary proceedings. Although this Reply focuses on Amex procedures, the New York Stock Exchange and the NASD have analogues for many of these procedures.

A person under investigation has the right to be represented by counsel at every stage of an Amex investigation and disciplinary proceeding.²³ At the conclusion of an interview conducted on the record, the interviewee is afforded an opportunity to make a statement regarding the matter at hand. Before any charges are served, he is given an opportunity to review the transcript of his testimony and to amend, clarify, or supplement his statement. Any charges must be specified "in reasonable detail,"²⁴ and in most instances relevant schedules and tables are annexed to the charges.

Disciplinary cases are heard by panels of Amex members consisting of a panel chairman appointed by the Amex Chairman with the approval of the Board of Governors, and two to four additional members selected by the panel chairman from a roster of approximately forty persons appointed annually by the Amex Chairman with the approval of the Board.²⁵ The Amex's compliance staff has no role in the selection of these panels or in the scheduling of hearings. In the course of time, a panel member may sit on several disciplinary panels, and may encounter issues similar to those he has decided on previous occasions. This is no more objectionable than when a judge decides cases with similar issues during the course of his career; in fact, it may be beneficial because it provides panel members with expertise on the matters under consideration.

with, its rules or any provisions of the Act, or if the SRO has failed to enforce compliance by any member or person associated with a member. The SEC is also authorized to remove from office or censure any officer or director of an SRO.

²² Securities Exchange Act of 1934, § 25, 15 U.S.C. § 78y (1976).

²³ See note 14 *supra*. As Lowenfels notes, SRO rules provide sanctions for a member's refusal to supply information requested in the course of an investigation, and do not recognize an exception where the information might incriminate the member. This procedure does not infringe on members' fifth amendment rights. See *United States v. Solomon*, 509 F.2d 863 (2d Cir. 1975). Moreover, each member agrees to be bound by these rules when he joins the SRO. See note 16 *supra*.

²⁴ AM. STOCK EX. CONST. art. V, § 1(b)(4), 2 AM. STOCK EX. GUIDE (CCH) 2154 (1978).

²⁵ *Id.* § 1(b)(1), 2 AM. STOCK EX. GUIDE (CCH) 2153; RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 1-3, 2 AM. STOCK EX. GUIDE (CCH) 3403-04 (1975).

The scheduling and administration of disciplinary hearings are handled by a panel assistant who is an attorney in the Amex's Legal Department and has no connection with the compliance staff.²⁶ This panel assistant attends hearings and advises the panel chairman on such matters as procedure and the interpretation of rules. On all such matters the final arbiter is the panel chairman.²⁷

At the disciplinary hearing, the respondent or his counsel has an opportunity to make opening and closing statements, to introduce witnesses, and to cross-examine the prosecution's witnesses.²⁸ Adherence to the rules of evidence is not required.²⁹ In this regard, Amex rules provide:

The parties . . . may offer such evidence and may conduct such examination of witnesses as may be deemed relevant to the issues raised by the charge or charges and by the answer, if any. The chairman of the Panel shall rule on all questions of admissibility, relevancy and materiality of evidence offered.³⁰

Once a decision is reached, a written opinion is prepared by the panel assistant at the panel's direction, circulated among the panel members and, after whatever changes they deem necessary have been made, signed by the panel chairman. The respondent may appeal a panel decision to the Board of Governors or its Executive Committee, but the Amex compliance staff has no such right of appeal.³¹ If the respondent does not appeal, the Board of Governors may, on the initiative of at least four governors, call up a case for review, but the Amex Board has no power to increase the penalty.³² If the Board believes that the panel has been too lenient, its only recourse is to remand the case to the panel with a recommendation that appropriate changes be made.

Against this background I will respond to Lowenfels' charges as they relate to Amex rules and practices. It is my belief that

²⁶ RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 6, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

²⁷ *Id.*, rules 4 & 7, 2 AM. STOCK EX. GUIDE (CCH) 3404-05, 3406.

²⁸ AM. STOCK EX. CONST. art. V, § 1(b)(4), 2 AM. STOCK EX. GUIDE (CCH) 2154 (1978). Neither the Amex Constitution nor the Disciplinary Rules expressly authorizes opening and closing statements.

²⁹ RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 7, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

³⁰ *Id.*

³¹ *See* AM. STOCK EX. CONST. art V, § 1(b)(5), 2 AM. STOCK EX. GUIDE (CCH) 2155-56 (1978).

³² *Id.*

most of my comments apply as well to the New York Stock Exchange and the NASD. Space does not permit me to answer every inaccuracy and innuendo, but it is possible to identify and respond to the chief problems of the Article.

There are three kinds of problems. First, the Article contains a large number of unsubstantiated (and untrue) statements and suggestions. Second, it charges the SROs with supposed deficiencies, which are in fact phenomena common to judicial proceedings and administrative proceedings brought by governmental agencies. Finally, Lowenfels criticizes SRO rules, or the absence of rules, but often ignores the actual practices of the SROs.

A. *Unsubstantiated Allegations*

Lowenfels asserts that the compliance staffs of the SROs conduct investigations because of "excessive zeal, narrow perspective, sheer momentum, inertia, or even personal animosity."³³ Since the Amex Compliance Department normally carries a case load of seventy to eighty cases divided among five attorneys, it seems unlikely that they can afford the luxury of conducting investigations for personal reasons. Lowenfels goes on to suggest that personnel on all levels of the SRO compliance staffs may occasionally share responsibility for members' transgressions, ranging from an innocent failure to discover violations early enough³⁴ to "actual complicity in misdeeds."³⁵ If a regulator is involved in misconduct, he should of course not participate in the investigation and should be punished himself, but Lowenfels cites no instance of such "complicity."

Lowenfels speculates that the prosecutor may take advantage of "[o]ld prejudices and rivalries" and "[e]xisting competitive considerations" in the respondent's relationship to the industry members that make up the disciplinary panel.³⁶ He adds that the prosecutor will often socialize with panel members in the airplane en route to the hearing, at their hotel, and during adjournments. This situation, he submits, creates "a significant and gratuitous risk of impermissible influence upon the judgment of the panel."³⁷ Lowenfels offers no support for these assertions. In any

³³ P. 377, *supra*.

³⁴ Although a regulator may be criticized for failing to discover a misdeed sufficiently early, it is not altogether clear why this would make him responsible for the misdeed.

³⁵ P. 377, *supra*.

³⁶ P. 383, *supra*.

³⁷ P. 389, *supra*.

case, panel members are more likely to sympathize with the respondent, with whom they may share common business experiences and problems.³⁸

The role of the panel assistant also comes under attack, referred to by Lowenfels as "supposedly impartial" and as a "facade."³⁹ He states that the panel assistant works closely with the prosecutor and that his job is to move cases as fast as possible. In fact, the panel assistant acts independently of the compliance staff,⁴⁰ and speed in bringing cases to a conclusion is only one of several purposes which he must keep in mind. The overall fairness of the proceedings is an even more important goal. Furthermore, it should be recognized that scheduling of disciplinary hearings is a difficult problem, particularly since these hearings are normally held after business hours in order to avoid interfering with the normal business activities of the respondents and the panel members.

These and other allegations of improper motives on the part of investigators, panel members, panel assistants, and prosecutors are not only unsupported but insulting to all concerned. Lowenfels should either substantiate or withdraw his McCarthyesque charges.

B. *Alleged SRO Deficiencies Common to Other Enforcement Proceedings*

Lowenfels identifies, as examples of unfairness, phenomena common to judicial and administrative proceedings. Although pervasiveness does not prove fairness, it indicates that the practices have sufficient merit to survive years of scrutiny in other areas of law.

A number of Lowenfels' criticisms, particularly those concerning the role of the panel assistant, follow from the juxtaposition of

³⁸ The SEC has consistently stated that the manner in which the NASD staff interacts with the District Committee is consistent with the dictates of the Act. *See, e.g.*, First Philadelphia Corp., Securities Exchange Act Release No. 14432 (Feb. 2, 1978), 14 SEC DOCKET 71, 73 n.10 (1978). In Sumner B. Cotzin, Securities Exchange Act Release No. 10850 (June 12, 1974), 4 SEC DOCKET 420 (1974), the SEC stated: "we nevertheless remain unpersuaded that a rigid separation between investigative and adjudicative personnel, such as that mandated by the APA, is an essential element of fairness in NASD proceedings at the district business conduct committee level." *Id.* at 423. The Commission went on to acknowledge that the NASD's procedures should be reexamined to avoid even the appearance of undue staff influence, but in no case has the Commission found undue influence.

³⁹ P. 386-87, *supra*.

⁴⁰ *See* RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 6, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

the prosecutorial and judicial functions within the same organization. This is equally true in an administrative agency such as the SEC. In both cases, respondents can be protected against prejudice by ensuring the separation of the two functions.⁴¹ This is accomplished at the Amex by making the panel assistant responsible to the head of the Legal Department and not the head of the Compliance Department.⁴²

Lowenfels directs other criticisms toward the issuance, timing, and content of formal charges. First, he complains that the decision to bring charges is a unilateral one made by the prosecutor. But at the Amex, all charges are reviewed by a senior officer of the Exchange, and the more serious charges receive close scrutiny by more than one senior officer.⁴³ Lowenfels proposes a procedure like that of a grand jury to determine whether there is probable cause to bring charges. Although arguments exist on both sides of this issue, such a prehearing proceeding would necessarily counteract one of the particular advantages of the self-regulatory process—speed. Second, Lowenfels notes that, by the time he brings formal charges, the prosecutor will have substantially prepared his case. This prosecutorial “head-start” inheres in all regulatory and criminal processes in which the prosecutor initiates the investigation of possible misconduct. Yet nothing prevents the respondent from beginning to prepare his defense as soon as he learns that he is under investigation. In fact, a prudent lawyer would counsel him to do so. Third, the prosecutor has discretion as to the order in which he brings cases pending against the same or different respondents. Lowenfels contends that prosecutors schedule related cases (involving the same respondent or similar issues) in order to gain unfair advantages over respondents in a given case. I know of no examples of this practice at the Amex,

⁴¹ The issue of separation of functions was considered by the Attorney General's Committee on Administrative Procedure, which stated in its Final Report that “[t]hese types of commingling of functions of investigation or advocacy with the function of deciding are thus plainly undesirable. But they are also avoidable and should be avoided by appropriate internal division of labor.” ATTORNEY GENERAL'S COMMITTEE ON ADMINISTRATIVE PROCEDURE, FINAL REPORT, S. DOC. NO. 8, 77th Cong., 1st Sess. 56 (1941). See Villani v. New York Stock Exchange, Inc., 348 F. Supp. 1185, 1190 (S.D.N.Y. 1972) (NYSE procedures for segregating prosecutorial and adjudicatory functions carry presumption of impartiality), *aff'd sub nom.* Sloan v. New York Stock Exchange, Inc., 489 F.2d 1 (2d Cir. 1973).

⁴² See RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 6, 2 AM. STOCK EX. GUIDE (CCH) 3406 (1975).

⁴³ This procedure has evolved through practice; it is not required by Amex rules.

and Lowenfels cites none. Moreover, as noted earlier, it is in the nature of the disciplinary process—whether judicial, administrative, or self-regulatory—that the prosecutor has the initiative. Fourth, Lowenfels argues that confusion results from charges preferred against specialist units or firms as entities, rather than solely against individual members. However, charging a firm with corporate responsibility for misdeeds is no more objectionable than the common practice of naming a corporation in a criminal indictment.⁴⁴

The respondent is further hindered in preparing his case, asserts Lowenfels, by the money and time needed to retain expert witnesses and analyze their findings. If a respondent feels that an expert witness is necessary for his defense, he must incur the expense, just as he would in a judicial or administrative proceeding. And as to time, an average of two months elapses between the date charges are served and the date scheduled for the Amex hearing. Furthermore, a respondent in need of more time can appeal to the panel chairman for an extension.⁴⁵ In practice, few such appeals are taken because the Amex panel assistant liberally grants requested extensions.

Other examples of unfairness allegedly occur at the hearing stage. Lowenfels contends that prehearing press coverage of the facts of the case, combined with the panel members' respect for an experienced prosecutor, may result in a *de facto* presumption of guilt. The possibility that press coverage of a matter has been seen by the triers of fact is equally likely in a jury trial. Similarly, factfinders are no more likely to rely upon the prosecutor in SRO hearings than in criminal trials or in proceedings before government agencies. In practice, the prosecution is more likely than the respondent to be hurt since SRO prosecutors tend to be young attorneys whereas respondents may retain experienced counsel.

C. Focusing on Rules or Their Absence While Ignoring Actual Practice

Lowenfels purports to speak from personal experience as respondents' counsel before the SROs. Nevertheless, it is an indica-

⁴⁴ See 1 WHARTON'S CRIMINAL LAW AND PROCEDURE § 52 (1957). This principle is recognized in AM. STOCK EX. CONST. art. V, § 4(r), 2 AM. STOCK EX. GUIDE (CCH) 2162 (1978).

⁴⁵ See RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 4, 2 AM. STOCK EX. GUIDE (CCH) 3404-05 (1975) (chairman has discretion to determine time and place of all panel meetings).

tion of the bias of his Article that where the SROs provide protections not required by their rules, he ignores the practice and points to the supposed inadequacy of the rules.

Lowenfels notes that the SROs do not have statutes of limitations for the bringing of disciplinary proceedings. However, few, if any, Amex disciplinary proceedings are brought more than two years after the conduct complained of occurred, and the vast majority are brought within a few months. Imposing a statute of limitations would thus have little practical impact. Nor need respondents fear that a delay will result in records being lost; SEC rule 17a-1⁴⁶ requires the SROs to retain records for five years.

Lowenfels states that the SROs do not in their rules provide for formal discovery rights.⁴⁷ However, applications for prehearing discovery are granted on a liberal basis where the relevancy of documents requested can be shown. Where an application is denied, the respondent may appeal the staff decision to the panel chairman. Furthermore, for an SRO to allow discovery equivalent to that allowed in federal court would deprive SRO proceedings of much of their special advantages of speed and relative simplicity.

In addition, Lowenfels complains that the SRO prosecutor is not obliged to furnish the respondent with a list of witnesses or the documentary evidence to be introduced at the hearing, and that issues cannot be narrowed because facts are not stipulated. In practice, lists of witnesses and all documentary evidence are furnished to the respondent upon his request. Furthermore, the parties may and do enter into stipulations of facts.⁴⁸

Perhaps SRO rules should be amended to reflect SRO practices, but fairness demands that critics acknowledge both.

D. *Lowenfels' Suggested Solutions*

Lowenfels concludes his Article with a number of suggestions for changes in the disciplinary procedures of the SROs. Some of these are inappropriate, for reasons given elsewhere in this re-

⁴⁶ 17 C.F.R. § 240.17a-1 (1978).

⁴⁷ In the Second Circuit, there is no constitutional right to discovery in New York Stock Exchange disciplinary proceedings. *See, e.g., Crimmins v. New York Stock Exchange, Inc.*, 368 F. Supp. 270 (S.D.N.Y. 1973), *aff'd*, 503 F.2d 560 (2d Cir. 1974).

⁴⁸ *See* NYSE CONST. art. XIV, § 14, 2 NYSE GUIDE (CCH) 1099 (1978); AM. STOCK EX. CONST. art. V, § 2, 2 AM. STOCK EX. GUIDE (CCH) 2157 (1978). The NASD does not currently have a formal stipulation procedure.

sponse, others are already part of the practice of the SROs, and still others are based on false premises. Two suggestions, however, merit additional comment.

Lowenfels suggests that disciplinary decisions should be accompanied by "carefully reasoned opinions" and that these opinions should be catalogued by subject matter and made available to respondents. As indicated above, the Exchange Act requires that any disciplinary action by an SRO be accompanied by a statement specifying, among other things, the acts or omissions complained of and the statutory provisions or rules that have been violated.⁴⁹ To require an opinion that does more than this would be burdensome and would further blur the beneficial distinctions between SRO proceedings and those of a court or administrative agency. As to indexing SRO opinions by subject matter, there is no question but that this should be done. It should be noted, however, that under Amex rules all disciplinary actions, other than minor actions of a "housekeeping" or administrative nature, are made public.⁵⁰ Where requested by a respondent or his counsel, the Amex supplies copies of public releases concerning any disciplinary cases relevant to the case at hand.

Finally, Lowenfels recommends that the SEC staff be prohibited from intervening, formally or informally, in any case pending before an SRO. It is unclear how the SEC is to be "prohibited" from such involvement, particularly where the SEC has concurrent jurisdiction over the matter, *i.e.*, where a possible violation of the federal securities laws is involved. Nevertheless, I agree with the basic spirit of Lowenfels' suggestion. Although the SEC has generally exercised restraint, it has occasionally brought proceedings even though an SRO has fully investigated a matter, initiated proceedings, and taken disciplinary action. Such duplicative action by the SEC is not only wasteful of regulatory resources and unnecessarily burdensome to respondents, but it also undermines the independent functioning of the self-regulatory system. In the rare case where it is clear, after the SRO has completed its action, that it has substantially failed to fulfill its obligations, the Commission might properly bring its own proceeding. But this should occur only in the most egregious cases if the self-regulatory system is to retain its vigor.

⁴⁹ Securities Exchange Act of 1934, §§ 6(d)(1), 15A(h)(1), 15 U.S.C. §§ 78f(d)(1), 78o-3(h)(1) (1976).

⁵⁰ RULES OF PROCEDURE APPLICABLE TO EXCHANGE DISCIPLINARY PROCEEDINGS 13, 2 AM. STOCK EX. GUIDE (CCH) 3407 (1975).

CONCLUSION

Over the years, the disciplinary procedures of the SROs have changed to incorporate a number of procedural protections. Since 1975, basic elements of fairness have also been required by the Exchange Act.⁵¹ Contrary to Lowenfels' unfounded assertions, SRO procedures are fair. Where challenged, they have been upheld by the courts. In evaluating these procedures it must be recognized that securities regulation involves a balance between protecting the rights of persons accused of misconduct and protecting investors. The tension that inevitably exists between these competing considerations is heightened in the SROs because they must regulate the conduct of their own members.

Unfortunately, Lowenfels ignores this basic truth and calls into question—without any factual basis—the integrity of the persons charged with accomplishing the difficult task of self-regulation. In taking this approach, he does not serve the best interests of the SROs, their memberships and staffs, or the investing public.

⁵¹ See note 18 *supra*.