UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 30,276

R. A. HOLMAN & CO., INC.,

Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT.

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STATEMENT OF THE CASE

This is a proceeding brought by R. A. Holman & Co., Inc., a broker and dealer registered with the Securities and Exchange Commission, to reverse an order of the Commission (31a-32a) which held that petitioner, its sole stockholder, Richard A. Holman ("Holman"), and petitioner's salesmen, Ben Eisenberg and Irwin Vincent Powell, had willfully violated anti-fraud and anti-manipulative provisions and of the Securities Act of 1933 and Securities Exchange Act of 1934 and rules thereunder.[1/]

1/ These provisions and rules are: Securities Act of 1933: Section 17(a), 15 U.S.C. 77q(a). Securities Exchange Act of 1934: Section 10(b), 15 U.S.C. 78j(b), and 15(c)(1), 15 U.S.C. 78o(c)(1) and Rule 10b-5, 17 CFR 240.10b-5, Rule 10b-6, 17 CFR 240.10b-6, Rule 15c1-2, 17 CFR 240.15c1-2, and Rule 15c1-5, 17 CFR 240.15c1-5, thereunder.

The Commission found "serious and extensive violations" warranting the revocation of petitioner's registration and expulsion of petitioner from membership in the National Association of Securities Dealers (NASD). It further concluded that Holman, Eisenberg and Powell were each a cause of such revocation and expulsion.[2/] The findings of the Commission were made in a consolidated proceeding involving:

(1) A proceeding initiated by Commission order, dated September 16, 1960, temporarily suspending a conditional exemption from registration under the Securities Act of 1933 provided by Regulation A, 17 CFR 230.251-236, under that Act with respect to the offer and sale by petitioner of stock in Pearson Corporation ("Pearson") commencing on April 24, 1959. (33a-35a).

2/ Section 15A(b)(4), 15 U.S.C. 78o3(b)(4), of the Securities Exchange Act of 1934 in subparagraph (C) provides that the Commission shall have jurisdiction to make such determinations. Section 15A(b), 15 U.S.C. 78o3(b), requires that the Rules of the National Association of Securities Dealers (NASD) shall provide that, without the approval of the Commission, no broker-dealer shall be admitted to or continued in membership in such association if a person found to be a cause by the Commission is associated with the broker-dealer.

(2) A proceeding, initiated by Commission order, dated September 26, 1960, to determine whether the broker-dealer registration of petitioner should be revoked, whether petitioner should be expelled from membership in the NASD and whether Holman should be named as cause thereof, in connection with its activities in respect to the Pearson offering. This order was amended on November 15, 1960 to include petitioner's activities in respect to an offering of stock of Precise Development Corporation ("Precise") commencing on October 14, 1958, and to provide for a determination whether Eisenberg and Powell should be named as causes. (36a-43a, 49a-61a).

(3) A proceeding, initated by Commission order, dated March 8, 1961, to determine whether the broker-dealer registration of Irwin Vincent Powell, doing business as Powell Securities Company, should be denied, based, in part, upon his activities in the Precise offering. 3/

Petitioner is wholly owned by Richard A. Holman who is its president and serves as a director. It was organized in September 1958 after Holman had left McDonald-Holman & Co., Inc., another broker-dealer firm, in which he had been one-third stockholder, and vice-president and treasurer. That firm had been

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3/ Powell and Eisenberg were both held to be willful violators of the Securities acts and named as causes of the sanctions imposed upon petitioner. Both have petitioned for review. The Commission's motion to consolidate their petitions with this petition for review was denied.

expelled from membership in the NASD, and Holman personally had been censured and his registration suspended for 90 days. 4/

The first public distribution of securities by petitioner involved the stock of Precise Development Corporation and commenced in October 1958. The Commission found that this first venture for the new firm involved violations of the anti-fraud and anti-manipulative provisions of the securities acts which by themselves were sufficiently serious to warrant revocation of petitioner's registration.

The Commission also found that in another distribution occurring shortly afterwards, commencing in April, 1959, involving Pearson Corporation, petitioner and Holman had been guilty of further serious violations.

As we show below, the violations found by the Commission were serious, repeated and clearly established, and for the most part the Commission's basic findings are undisputed. Instead, petitioner relies upon asserted procedural errors to invalidate the Commission's proceeding. On four previous occasions petitioner has relied upon similar charges in unsuccessful attempts to invalidate the administrative proceeding. R. A. Holman & Co., Inc. v. Securities and

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4/ Holman petitioned the Commission for review of the NASD decision, and the Commission affirmed the censure and suspension. SEA Rel. No. 6931 (1962).

Exchange Commission, 112 App. D. C. 43, 299 F. 2d. 127 (1962), certiorari denied, 370 U. S. 911 (1962); Securities and Exchange Commission v. R. A. Holman & Co., Inc., 323 F. 2d 284 (1963), certiorari denied, 375 U. S. 943 (1963); C.A.D.C. No. 18,300, January 28, 1964 (petition for writ of mandamus denied); R. A. Holman & Co., Inc. v. Securities and Exchange Commission, 339 F. 2d 753 (C.A.D.C. 1964). While petitioner has been unsuccessful in invalidating the administrative proceeding, it did succeed through these attempts in delaying the Commission's decision. During the pendency of the proceeding -- and, indeed, in a period when the Commission was enjoined from continuing it -- petitioner engaged in the "boiler-room" activities found by the District Court for the Southern District of New York, which are the subject of the appeal in No. 30039.[6/]

[5/] Counsel for Holman requested that the Commission incorporate in this record the record on appeal in the above case (122a), and the Commission both in its order of January 3, 1964 (123a), and its findings and opinion of December 15, 1965 (22a), took notice of the materials in that record on appeal as "matters of public record in judicial proceedings" (123a). Accordingly, the joint appendix in that case has been included in the appendix numbered 1b-168b. The balance of the Commission's Appendix is numbered 1c-173c. References to the original record are preceded by "R".

[6/] Those activities occurred between September 1962 and March 1963, See Commission brief in No. 30039 (p. 7). The petitioner had obtained a preliminary injunction in July 1962, which was reversed on June 13, 1963, R. A. Holman & Co., Inc. v. Securities and Exchange Commission, 323 F. 2d 284 (1963). The Commission proceeding was in abeyance until after denial of certiorari on December 9, 1963, 379 U. S. 943.

The Commission's decision in this case, which was in accord with the recommended decision of the Hearing Examiner, was rendered by three Commissioners, Hugh R. Owens, Hamer H. Budge and Francis M. Wheat, who had no connection with the Commission until after the record in this proceeding had been closed.[7/] Commissioner Woodside, whose participation in the proceeding below is challenged, withdrew from consideration of the case and did not participate in the decision (30a). Commissioners Owens, Budge and Wheat independently reviewed the record, including all prior rulings complained of and determined that the proceeding had been conducted in a fair and impartial manner (7a, 21a, 26a).

The charge now seems to be that there has been a conspiracy from 1960 to date on the part of the Securities and Exchange Commission, its staff and an allegedly subservient hearing examiner.[8/]

7/ The record in this proceeding was closed on January 16, 1964. Mr. Owens was first appointed to the Commission on March 23, 1964; Mr. Budge on July 8, 1964; and Mr. Wheat on October 2, 1964. 31 SEC Ann. Rep. XIV, XV (July-June, 1965).

8/ This same allegedly subservient hearing examiner, in another administrative action (In the Matter of Russell L. Irish, S.E.C. File No. 8-2118), over which he was exercising jurisdiction at the same time as the Holman case, dismissed that proceeding on the ground that the Commission's staff had been guilty of laches. Memorandum of Hearing Examiner, October 23, 1963. After the Commission had reversed his decision (Memorandum of Commission, Dec. 12, 1963), he then determined that in view of the amount of time which had elapsed in the proceeding the imposition of a sanction upon the registrant would not be in the public interest. Recommended Decision by Hearing Examiner, April 3, 1964. Thereafter, the Commission again reversed the Hearing Examiner and revoked the registrant. Findings, Opinion and Order In the Matter of Russell L.Irish, SEA Rel. No. 7687 (1965).

Petitioner appears to suggest that they have trumped up charges against Richard A. Holman in order to prevent him from engaging in the securities business. No motivation for such a conspiracy is stated. That the violations in fact occurred, as found by the Commission, suggest the purpose for these charges.

ARGUMENT

I. The Record Amply Sustains the Commission's Findings of Fraud in the Sale of Securities by Petitioner.

A. Petitioner Followed a Classic Fraud Pattern in the Sale of Precise Development Corporation Securities.

By wholly unsupported charges that the Commission had conducted a Star Chamber proceeding (Br. 40)[9/] and that its decision is an "ex post facto formulation and application of policy" (Br. 49) (see page 19, infra), petitioner seeks to dispute findings of the Commission, fully sustained by the evidence, that petitioner from its very first underwriting (Br. 52) has been selling securities fraudulently in the most traditional sense.

9/ This charge is hardly consistent with petitioner's complaint to the Commission "that the proceedings should not have been made public" (27a, fn. 25). And see Justice Cardozo's dissent in Jones v. Securities and Exchange Commission, 298 U. S. 1, 33 (1936):

> "A commission which is without coercive powers, which cannot arrest or amerce or imprison though a crime has been uncovered or even punish for contempt, but can only inquire and report, the propriety of every question in the course of the inquiry being subject to the supervision of the ordinary courts of justice, is likened with denunciatory fervor to the Star Chamber of the Stuarts."

The Commission held that petitioner's "extensive fraudulent activity in the offer and sale of Precise stock in itself" warranted the revocation of petitioner's registration and its expulsion from membership in the NASD (27a-28a). In this connection the Commission found, inter alia, that petitioner's salesmen offered and sold Precise common stock to customers by means of false and misleading statements and extravagant predictions and the nondisclosure of material information; that one salesman selling the stock at 1-1/8 told purchasers that it would double or triple in value within a short time, would rise to 4 or 5 within about 90 days, was an excellent investment, and was a "baby blue chip"; and that another salesman selling the stock at 1-7/8 told his customers that Precise would go to 3 or 4 in a month or two, would be "around" $4 a share when a "public offering" was made, would "probably have a top value of $9 or $10 per share", had good prospects and a promising future with expected sales of about $1,000,000, and that a customer would have to order 2,000 shares in order to be sure of getting 1,000 shares (13a). These representations were made in January and May of 1959 and by November of that year Precise had filed a petition for an arrangement under Chapter XI of the Bankruptcy Act (13a-14a, 16a).

The Commission found that neither Holman, who himself "made optimistic representations and recommended the stock without the disclosure of material information", nor the salesmen had any "reasonable basis for the representations and predictions made" (13a-14a). Indeed, the Commission found that Holman, who had become the principal stockholder of Precise "must have known of Precise's adverse financial condition" (17a). It detailed facts showing that while the securities were being sold, Precise "was not operating efficiently or economically" and was in perilous financial condition (15a-17a).

Petitioner does not dispute that the representations recited above were made by petitioner's salesmen in the sale of Precise stock. It argues only that it "had ample grounds for confidence in the offering" (Br. 53). But the Commission held that even if petitioner had "had a sincere belief in the potential of Precise, such selling techniques were violative of the anti-fraud provisions" (18a). And facts set forth by the Commission which petitioner does not dispute make clear that the possibility of such a "sincere belief" had no basis in fact.

Thus, petitioner does not dispute facts found by the Commission showing that Precise's June 30, 1958 financial statements

made clear that its financial position was precarious,[10/] and facts showing that petitioner knew that Precise was so short of funds that its controlling persons were continually called upon to advance it

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10/ Petitioner states (Br. 52) that the Precise balance sheet of June 30, 1958 showed a net worth of $137,278 and that the balance sheet of June 30, 1959 showed a net worth of $256,978. It does not dispute, however, the Commission's findings that the financial statements in the offering circular showed a net profit for the fiscal year ending June 30, 1958 of only $1,817, following a net loss for the previous fiscal year of $38,625 (15a) and that the net sales for fiscal year 1958 reflected a decline of $87,421 from the previous year figure of $498,342 and that Precise had an accumulated deficit of $58,364 as of June 30, 1958 (15a). Nor does it dispute the Commission's finding that the stated total capital of $137,287 as of June 20, 1958, resulted from the relinquishment by Eugene Silber of an indebtedness of $132,047 in exchange for Precise stock, that this was noted on the balance sheet, and that, absent this conversion of indebtedness to capital, Precise's total capital would have been only $5,240. (15a). In fact, the reorganization which resulted in Eugene Silber's relinquishment of this claim was suggested by Holman (83c-84c).

Nor does petitioner dispute that the accountant who prepared the June 30, 1959 financial statements upon which petitioner relies -- even though they were as of a date later than representations made in the sale of Precise securities -- stated in his letter of transmittal that he was "not in a position to express an opinion on the accuracy of the figures" (16a) nor is there any dispute as to the Commission's finding that these very statements show an operating loss of $110,163, and, after deducting a "gain" on the repurchase on May 30, 1959 of notes payable to and a loan from Eugene Silver totally $78,434 for $1, a net loss of $31,730.

As a matter of fact, as the Commission pointed out:

> "Under generally accepted accounting principles the so-called 'gain' should have been treated as a capital contribution . . . and Precise's net loss should not have been reduced by this item." (16a, fn. 11)

cash so that it could operate on a day to day basis.[11] Petitioner's quotation from a report of an engineering consultant (Br. 53-54) who prepared a report of Precise as of February 1959 is misleading since it sets forth only the favorable factors found by the consultant and fails to quote the unfavorable factors which he found.[12]

11/ Petitioner does not dispute that prior to June 30, 1958, Eugene Silber had advanced $132,047 to Precise, and between June and December 1958 Precise borrowed $94,500 from him to keep its head above water, that Eugene Silber's son, Albert Silber, vice president of Precise, kept Holman advised of Precise's urgent financial needs; that a management advisor, between October 1958 and February 1959, advised Holman of the company's low sales, high rate of returns of finished products, and insufficient funds for the purchase of supplies; and that during the first half of 1959 petitioner in numerous instances wired funds to Precise, and that, finally, Holman, aware of the company's need for money, suggested the sale of stock for investment purposes to raise money and was authorized to sell 50,000 shares by this method (16a-17a).

That Precise may have returned $21,000 from petitioner on March 25, 1959, in connection with a proposed investment on undisclosed terms (Br. 54; 167a), is of little significance in view of the fact $40,000 was accepted from petitioner for "investment stock" only one month later (166a-169a). Further, five days later on March 30, 1959, Eisenberg's wife loaned Precise $9,000 under her maiden name. (105c-106c).

12/ Directly after the sentences quoted from that report by petitioner, the following statement appears:

> "II. Despite the above, this company has had a generally unsatisfactory financial record. The reasons for this are believed to be the following:
>
> 1) The market in which the company is operating is extremely competitive. . . ." (Emphasis in report). (Div. Exh. 280, 148c-150c).

Petitioner does not even refer to the cases cited by the Commission to support the Commission's statement that it has repeatedly held that "predictions as to speculative securities of unseasoned companies [of specific and substantial price increases within short periods of time] are inherently fraudulent and cannot be justified" (14a). For this proposition the Commission cited as illustrative Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6486, p. 15 (July 11, 1962), aff'd sub nom; Berko v. Securities and Exchange Commission, 316 F. 2d 137 (C. A. 2, 1963); Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962). See also the cases and discussion at pages 17 and 18 in No. 30.039 filed herewith.

As was recently said in a different context:

> "We are concerned in this case with a garden variety instance of deception, nondisclosure, and self-preferment by a broker purporting to act as a selling agent." Opper v. Hancock Securities Corp., CCH Fed. Sec. L. Rep. ¶91,628 (S.D.N.Y., Feb. 15, 1966), appeal pending.

As in that case, where the court noted that the duties of a broker-dealer are more demanding than those imposed on the ordinary agent, so might it be stated in this case:

> "All that is necessary here is to hold defendant to standards that would govern an agent for the sale of potatoes." (Id. at p. 95,339).

B. Petitioner Engaged in Fraudulent and Manipulative Activities Through Continuing Distributions of Securities After They Had Purportedly Been Terminated.

Pursuant to a conditional exemption from the registration provisions of the Securities Act contained in Regulation A, 17 CFR 230. 251-263, petitioner underwrote an issue of Precise securities commencing October 14, 1958 and an issue of Pearson stock commencing April 24, 1959. The Precise offering of 60,000 units at $5.00 per unit, each consisting of one share of common stock and one share of preferred stock convertible into four shares of common stock, was reported by petitioner to have terminated on December 31, 1958, after the reported sale of 33,220 units.[13/] The Pearson offering of 175,000 shares of stock at $1.00 per share was reported to have been completed on April 28, 1959 by the sale of the entire 175,000 shares. In both instances, the Commission found that the distribution was not completed on the dates claimed because the shares offered had not ultimately come "to rest in the hands of the investing public" (9a, 12a). Cf. Batten & Co., Inc., SEA Release No. 7086 (May 29, 1963), affirmed 345 F. 2d 82 (C.A.D.C. 1964); Lewisohn Copper Corporation, 38 SEC 226 (1958); Advanced Research Associates, Inc., SA Release No. 4630, pp. 20-22 (August 16, 1963).

13/ Rule 260, 17 CFR 230.260, requires the filing of a report with the Commission on Form 2-A setting forth the total number of shares sold.

Through continuing these distributions after they had purportedly been terminated without appropriate disclosure, petitioner falsely conveyed the impression that in each instance the shares offered in the offering circular had been unconditionally sold and that the offering had been successfully concluded at the offering price; and by purchasing securities during the periods through which the distributions continued, petitioner violated anti-manipulative regulations.

Precise Development Corporation

In reaching its conclusion that the Precise offering continued beyond December 31, 1958, the Commission found that purported sales of large blocks of units on December 30, 1958 to two individuals, Ludwig J. Kabian and David S. Greenspan, had not in fact occurred and that two other large blocks of Precise stock which petitioner subsequently obtained from the issuer were not sold until March and May of 1959 (12a-13a). Petitioner apparently does not dispute the latter findings. It contends, however, that the Kabian and Greenspan transactions were legitimate sales on a delayed delivery basis (Br. 55). The context in which these transactions arose was that petitioner was having difficulty selling the Precise offering (159a) and, after over two months of selling effort and before these allocations took place, only 15,220 units out of the 60,000 units being offered had been sold. The day before the offering was reported closed by

petitioner, 18,000 units, or 54% of the total units reported as sold,[14] were allocated to Kabian (13,000 units) and Greenspan (5,000).

Kabian testified that his understanding with Holman was that there would be a "delayed delivery" so that he could determine whether he "approved of the deal" (58c); that after investigation he decided against it and so advised Holman on at least two occasions between January 5 and January 10 and Holman then agreed that the confirmation "would be cancelled" (60c). On January 28, 1959 he sent Holman a registered letter requesting the cancellation (60c-61c, Div. Exh. 144, R. 3094). Nor was Greenspan required to make any out-of-pocket payment for the 5,000 units of Precise allocated to him (64c, 66c, 77c-78c). Although he testified that he considered himself firmly bound to pay for the units at the time such payment would become due on February 3, 1959 (Div. Exh. 184, 147c; 62c-63c), before such payment was due, petitioner, on Greenspan's instructions, on January 30, 1959 and February 2 and 3, 1959 sold the 5,000 units to the public and paid Greenspan the profit on the sale of $1,301 (11a, 65c-76c).[15]

14/ Treating these transactions as bona fide sales permitted petitioner to represent that the offering was partially successful, since 33,220 units or 55% of the 60,000 units could then be reported as sold. The Form 2-A reporting the 33,220 units as sold had no explanatory note concerning the "delayed delivery" basis (on which the Kabian and Greenspan transactions allegedly were effected). (Div. Exh. 92, Form 2-A of 24 NY 4734).

15/ Edgerton, Wykoff & Co., 36 S.E.C. 583-586 (1955), cited by petitioner (Br. 55), for the proposition that customer cancellations do not retroactively reopen an offering, is clearly distinguishable. There the offering had been completely sold out in seven days, and the Commission found that the selling broker had no reason to believe that the customer would not execute his purchase.

Pearson Corporation

Petitioner does not dispute the facts found by the Commission (7a-9a) in connection with the Pearson offering (Br. 40-51).

The Commission's over-all conclusion, based upon these findings was "that registrant, together with or aided and abetted by Holman willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b-5, and 15c1-2 thereunder"(10a-11a).[16/]

The issue is not, as petitioner suggests (Br. 40, 47-51), whether an underwriter can purchase part of an offering or may sell to relatives or friends and associates. The issue is whether the underwriter can without disclosure temporarily lodge stock with such persons with an understanding that such stock may be repurchased by the underwriter for distribution to the public at higher prices. Such practices tend to place the market under the underwriter's continuing control in that such stock will be off the market until the underwriter determines the market will absorb it at the price desired by the underwriter. See the "Hot Issues" Release, SEA Rel. No. 6097 (Oct. 29, 1959)(R. 13443-6).

16/ In view of these conclusions the Commission determined that the terms and conditions of Regulation A had not been complied with and made the Regulation A suspension permanent.

The Commission found that petitioner had sold a substantial portion, 40,000 shares, of the Pearson Regulation A offering to insiders and "affiliated" persons with a view to its subsequent repurchase and distribution to the public at prices in excess of the offering price (9a). While Holman was telling his public customers the offering was oversold and additional shares could only be purchased at $3.50 per share (1c-3c, 11c, 6c-7c, 12c-14c), he personally loaned petitioner's counsel Halperin (Holman's future law partner) $6,000 (18c, 101c) toward the purchase of 8,100 shares[17/] at the public offering price of $1 per share on April 28, 1959, and petitioner repurchased these shares from Halperin[18/] on the very same day at 1-3/4 per share (102c-103c). In fact, Halperin did not pay for this stock until May 2, 1959 (Div. Exh. 27, 115c). In a similar situation in Advanced Research Associates, Inc., Securities Act Release No. 4630, pp. 20, 22 (1963), cited in its

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17/ Halperin had never before purchased any stock from petitioner and had not purchased any stock at all for 11 years before buying the 8,100 shares of Pearson (15c-16c, 17c). Halperin's purchase of 8,100 shares was the third largest purchase at the offering price (Div. Exh. 5, 111c).

18/ On April 28, 1959 petitioner sold 4,000 shares to James Margolis, Holman's brother-in-law, at $1 per share and repurchased these same shares from him on the same day at 1-1/2 (Div. Exh. 61-H, 117c). Petitioner also sold 500 shares to Holman's secretary which were repurchased on April 28, 1959, and at 1-7/8 (19c-21c, Div. Exh. 35, 116c).

The balance of the 40,000 shares repurchased later was primarily from Holman family accounts and served to provide petitioner with stock to cover its continuing short position (Div. Exh. 8, 113c, R. 15763).

opinion in this case (9a), the Commission stated concerning a purchase by an insider, who was registrant's accountant:

> "We think the inference is compelling that he [the accountant], as well as Rex and Stanford, were given the opportunity to make a quick profit and that their purchaseswere made toward that end. First Washington [the registrant broker-dealer], on its part, was anxious to close out the offering and to commence trading, and by means of the transactions discussed above was able to create the appearance that the offering had in fact been sold out, assure itself of a supply of stock with which to begin trading, and realize additional profits on the sale of the same stock."

Such "additional profits," in the instant case are reflected by sales on petitioner's books on April 28, 1959 of 3,100 shares at 1-7/8, 5,000 at 2-1/2, 1,000 at 2-3/4 and 6,975 at 2-1/2 (Div. Exh. 8, 112c).[19/] Petitioner's sales on the following day were effected in a range from 2-1/2 to 3-5/8, all of which should be contrasted to the one dollar offering price. Some of the sales on April 29, 1959 were made to the same persons who had previously been told that no additional stock was available at the offering price of $1 per share and who had agreed prior to the expiration of the offering period to pay $3.50 per share (2c-3c, 7c-9c, 14c, R. 380-381, Exh. 13B, 114c).

Petitioner argues that the Commission order charged that the accounts of these affiliates and insiders were "dummy" accounts, and[20/]

19/ The petitioner's trading account lists transactions on the "settlement date" (date on which payment is to be made) which is four business days after the "trade date" (date on which sale is made).

20/ The petitioner defines "dummy" accounts as "controlled and dominated" (Br. 40) but also equates them with "fictitious" accounts (Br. 45).

over-the-counter market except under certain restrictions set forth therein. The Commission found that petitioner had violated Rule 10b-6 by making purchases, which petitioner does not dispute were made, while the Precise and Pearson distributions continued (10a, 13a, 20a).

C. Holman and Petitioner Engaged in Other Fraudulent Activities.

The Commission found that Holman acquired control of Precise in December 1958 and did not amend the offering circular or otherwise disclose the acquisition of such control. It found that such nondisclosure violated 15(c)(1) of the Exchange Act and Rule 15c1-5, 17 CFR 240.15c1-5, thereunder (19a).

Petitioner (Br. 55-56) contends that Eugene and Albert Silber, the principal stockholders in Precise, did not "sell" their 75,000 shares of Precise to Holman on December 9, 1959, but the agreement of sale specifically states that they "hereby transfer to Richard A. Holman all of their right, title and interest in and to said seventy-five thousand (75,000) shares of Precise common stock" (Div. Exh. 87, 120c) and it is clear that they intended to divest themselves of all their interest in Precise when they entered into that agreement (32c-47c). In two subsequent agreements Holman recited

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21/ On December 9, 1958 there were at most 160,220 shares outstanding with voting rights (Holman App. 252a) and Holman's 75,000 shares represented over 46% of the outstanding stock.

that no such charge has been proved (Br. 40). No charge was made that "fictitious" accounts were used. The order for proceedings alleged that petitioner "placed a substantial portion of such offering in accounts controlled and dominated by registrant [petitioner] and in accounts of affiliated persons" (37a).

Petitioner contends that the Commission in condemning the type of fraud described above has somehow taken unprecedented action which could not have been anticipated (Br. 44, 45). The language of the statute and rules involved would, themselves, afford sufficient warning. Further, Lewisohn Copper Corp., 38 SEC 226, decided in 1958, one year before these sales occurred, and cited and quoted from by the Commission in its opinion (9a), had already held that a distribution continues until stock purchased for resale for the accounts of broker-dealers and "for the accounts of members or their families" (id. at 234) was resold to the public.

Violations of Rule 10b-6

Rule 10b-6 of the Securities Exchange Act (17 CFR 240.10b-6), which defines certain manipulative activity pursuant to 10(b) of that Act, prohibits an underwriter engaged in a distribution to the public from making purchases of shares of the stock being distributed on the

that he was the owner of the Silber shares (Div. Exh. 104, 144c; Div. Exh. 90, 127c). [22/] In arguing that "because of the escrow" Holman "could not vote these shares which remained the Silbers' of record" (Br. 56), petitioner ignores a specific term of the sales agreement that:

> "Eugene Silber and Albert Silber agree to execute simultaneously herewith a proxy or proxies for said seventy five thousand (75,000) shares of Precise common stock in favor of Richard A. Holman, with full power of substitution, and to contain a provision that said proxy or proxies is or are irrevocable, and further agree to execute any other proxy or proxies from time to time as requested by Richard A. Holman, likewise to be irrevocable." (Div. Exh. 87, 121c).

22/ The purpose of the escrow agreement, as found by the Commission and expressly referred in the agreement itself (Holman App. 254a), was to achieve compliance with Rule 253(c), 17 CFR 230.253(c), of Regulation A under the Securities Act of 1933.

Contrary to the suggestion in petitioner's brief (p. 56), the Hearing Examiners and the Commission found that Holman did exercise control, and this finding is fully supported by the evidence.[23/] The Commission further found that between August 1959 and March 1960 petitioner sent confirmations of Pearson stock and securities of other companies to customers who had not in fact agreed to purchase such securities and that this conduct violated the anti-fraud provisions of the Securities Acts (21a).[24/] Petitioner does not dispute that these violations occurred, but complains that since they were "hot issues," the customers could only have profited (22a). Petitioner ignores the fact that this practice may itself cause a "hot issue."

23/ In December 1958 all directors other than Holman and Bryon resigned, and Holman asked his secretary, Lillian Newman, Stanley D. Halperin, his future law partner, and Abraham K. Weber, a friend, to serve as directors, and they agreed to do so (Div. Exh. 294, 151c; Div. Exh. 296, 153c; Div. Exh. 85, 119c; Div. Exh. 84, 118c; 22c-28c, 57c, 32c-33c). Although Holman disputed their appointment before the Commission, Byron testified the appointment had been made (26c-29c), and an agreement, dated May 30, 1959, between Holman, petitioner, Bryon and Precise states at page 5:

> "Holman and Byron agree that at a meeting of the Board of Directors held on Dec. 1958 the following people were elected as directors: Halperin, Newman and Weber. Holman and Byron agree that no meeting of the Board has been held since that date (Div. Exh. 90, 131c).

Byron further testified that Holman resolved a dispute with Byron in Holman's favor by indicating that he would call a meeting of his friendly directors (30c-31c).

24/ Such unauthorized transactions have been described as follows:

> "Another device not uncommon to a high-pressure selling effort is known as the 'wooden order.' Under this practice, confirmations are mailed to individuals who have not agreed to purchase the stock being offered. Although the wary investor can refuse to complete the transaction, an unsophisticated individual, intimidated or confused, may pay for the stock he had not ordered." SEC, Report of the Special Study of Securities Markets, pt. I 267 (1963).

II. Petitioner Was Accorded a Fair Hearing in Compliance with the Requirements of Due Process and the Administrative Procedure Act.

A. Since the Decision under Review Was that of Three Commissioners who are Not and Cannot be Challenged by Petitioner, Had there Been Any Error by the Participation of Another Commissioner in Preliminary Rulings or of the Hearing Officer in Presiding over the Proceeding and Preparing a Recommended Decision, It Would Have Been Harmless.

The Commission's decision was made solely by three commissioners who had not taken office until after the close of the hearings and who independently reviewed the 16,000 page record made over a five-year period (7a).[25/] Petitioner nevertheless contends that it was deprived of "administrative due process" in that (1) the hearing examiner who had presided over the hearing and written a recommended decision had passed the age of mandatory retirement and accordingly served "at the will of" the Commission and (2) at the institution of the proceeding and in connection with certain intermediate procedural rulings, subsequently upheld by the three deciding commissioners, another commissioner had participated who, petitioner claims, headed "investigation units of the Commission staff from which the Commission's complaint ensued" (Br. 2). We show below that the hearing examiner was in all respects qualified to conduct the proceeding and write the advisory opinion, that the commissioner to whom petitioner refers was not disqualified;

25/ The length of time this proceeding has been pending and the frequent court reviews are suggestive of Consolo v. Federal Maritime Commission, ___ U.S.___, 86 S.Ct. 1018, 1027 (1966), where it was stated: ". . . in view of the fact that this controversy already dates back more than eight years, that it has been before the Court of Appeals twice and that the relevant standard is not hard to apply in this instance, we think this controversy had better terminate now."

and, indeed, that he could have properly participated in the final decision. In view of the decision by the three unchallenged Commissioners who independently considered and reaffirmed all the intermediate rulings complained of and who "carefully evaluated" the evidence in light of the entire record (7a, 21a-26a), any possible error was harmless.

In Kerner v. Celebrezze, 340 F.2d 736, 740 (1965), this Court noted:

> "Although the harmless error statute, 28 U.S.C. § 2111, is not in terms applicable to review of administrative action, we perceive no reason why the salutary principle embodied in it should not be so applied, even when the error consists of a procedural irregularity under the APA as, indeed, § 10(e) of the APA contemplates."

In that case this Court, quoting from Justice Frankfurter, stated that the significance of the hearing examiner's report "depends largely on the importance of credibility in the particular case" (ibid.). While in the instant case there was "conflicting evidence in a number of instances", and the hearing examiner's findings were necessarily given weight with respect thereto, in light of the Commission's holding that the sanction imposed upon petitioner would be warranted solely by reason of petitioner's "extensive fraudulent activity in the offer and sale of Precise stock" (28a) -- which was based on representations to investors that petitioner has not challenged - credibility played a relatively minor role. Here, as in Kerner: "It would be fatuous to suppose that if the hearing officer had recommended a decision in . . . [petitioner's] favor, the ultimate result would have been different, cf. FCC v. Allentown Broadcasting Co.,

349 U.S. 358, 75 S.Ct. 855, 99 L.Ed. 1147 (1955), or that a remand to obtain a recommendation from him now would accomplish anything save further expense and delay."[26/] Ibid. And see Standard Distributors v. Federal Trade Commission, 211 F.2d 7, 11-12 (1954), where this Court held that "since the Commission did make findings of its own, any possible bias on the part of the trial examiner in recommending decision . . . was so isolated as to be harmless." This Court has also recently held, in connection with a determination of the National Railroad Adjustment Board, that "[a]s long as the final hearing officer was impartial the requirements of due process were satisfied", even though the officer presiding over the preliminary inquiry may have been prejudiced. D'Elia v. New York, New Haven and Hartford R.R., 338 F.2d 701, 702 affirming 230 F. Supp. 912, 915 (D. Conn., 1964).

As to the allegedly disqualified commissioner, Berkshire Employees Ass'n, etc. v. National Labor Relations Board, 121 F.2d 235, 239 (C.A. 3, 1941), held that if one member of an agency should be found to be disqualified "the entire case will be reconsidered by the members not so disqualified". The case was thereafter reconsidered on substantially the same record by the board without the disqualified member,[27/] and

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26/ While this Court distinguished cases going to the "legal competence" of the hearing examiner, it also cited United States v. L.A. Tucker Truck Lines, Inc., 344 U.S. 33 (1952), which held (id. at 38) that a defect in an examiner's appointment was merely an irregularity and not jurisdictional.

27/ During proceedings after remand, the Board denied a motion for a hearing de novo, concluding "that the alleged bias can only be considered as having affected the earlier consideration of the case by the Board itself, and not the making of the record on which such consideration was had". In the Matter of Berkshire Knitting Mills, 37 NLRB 926, 927 (1941).

that determination was sustained on appeal. Berkshire Knitting Mills v. National Labor Relations Board, 139 F.2d 134 (C.A. 3, 1943).[28/] A fortiori, where the challenged commissioner never participated in the first decision, as here, the decision of those who did is not subject to challenge.

B. The Hearing Examiner was not Disqualified.

One of the two "transcendent issues of administrative due process" which petitioner contends "wholly vitiated the proceedings below" (Br. 2) is based on petitioner's contention that the hearing examiner "did not have the independence from the Securities and Exchange Commission required by Section 11 of the Administrative Procedure Act" (Br. 32), 5 U.S.C. 1010, because, having reached retirement age and being re-employed pursuant to Section 13(a) of the Civil Service Retirement Act, 5 U.S.C. 2263(a), he served "at the will of the appointing officer." Petitioner first raised this question in May 1962, after the proceeding had already progressed for a year and a half, 440 exhibits had been introduced, and over

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28/ Similarly, in Texaco, Inc. v. F.T.C., 336 F. 2d 754, 760 (C.A. D.C., 1964), vacated on other grounds, 381 U.S. 739 (1965) it was indicated that the infirmity resulting from participation in the decision by a disqualified commissioner could be cured by a "de novo consideration" by the remaining commissioners, presumably on the same record, since Judge Washington, concurring in part and dissenting in part, referred to " a de novo consideration of the record" in the portion of his opinion where he concurred, 336 F. 2d at 764.

Also, in Pillsbury Company v. Federal Trade Commission, 354 F.2d 952, 965 (C.A. 5, 1966), where the decision of the Trade Commission was reversed because certain of the deciding members had been subjected to questioning on the case while it was pending by a Senate sub-committee, the court held "that the passage of time, coupled with the changes in personnel on the Commission, sufficiently insulate the present members" so that "the Commission is not permanently disqualified to decide this case".

8000 pages of record had been amassed (100a-101a).[29] The Commission found that the employment of the hearing examiner pursuant to the provisions of the Civil Service Retirement Act was not inconsistent with the letter or spirit of Section 11 of the Administrative Procedure Act and, in any event, that petitioner's motion was "not timely as required by Section 7(a)" of that Act (24a, 93a-105a). As we have noted, petitioner then unsuccessfully attempted to enjoin the administrative proceeding on the basis of the Commission's alleged error in not starting the proceeding anew with a different examiner. See p. 5, supra.

In view of the thoughtful discussion by the Commission on this point (93a-105a), we add here only:

(1) Petitioner's contention raises no problem of "independence" of the hearing examiner from the Commission's prosecutory staff, the "independence" which is protected by Section 5(c) of the Administrative Procedure Act, 5 U.S.C. 1004(c), but only as to "independence" from the Commission, which the hearing examiner was assisting in its adjudicatory functions.[30]

29/ While petitioner stated that it "first learned that the hearing examiner had passed the mandatory retirement age in April 1962 (Br. 31), as the hearing examiner observed when ruling on petitioner's motion, the fact that he was "well along in life" was no secret to petitioner during the course of the proceedings (101a). Furthermore, petitioner's counsel had been acquainted with the hearing examiner for many years (R. 15352-15353).

30/ See, e.g., Final Report of the Attorney General's Committee on Administrative Procedure, S. Doc. No. 8, 77th Cong., 1st Sess. (1941), p. 47, where it was noted that hearing examiners were "in a very real sense acting for the head of the agency" and were hearing cases "because the heads cannot as a practical matter themselves sit."

(2) The purpose of providing for the "independence" of hearing examiners in Section 11 of the Administrative Procedure Act was to enable the agencies and their members, who themselves can preside over administrative hearings,[31] to delegate a greater amount of decisional responsibility[32] by attracting "men of ability and prestige"[33] who would be free of the fear of loss of employment by reason of political or other changes that might discourage "men of judicial qualifications and capacity" from seeking hearing examiner positions.[34]

(3) Petitioner does not question the fact that the hearing examiner involved was originally properly appointed and, accordingly, that the congressional purpose of achieving a hearing examiner of the appropriate competency has been served. Nor is there anything to indicate that he has not continued to be competent. The question whether or not, subsequent to his seventieth birthday, a hearing examiner with over 20 years of service may now be removable only for "good cause" established by the

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31/ See Section 7(a) of the Administrative Procedure Act, 5 U.S.C. 1006(a).

32/ See Final Report of the Attorney General's Committee on Administrative Procedure (1941), pp. 46-47, 214.

33/ Id. at p. 46.

34/ Id. at p. 47. As stated with respect to Section 11 by Congressman Walter, who was Chairman of the Subcommittee of the House of Representatives Committee on the Judiciary that was responsible for drafting the Administrative Procedure Act:

> "If there be any criticism of the operation of the civil-service system, it is that the tenure security of civil-service personnel is exaggerated." S. Doc. No. 248, 79th Cong., 2d Sess., p. 371 (1946).

Civil Service Commission would appear to be one to be raised only by him and not by a party to the proceeding before him. Cf. Nash v. Interstate Commerce Commission, 225 F. 2d 42, 43 (C.A. D.C., 1955), and Federal Trial Examiners Conference v. Ramspeck, 104 F. Supp. 734, 741 (D.D.C., 1952), affirmed per curiam, 202 F. 2d 312 (C.A. D.C., 1952), reversed, 345 U.S. 128 (1953).

(4) One of the determinations by the district court in Ramspeck, from which no appeal was taken, was that a regulation of the Civil Service Commission providing that agencies may make conditional appointments of hearing examiners,pending final decision of their eligibility for absolute appointment, was valid.

(5) The Supreme Court, in Ramspeck, rejected the argument that the regulation there challenged concerning promotions would enable the agency to control and coerce its examiners, stating,"it must be assumed that the [Civil Service] Commission will prevent any devious practice by an agency which would abuse this Rule." 345 U.S. at 142.

(6) The retention of retired employees had been a part of the Civil Service Program since 1920,[35/] long before the enactment of the Administrative Procedure Act. In the enactment of Section 11 of that Act "Congress put 'the entire tradition of the Civil Service Commission to use.'"[36/] The subsequent enactment in 1956 of the re-employment

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35/ See 5 U.S.C. 715, 41 Stat. 617 (1920).

36/ Ramspeck v. Federal Trial Examiners Conference, 202 F. 2d 312, 313 (C.A. D.C., 1952), (dissenting opinion, quoting from Administrative Procedure Act--Legislative History, S. Doc. No. 248, 79th Cong., 2d Sess. (1946), p. 215).

provision in its present form was expressly stated to be "notwithstanding any other provision of law."[37] Congress surely could have specifically excluded hearing examiners from the re-employment provision, but it did not do so, although various other classes of persons were specifically excluded from its coverage. See Section 2 of the Retirement Act, 5 U.S.C. 2252.[38]

(7) To uphold petitioner's contention would not only deprive all agencies of the benefit of service of able and experienced hearing examiners who have reached retirement age and are willing and able to continue to serve in their prior capacities, but would force agencies either not to utilize examiners close to retirement age or run the risk that extensive hearings would have to begin anew in the event that the examiner reached the retirement age during the pendency of those hearings, at least where the credibility of witnesses might be in issue.[39]

37/ See 5 U.S.C. 2263(a), 70 Stat. 757 (1956).

38/ The language of Section 12 of the Administrative Procedure Act upon which petitioner relies that "no subsequent legislation shall be held to supersede or modify the provisions of this Act except to the extent that such legislation shall do so expressly" was stated in the legislative history to be "a rule of construction" so that courts would "interpret the Act as applicable on a broad basis unless some subsequent act clearly provides to the contrary." Statement of Attorney General appended to Senate Report, Administrative Procedure Act--Legislative History, S. Doc. No. 248, 79th Cong., 2d Sess. (1946), p. 231.

39/ See Gamble-Skogmo, Inc. v. Federal Trade Commission, 211 F. 2d 106, 115 (C.A. 8, 1954), which held that since there had been an issue of credibility the new hearing examiner could not use the record made by the retired hearing examiner. That case assumed (id. at 111) that an agency has the privilege of re-employing retired hearing examiners, although the question of the effect of Section 11 of the Administrative Procedure Act was not raised.

(8) In Parrott v. Cary, 234 F. Supp. 572, 574 (D. Colo., 1964), the same hearing examiner's qualifications were challenged for the same reasons asserted here. The court there held that Section 13(a) of the Civil Service Retirement Act authorizes the re-employment of retired hearing examiners.

(9) Petitioner contends (Br. 36) that the Supreme Court in Riss & Co. v. United States, 341 U.S. 907 (1951), "held that the challenge . . . was timely," although the objection was made on the "last day of extended hearings" but neglects to mention that the last day was the seventh day of actual hearings.[40/]

(10) Petitioner's contention (Br. 31-32) and the cases cited in support thereof "that administrative proceedings are entirely void unless there is a duly qualified hearing examiner" ignores the Supreme Court's later decision in United States v. L. A. Tucker Truck Lines, Inc., 344 U.S. 33 (1952), which specifically discussed the cases petitioner cites and rejected petitioner's contention. Concluding that the hearing examiner was disqualified, the court stated:

> "We hold that the defect in the examiner's appointment was an irregularity which would invalidate a resulting order if the [Interstate Commerce] Commission had overruled an appropriate objection made during the hearings. But it is not one which deprives the Commission of power or jurisdiction, so that even in the absence of timely objection its order should be set aside as a nullity." 344 U.S. at 38.

(11) Petitioner makes no claim of actual prejudice, indeed it

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40/ Riss & Co. v. United States, 96 F. Supp. 452, 453 (W.D. Mo., 1950), reversed without opinion, 341 U.S. 907 (1951).

specifically disclaimed "any intent to 'impugn' the examiner's 'integrity'" and disavowed any claim of "actual bias or prejudice." (91a, 94a-100a).[41/]

C. The Commission Fully Complied with the Instructions of the Court of Appeals in Securities and Exchange Commission v. R.A. Holman & Co., 323 F. 2d 284.

In Securities and Exchange Commission v. R.A. Holman & Co., 323 F. 2d 284 (1963), the Court of Appeals for the District of Columbia Circuit stated with regard to the challenged participation of Commissioner Woodside that "[t]he party asserting disqualification must make his record in the administrative hearing." 323 F. 2d at 287. Petitioner contends (Br. 24) that it was error thereafter for the Commission in the proceeding below to have refused to issue subpoenas relevant to Mr. Woodside' activities prior to the time he became a Commissioner. The Commission refused petitioner's request for subpoenas directed to Commissioner Woodside, former Chairman Gadsby and certain Commission employees on the ground that petitioner "had not met the burden on it of showing that the evidence it expected to produce warranted the issuance of subpoenas"(123a, 22a-23a).

Commissioner Woodside's participation in this administrative proceeding had been challenged in the court proceeding on the allegation that, as former Director of the Commission's Division of Corporation Finance,

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41/ Petitioner's counsel had also earlier stated: "We wish particularly to state that the hearing examiner, under very difficult circumstances and in an atmosphere which frequently disrupted the proceedings has acted with great patience and scrupulous fairness to all parties concerned." (R. 14191).

he had been "responsible for the initiation, conduct, and supervision" of an investigation by the Division of petitioner's activities in connection with a subsequently withdrawn registration statement for an offering of Pearson stock in which petitioner had been named as underwriter. It was alleged that as Director of the Division Commissioner Woodside acquired substantial knowledge of the facts in issue in the proceeding (7b-8b, 121a).

No proceedings involving the petitioner were instituted during Mr. Woodside's directorship of the Division. Mr. Woodside became a Commissioner on July 15, 1960, before the Division of Corporation Finance submitted a recommendation that a temporary suspension order be issued with respect to an earlier Pearson Regulation A offering, which order initiated the proceeding below (33a).[42] Indeed, not even the order authorizing the formal investigation, which later led to the administrative proceeding, was entered until after Mr. Woodside had become a member of the Commission, and the order for formal investigation was entered on the recommendation of a division of the staff with which he had never been connected (71b).

Commissioner Woodside participated in adopting the order of September 16, 1960, initiating the administrative proceeding, and in several subsequent orders therein.[43] Because of petitioner's objections, however, he decided not to participate in the ultimate decision of the instant case (Br. 18-19).

42/ The Regulation A suspension proceeding involving Pearson Corporation was initiated by Commission order dated September 16, 1960. While petitioner suggests (Br. 4-5) that the procedure followed in initiating this proceeding was improper, it recognizes that the procedure has been specifically upheld in R.A. Holman & Co., Inc. v. Securities and Exchange Commission, 299 F. 2d 127 (C.A. D.C., 1962), certiorari denied, 370 U.S. 911. It was there held that the challenged procedure was "reasonably designed to protect the public" until the charges against petitioner could be determined. Id. at 133.

43/ At times because of vacancies on the Commission and the fact that another Commissioner had disqualified himself, Commissioner Woodside's participation was necessary for a quorum.

under 28 U.S.C. 144, where bias or prejudice is claimed.[47] As the above quotation from Morgan indicates, no different rule should apply to a member of the Securities and Exchange Commission.[48]

D. Registrant is Estopped from Urging that the Facts Warrant Commissioner Woodside's Disqualification.

In Securities and Exchange Commission v. R.A. Holman & Co., 323 F. 2d 284 (C.A. D.C., 1963), it was determined that Commissioner Woodside's earlier ultimate responsibility as Division Director for the inquiry into the subsequently withdrawn Pearson registration statement, which was admitted, did not require cessation of the administrative proceeding, such as had been required by the court in Amos Treat and Co. v. Securities and Exchange Commission, 306 F. 2d 260 (C.A. D.C., 1962). While indicating that Amos Treat had been disposed of summarily, see 323 F. 2d at 286. n. 3, that case was distinguished and not overruled in Holman. Accordingly, the Court of Appeals for the District of Columbia Circuit in Holman must have determined that on the record before it there had been no

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47/ A sufficient affidavit "must contain more than mere conclusions on the part of the pleader. Facts must be pleaded. . . ." Inland Freight Lines v. United States, 202 F. 2d 169, 171 (C.A. 10, 1953). See also Simmons v. United States, 302 F. 2d 71 (C.A. 3, 1962).

48/ Cf. Fougherouse v. Brownell, 163 F. Supp. 580, 588 (D. Ore., 1958), in which a challenged inquiry officer who determined the deportability of aliens had "indicated of record" that he did not participate in an investigation. The court, holding that the inquiry officer was not disqualified from adjudicating, stated:

> "No statute or regulation is cited and none has been found, requiring an inquiry officer to make an affirmative showing of nonparticipation. . . ."

violation of due process arising from Mr. Woodside's ultimate responsibility over the informal inquiry concerning the Pearson registration statement.[49/] Although, as we have seen, petitioner was afforded an opportunity to introduce additional specific evidence, it did not do so with the result that the record before this Court is the same as the record before the Court of Appeals for the District of Columbia Circuit.

Petitioner is thus estopped from contending to this Court that the record justifies dismissal of these proceedings. See Commissioner v. Sunnen, 333 U.S. 591, 598 (1948):

> "Once a party has fought out a matter in litigation with the other party, he cannot later renew that duel."

In Lummus Company v. Commonwealth Oil Refining Company, 297 F. 2d 80 (1961), this Court held that while a decision of the Court of Appeals for the First Circuit reversing a preliminary injunction in a collateral proceeding was not conclusive with respect to certain issues which it left for determination, nevertheless it conclusively determined the issue then before it.

49/ In the Commissioner's verified answer in Holman, it was admitted that Mr. Woodside "had been a director of the Commission's Division of Corporation Finance and as such had, during the period of his directorship, ultimate responsibility to the Commission for all work of that Division" (64b) and that during this period "personnel in . . . [that Division] began an examination in April 1960 of the registration statement that had been filed by Pearson Corporation on March 30, 1960, and that said examination led to [certain specified] inquiries" (63b) more fully described in the answer. Petitioner's general allegations and conclusions in its offer of proof (85c-98c, 99c and 107c-110c) add nothing of substance.

Petitioner concedes that "the record reflects only that Mr. Woodside, until mid-July, 1960, headed the Division before which the Pearson registration statement was pending and before which it remained pending. . ." without any letter of comment being sent by the Division during the three and one-half months Mr. Woodside remained as Director of the Division (Br. 24-25, 7).

E. Commissioner Woodside Would Not Have Been Disqualified from Participating in the Decision Below and Clearly Was Not Disqualified from Voting to Institute the Proceeding and Participating in Procedural Rulings Therein.

Petitioner contends that the mere ultimate responsibility by Mr. Woodside, as Division Director, for an informal investigation by staff members of his Division, disqualifies him after appointment to the Commission from acting in any manner in an adjudicatory capacity as to matters which may have been related to facts developed in the informal investigation (Br. 22). This contention appears to go well beyond the holding in the Court of Appeals for the District of Columbia Circuit in Amos Treat & Co. v. Securities and Exchange Commission, 306 F.2d 260 (1962).

We note initially that due process does not necessarily require separation of functions in an administrative agency. This is indicated by the last sentence of Section 5(c) of the Administrative Procedure Act which provides an exception for members of the agency from the requirements therein concerning separation of functions. It has been specifically held:

> "If an administrative tribunal may on its own initiative investigate, file a complaint, and then try the charge so preferred, due process is not denied. . . because one or more of the board aided in the investigation." 50/

50/ Brinkley v. Hassig, 83 F. 2d 351, 357 (C.A. 10, 1936). See also Pangburn v. C.A.B., 311 F. 2d 349, 356 (C.A. 1, 1962) which stated: "It is well settled that a combination of investigative and judicial functions within an agency does not violate due process."

Prior to the date the Commission authorizes the institution of an administrative proceeding, the responsibility of the Director of its Division of Corporation Finance and of the individual commissioners with respect to investigations are not dissimilar, since the Commission itself has prosecutory as well as decisional functions.[51/] As Director of the Division of Corporation Finance, Mr. Woodside's functions included those of an administrative, legislative and interpretative nature under the various laws administered by the Commission, and only a small portion of his responsibility embraced duties of a prosecutory or investigative nature, the primary purpose of the Division being to aid registrants in complying with the reporting standards of the securities laws.[52/]

The functions of the Director of the Corporation Finance Division may be contrasted to those of states attorneys, substantially all of whose responsibilities are prosecutory in nature. Yet judges, who as states attorneys previously have had the ultimate responsibility for the prosecution of cases, have been held qualified to

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51/ See, e.g., Sections 8(e), 19(b) and 20 of the Securities Act of 1933, 15 U.S.C. 77h(e), 77s(b) and 77t; and Section 21 of the Securities Exchange Act of 1934, 15 U.S.C. 78u. It is because of this aspect of administrative agencies that the requirements of Section 5(c) of the Administrative Procedure Act, 5 U.S.C. 1004(c), with respect to separation of functions are specifically stated not to "be applicable in any manner to the agency or any member or members of the body comprising the agency". See page 46, infra.

52/ For a description of the responsibilities of the Director of the Division of Corporation Finance see 17 CFR 200.18.

adjudicate therein if they had not actually participated in a particular prosecution. Thus in Aetna Insurance Co. v. Travis, 124 Kan. 350, 259 Pac. 1068 (1927), certiorari denied sub nom. Aetna Insurance Co. v. Baker, 276 U.S. 628 (1928), a judge, who as state attorney general had signed the pleadings and had appointed a particular assistant to handle the case, was held qualified to sit on the appeal of the case since he had not given personal consideration to it while acting as attorney general. In observing that the state had no statute disqualifying judges who had been of counsel (as many jurisdictions do) the court pointed out:

> "Much business of a legal and of an administrative nature flows through the office of the Attorney General . . . the general administrative duties of his office make it practically impossible, generally speaking, for him to give his personal attention to preparation and trial of lawsuits, or personally to conduct pending litigation. . . .
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> "The authorities hold that a prosecuting attorney who later becomes judge is not disqualified to sit in a case by reason of having had something to do with the preliminary stages of the prosecution, unless the statute specifically so provides. . . ." (259 Pac. at 1069, 1070).

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Numerous other cases are to the same effect.

That neither due process nor accepted standards of propriety are violated if a person who has had merely a formal supervisory

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53/ See, e.g., Rose v. United States, 295 Fed. 687 (C.A. 4, 1924); Kirby v. State, 78 Miss. 175, 28 So. 846 (1900); Gulf Coast Transportation Co. v. Standard Milling Co., 197 S.W. 874, 884 (Tex. Civ. App., 1917) reversed on other grounds, 252 S.W. 751 (Tex., 1923); Borough of Hasbrouck Heights, N.J. v. Agrios, 10 F. Supp. 371, 374 (N.J.,1935); Eastridge v. Commonwealth, 195 Ky. 126, 241 S.W. 806 (1922).

responsibility for the investigation or conduct of a case subsequently participates in its adjudication[54/] is further confirmed by the practice of United States Supreme Court justices who have been elevated from the position of Attorney General. Whether such justices disqualify themselves from hearing a case which was being investigated, prosecuted, or defended by the Department of Justice while they had theoretical responsibility for such activity depends upon the degree of direct connection with the case which in their view they had. For example, after Justice Clark was seated on August 24, 1949, he participated within the year in the decision of at least 15 cases concerning which, as Attorney General, he had had ultimate responsibility for the investigation, prosecution,or defense.[55/] Similarly, within the year after Justice Murphy was seated on February 5, 1940, despite the fact that he had been Attorney General, he participated

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54/ Petitioner makes no claim that Commissioner Woodside violated the Administrative Procedure Act. Cf. Consolo v. Federal Maritime Commission, ___ U.S. ___, 86 S. Ct. 1018, 1039, n.27 (March 22, 1966), where a party's contention was held to be "without merit" that "counsel for the Commission, who participated in the writing of the Commission's reparation award upon remand, had violated 5 U.S.C. § 1004 (1964 ed.) [Section 5 of the Administrative Procedure Act] because he had previously participated as Public Counsel in the trial before the Hearing Examiner on the issue of whether Flota [the party in the present proceeding] had violated the Shipping Act (although not in the trial of the reparations issue) and had defended the Commission's finding of violation and award of reparations before the Court of Appeals in the first consolidated appeals."

55/ In the following cases Justice Clark participated in the decisions, although during his tenure as Attorney General Justice Department attorneys under his general supervision appeared in them in the lower courts. See United States v. Alpers, 338 U.S. 680 (1950); Bryan v. United States, 338 U.S. 552 (1950); United States v.

(continued on p. 44)

in numerous decisions arising out of the Department of Justice.[56] Indeed, in United States v. Dickerson, 310 U.S. 554 (1940), Justice Murphy delivered the opinion of the Court in a 5-4 decision which reversed a Court of Claims decision sustaining the claim of a veteran to a reenlistment bonus, 89 Ct. Cl. 520. This suit, argued to the Court of Claims on May 29, 1939, had been defended by the Department of Justice during Justice Murphy's tenure as Attorney General, which commenced January 20, 1939. And see also Frank, Disqualification of Judges, 56 Yale L.J. 605, 624 (1947), to the effect that "Chief Justice Stone also recognized that an Attorney General's contact with a case might be so formal as not to require disqualification" n. 76.

55/ (continued from p. 43) Rabinowitz, 339 U.S. 56 (1950); Savorgnan v. United States, 338 U.S. 491 (1950); United States v. Spelar, 338 U.S. 217 (1949); United States v. Toronto Navigation Company, 338 U.S. 396 (1949); Alcoa Steamship Company v. United States, 338 U.S. 421 (1949); Hubsch v. United States, 338 U.S. 440 (1949); United States v. Commodities Trading Corporation, 339 U.S. 121 (1950); United States v. Westinghouse Company, 339 U.S. 261 (1950); Johnson v. Eisentrager, 339 U.S. 763 (1950). See also United States v. Aetna Surety Company, 338 U.S. 366 (1949); Standard-Vacuum Oil Company v. United States, 339 U.S. 157 (1950); United States v. Gerlach Live Stock Company, 339 U.S. 725 (1950); United States v. Kansas City Life Insurance Company, 339 U.S. 799 (1950).

56/ For example, Justice Murphy participated in the decisions in the following cases, although during his tenure as Attorney General Justice Department attorneys under his general supervision appeared in them in the lower courts: Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940); United States v. San Francisco, 310 U.S. 16 (1940); Perkins v. Lukens Steel Co., 310 U.S. 113 (1940); United States v. Bush & Co., 310 U.S. 371 (1940); United States v. Summerlin, 310 U.S. 414 (1940); United States v. Dickerson, 310 U.S. 554 (1940), Petition for rehearing that specifically adverted to Justice Murphy's role denied, 311 U.S. 724 (1940).

In holding that due process is not violated when a former states attorney presides as a judge over cases that were in his office but with which he had no close connection, it has been stated that it is very often the most efficient states attorneys who subsequently become judges and that "[t]he people of the district should not be deprived of the services of the regular judge for trivial causes" since this "would interfere with the speedy disposition of leftover cases every time a commonwealth's attorney is elected judge, possibly adding greatly to the expense of their trial without any substantial reason therefor." Eastridge v. Commonwealth, 195 Ky. 126, 241 S.W. 806, 808 (1922).

Similarly, the Commission is benefited by having among its members former staff officials with a detailed working knowledge of the agency.[57/] But, as District Judge Hart remarked, under the interpretation sought by petitioner, it is hard to see "how in the name of heaven . . . you ever promote anybody in these governmental departments" (149b).

F. Petitioner's Other Claims of Procedural Error are Without Merit.

Petitioner complains of the Commission's denial of access to Commission files as to the origin of these proceedings and as to alleged

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57/ 3 Loss, Securities Regulation (2d ed. 1961) 1883.

improper communications between the staff and the Commission with respect thereto (Br. 37). Petitioner sought this information in the form of interrogatories to the Commission (62a-63a). The Commission was of the opinion, reaffirmed in its opinion deciding the case on its merits, that petitioner was not entitled to this information because in deciding to institute the constituent proceedings ultimately consolidated into the proceeding in which the order under review was entered "the Commission's actions were prosecutory or investigatory, not adjudicatory, in nature and under Section 5(c) of the Administrative Procedure Act, the Commission was not precluded from consulting any members of the staff in connection with them" (23a-24a, 64a-66a). The last sentence of Section 5(c) of the Administrative Procedure Act, 5 U.S.C. 1004(c), dealing with separation of functions, states that the provisions of that subsection are not "applicable in any manner to the agency or any member or members of the body comprising the agency." That exemption, as noted in the legislative history, was "required by the very nature of administrative agencies, where the same authority is responsible for both the investigation-prosecution and the hearing and decision of cases."[58/]

58/ H. Rep. No. 1980, (1946) 31; S. Rep. No. 752, 79th Cong., 1st Sess., (1945) 18. See also id. at 41, where the Attorney General noted that this Section "would not preclude, for example, a member of the Interstate Commerce Commission personally conducting or supervising an investigation and subsequently participating in the determination of the agency action arising out of such investigation." And see Attorney General's Manual on the Administrative Procedure Act, (1947) 58.

Petitioner also complains that it was prevented from presenting certain evidence as to the "actual market activity of the securities involved in these proceedings" (Br. 37). The record reveals, however, that petitioner merely sought to prove that other broker-dealers engaged in transactions in Pearson and Precise stock during the periods in question (157c-158c, 162c-163c, 167c, 171c-173c), a fact which was conceded by the staff several times (see, e.g., 157c-158c, 161c, 165c, 168c and 169c). The evidence petitioner was prevented from presenting was merely cumulative, as the hearing examiner ruled on many occasions (see, e.g., 164c, 166c and 170c).

In addition, petitioner contends that it was error to exclude evidence of the Commission's alleged "new issue policies" and "the understanding of such policies by the trade" (Br. 37). The Commission's requirements of disclosure as to bona fide purchases by affiliates of underwriters and insiders were not relevant, as the hearing examiner ruled (160c, 159c), and the Commission was necessarily aware of its own stated policies. How others might interpret them was not material.

Petitioner further contends that it was improperly denied access to a staff investigator's report respecting the Kabian transaction (Br. 37). The report was that of a routine broker-dealer inspection of petitioner. Petitioner asserted before the Commission that production was required by Jencks v. United States, 353 U.S. 657 (1957), because it believed the report concerned entries on the petitioner's books made by Klapper, a staff witness who was petitioner's cashier at the

time, with respect to the Precise transactions (155c). The report was produced for the hearing examiner's and Commission's examination in camera.[59] As the Commission noted "the report did not contain any statement by Klapper as defined in the so-called Jencks statute (18 U.S.C. 3500), and any figures contained in such report did not come within the Jencks doctrine merely because they may originally have been entered in Holman & Co.'s books by Klapper" (72a) and "no sufficient showing had otherwise been made to warrant production of the report, which was confidential under Rule 26(c) of the Rules of Practice"[60] (72a-73a). Petitioner urges that this report would "conclusively refute testimony underlying the finding respecting the Kabian transaction" (Br. 37), but it makes no attempt to explain how a report of an inspector, based on petitioner's own books and records, could reveal evidence of the nature of a transaction which petitioner could not establish on its own.

Finally, petitioner contends (Br. 37) that it was allegedly denied access to "prior testimony of witnesses in patent disregard of

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59/ "In camera inspection of secret or confidential information has been an approved procedural method to protect the rights of a party, through judicial control, while at the same time preserving the secret and confidential character of grand jury minutes and government investigative information. See United States v. Giampa, 290 F. 2d 83 (2d Cir., 1961); United States v. Consolidated Laundries Corp., 291 F. 2d 563, 574 (2d Cir., 1961)." In re Grand Jury Investigation (General Motors Corp.), 32 F.R.D. 175 (S.D. N.Y., 1963).

Should this Court deem the matter material, we will be glad to certify the report to it for in camera inspection.

60/ 17 CFR (1964) §201.26(c), now substantially contained in Rule 2 of Rules Relating to Investigations, 17 CFR §203.2.

the Jencks rule," when its counsel was permitted to examine an otherwise confidential report but was not permitted to remove it from the hearing.[61/] As recently noted by the Court of Appeals for the Seventh Circuit, there is no abuse of discretion where attorneys who have a right to see non-public documents in the Commission's possession are limited to inspection thereof under controlled conditions even though "it would be a convenience" for them to have the documents in their possession. Commercial Capital Corporation v. Securities and Exchange Commission, CCH Fed. Sec. L. Rep. ¶91,675 (May 2, 1966).

61/ The staff had stated "that it had no objection to removal provided that no copies were made and the transcript was not shown to anyone except the client or other counsel in the case. The hearing examiner expressed approval of these conditions, but counsel for Holman & Co. asserted that they were unreasonable and that he should be permitted to make copies for purposes of consulting co-counsel and interviewing witnesses as to the accuracy of the statements in the transcript." (70a.)

CONCLUSION

For the foregoing reasons the order of the Commission should be affirmed.

Respectfully submitted,

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