Nos. 20061 and 20062

In the United States Court of Appeals for the Ninth Circuit

SECURITIES AND EXCHANGE COMMISSION, APPELLANT AND CROSS-APPELLEE

v.

CHARLES Y. HIGASHI, APPELLEE AND CROSS-APPELLANT

DON JENKS, APPELLANT

v.

SECURITIES AND EXCHANGE COMMISSION, APPELLEE

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

BRIEF OF SECURITIES AND EXCHANGE COMMISSION, APPELLANT NO. 20061

PHILIP A. LOOMIS, Jr.,
General Counsel,
DAVID FERBER,
Solicitor,
MARTIN D. NEWMAN,
Attorney,
Securities and Exchange Commission,
Washington, D.C., 20549.

FRANK E. KENNAMER, Jr.,
Assistant General Counsel,
Securities and Exchange Commission,
San Francisco Regional Office,
450 Golden Gate Avenue,
Box 36042,
San Francisco, California, 94102.

TABLE OF CONTENTS

CITATIONS

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STATEMENT OF PLEADINGS AND JURISDICTION

On March 24, 1965, the United States District Court for the District of Hawaii entered an order requiring Charles Y. Higashi, appellee in No. 20061 to obey a subpoena *duces tecum* (R. 47–48)[1] issued by the Securities and Exchange Commission in *In the Matter of Silver King Mines, Inc. and Kay L. Stoker,* an

[1] The reproduced record in No. 20061 is herein referred to as "R. —."

Act of 1934, 15 U.S.C. 78u(b). Section 19(b) of the Securities Act provides:

> For the purpose of all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of this title, any member of the Commission or any officer or officers designated by it are empowered to administer oaths and affirmations, subpena witnesses, take evidence, and require the production of any books, papers, or other documents which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of such documentary evidence may be required from any place in the United States or any Territory at any designated place of hearing.

Section 21(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(a), refers to such investigations as the Commission "deems necessary to determine whether any person has violated or is about to violate any provision" of that Act "or any rule or regulation thereunder" and Section 21(b) provides:

> For the purpose of any such investigation, or any other proceeding under this title, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

in *In the Matter of Silver King Mines, Inc. and Kay L. Stoker* (R. 11a–11b). Mr. Stoker is a director, the principal promoter and a substantial stockholder of Silver King Mines, Inc. ("Silver King") (R. 3, 22). The Commission's order directed that an investigation be conducted to determine, *inter alia,* whether in the offer and sale of shares of Silver King, "Kay L. Stoker and others" had violated or were about to violate the registration provisions of the Securities Act of 1933, Sections 5(a) and (c), 15 U.S.C. 77e(a) and (c), or the anti-fraud provisions of that Act, Section 17(a), 15 U.S.C. 77q(a), or the anti-fraud provisions of the Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. 78j(b), and Rule 10b–5 thereunder, 17 CFR 240.10b–5. The order, issued pursuant to Section 19(b) of the Securities Act of 1933, 15 U.S.C. 77s(b), and Section 21(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(b), designated certain persons as officers of the Commission empowered "to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda or other records deemed relevant and material to the inquiry, and to perform all other duties in connection therewith as prescribed by law." (R. 11b). On August 10, 1964, the Commission issued a supplemental order amending the foregoing order, by including Arthur E. Pennekamp, Administrator of the Commission's San Francisco Regional Office, as an additional officer in the investigation (R. 12a).

Acting pursuant to these orders, Mr. Pennekamp on January 15, 1965, issued and served by certified

tion and Mr. Stoker (Tr. 103–104). From his subsequent correspondence with the Clerk of this Court[4] it appears that Mr. Bushnell is executive vice president of Silver King.

In his January 22 telephone call to Mr. Pennekamp Mr. Bushnell reported that he had been retained by Mr. Higashi. He requested that Mr. Higashi be excused from appearing on the prescribed day in Honolulu but that he be permitted to appear in San Francisco when Mr. Bushnell was scheduled to represent another witness, Don Jenks, who had also been subpoenaed by the Commission in connection with the Silver King investigation (R. 4, 22).[5]

On that same day Mr. Pennekamp wrote Mr. Bushnell that his representation of Mr. Higashi would not be permitted under Rule 7(b) of the Commission's Rules Relating to Investigations. Mr. Pennekamp noted that Mr. Bushnell had "previously represented Silver King Mines, Inc., Shasta Minerals & Chemical Co., Kay Stoker, Messrs Don Jenks, Harry L. Gormley, Thomas F. Boyle, and J. Albert Kramer in connection with" the investigation. Mr. Pennekamp stated that in permitting Mr. Bushnell "to represent all of these individual witnesses, the officers of the Commission conducting the investigation, in the discretion accorded to

[4] See letter of Mr. Bushnell to Mr. Schmid dated, July 2, 1965.

[5] An order enforcing the Jenks subpoena was entered on March 23, 1965 (*Securities and Exchange Commission* v. *Jenks* (D. Hawaii, No. 2357)), the appeal from which (No. 20062) has now been consolidated with this appeal (No. 20061). See page 2, *supra*.

> its stockholders to cooperate with the S.E.C. The attorney for Shasta has advised us that the stockholders are not required to answer these questionnaires, nor are they required to grant an interview or answer any questions asked them by S.E.C. representatives. Further, he advises that the stockholder should not answer the questionnaire or answer any questions unless they are represented at the time by legal counsel. (R. 16a).

Mr. Bushnell has admitted that he participated in the preparation of this letter (Tr. 95).

On January 27, 1965, Mr. Higashi failed to appear as directed by the subpoena, without having asked for additional time to obtain counsel. The Commission accordingly brought an action in the United States District Court for the District of Hawaii to enforce its subpoena.

It had previously been agreed between Mr. Bushnell and Mr. Pennekamp that Mr. Jenks, who was represented by Mr. Bushnell, would appear to testify in San Francisco on February 10, 1965. On February 9, 1965, Mr. Bushnell telephoned Mr. Pennekamp and stated that he was not going to have Mr. Jenks appear on that day, pointing out that Mr. Stoker was "boiling mad" because the Commission had announced the institution of the subpoena enforcement proceeding against Mr. Higashi (R. 52, Tr. 50). Thereafter, the Commission brought an action to enforce its subpoena issued to Mr. Jenks.

Because charges had been made by Mr. Bushnell

that Rule 7(b) of the Commission's Rules Relating to Investigations was invalid and that the refusal of the Commission to permit Mr. Bushnell to represent him was "arbitrary, capricious and unreasonable," "oppressive, amount[ing] to persecution * * * an abuse of discretion and * * * otherwise unreasonable." (R. 23–24). He also filed a "Demand for Production of Documents" by which he sought a great mass of material from the Commission's files, including numerous non-public documents relating to Silver King, Shasta, and the other companies in which Mr. Stoker has been involved as a promoter. (R. 27–31).

The district court denied respondent's request for documents (Tr. 75) and found no harassment of Mr. Higashi (Tr. 73). It held that Rule 7(b) of the Commission's Rules Relating to Investigations was valid (Tr. 20) but that it could not be applied to prevent a director of a corporation which was the subject of the investigation from being represented by company counsel. The court thereupon entered an order directing that Mr. Higashi obey the Commission's subpoena but on the condition that he be permitted to be represented by Mr. Bushnell. Since it is convinced that this condition impairs the efficacy of its investigative function, mandated by Congress and implemented by its Rule 7(b),[8] the Commission has appealed.

[8] The Commission's reasons were explained to the district court by counsel as follows:

"The Commission's determination, your Honor, was based on a number of grounds which we believe would be convincing. First, it is evident from the record, including Mr. Bushnell's

judgment was reasonable." *Cf. FCC* v. *Schreiber*, — U.S. —, 33 U.S. L. Week, 4492, 4495 (May 24, 1965).

In allowing Mr. Bushnell to represent Mr. Higashi in the Commission's investigation into possible securities violations by Silver King and Mr. Stoker, Silver King's principal officer and director, the district court interfered with the basic purpose of the sequestration provision of the Commission's investigative rule—obtaining the unvarnished facts. Requiring witnesses to testify separately and out of the presence of other witnesses is a time-honored method for learning the truth and is often important even in public trials. See *Estes* v. *Texas*, — U.S. —, 33 U.S. L. Week 4543, 4547 (June 7, 1965). This is even more essential during an investigation where the possibilities as to what the witnesses will testify have not yet been limited by their earlier versions of the facts. Investigations by the Securities and Exchange Commission have been compared by this Court to investigations by a grand jury, where witnesses are not even permitted to be accompanied by counsel. Accordingly, limitations on the rights of counsel in agency investigations have been upheld by this Court.

Particularly with respect to possible violations of the federal securities laws, the provision here involved is a reasonable means for obtaining the truth. Violations in this area are often difficult to detect and require extensive investigations; in this connection it may be necessary to determine whether or not individuals are acting in concert and to determine the possible relationships of persons and corporations. Investigations are often sought to be frustrated through

ARGUMENT

The district court erred in holding that an attorney appearing for a corporation and its principal officer and director in a Commission investigation might also represent in the investigation another director of the corporation, contrary to a rule of the Commission precluding one counsel from representing various witnesses in an investigation.

The issue involved

While, as noted, the court below purportedly held valid the Commission's rule, in effect it sought to amend the rule by carving out an exception for directors of corporations under investigation. The rule itself, however, provides that exceptions are to be made only "in the discretion of the officer conducting the investigation." The question here is whether the Commission's exercise and application of its rulemaking authority were valid, not whether the district court abused its discretion in devising "procedures to be followed by the Commission on the basis of the court's conception of how the public and private interests involved could best be served." Cf. *FCC* v. *Schreiber,* — U.S. —, 33 U.S. L. Week 4492, 4495 (May 24, 1965). It was there stated that the question for decision by this Court "was whether the exercise of discretion *by the Commission* was within permissible limits, not whether the District Judge's substituted judgment was reasonable." *Ibid.*

We show below that application of the sequestration rule here was within permissible limits. We first address ourselves, however, to the contention not accepted by the district judge, that any sequestration rule which

Charles v. *United States*, 215 F. 2d 825, 827, 828 (1954). The opinion continues (*id.* at 827):

> Of course all witnesses are (as the District Court said) 'required to tell the truth under oath whether they hear anybody else testifying or not.' Unfortunately, however, some witnesses pay little heed to this requirement. Such witnesses may, and often do, shape their testimony to match that given by other witnesses within their hearing. To prevent such matching of testimony is the prime purpose of putting witnesses under the rule. (Footnotes omitted.)

Preventing the testimony of others from being made available to potential witnesses is of even greater importance during investigations, where the possibilities as to what the witnesses will testify have not yet been limited by their earlier versions of the facts to the extent that they normally have been by the time of actual trial. Thus the necessity for secrecy during the investigatory stages of a proceeding precludes a witness before a grand jury even from being accompanied by counsel.[10] In the very recent case of *In Re Bonanno*, 344 F. 2d 830 (C.A. 2, 1965), by means of separate examination of witnesses before the grand jury, the United States Attorney was able to show that a lawyer-client relationship attempted to be relied upon did not exist. The Court of Appeals for the Second Circuit in that case stressed the fact

[10] See *e.g.*, *United States* v. *Scully*, 225 F. 2d 113, 116 (C.A. 2, 1955), *certiorari denied*, 350 U.S. 897 (1955); *United States* v. *Central Supply Ass'n*, 34 F. Supp. 241, 244 (N.D. Ohio, 1940).

broad powers of investigation granted to the Commission. See, *e.g.* Section 20(a) of the Securities Act of 1933, 15 U.S.C. 77t(a), and Section 21(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(a) (p. A1–A2, A2, *infra*). Unlike those guilty of some types of crimes, violators of the federal securities laws are often exceptionally clever persons who may have substantial resources to assist them in covering their tracks. Whether or not a violation has occurred at all sometimes cannot be determined without careful and thorough study of all the details of a financing, including the interviewing of numerous associates and investors and the examination of many complex documents. It is often necessary to determine whether or not individuals may be acting in concert and may concern possible relationships among such persons a key part of the investigation. This is not to suggest that all persons who act together are necessarily guilty of any offense since some may be the victims of others. See for example *Hammill & Co.*, 28 S.E.C. 634, 636 (1948), where a widow without business experience was made a partner in a securities firm whose registration the Commission revoked for various violations, including its inducement to the widow to become a partner so that the firm might obtain the investment of her security holdings.

Attempts may be made to frustrate such investigations through techniques ranging from non-cooperation to the subornation of perjury by bribe or threat.[12]

[12] This Court and other courts of appeals have affirmed convictions for perjury arising out of this Commission's investigations. *Woolley* v. *United States*, 97 F. 2d 258 (C.A. 9, 1938),

be present during the examination of other witnesses unless permitted in the discretion of the officer conducting the investigation. The purpose of sequestration could be defeated by an attorney advising witnesses as to the testimony of others. Even with respect to trials, as distinguished from investigations, Dean Wigmore points out that "[w]hether an *attorney* in the cause *may consult* with a sequestered witness has been the subject of some difference of opinion."[13] In this connection he states that "the possibilities of abuse by unscrupulous persons (and by the hypothesis there is about to be perjury, *i.e.* the rule is most needed for unscrupulous persons) are certainly great; and it seems clear, first, that it may not be done without leave of Court, and, secondly, that it may be done only aloud and in the presence of a court-officer; an honest attorney can hardly object to such regulations."

There is no "due process" requirement that a witness in a private investigation may have counsel present. *In re Groban,* 352 U.S. 330 (1957). And see footnote 10, *supra.* The only statutory requirement pertaining to this Commission is the provision in Section 6(a) of the Administrative Procedure

[13] 6 Wigmore, *Evidence*, § 1840 (3d ed. 1940). *Cf. United States* v. *Leggett*, 326 F. 2d 613 (C.A. 4, 1964), where the court of appeals refused to reverse a conviction merely because a prosecuting attorney had conferred out of the courtroom with a sequestered witness to obtain the credentials of that witness for the purpose of examining the witness who was testifying. The court nevertheless suggested (*id.* at 614) that "it may have been an impropriety on the part of counsel for the government to contact [the witness] * * * without first obtaining leave of the court * * *."

to permit a witness to be represented by an attorney who has been disbarred pursuant to rules of the agency.[17]

Indeed, when the Administrative Procedure Act was adopted, Congress specifically guarded against the danger of permitting witnesses in a private investigation to examine the testimony of other witnesses. It did so by making an exception to the provision in Section 6(b) of the Act, 5 USC 1005(b), which authorizes witnesses compelled to testify to "procure a * * * transcript" of their testimony. The exception provides "that in a nonpublic investigatory proceeding the witness may for good cause be limited to inspection of the official transcript of his testimony." The House Report states in pertinent part with respect thereto:

> The limitation, for good cause, to inspection of the official transcript may be properly invoked by an agency where evidence is taken in a case in which prosecutions may be brought

[17] See *Attorney General's Manual on the Administrative Procedure Act* (1947), p. 66, which states with respect to Section 6(a):

"It is clear, therefore, that the existing powers of the agencies to control practice before them are not changed by the Administrative Procedure Act. For example, an agency may exclude, after notice and opportunity for hearing, persons of improper character from practice before it, *Goldsmith* v. *Board of Tax Appeals*, 270 U.S. 117 (1926), or exclude parties or counsel from participation in proceedings by reason of unruly conduct, *Okin* v. *Securities and Exchange Commission*, 137 F. (2d) 398 (C.C.A. 2, 1943), or impose reasonable time limits during which former employees may not practice before the agency."

vealing to a prospective defendant in a criminal proceeding just what testimony the Government has.

It is a time-honored safeguard against perjury and conspiracy among witnesses to exclude other witnesses from a courtroom, or hearing room, while a particular witness is testifying, and, of course, witnesses are always examined in secret in grand jury proceedings. Where transcripts are made available to witnesses there is no way of guarding against their being made available to the persons whose activities are the principal subject of investigation.

An example of a very difficult investigation conducted by the Commission was the investigation of the so-called political slush fund of the Union Electric Company of Missouri. While the existence of that slush fund was so notorious as to be a matter of newspaper comment at the time the investigation began, it was only after efforts of a large number of investigators over a period of many months that any reliable evidence was elicited, and when it was developed the evidence furnished the basis for perjury prosecutions of a number of the leading officials in the company, as well as convictions of violation of the statutory provision against political contributions. It would seriously have impeded, if not completely frustrated, that investigation if the Commission had been forced to make transcripts of testimony available to witnesses, and thus indirectly to those principally involved in the violations of the law.

In cases where the investigation involves examination of employees of the suspected law violator, the employees may be under considerable

mission's Rules Relating to Investigations.[22] In that case a Mr. Lubell was counsel for Alaska International Corporation (referred to in the opinion as "Alaska"), a subject of the investigation. The court stated (238 F. Supp. at 577):

> Assuming that the Administrative Procedure Act does apply to investigations, nothing in Rule 3(c) of the Rules of Practice of the Commission and nothing done here was any denial of counsel. The Commission officers merely ruled that Mr. Lubell could not at the same time in the same investigation represent both movant and Alaska. The order for investigation had named Alaska as a subject of the investigation; movant had been, but was not at the time, an officer of Alaska. Mr. Lubell was then and for some time had been general counsel to Alaska. Movant was free to select any counsel of her choice other than Mr. Lubell. Movant could not insist on Mr. Lubell when Rule 3(c) and the conclusion of the Commis-

[22] Rule 3(c) of the Commission's Rules of Practice, which was rescinded on April 1, 1964, (Securities Act Release No. 4677, Mar. 12, 1964) when the Commission adopted a comprehensive set of Rules Relating to Investigations, including Rule 7(b) here involved, provided that:

"Any person compelled to appear in person at an investigation designated in paragraph (a) of this rule may be accompanied, represented and advised by counsel, but such counsel may not represent any other witness or any person being investigated unless permitted in the discretion of the officer conducting the investigation or of the Commission upon being satisfied that there is no conflict of interest in such representation and that the presence of identical counsel for other witnesses or persons being investigated would not tend to hinder the course of the investigation."

to answer questions after a grant of immunity, where the questions which appellant had refused to answer related to another client of the same counsel. There, as here, the person subpoenaed had stated that he desired to be represented by the attorney involved. *Id.* at 81. Here, as in that case, the possibility exists that the advice of counsel, if unclouded by his primary representation of someone else, would be that it was in the witness's best interests to make a full and candid disclosure of all facts relating to his participation in the enterprise, whether or not such disclosure would be in the interest of the principal subjects of the investigation. As suggested above, for example, it is possible that if there has been a violation in this case, Mr. Higashi might be a victim rather than a knowing participant; that he may be aware that Mr. Bushnell's representations of others could create conflicts and nevertheless agree that Mr. Bushnell may represent him may result from lack of sophistication. *Cf. Campbell* v. *United States,* — F. 2d — (C.A.D.C., June 28, 1965, No. 18,916), where, in reversing a conviction because a defendant whose attorney also represented another defendant was found not to have had proper representation, the court said (slip opinion, p. 3):

> An individual defendant is rarely sophisticated enough to evaluate the potential conflicts, and when two defendants appear with a single attorney it cannot be determined, absent inquiry by the trial judge, whether the attorney has made such an appraisal or has advised his clients of the risks.

mission in its investigations (See pages 8–9, *supra*). Under these circumstances the Commission's refusal to exempt him any further from the provision of its rule against sequestration was reasonable. Indeed, since it appears that Mr. Bushnell is an officer of Silver King, he himself might be required to be a witness in the investigation.

The district court held that the rule should not be applied to Mr. Higashi because "[u]nder the present thrust of the law of cases regarding the obligations and liabilities of directors, a director of a corporation may himself be held responsible for the acts of that corporation" (Tr. 107). This possibility is balanced, however, by the fact that corporate directors may themselves sometimes be deceived by corporate officers and other directors purportedly acting for the corporation. See, *e.g., Ruckle* v. *Roto American Corp.,* 339 F. 2d 24 (C.A. 2, 1964), where a corporation was held to have been defrauded by the failure of the majority of its board of directors to disclose pertinent facts to the remaining directors respecting a proposed issuance of stock. And, as we have noted, a person may sometimes be taken into an enterprise as an official in order to victimize him. See p. 19, *supra.* Because of such possibilities it is reasonable for the Commission to determine that in the investigation of securities violations it need not necessarily make an exception from its sequestration rule in order to permit counsel for the corporation to represent each of its directors. As this Court indicated in the *Schreiber* case, *supra,* 329 F. 2d at 526.

CONCLUSION

For the foregoing reasons this action should be remanded to the district court with instructions to order unconditional obedience to the Commission's subpoena.

PHILIP A. LOOMIS, JR.,
General Counsel,
DAVID FERBER,
Solicitor,
MARTIN D. NEWMAN,
Attorney,
Securities and Exchange Commission,
Washington, D.C., 20549.

FRANK E. KENNAMER, JR.,
Assistant General Counsel, Securities and Exchange Commission, 450 Golden Gate Avenue, San Francisco, California, 94102.

July 1965.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

DAVID FERBER,
Solicitor, Securities and Exchange Commission,
Washington, D.C., 20549.

STATUTORY APPENDIX

Securities Act of 1933, 15 U.S.C. 77a, *et seq.*

Section 19, 15 U.S.C. 77s.

(a) The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this title. * * *

(b) [Quoted in full at page 3, *supra,* of the text.]

Section 20(a), 15 U.S.C. 77t(a).

Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this title, or of any rule or regulation prescribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

Section 22(b), 15 U.S.C. 77v(b).

In case of contumacy or refusal to obey a subpena issued to any person, any of the said United States courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such

of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpena of the Commission, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.

* * * * *

Section 23(a), 15 U.S.C. 78w(a)

The Commission * * * shall * * * have power to make such rules and regulations as may be necessary for the execution of the functions vested in [it] by this title, and may for such purpose classify issuers, securities, exchanges, and other persons or matters within * * * [its jurisdiction] * * *

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