SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

October 23, 1978

Wallace J. Furstenau, Esquire
Clerk, United States District Court
District of Arizona
Room 6218, Federal Building
Phoenix, Arizona 85025

Re: High Valley Investments, Inc., et al. v. Securities and Exchange Commission, et al., Civil Action No. ____ PHX

Dear Mr. Furstenau:

Enclosed for filing in the above-captioned case are an original and one copy of the Securities and Exchange Commission's Verified Petition for Removal. Also enclosed for filing are the original and one copy of the Motion of the Defendant Securities and Exchange Commission to Dismiss, or, in the Alternative, for a More Definite Statement, and the Memorandum of Points and Authorities filed in support thereof.

My application for limited admission pursuant to Rule 6(b) of the rules of this Court has been forwarded to the United States Attorney's Office for this District, and will be promptly filed with the Court.

Sincerely,

James H. Schropp
Assistant General Counsel

Enclosures

cc: Mr. A. Lee Tabler
"Agent-at-Large" for the plaintiffs

CIVIL COVER SHEET

PLAINTIFFS

High Valley Investment, Inc.,
A. Lee Tabler,
Robert A. Wagner,
Charles Von Goerken

DEFENDANTS

Securities and Exchange Commission, et al.

ATTORNEYS (FIRM NAME, ADDRESS, AND TELEPHONE NUMBER)

A. Lee Tabler, in propria persona
agent-at-large for plaintiffs

4039 West Huntington Drive
Phoenix, Arizona 85041

ATTORNEYS (IF KNOWN)

Paul Gonson
James H. Schropp
Julie Allecta (202) 755-1335

Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

(PLACE AN ☒ IN ONE BOX ONLY) **BASIS OF JURISDICTION** *IF DIVERSITY, INDICATE RESIDENCE BELOW.*

☐ 1 U.S. PLAINTIFF ☒ 2 U.S. DEFENDANT ☐ 3 FEDERAL QUESTION (U.S. NOT A PARTY) ☐ 4 DIVERSITY

CAUSE OF ACTION (CITE THE U.S. CIVIL STATUTE UNDER WHICH YOU ARE FILING AND WRITE A BRIEF STATEMENT OF CAUSE)

Removal pursuant to 28 U.S.C. 1441(b) and 1442(a)(1)—suits against federal agency and unnamed federal officials alleging constitutional violations.

(PLACE AN ☒ IN ONE BOX ONLY) **NATURE OF SUIT** *(PLACE AN ☒ IN ONE BOX ONLY)*

CONTRACT
- ☐ 110 INSURANCE
- ☐ 120 MARINE
- ☐ 130 MILLER ACT
- ☐ 140 NEGOTIABLE INSTRUMENT
- ☐ 150 RECOVERY OF OVERPAYMENT & ENFORCEMENT OF JUDGEMENT
- ☐ 190 OTHER CONTRACT
- ☐ 195 CONTRACT PRODUCT LIABILITY

REAL PROPERTY
- ☐ 210 CONDEMNATION
- ☐ 220 FORECLOSURE
- ☐ 230 RENT LEASE & EJECTMENT
- ☐ 240 TORTS TO LAND
- ☐ 245 TORT PRODUCT LIABILITY
- ☐ 290 ALL OTHER REAL PROPERTY

TORTS

PERSONAL INJURY
- ☐ 310 AIRPLANE
- ☐ 315 AIRPLANE PRODUCT LIABILITY
- ☐ 320 ASSAULT, LIBEL & SLANDER
- ☐ 330 FEDERAL EMPLOYERS' LIABILITY
- ☐ 340 MARINE
- ☐ 345 MARINE PRODUCT LIABILITY
- ☐ 350 MOTOR VEHICLE
- ☐ 355 MOTOR VEHICLE PRODUCT LIABILITY
- ☐ 360 OTHER PERSONAL INJURY
- ☐ 365 PERSONAL INJURY PRODUCT LIABILITY

PERSONAL PROPERTY
- ☐ 370 FRAUD OR TRUTH IN LENDING
- ☐ 380 OTHER PERSONAL PROPERTY DAMAGE
- ☐ 385 PROPERTY DAMAGE PRODUCT LIABILITY

ACTIONS UNDER STATUTES

CIVIL RIGHTS
- ☐ 441 VOTING
- ☐ 442 JOBS
- ☐ 443 ACCOMMODATIONS
- ☐ 444 WELFARE
- ☐ 440 OTHER CIVIL RIGHTS

PRISONER PETITIONS
- ☐ 510 VACATE SENTENCE (2255)
- ☐ 520 PAROLE BRD. REVIEW
- ☐ 530 HABEAS CORPUS
- ☐ 540 MANDAMUS & OTHER
- ☐ 550 CIVIL RIGHTS

FORFEITURE/PENALTY
- ☐ 610 AGRICULTURE
- ☐ 620 FOOD & DRUG
- ☐ 630 LIQUOR LAWS
- ☐ 640 R.R. & TRUCK
- ☐ 650 AIR LINE REGS.
- ☐ 660 OCCUPATIONAL SAFETY/HEALTH
- ☐ 690 OTHER

LABOR
- ☐ 710 FAIR LABOR STANDARDS
- ☐ 720 LABOR/MGMT. RELATIONS
- ☐ 730 LABOR/MGMT. REPORTING & DISCLOSURE ACT
- ☐ 740 RAILWAY LABOR ACT
- ☐ 790 OTHER LABOR LITIGATION

PROPERTY RIGHTS
- ☐ 820 COPYRIGHT
- ☐ 830 PATENT
- ☐ 840 TRADEMARK

OTHER STATUTES
- ☐ 400 STATE RE-APPORTIONMENT
- ☐ 410 ANTI-TRUST
- ☐ 420 BANKRUPTCY TRUSTEE
- ☐ 430 BANKS AND BANKING
- ☐ 450 COMMERCE ICC RATES, ETC.
- ☐ 460 DEPORTATION
- ☐ 810 SELECTIVE SERVICE
- ☐ 850 SECURITIES COMMODITIES EXCHANGE
- ☐ 860 SOCIAL SECURITY
- ☐ 862 BLACK LUNG
- ☐ 870 TAX SUITS
- ☐ 891 AGRICULTURAL ACTS
- ☐ 892 ECONOMIC STABILIZATION ACT
- ☐ 893 ENVIRONMENTAL MATTERS
- ☐ 894 ENERGY ALLOCATION ACT
- ☐ 950 CONSTITUTIONALITY OF STATE STATUTES
- ☐ 970 NARA, TITLE III
- ☒ 890 OTHER STATUTORY ACTIONS

(PLACE AN ☒ IN ONE BOX ONLY) **ORIGIN** *(PLACE AN ☒ IN ONE BOX ONLY)*

☐ 1 ORIGINAL PROCEEDING ☒ 2 REMOVED FROM STATE COURT ☐ 3 REMANDED FROM APPELLATE COURT ☐ 4 REINSTATED OR REOPENED ☐ 5 TRANSFERRED FROM (SPECIFY DIST.) ☐ 6 MULTIDISTRICT LITIGATION

RESIDENCE OF PRINCIPAL PARTIES (IF DIVERSITY) Residency, as used means Citizenship.

	PTF	DEF
RESIDENT OF YOUR STATE	☐ 1	☐ 1
NON-RESIDENT CORPORATION DOING BUSINESS IN STATE	☐ 2	☐ 2
NON-RESIDENT CORPORATION NOT DOING BUSINESS IN STATE	☐ 3	☐ 3
OTHER NON-RESIDENT OF YOUR STATE	☐ 4	☐ 4

☐ CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23 | DEMAND $ | OTHER

REMARKS

JURY DEMAND: ☒ YES ☐ NO

DATE 10/23/78

SIGNATURE OF ATTORNEY OF RECORD James H. Schropp

STATES DISTRICT COURT

JS-44a (Rev. 1/75)

PAUL GONSON
JAMES H. SCHROPP
JULIE ALLECTA
Attorneys for the defendant
Securities and Exchange Commission
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF ARIZONA

SECURITIES AND EXCHANGE COMMISSION, Petitioner,	
v.	Civil Action No. _____ PHX
HIGH VALLEY INVESTMENTS, INC., A. LEE TABLER, ROBERT A. WAGNER, CHARLES VON GOERKEN, Respondents.	

VERIFIED PETITION FOR REMOVAL

The petition of the Securities and Exchange Commission ("Commission") respectfully shows:

1. On September 20, 1978, an action was commenced against the Commission, its investigators and attorneys by the filing of a complaint in the Superior Court of the State of Arizona, in and for the County of Maricopa, entitled High Valley Investments, Inc., et al., plaintiffs, v. Securities and Exchange Commission, et al., defendants, Civil No. C-375252. A copy of the complaint was served on and received by the Commission on September 25, 1978, and is annexed hereto. No further proceedings have been had in that action.

2. The above-described action is a civil action that seeks judgment against the Commission, an agency of the United States, and against various unnamed officers of the Commission or persons acting under such officers, generally referring to such persons as the "several attorneys and investigators" of the Commission (Complaint ¶ I). While the allegations in the plaintiffs' Complaint are vague and generalized, it appears that the claim asserted by the plaintiffs is one arising under the Constitution and laws of the United States, and that the actions of which the plaintiffs complain were performed by Commission personnel in connection with their duties as Commission employees, under color of their office, and in accordance with the authority granted to the Commission and to such persons under the federal securities laws. Therefore, the above-described action is one which may be removed to this Court by the Commission, a defendant therein, pursuant to the provisions of 28 U.S.C. 1441(b) and 1442(a)(1).

3. Since this petition is filed on behalf of an agency of the United States, no bond for costs and disbursements incurred by reason of the removal proceedings is required. 28 U.S.C. 1446(d).

WHEREFORE, pursuant to Rule 81(c) of the Federal Rules of Civil Procedure, the Commission respectfully petitions that the above-described action now pending in the Superior Court for the State of Arizona, in

and for the County of Maricopa, be removed therefrom to this Court.

Respectfully submitted,

PAUL GONSON
Associate General Counsel

JAMES H. SCHROPP
Assistant General Counsel

JULIE ALLECTA
Attorney

Securities and Exchange Commission
Washington, D.C. 20549

Local Counsel:

MICHAEL SCOTT
Assistant United States Attorney

5000 Federal Building
230 North First Avenue
Phoenix, Arizona 85025

DECLARATION

James H. Schropp, attorney for the Petitioner Securities and Exchange Commission in the above-entitled cause, states that he has read the contents of the foregoing Petition and that the matters contained therein are true to the best of his knowledge and belief. Pursuant to 28 U.S.C. 1746, I declare under penalty of perjury under the laws of the United States of America that the foregoing statement is true and correct. Executed on October 23, 1978.

JAMES H. SCHROPP

A. Lee Tabler
4039 West Huntington Drive
Phoenix, Arizona 85041

In Propria Persona

SUPERIOR COURT OF THE STATE OF ARIZONA

FOR THE COUNTY OF MARICOPA

HIGH VALLEY INVESTMENTS, INC.)
A. LEE TABLER)
ROBERT A. WAGNER)
CHARLES VON GOERKEN)
)
Plaintiffs,)
)
v.)
)
UNITED STATES SECURITIES AND)
EXCHANGE COMMISSION, IT'S)
INVESTIGATORS AND ATTORNEYS)
)
Defendants.)

CIVIL NO. C375252

ACTION IN TRESPASS AT COMMON LAW, PLAINTIFFS DEMAND (12) PERSON COMMON LAW JURY, TO JUDGE LAW AND FACT, OF ISSUES ONLY

I.

I, A. Lee Tabler, a United States Citizen and Agent-at-Large, as well as a co-owner of High Valley Investments, Inc. Under this authority and under the authority of the COMMON LAW as guaranteed by the Constitution of the United States and the Bill of Rights, Articles 1, 4 and 7 thereof, do hereby respectfully demand at COMMON LAW, to be heard by a twelve (12) person jury and based on the facts, herein contained, find the Securities and Exchange Commission and it's several attorneys and investigators, guilty of trespass on our Rights and guilty of damages to the Plaintiffs in the following sums:

Actual damages of.....$4,000,000.00

Punitive damages of.....$75,000,000,000.00

II.

The Securities and Exchange Commission and it's several attorneys and investigators are guilty of knowingly presenting perjured evidence to a Grand Jury. (Each attorney and Investi-

gator will be named by name.)

III.

Knowingly and willfully misrepresented the facts and definitions to a Grand Jury.

IV.

Knowingly and willfully usurped powers of the United States Justice Department. Thereby being in trespass of Articles 1, 4 and 6 of the Bill of Rights.

V.

Did knowingly and willfully harrassed the officers and investors with threats and pre-written depositions to the point of a personal vendetta.

VI.

Attorneys for the Securities and Exchange Commission have filed or caused to be filed an indictment that is in itself false and based on false information supplied to a Grand Jury. Knowing at the time of filing that it was false.

VII.

The harrassment of High Valley Investments, Inc.'s officers with threats of imprisonment and fines to acquire a guilty plea, a plea which would have, in fact, made both officers guilty of perjury, constitutes a willful and merciless denial of due process of Law as guaranteed by our Constitution.

VIII.

In view of these facts, which will be proven before a COMMON LAW jury, High Valley Investments, Inc. officers, et al, have not sold Securities, Oil, Gas or Mineral Rights, therefore, they cannot be guilty of Securities Violations.

We respectfully request a trial by jury of twelve (12) persons under COMMON LAW, to judge the FACT as well as the LAW on issue pleadings only.

A. Lee Tabler, Agent-at-Large
High Valley Investments, Inc.

Charles von Goerken
Robert A. Wagner
Et al

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing instrument has been sent by Certified Mail by me, to: Gerald G. Cunningham, c/o U.S. Attorney, Federal Building, Phoenix, Arizona 85025 and Lane B. Emory, Assistant Administrator, Seattle Regional Office, Securities and Exchange Commission, 915 2d Avenue, Seattle, Washington 98174.

A. Lee Tabler

PAUL GONSON
JAMES H. SCHROPP
JULIE ALLECTA
Attorneys for the defendant
Securities and Exchange Commission
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF ARIZONA

HIGH VALLEY INVESTMENTS, INC., A. LEE TABLER, ROBERT A. WAGNER, CHARLES VON GOERKEN, Plaintiffs,	:	Civil Action No. _____ PHX
v.	:	
SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.	:	

MOTION OF THE DEFENDANT SECURITIES AND EXCHANGE COMMISSION TO DISMISS, OR, IN THE ALTERNATIVE, FOR A MORE DEFINITE STATEMENT

The defendant Securities and Exchange Commission, respectfully moves this Court pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure to dismiss this action on the ground that the plaintiffs have failed to state a claim upon which relief can be granted. In the alternative, the defendant respectfully moves this Court for an order pursuant to Rule 12(e) of the Federal Rules of Civil Procedure requiring the plaintiffs to file a more definite statement of their claim.

In support of this Motion, the Court is referred to the memorandum of points and authorities filed herewith.

Respectfully submitted,

Local Counsel:

MICHAEL SCOTT
Assistant United States Attorney

5000 Federal Building
230 North First Avenue
Phoenix, Arizona 85025

PAUL GONSON
Associate General Counsel

JAMES H. SCHROPP
Assistant General Counsel

JULIE ALLECTA
Attorney

Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

Dated: October 23, 1978

PAUL GONSON
JAMES H. SCHROPP
JULIE ALLECTA
Attorneys for the defendant
Securities and Exchange Commission
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF ARIZONA

HIGH VALLEY INVESTMENTS, INC., A. LEE TABLER, ROBERT A. WAGNER, CHARLES VON GOERKEN, Plaintiffs,	:	Civil Action No. _____ PHX
v.	:	
SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.	:	

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THE MOTION OF THE SECURITIES AND EXCHANGE COMMISSION TO DISMISS, OR, IN THE ALTERNATIVE, FOR A MORE DEFINITE STATEMENT

The defendants in this action are the Securities and Exchange Commission ("Commission") and certain of its attorneys and investigators who are unnamed in the plaintiffs' complaint. The action was commenced in the Superior Court of the state of Arizona, in and for the county of Maricopa, and removed to this Court; the plaintiff in this action seeks $4,000,000 in actual damages and $75,000,000,000 in punitive damages against the defendants (Complaint ¶I). 1/ The vague and conclusary character of the plaintiffs' allegations do not permit us to ascertain with any degree of certainty the substance of the plaintiffs' charges; it appears, however,

1/ The complaint does not specify how or why the plaintiffs believe themselves entitled to this amount of money damages.

that the plaintiffs' complaint centers around certain actions of the Commission concerning High Valley Investment, Inc. ("High Valley") and two of its officers and directors, Robert A. Wagner and Charles von Goerken. 2/

The Commission's Action Against High Valley

On August 5, 1975, the Commission issued a formal order of investigation in the matter of High Valley Investments, Inc., to investigate possible violations of the federal securities laws in connection with the offer and sale of undivided fractional interests in oil and gas leases to be explored and developed by High Valley. In the course of the Commission's investigation, it was necessary for the Commission, on September 17, 1975, to bring a subpoena enforcement action against Mr. von Goerken in the United States District Court for Montana, and subsequently, on March 12, 1976, to initiate a civil contempt proceeding against Mr. von Goerken for his refusal to comply with the orders of the court entered in that action. 3/ An order was entered November 21, 1975, and amended January 6, 1976, requiring Mr. Goerken to produce the subpoenaed records.

On April 8, 1976, the Commission instituted in that court an injunctive action against High Valley, and Messrs. von Goerken and Wagner. 4/ The Commission's complaint alleged violations of the securities registration and antifraud provisions of the federal securities laws. On August 31, 1976, after a hearing at which none of the defendants appeared, the court entered a preliminary injunction against High Valley and Mr. Wagner. Mr. von Goerkin could not be located at that time, and the Commission was not able to effect service upon him in that action.

2/ High Valley is a closely held Nevada corporation headquartered in Montana. Mr. von Goerken is an officer of the company, its majority shareholder, and chairman of its board of directors. Mr. Wagner is also an officer and director of the company.

3/ Securities and Exchange Commission v. von Goerken, CV 75-119-M, D. Mont., Missoula Division.

4/ Securities and Exchange Commission v. High Valley Investments, Inc., et al., CV 76-39-M, D. Mont., Missoula Division.

On September 28, 1976, the Commission referred its investigative files, without any recommendation as to whether criminal prosecution was warranted, to the United States Attorney for the District of Arizona, pursuant to the request of that office. Thereafter, a federal grand jury in Phoenix, Arizona indicted Messrs. Wagner and von Goerken on sixteen counts of violations of the federal securities laws; 5/ the indictments were based on the same transactions that were the basis for the Commission's injunctive action. The Commission staff attorney primarily responsible for the conduct of the Commission's investigation and injunctive action was appointed to specially assist the United States Attorney for Arizona in this matter, and, in order to avoid any possible prejudice to the defendants that might have resulted from parallel civil and criminal proceedings, the Commission has deferred further prosecution of its injunctive action until the criminal case has been concluded. 6/ Trial in the criminal case is scheduled to begin on October 26, 1978.

ARGUMENT

I. SOVEREIGN IMMUNITY PRECLUDES THE MAINTENANCE OF THIS SUIT AGAINST THE COMMISSION FOR MONETARY DAMAGES.

While the plaintiffs' complaint does not provide enough information for us to determine the basis of the charges, the actions complained of appear to center around the presentation of evidence to a grand jury, the subsequent filing of a grand jury indictment, and the alleged harassment of certain High Valley officers in connection with the prosecution of a criminal action against them. Thus, the gravamen of the complaint presumably may be characterized as an action for money damages for the intentional tort of malicious prosecution, all cast in constitutional terms.

5/ United States v. von Goerken, et al., Criminal Action No. 76-478-PHX.

6/ Certain pleadings have recently been filed in the Commission's injunctive action by A. Lee Tabler, a plaintiff herein but not a party to the injunctive action. The Commission has moved to strike these pleadings as sham and false on the ground that the pleadings were not signed by any party to the proceeding.

It is well settled that the United States, as sovereign, is immune from suit except as it consents to be sued. See, e.g., Hawaii v. Gordon, 373 U.S. 57, 58 (1963); Larson v. Domestic & Foreign Commerce Corp., 337 U.S. 682, 688 (1949); Mine Safety Co. v. Forrestal, 326 U.S. 271, 374-375 (1945); United States v. Sherwood, 312 U.S. 584 (1941); Mom's v. United States, 521 F.2d 872, 874-875 (9th Cir. 1975). The Securities and Exchange Commission has been established as an agency of the United States and as such, is subject to suit only in such manner as authorized by Congress. Dalehite v. United States, 346 U.S. 15 (1952); Holmes v. Eddy, 341 F.2d 477 (4th Cir. 1965), certiorari denied, 382 U.S. 892 (1965), rehearing denied, 383 U.S. 922 (1966).

Thus, insofar as this action is brought against the Commission, qua Commission, in an effort to recover monetary damages, the doctrine of sovereign immunity requires dismissal. Congress has nowhere declared that the Commission may be sued in its own name, apart from having its orders and rules reviewed in courts of appeals pursuant to Section 25 of the Securities Exchange Act, 15 U.S.C. 78y, or its actions reviewed pursuant to 5 U.S.C. 702, provisions which have no application in this case. 7/ As the Supreme Court declared in Blackmar v. Guerre, 342 U.S. 512, 515 (1952), in affirming the dismissal of a complaint against the Civil Service Commission:

> "When Congress authorizes one of its agencies to be sued eo nomine, it does so in explicit language, or impliedly because the agency is the offspring of such a suable entity. See Keifer & Keifer v. R.F.C., 360 U.S. 381, 390." 8/

7/ Although 5 U.S.C. 702 permits judicial review of agency action in cases where a person has suffered "legal wrong" or has been "adversely affected or aggrieved * * * within the meaning of a relevant statute," that provision does not allow for the recovery of money damages against an agency. It should also be noted that the Administrative Procedure Act cannot be construed as creating a separate jurisdictional basis against the United States. Califano v. Sanders, 430 U.S. 99 (1977).

8/ Holmes v. Eddy, supra, 341 F.2d 477, cited with approval in National Labor Relations Board v. Nash-Finch Co., 404 U.S. 146, 15 n.4 (1972).

Although Congress recently enacted a provision waiving the defense of sovereign immunity in certain actions, the provision specifically states that this waiver is applicable only in actions "seeking relief other than money damages." See P.L. 94-574 (1976), codified as 5 U.S.C. 702. Because the United States is "not suable of common right, the party who institutes such suit must bring his case within the authority of some act of Congress, or the court cannot exercise jurisdcition over it." United States v. Clarke, 33 U.S. (8 Pet.) 436, 444 (1834). See also, Larson v. Domestic & Foreign Corp., 337 U.S. 682, 693 (1949), rehearing denied, 338 U.S. 840 (1950); United States v. Lee, 106 U.S. (16 Otto) 196, 204 (1882). Therefore, this action should be dismissed.

The United States has consented to be sued for torts pursuant to the Federal Torts Claims Act, 28 U.S.C. 1346(b), but the plaintiffs have not claimed jurisdiction under the Federal Torts Claims Act. Even if they had, it appears that the plaintiffs' action may well be outside the scope of that Act and therefore not actionable at all. As we have stated, the complaint appears to allege, in essence, tortious conduct in the form of malicious prosecution. The United States, however, has not granted its consent to be sued for such torts. Holms v. Eddy, supra, 341 F.2d 477; Boruski v. Division of Corporation Finance of the Securities and Exchange Commission, 321 F. Supp. 1273, 1278 (S.D. N.Y. 1971); see also, Dabhite v. United States, supra, 346 U.S. 15. In fact, the Federal Tort Claims Act expressly provides that the Act

> "shall not apply to any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights * * *." 28 U.S.C. 2680(h).

Accordingly, it appears that the plaintiffs have not stated a claim that is actionable. Redmond v. United States, Securities and Exchange Commission, 518 F.2d 811 (7th Cir. 1975). But, even assuming that the

Federal Tort Claims Act would permit this suit, the plaintiffs' claims nevertheless would be barred because their suit has been brought prematurely. Before an action may be commenced pursuant to the Federal Torts Claim Act, that Act requires that the claim first be presented to the appropriate federal agency, in this case, the Commission. 9/ This requirement is jurisdictional and cannot be waived. Three-M Enterprises, Inc. v. United States, 548 F.2d 293 (10th Cir. 1977).

The plaintiffs in this action have not presented any claim to the Commission. Thus, even if the action is not barred by the doctrine of sovereign immunity by virtue of the limited waiver to such suit provided by the Federal Tort Claims Act, the plaintiffs' action must be dismissed because the plaintiffs have not exhausted their administrative remedies. Caton v. United States, 495 F.2d 635, 638 (9th Cir. 1974). 10/

THE UNNAMED INDIVIDUAL DEFENDANTS ARE ABSOLUTELY IMMUNE FROM PRIVATE DAMAGE LIABILITY.

The Supreme Court, in Butz v. Economou, 98 S. Ct. 2894, 2911 (1978), recently held that damage suits against federal officials must be carefully scrutinized by the courts "to ensure that federal officials are not harassed by frivolous lawsuits." To that end, the Court emphasized that it is the responsibility of the federal courts to dismiss lawsuits for money damages against federal officials that, like the instant suit, do not state a cause of action. Thus, the Supreme Court declared:

9/ Section 2675(a) provides:

> "An action shall not be instituted upon a claim against the United States which has been presented to a federal agency, for money damages for injury or loss of property or personal injury or death caused by the negligent or wrongful act or omission of an employee of the government while acting within the scope of his authority, unless such federal agency has made final disposition of the claim."

10/ The procedures established by the Act must be strictly adhered to inasmuch as the Act constitutes a waiver of immunity. Three-M Enterprises, Inc. v. United States, supra, 548 F.2d at 295; Pennsylvania v. National Association of Flood Insurers, 520 F.2d 11, 20 (3rd Cir. 1975).

> "Insubstantial lawsuits can be quickly terminated by federal courts alert to the possibilities of artful pleading. Unless the complaint states a compensable claim for relief under the Federal Constitution, it should not survive a motion to dismiss." Id.

The plaintiffs' frivolous claims for money damages should be treated in accord with the Supreme Court's direction.

Even assuming that the plaintiffs have stated a claim upon which money damages could be awarded (a proposition which we refute, infra), the unnamed individual defendants are immune from liability for money damages in this matter. The Supreme Court in Butz v. Economou, supra, thoroughly reviewed the scope of official immunity and reaffirmed the principle of absolute immunity for criminal prosecutors established in Imbler v. Pachtman, 424 U.S. 409 (1976), holding "that agency officials performing certain functions analogous to those of a prosecutor should be able to claim absolute immunity with respect to such acts." 98 S. Ct. at 2915. In this regard, the Court noted that agency officials who participate in the decision to bring an enforcement action should be accorded absolute immunity:

> "An agency official, like a prosecutor, may have broad discretion in deciding whether a proceeding should be brought and what sanctions should be sought. The discretion which executive officials exercise with respect to the initiation of administrative proceedings might be distorted if their immunity from damages arising from that decision was less than complete * * *" (id.).

The need for absolute immunity is all the more clear where agency officials participate in judicial proceedings and criminal law enforcement actions.

Inasmuch as the allegations of the plaintiffs appear to concern the actions of unnamed Commission employees in presenting evidence to a grand jury and otherwise pursuing the conduct of a criminal prosecution against

certain High Valley officers, these actions come squarely within the scope of the absolute immunity defined by the Court in Butz v. Economou. There the Court observed, noting with approval its earlier opinion in Imbler v. Pachtman, 424 U.S. 409 (1976), that:

> "'The common-law immunity of a prosecutor is based upon the same considerations that underlie the common-law immunities of judges and grand jurors acting within the scope of their duties.' [Imbler v. Pachtman, supra, 424 U.S. 422-423, 96 S. Ct., at 991.] * * * A qualified immunity might have an adverse effect on the functioning of of the criminal justice system, not only by discouraging the initiation of prosecutions, see id. at 426 n. 24, 96 S. Ct., at 993, but also by affecting the prosecutor's conduct of the trial * * *.
>
> * * *
>
> "In light of these and other practical considerations [federal officials were] entitled to absolute immunity with respect to his activities as an advocate, 'activities [which] were intimately associated with the judicial phase of the criminal process, and thus were functions to which the reasons for absolute immunity apply with full force.' Id. at 430, 96 S. Ct. at 995."

98 S. Ct. at 2913 (footnote omitted).

We further submit that quasi-judicial immunity also extends to any Commission investigator whose work constitutes an integral part of the judicial-prosecutoral process. The theory and public policy behind the principle of judicial and quasi-judicial immunity supports this view. There is no need for a civil suit against prosecutors or prosecutor-investigators with regard to allegedly illegal investigatory actions when questions regarding the legality of these actions can be raised fully litigated in the criminal

action. Thus, if a criminal defendant can have his "day in court" on these issues in the criminal trial, there is no need to subject prosecutors or their investigators to duplication and potentially frivolous, harassing and vexatious civil suits. Cambist Films, Inc. v. Duggan, 475 F.2d 887 (3rd Cir. 1973). As noted, trial in the criminal action pending against the plaintiffs is scheduled to begin soon; thus, they will be afforded their day in court and may raise all claims regarding violations of constitutional rights.

The Court in Economou, in examining the absolute immunity of judges, noted that the judicial process provided safeguards against the kind of tortious, unconstitutional conduct alleged here, thus reducing the need for private damage actions. And, in a recent decision, the United States District Court for the Southern District of New York held, based on Economou, that a Commission investigatory official was absolutely immune from liability from damages. See Tserpes v. Securities and Exchange Commission, 77 Civ. 4071 (CHT) (Aug. 8, 1978) (a copy of the decision is attached for the convenience of the Court and counsel as Exhibit A). The District Court cited the holding in Butz v. Economou, supra, 98 S. Ct. at 2915, that "agency officials performing certain functions analogous to those of a prosecutor should be able to claim absolute immunity with respect to such acts." Tserpes v. Securities and Exchange Commission, slip op. at 6. And, the District Court held that the Commission officials participating in an investigation shared in that immunity. Id. at 6-7.

The individual defendants are, therefore, entitled to the absolute immunity accorded those government officials "whose special functions require a full exemption from liability." Butz v. Economou, supra, 98 S. Ct. 2912. Accord, Imbler v. Pachtman, 424 U.S. 409 (1976). The individual defendants are absolutely immune from private damages liability for the discretionary acts complained of, all of which are within the scope of their authority and performed during the course of their official duties.

Moreover, even in the absence of the absolute immunity which is accorded those federal officials exercising quasi-judicial or quasi-prosecutorial

functions, all federal officials are absolutely immune from liability for non-constitutional torts or statutory claims. Butz v. Economou, supra, 98 S. Ct. at 2905, reaffirming Barr v. Mateo, 360 U.S. 654 (1959).

We recognize that that the plaintiffs here are proceeding pro se and that their pleadings should, to a degree, be liberally read. But, even a pro se complaint is subject to dismissal for failure to state a claim if it appears beyond doubt that the plaintiff will fail to prove any set of facts in support of his claim that could entitle him to relief, Estelle v. Gamble, 429 U.S. 97, 166 (1977); Haines v. Kerner, 404 U.S. 519, 521-522 (1972). 11/ "[A] plaintiff [is] bound to do more than merely state vague and conclusory allegations respecting the existence of a conspiracy." Powell v. Workmen's Comp. Bd. of State of New York, 327 F.2d 131, 137 (2nd Cir. 1964). See also, Coopersmith v. Supreme Court, State of Colorado, 465 F.2d 993 (10th Cir. 1972); Turack v. Guido, 464 F.2d 535 (2nd Cir. 1972). Nor is it sufficient to construct a cause of action from frivolous assertions. Radovich v. National Football League, 352 U.S. 445 (1957).

The allegations advanced here are gross conclusions devoid of any factual support, and the plaintiffs' complaint should be dismissed.

II. IF THE ACTION IS NOT DISMISSED AT THIS TIME, THE DEFENDANTS ARE ENTITLED TO A MORE DEFINITE STATEMENT OF THE ALLEGATIONS THAT FORM THE BASIS OF THE PLAINTIFFS' COMPLAINT.

Although we believe this action should be dismissed, in the event the Court does not do so at this time, the defendants respectfully seek, in the alternative, an order requiring the plaintiffs to file a more definite statement of their claims.

The actions alleged in the complaint are framed in overly broad terms. We have only assumed that this action relates to the criminal proceedings

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11/ Though courts have expressed a willingness to relax technical standards of pleading on behalf of pro se litigants, in cases where imperfections in pleading would prevent the maintenance of a viable cause of action, Dioguardi v. Durning, 139 F.2d 744 (2nd Cir. 1944), 2A Moore's Federal Practice ¶8.13, the courts have not permitted the assertion of allegations so broad and scandalous that, because they are wholly unsupported by evidence or factual background, cannot be construed as anything but unintelligible. Anderson v. United States, 182 F.2d 296 (1st Cir. 1950).

now pending against Messrs. Wagner and von Goerkin; the complaint itself fails to state when the actions complained of occurred or in what context. Moreover, the complaint contains no allegation as to the identity of the individual defendants and whether each allegation is made with respect to some or all of the defendants; certainly the plaintiffs must know the identities of some of the government agents who they believe have wronged them. 12/ Nor do the plaintiffs specify which of the plaintiffs have suffered what particular monetary damages, or the causal relationship between any act complained of and any alleged damages. Indeed, it is not even clear who the plaintiffs in the action are. 13/ In view of the plaintiffs' assertion in paragraph II of the complaint that they are able to supply additional details, such details should be required. The vagueness and ambiguity of the plaintiffs' complaint, as it now stands, renders it impossible for the Commission and the unnamed individual defendants to file an appropriate responsive pleading in this case.

Although plaintiffs who appear pro se may be entitled to certain allowances, the Supreme Court has admonished:

> "The right of self-representation is not a license to abuse the dignity of the courtroom. Neither is it a license not to comply with the relevant rules of procedural and substantive law." Faretta v. California, 422 U.S. 806, 835 n.46 (1975).

CONCLUSION

For the reasons stated above, this action should be dismissed for failure to state a claim upon which relief may be granted.

12/ No individual defendant has yet been served with the complaint; and the defendants do not waive any jurisdictional defenses, including defenses based on this failure.

13/ The complaint is signed only by A. Lee Tabler who is appearing "in propria persona." Since Mr. Tabler is presumably not an attorney, he may not represent the other designated plaintiffs in this case.

In the alternative, the Court should grant the Commission's motion, pursuant to Rule 12(e), and direct the plaintiffs to file, within ten days, a more definite statement as to the nature of their claim, failing which the complaint shall be dismissed.

Respectfully submitted,

Local Counsel:

MICHAEL SCOTT
Assistant United States Attorney

5000 Federal Building
230 North First Avenue
Phoenix, Arizona 85025

PAUL GONSON
Associate General Counsel

JAMES H. SCHROPP
Assistant General Counsel

JULIE ALLECTA
Attorney

Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

Dated: October 23, 1978

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

KONSTANTINOS M. TSERPES,

Plaintiff,

-against-

SECURITIES AND EXCHANGE COMMISSION, WILLIAM D. MORAN, FRANKLIN D. ORMSTEN, IRA M. BRATT, MARK N. JACOBS, and IRVING SOMMER,

Defendants.

77 Civ. 4071 (CHT)

MEMORANDUM
#47522

APPEARANCES

Plaintiff Pro Se: KONSTANTINOS M. TSERPES
333 West 39th Street
New York, N.Y. 10018

For Defendants: SECURITIES AND EXCHANGE COMMISSION
500 North Capitol Street, N.W.
Washington, D.C. 20549

By: PAUL GONSON, Associate General Counsel
FREDERICK B. WADE, Special Counsel
MICHAEL E. BLOUNT, Attorney

Of Counsel:

DONALD N. MALAWSKY, Associate Administrator
New York Regional Office
Securities and Exchange Commission
26 Federal Plaza
New York, N.Y. 10007

TENNEY, J.

Konstantinos M. Tserpes appears pro se to press claims against the Securities and Exchange Commission ("SEC") and five

EXHIBIT A

individual defendants, four of whom are or were SEC staff members. The fifth individual defendant is an Administrative Law Judge at the SEC. Plaintiff's vague and conclusory complaint ascribes to the defendants a malicious conspiracy to injure his business and to disparage his professional abilities, charges which apparently arise from SEC administrative and judicial prosecution of the plaintiff in connection with the sale of shares in a corporation of which he is president. [1] All defendants have moved for dismissal of the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure ("Rules") or, in the alternative, for summary judgment pursuant to Rules 12(c) and 56. The Court having considered matters outside the pleadings the motion will be treated as one for summary judgment which, for the reasons to follow, is awarded to the defendants.

This Court is mindful of the traditional generosity afforded pro se plaintiffs. Haines v. Kerner, 404 U.S. 519 (1972); Jackson v. Statler Foundation, 496 F.2d 623 (2d Cir. 1974). Consequently, it has dealt sympathetically and somewhat informally with the plaintiff who, for reasons of alleged illness, was not required to hew to normal chronology in responding to this motion. Numerous extensions of time to respond were granted. Finally, by Order dated March 28, 1978, the Court instructed the plaintiff to submit a medical report explaining his physical condition. No such report was ever

filed. In its stead, plaintiff submitted copies of forms apparently generated in the Medical Records Department of Metropolitan Hospital Center. Plaintiff's Notice of Motion, sworn to April 5, 1978, Exhibits. These extremely sketchy documents indicate that the plaintiff was admitted to that hospital on February 10, 1978, and was discharged on March 8, 1978. In his April 5 motion plaintiff provided some small illumination by stating that he was "required to recuperate from surgery for six more weeks." Giving plaintiff the leeway he requested and more, it would appear that this matter should have been attended to by the end of May. To date the Court has received no response from plaintiff to defendants' motion to dismiss.

It would not be unreasonable, therefore, to invoke the Rule 56 instruction that when faced with a properly supported summary judgment motion the party who does not respond may have judgment entered against him "if appropriate." However, the Court need engage in no such discretionary exercise. As a matter of substantive law the plaintiff could not prevail on his claim, for whatever support he might have garnered in response would collide with immunity doctrines clearly applicable to this case.[2/] As applied to each of the six defendants named, immunity is afforded as follows:

1. The SEC: As a federal agency, the SEC is an integral part of the United States government, having full sovereign

immunity in the absence of waiver. Blackmar v. Guerre, 342 U.S. 512 (1952); Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682 (1949). Apart from specific provisions of law providing for review of SEC action, e.g., 15 U.S.C. § 702, no such waiver has been made.

2. Irving Sommer: This defendant is an Administrative Law Judge and as such invulnerable for his official acts in connection with plaintiff's administrative case under the recent Supreme Court holding that "persons . . . performing adjudicatory functions within a federal agency are entitled to absolute immunity from damages liability for their judicial acts." Butz v. Economou, 46 U.S.L.W. 4952, 4962 (U.S. June 29, 1978).

3. William D. Moran: Defendant Moran is presently Regional Administrator of the New York Regional Office ("NYRO") of the SEC. In this capacity and in his former capacity as Associate Regional Administrator it was and is his responsibility to execute the mandate of that office which involves

> conducting investigations under each of the statutes administered by the Commission . . . reviewing evidence acquired in such investigations . . . recommending appropriate enforcement action to the Commission, and [supervising] and conduct[ing] . . . activities to enforce the provisions of those statutes.

Affidavit of William D. Moran, sworn to November 3, 1977, ¶ 2. Moran had a supervisory and discretionary role in the administrative proceeding taken against the plaintiff. This brings

his activity squarely within the Butz holding that "those officials who are responsible for the decision to initiate or continue a proceeding subject to agency adjudication are entitled to absolute immunity from damages liability for their parts in that decision." Butz v. Economou, supra, 46 U.S.L.W. at 4962.

4. Franklin D. Ormsten: This defendant is Assistant Regional Administrator of the NYRO and like Moran is charged with similar agency responsibilities. Ormsten, however, did not participate in the agency proceedings against the plaintiff, but was responsible "for the overall supervision of the litigation of [the] civil injunctive action that the Commission had filed against [the plaintiff]." Affidavit of Franklin D. Ormsten, sworn to November 3, 1977, ¶¶ 2-4. Logic dictates that the Butz holding immunizing "those who are responsible for the decision to initiate or continue [an agency] proceeding" must extend to those agency officials whose administrative duties carry them outside the administrative process and into the courts in a prosecutorial role. Under 15 U.S.C. §§ 77t(b) and 78u(e) the SEC has authority to bring an action in a federal district court to enjoin "any acts or practices which constitute or will constitute" a violation of securities law and regulations. Thus an SEC injunctive proceeding in a district court might be considered a "continuation" of an agency proceeding already begun, and this view would immunize under the Butz

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5 & 6. Mark N. Jacobs and Ira M. Bratt: Defendant Jacobs was employed as an enforcement attorney with the SEC, in the course of which employment he participated in the investigation of plaintiff's activities in connection with his corporation's issuance of public shares. Jacobs also participated in the civil litigation begun by the SEC against the plaintiff. Affidavit of Mark N. Jacobs, sworn to November 3, 1977, ¶¶ 3-5. Defendant Bratt is currently an enforcement attorney with the SEC and he also took part in the litigation against the plaintiff. Affidavit of Ira M. Bratt, sworn to November 3, 1977, ¶¶ 4, 5. The activities of defendants Jacobs and Bratt evoke the protection of the further Butz holding that "an agency attorney who arranges for the presentation of evidence on the record in the course of an [administrative] ad-

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For all of the foregoing reasons the defendants' motion for summary judgment pursuant to Rules 12(c) and 56 is granted.

Settle judgment on notice.

Dated: New York, New York
August 8, 1978

CHARLES H. TENNEY
U.S.D.J.

KONSTANTINOS M. TSERPES,
Plaintiff,

-against-

SECURITIES AND EXCHANGE COMMISSION, et al.,
Defendants.

77 Civ. 4071 (CHT)

FOOTNOTES

1/ See SEC v. Research Automation Corp., 521 F.2d 585 (2d Cir. 1975).

2/ The Complaint does not specifically state that this suit arises from SEC litigation in connection with halting issuance of public shares in plaintiff's corporation. However, it does not take a great deal of imagination to cull from the Complaint evidence that this is so. To begin with, all of the defendants are or were connected with the SEC and with its case against Tserpes and his corporation. Moreover, the plaintiff states that the defendants "illegally stopped the standard business financing and benefits from plaintiff's 70% ownership of the business in Research Automation Corporation." Complaint ¶ 4(c)(1). Further, there is a charge that "[i]n their conspiracy, the defendants have deprived plaintiff access to the capital stock . . . . ." Id. ¶ 4(5). It seems beyond cavil that plaintiff's charges against these defendants arise from their execution of official responsibilities.

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77 Civ. 4071 (CHT)

MEMORANDUM
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For Defendants: SECURITIES AND EXCHANGE COMMISSION
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For all of the foregoing reasons the defendants' motion for summary judgment pursuant to Rules 12(c) and 56 is granted.

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Dated: New York, New York
August 8, 1978

CHARLES H. TENNEY
U.S.D.J.

KONSTANTINOS M. TSERPES, Plaintiff, 77 Civ. 4071 (CHT)

-against-

SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.

FOOTNOTES

1/ See SEC v. Research Automation Corp., 521 F.2d 585 (2d Cir. 1975).

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PAUL GONSON
JAMES H. SCHROPP
JULIE ALLECTA
Attorneys for the defendant
Securities and Exchange Commission
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-1335

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF ARIZONA

HIGH VALLEY INVESTMENTS, INC., A. LEE TABLER, ROBERT A. WAGNER, CHARLES VON GOERKEN, Plaintiffs,	:	Civil Action No. _____ PHX
v.	:	
SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.	:	

CERTIFICATE OF SERVICE

I hereby certify that on this day copies of (1) Verified Petition for Removal, (2) Motion of the Defendant Securities and Exchange Commission to Dismiss, or, in the Alternative, for a More Definite Statement, and (3) Memorandum of Points and Authorities in Support of the Motion of the Securities and Exchange Commission to Dismiss, or, in the Alternative, for a More Definite Statement, were served by mail on the plaintiff, Lee A. Tabler, agent-at-large for all the plaintiffs, at 4039 West Huntington Drive, Phoenix, Arizona 85041.

JAMES H. SCHROPP

Dated: October 23, 1978

SUPERIOR COURT OF THE STATE OF ARIZONA
FOR THE COUNTY OF MARICOPA

HIGH VALLEY INVESTMENTS, INC., A. LEE TABLER, ROBERT A. WAGNER, CHARLES VON GOERKEN, Plaintiffs,	:	Civil Action No. C375252
v.	:	
UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Its Investigators and Attorneys, Defendants.	:	

TO: A. LEE TABLER,
plaintiff, in Propria Persona
and "Agent-at-Large" for the plaintiffs
4039 West Huntington Drive
Phoenix, Arizona 85041

PLEASE TAKE NOTICE, pursuant to 28 U.S.C. 1446(e), that the Securities and Exchange Commission, the defendant in the above-captioned action, has this date filed its verified petition for removal, a copy of which is attached hereto, in the United States District Court for the District of Arizona at Phoenix.

JAMES H. SCHROPP
Attorney for the Defendant

Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549
Telephone (202) 755-4709

Dated: October 23, 1978

→ Richard Breyer

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

LUCIUS G. HILL, et al.,	:	
Plaintiffs,	:	
v.	:	Civil Action No. 82-2675
SECURITIES AND EXCHANGE COMMISSION, et al.,	:	
Defendants.	:	

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT OR, IN THE ALTERNATIVE, TO DISMISS

LINDA D. FIENBERG
Associate General Counsel
WHITNEY ADAMS
Assistant General Counsel
RUTH E. EISENBERG
Attorney
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549
Telephone: (202) 272-2454

April 7, 1983

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UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

LUCIUS G. HILL, et al., Plaintiffs, v. SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.	Civil Action No. 82-2675

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT OR, IN THE ALTERNATIVE, TO DISMISS

PRELIMINARY STATEMENT

This lawsuit arises from a routine examination under the Securities Exchange Act 1/ of the books and records of a registered broker-dealer, Lucius G. Hill Securities, Inc., which took place almost three years ago. Plaintiffs, the broker-dealer and its principal, now challenge that examination and the statutory provision pursuant to which it was conducted, under the fourth amendment. Defendants, the Securities and Exchange Commission and its individual Commissioners (collectively, "the Commission"), have moved this Court to grant them summary judgment on all claims. Warrantless examinations of books and records under the Securities

1/ 15 U.S.C. 78q(b).

Exchange Act ("Exchange Act") are reasonable under the fourth amendment; they involve only a minimal intrusion of commercial property in a single, pervasively regulated industry, with a long history of government supervision, and are necessary for effective enforcement of the Act.

In any event, the statute is not unconstitutional as applied to plaintiffs. As is clear from the face of their complaint, plaintiffs' agent consented to the records' examination, and plaintiffs' themseleves ratified this consent. Thus, the complaint fails to state a constitutional claim and should be dismissed. Rule 12(b)(6), Federal Rules of Civil Procedure.

The Commission also requests this Court to dismiss, pursuant to Rule 12(b)(1), all claims for an injunction against use of any documents obtained in the examination. Those claims are not ripe because the Commission has not sought to use the documents in any proceeding; if the Commission should seek to do so at some later time, plaintiffs will have an adequate remedy at law in that proceeding.

STATEMENT OF THE CASE

I. STATUTORY AND REGULATORY SCHEME 2/

Almost 50 years ago, when Congress first enacted legislation governing the securities markets, it directed

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2/ To place in context the routine examination of plaintiffs' books and records (the issue in this case), the Commission sets forth a summary description of the statutory and regulatory framework pursuant to which that examination took place.

pervasive regulation of securities broker-dealers 3/ because it found that unscrupuluous or financially irresponsible broker-dealers had posed particular dangers to investors and interstate commerce. 4/ In enacting federal securities legislation, Congress was concerned that securities dealers adhere to "standards of fair, honest and prudent dealing that should be basic to the encouragement of investment in any enterprise." H.R. Rep. No. 85, 73rd Cong., 1st Sess. 2 (1933). 5/ Accordingly, broker-dealers in securities listed

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3/ A broker is a person in the business of effecting securities transactions for the accounts of others; a dealer is a person in the business of effecting securities transactions for his own account. Sections 3(a)(4) and 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(4) and 78(c)(a)(5). As most persons in the business engage in both types of transactions, they are commonly referred to as "broker-dealers." E.g, United States v. Nat'l Ass'n of Securities Dealers, 422 U.S. 694, 701 (1975).

4/ Securities brokers have been subject to licensing requirements and prosecution for violating those requirements since 1285. Even prior to enactment of federal securities legislation, most states regulated the activities of brokers and dealers. For the history of broker-dealer regulation in England and this country, see generally 1 L. Loss, Securities Regulation §1 (2d ed. 1961).

5/ See also Proposed Amendments to the Securities Act of 1933 and Securities Exchange Act of 1934: Hearings before the House Comm. on Int. and For. Commerce, 77th Cong., 1st Sess. (1941) 20-24 (noting need for financial safeguards for broker-dealers); United States v. Naftalin, 441 U.S. 768, 775 (1979) ("Prevention of frauds against investors was surely a key part of [the federal securities laws], but so was the effort 'to achieve a high standard of business ethics * * * in every facet of the securities industry'") (emphasis in original).

on a national securities exchange have been regulated by the Commission since 1934, the year the stock exchanges first became regulated. 6/ In 1938 Congress extended the Commission's regulatory authority to include broker-dealers operating in the over-the-counter market. 7/

Today, as we describe below, federal regulation of securities broker-dealers is far-reaching and extensive. Regulatory authority is shared by the Commission and a number of self-regulatory organizations (SROs) registered with the Commission. 8/ SROs are stock exchanges or other private registered securities associations to which Congress has delegated certain regulatory authority under the general supervision of the Commission. The SROs have responsibility to assure their members' compliance with the federal securities laws, as well as with rules and regulations they have promulgated. 9/

6/ Exchange Act, 15 U.S.C. 78(a) et seq.

7/ Maloney Act of 1938, 15 U.S.C. 78o(c)(i), 78o(c)(2) and 78o-3. The over-the-counter market encompases securities transactions that take place other than on a national securities exchange. See V. Loss, Securities Regulation § 8 (2d ed., 1961).

8/ See 15 U.S.C. 78o(b)(8) and United States v. Nat'l Ass'n of Securities Dealers, 422 U.S. at 700-01 n.6; Silver v. New York Stock Exchange, 373 U.S. 341, 350-53 (1963).

9/ See Section 6, Exchange Act, 15 U.S.C. 78f (provisions governing exchanges); Section 15A, Exchange Act, 15 U.S.C. 78o-3 (provisions governing registered associations); and Section 19, Exchange Act, 15 U.S.C. 78s (provisions governing all SROs).

Members of stock exchanges, as well as non-member broker-dealers, may join the National Association of Securities Dealers (NASD), the primary SRO for broker-dealers limiting their trading activity to the over-the-counter market. 10/ Currently over 90% of registered broker-dealers (7,250 of 7,800) are members of the NASD (Kwalwasser Declaration ¶ 3). The remaining (about 550), called SECO (SEC Only) broker-dealers, are regulated directly by the Commission pursuant to Commission rules that are comparable to NASD rules. 11/

A. Survey of Broker-Dealer Regulation 12/

1. Registration

With very limited exceptions, all broker-dealers engaging in interstate commerce must register with the Commis-

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10/ The only other such SRO is the Municipal Securities Rulemaking Board.

11/ See Comparability of NASD and SECO Regulation, Securities Exchange Act Rel. No. 9420 (December 20, 1971); and, e.g., 17 C.F.R. 240.15b8-1, and 240.15b10-1 et seq. Legislation has been introduced that would require all broker-dealers effecting transactions in the over-the-counter market to join a registered securities association. See H.R. 562, 98th Cong. 1st Sess. (1983) and S. 896, 98th Cong. 1st Sess. (1983). If enacted, this legislation would eliminate the SECO program.

While SEC and NASD supervision are comparable, to the extent there are any differences we discuss in this memorandum rules affecting SECO broker-dealers since Mr. Hill did not join an SRO.

12/ Examinations of broker-dealers are discussed separately in part I.B., infra, p. 13.

sion. 13/ To register, the broker-dealer files an application requiring extensive disclosures about the registrant's background, financial condition, and the type of business in which he intends to engage. 14/ A separate registration form must be filed with the Commission or the appropriate SRO for each employee of the firm who directly or indirectly effects securities transactions. 15/ Broker-dealers are under a continuous obligation to amend their registration form should circumstances render it inaccurate. Moreover, to withdraw from registration, a broker-dealer's notice of withdrawal must be accepted by the Commission. 16/

The Commission has extensive disciplinary authority to deny, suspend, or revoke any broker-dealer registration upon a finding of, among other things, a willful violation of the federal securities laws or a failure reasonably to supervise an employee who commits such a violation. The Commission

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13/ Section 15(a) of the Exchange Act, 15 U.S.C. 78o(a).

14/ See 17 C.F.R. 240.15b1-1 and Securities Exchange Act Form BD (reproduced in Fed. Sec. Laws (CCH)).

15/ 17 C.F.R. 240.15b8-1.

16/ Section 15(b)(5) of the Exchange Act, 15 U.S.C. 78o(b)(5). See Shuck v. SEC, 264 F.2d 358 (D.C. Cir. 1958) (Commission may order revocation of registration even when registrant wishes to withdraw voluntarily).

may also limit a broker-dealer's activities, functions or operations. 17/

2. Financial Responsibility

Broker-dealers must comply with Commission regulations governing financial responsibility and related practices affecting customers' funds, including segregation of funds and financial reporting. 18/

(a) Net Capital Rule

The net capital rule is the "principal regulatory tool" that the Commission uses to "monitor the financial health of brokerage firms and protect customers from the risks involved in leaving their cash and securities with broker-dealers." Touche Ross & Co. v. Redington, 442 U.S. 560, 570 (1979). The rule, which requires each broker-dealer daily to compute its net capital, 19/ has, as its basic purpose, to ensure that the broker-dealer always has sufficient, liquid assets to cover

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17/ Section 15(b)(4), Exchange Act, 15 U.S.C. 78o(b)(4).

18/ E.g., Section 15(c)(3), Exchange Act, 15 U.S.C. 78o(c)(3); Section 17(e), Exchange Act, 15 U.S.C. 78q(e).

19/ 17 C.F.R. 240.15c3-1. Net capital is the firm's net worth minus non-liquid assets, plus certain subordinated liabilities. Certain assets are reduced by a percentage called a "haircut." No broker-dealer can permit aggregate indebtedness to exceed 15 times net capital.

debts to customers. 20/ Broker-dealers nearing violation of the net capital requirement must immediately notify the Commission by telegraph and file certain additional financial reports. 21/

(b) Safeguarding Customer Funds and Securities

Congress has authorized the Commission to promulgate rules to protect customer funds and securities in the broker-dealer's possession, in the event a broker-dealer fails. 22/ Accordingly, most broker-dealers must determine, on a daily basis, which of their customers' securities are fully paid for, or, as to securities purchased on margin, which portion is fully paid for. 23/ In addition, firms that hold customer funds and securities must keep a reserve bank account for the special benefit of customers. The amount to be deposited, which must be enough to cover certain losses, must be computed every Friday and placed in the bank by the following Tuesday

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20/ Securities Exchange Act Rel. No. 11497 (June 26, 1975). The rule is "one of the most important weapons in the Commission's arsenal to protect investors." Blaise d'Antoni & Associates, Inc. v. SEC, 289 F.2d 276, 277 (5th Cir.), cert. denied, 368 U.S. 899 (1961).

21/ 17 C.F.R. 240.17a-11. The Commission also imposes minimum capitalization requirements ranging from $2,500 to $50,000. 17 C.F.R. 15c3-1.

22/ Section 15(c)(3) of the Exchange Act, 15 U.S.C. 78o(c)(3). See 17 C.F.R. 240.15c3-3.

23/ Section 15(c)(3) of the Exchange Act, 15 U.S.C. 78o(c)(3); 17 C.F.R. 15c3-3.

before opening of business. 24/

Many other rules are also designed to protect customers' funds or securities. For example, every quarter each broker-dealer must make a "box count" to determine the number of securities it holds. 25/ Whenever effecting securities transactions for any customer, the broker-dealer must send written confirmation containing prescribed information. 26/ To prevent broker-dealers from using their customers' securities as collateral to finance the firm's business, hypothecation rules regulate the manner in which securities may be pledged as collateral for a loan. 27/

3. Trading Practices

The Commission has broad authority, pursuant to Sections 10(b) and 15(c) of the Exchange Act and 17(a) of the Securities

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24/ 17 C.F.R. 240.15c3-3.

25/ 17 C.F.R. 240.17a-13.

26/ 17 C.F.R. 240.10b-10.

27/ 17 C.F.R. 240.8c-1 and 240.15c2-1.

In addition, most registered broker-dealers must become members of the Securities Investor Protection Corporation (SIPC), which insures customer's funds and securities up to $500,000 of which $100,000 can be cash. Section 3(a)(2) and (9) of the Securities Investor Protection Act, 15 U.S.C. 78fffc(a)(2) and (9). They also must carry a fidelity bond (17 C.F.R. 240.15b10-11) and provide fingerprints for certain employees (17 C.F.R. 240.17f-2). The Commission also requires most broker-dealers to register in the Lost and Stolen Securities Program. 17 C.F.R. 240.17f-2.

Act, to prohibit fraud by broker-dealers. 28/ As a result of decisions in administrative and court proceedings instituted by the Commission under these statutes, a comprehensive code of broker-dealer conduct has developed. 29/

SECO broker-dealers also must obey rules prescribed by the Commission to "promote just and equitable principles of trade," to foster a free market, and to protect investors and the public interest. 30/ For example, a broker-dealer may not recommend securities to a customer unless he has determined that the security is suitable to the customer's investment objectives and financial situation. 31/ Prior to effecting transactions for securities in which the broker-dealer has a "control" interest, broker-dealers must disclose that fact to customers in writing. 32/ Broker-dealers managing customers'

28/ Section 10(b) and 15(c) of the Exchange Act, 15 U.S.C. 78j(b) and 78o(c); Section 17(a) of the Securities Act, 15 U.S.C. 77q(a).

29/ See generally N. Wolfson, R. Phillips and T. Russo, Regulation of Brokers, Dealers and Securities Markets §2 (1977); Samuel B. Franklin & Co. v. Securities and Exchange Commission, 290 F.2d 719 (9th Cir.), cert. denied, 368 U.S. 889 (1961); Hughes v. SEC, 174 F.2d 969, 975-76 (D.C. Cir. 1949); and Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir.), cert. denied, 321 U.S. 786 (1943).

30/ Section 15(b)(9) of the Exchange Act, 15 U.S.C. 78o(b)(9).

31/ 17 C.F.R. 240.15b10-3. The broker-dealer must keep records on each customer to make suitability determinations. See 17 C.F.R. 240.15b10-6(a).

32/ 17 C.F.R. 240.15c1-5. A "control" interest exists when the dealer is "controlled by, controlling, or under common control with, the issuer of any security." Id. See also 17 C.F.R. 240.15c1-6.

discretionary accounts 33/ must have the customer's written authorization 34/ and bear fiduciary responsibilities. 35/

4. Recordkeeping and Reporting Requirements

The recordkeeping and reporting provisions governing broker-dealers elicit information designed in part to provide the Commission and SROs "sufficiently early warning to enable them to take appropriate action to protect investors before the financial collapse of the particular broker-dealer involved." Touche Ross & Co. v. Redington, 442 U.S. at 570. Thus, Commission Rules 17a-3, 17a-4, and 15b10-6 (17 C.F.R. 240.17a-3, 17a-4, and 15b10-6), among others, require broker-dealers to make detailed books and records pertaining to their business, to preserve these and any other records they make, and to provide copies to the Commission. 36/ Implicit

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33/ Generally, in a discretionary account, the customer has given the broker certain authority to effectuate transactions; the broker need not obtain express approval as to these transactions. See United States v. Kendrick, 692 F.2d. 1262, (9th Cir. 1982) (pet. for cert. pending).

34/ 17 C.F.R. 240.15b10-5 and 240.15b10-6(d)(1).

35/ 17 C.F.R. 240.15b10-6(d)(2). For example, the broker-dealer managing such an account may not effect transactions that "are excessive in size or frequency in view of the financial resources and character of such account." 17 C.F.R. 240.15c1-7(a).

36/ Examples of books and records broker-dealers must make or keep include cancelled checks, customer complaint letters, order tickets, blotters or other records of original entry giving a daily record of all purchases and sales of securities, general ledgers and a securities position record (a ledger reflecting all long and short stock positions carried by the broker). 17 C.F.R. 240.17a-3.

in the requirement to keep books and records is the assumption that they will be kept accurately. 37/

Additionally, SECO broker-dealers must file with the Commission very detailed periodic and annual reports of their financial condition called FOCUS reports. 38/ FOCUS reports include statements of income, net capital and aggregate indebtedness computations and reserve bank account figures. Broker-dealers also must contract with an independent public acountant to perform a certified audit on an annual basis. 39/

5. Training and Supervision

SECO broker-dealers and their "associated" employees 40/ must meet standards of training, experience, competence and other qualifications as set by the Commission. 41/ These requirements include passing a general securities examination that must include coverage of the Commission's rules and

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37/ See Armstrong, Jones & Co., Securities Exchange Act Rel. No 8420 (1968); V L. Loss, Securities Regulation 1346 and n.215 (2d ed. 1961).

38/ 17 C.F.R. 240.17a-5; Form X-17a-5. FOCUS stands for "financial and operational combined uniform single report."

39/ 17 C.F.R. 240.17a-5(f)(2).

40/ Those associated with broker-dealers include any persons except those whose functions are solely clerical or ministerial. See Section 3(a)(18) of the Exchange Act, 15 U.S.C. 78c(3)(a)(18).

41/ Section 15(b)(7) of the Exchange Act, 15 U.S.C. 78o(b)(7).

regulations governing broker-dealers. 42/ Broker-dealers have statutory duties to supervise all their employees, 43/ and are liable for their acts under certain circumstances. 44/ Broker-dealers must maintain extensive background files on all their personnel dealing with securities or handling customer funds to help ensure those persons' integrity. 45/

B. The Examination Program

Congress has directed the Commission to examine broker-dealers' books and records periodically "in the public interest" and "for the protection of investors." 46/ These examinations serve two basic purposes: first, to determine whether the firm is complying with all the federal securities laws; second, to educate broker-dealers about their legal responsibilities and to help them correct minor deficiencies

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42/ 17 C.F.R. 240.15b8-1(a)(1)(i) and (ii). The examination also must cover corporate structure, accounting, and legal obligations; investment companies; distribution of securities; stock exchanges and over-the-counter markets, among other things. Id.

43/ Section 15(b)(4)(E) of the Exchange Act, 78o(b)(4)(E), and Section 20(a), 15 U.S.C. 78t(a).

44/ 17 C.F.R. 240.15b10-4(c).

45/ 17 C.F.R. 240.17a-3(a)(12). For example, the file must contain a description of each person's business associations during the preceding 10 years. 17 C.F.R. 240.17a-3(a)(12)(A)(4).

46/ Section 17(b) of the Exchange Act, 15 U.S.C. 78q(b). See also Section 15(b)(2)(c) of the Exchange Act, 15 U.S.C. 78o(b)(2)(C).

informally. See Securities Industry study, Report of the Subcomm. on Com. & Fin. of the House Comm. on Int. and For. Commerce, 92nd Cong., 2d Sess. 23 (1972).

The Commission's inspection program is administered by its nine Regional and six Branch Offices together with the Division of Market Regulation. See, e.g., 46 SEC Ann. Rep. 8 (1980). The Commission conducts three basic types of examinations -- routine SECO, oversight, 47/ and cause, 48/ only the first of which is relevant here.

Routine SECO Examinations

The routine examination is the primary method by which the Commission carries out its obligation to ensure that SECO broker-dealers are complying with the federal securities laws. The Commission examines all aspects of a SECO broker-dealer business to determine the firm's financial and operational condition as well as its sales practices. The Commission's regional offices conduct the examinations on a surprise basis

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47/ As noted, broker-dealers that are members of SROs are routinely examined by the SRO, subject to oversight by the Commission. The Commission conducts oversight examinations of SRO member broker-dealers as well as of the SROs themselves, to verify, among other things, that each SRO is capable of ensuring that its members comply with the Exchange Act. See Sections 6(a)(1), 15A(b) and 19 of the Exchange Act, 15 U.S.C. 78f(i) and 78o-3(b) and 78s.

48/ The Commission conducts cause examinations of broker-dealers that belong to SROs and of SECO broker-dealers whenever a possible financial, operational, or other problem is suspected (Hochmuth Declaration ¶ 4).

so that firms do not have the opportunity to alter their books and records or transfer funds or securities to conceal net capital or other violations (Kwalwasser Declaration ¶ 6; Hochmuth Declaration ¶ 8). 49/

Although specific examinations are not announced, the Commission notifies all broker-dealers of its examination policy. For example, all persons who apply for registration as broker-dealers are mailed "Information on Regulation of Broker-Dealers" which states that they will be responsible for compliance with the federal securities laws (Kwalwasser Declaration ¶ 4 and Exhibit A thereto). In addition, the Commission provides every applicant with a pamphlet entitled "General Information on the Registration and Regulation of SECO Broker-Dealers" (Kwalwasser Declaration ¶ 4 and Exhibit B thereto). That pamphlet, first distributed in March 1982, notifies registrants that they

> should be aware that the Commission has authority to inspect all books and records at any time. The Commission has a routine examination program in which it inspects SECO broker-dealers on a cyclical basis. (Id., Exhibit B at 13).

49/ Regional offices conduct conferences with new SECO firms shortly after their registration becomes effective and before the first on-site examination. In these post-effective conferences, Commission compliance examiners speak with principals of the firm to educate the registrant about the applicable Commission rules and regulations and to review with the registrant what type of securities business it will operate (Kwalwasser Declaration ¶ 4; Hochmuth Declaration ¶ 5; Mahoney Declaration ¶ 3).

(footnote continued on next page)

Most compliance examiners divide routine examinations into three parts: interview, books and records, and sales practices. In the interview, the examiner discussses with the registrant's principal the type of business he operates. This helps the examiner to determine what particular type of books and records the broker-dealer keeps or should keep. In the review of books and records, the examiner requests books and records relating to the business. He checks them for accuracy and currency, and determines whether the broker-dealer is complying with applicable aspects of the federal securities laws. In the sales practices portion of the examination, the examiner looks primarily at records of customer accounts to determine compliance with such requirements as

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(footnote continued from previous page)

For example, examiners attempt to determine whether the broker-dealer is familiar with the books and records and financial reporting requirements, as well as the net capital rule (Hochmuth Declaration ¶ 5; Mahoney Declaration ¶¶ 3,4). Registrants are advised to read the Exchange Act. If the registrant demonstrates lack of familiarity with its legal responbilities, it is requested to obtain a copy of the applicable statutes and regulations. (Mahoney Declaration ¶ 3).

During this "get-acquainted" conference, the staff notifies the broker-dealer that its books and records will be inspected once during its first year of operation and periodically thereafter (Kwalwasser Declaration ¶ 4; Hochmuth Declaration ¶ 5; Mahoney Declaration ¶ 3). The Miami Branch Office conducted such post-effective conferences during the period relevant to this case. (Mahoney Declaration ¶¶ 3, 4).

suitability, 50/ proper mark-ups, 51/ prohibitions against excessive trading, and fairness 52/ (Mahoney Declaration ¶¶ 7-8; Kwalwasser Declaration ¶ 5).

All new SECO firms are examined during their first six months or no later than their first year of operation, as required by Congress in Section 15(b)(2)(C) of the Exchange Act, 15 U.S.C. 78o(b)(2)(C). 53/ Congress "believe[d] that such early and frequent inspections of new entrants by the SEC * * * are critically important to nip incipient problems in the bud * * *." 54/ After the first year, the

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50/ See, supra, p. 10 and 17 C.F.R. 240.15b10-3 and 240.15b10-6(a).

51/ A "mark-up" is the difference between the prevailing wholesale, or inter-dealer, market price for a security and the retail price a dealer charges its public customers. L. Engel, How to Buy Stocks, 130-31 (6th rev. ed. 1977).

52/ Charles Hughes & Co. v. SEC, 139 F.2d at 434.

53/ Section 15(b)(2)(C), enacted in 1975, permits the Commission to extend the 6 month period to 12 months for classes of broker-dealers it designates. The examination in this case was conducted in the seventh month, and thus technically under Section 17(b), because the Commission had not yet officially designated the classes of broker-dealers whose examination could be postponed until the second half of the year. However, the Commission policy to examine all SECO broker-dealers in the first 12 months, pursuant to which plaintiffs' examination was scheduled, arose out of the same concerns as Congress expressed in enacting the 1975 Amendments (see text and note 54, infra).

54/ Securities Industry Study, Report of the Subcomm. on Com. & Fin. of the House Comm. on Int. and For. Commerce, 92nd Cong., 2d Sess. 23 (1972).

examination schedule depends on the type of business the broker-dealer operates. If the firm is an "introducing" broker, i.e., it does not hold customer funds or securities or clear its own transactions, it is generally inspected every three years (Kwalwasser Declaration ¶ 5; Hochmuth Declaration ¶ 6). Since firms that hold customer funds or securities, or firms that clear their own transactions, pose a greater risk of loss to investors, the Commission inspects them on a yearly basis. 55/ Of course, SECO, as well as other, firms may also be inspected for cause (Kwalwasser Declaration ¶ 3; Hochmuth Declaration ¶¶ 4, 6).

II. THE JUNE, 1980 ROUTINE EXAMINATION OF LUCIUS G. HILL SECURITIES, INC. 56/

In summary, this case arises out of a routine examination of books and records of a SECO broker-dealer on June 26 and 27, 1980. John Mahoney, a Commission securities compliance

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55/ Typically, an introducing broker is one unable or unwilling to meet either (1) the expense of maintaining an operational capacity to handle money and securities, commonly known as "back-office" operations, or (2) the minimum net capital requirements imposed on firms handling customer funds and securities. An industry practice has thus emerged in which a smaller broker-dealer contracts with a larger broker-dealer for performance of back-office services. Under this arrangement, the "introducing" broker will "introduce" accounts and transactions to a "clearing" or "carrying" broker which agrees to perform the necessary back-office operations for a percentage of the commissions to be generated by the transactions introduced. See generally, 1 S. Goldberg, Fraudulent Broker Dealer Practices §7.5(a)(1978).

56/ The Commission respectfully incorporates by reference the Statement of Material Facts As To Which There Is No Genuine Issue submitted in support of the Commission's motion.

examiner, visited the West Palm Beach, Florida offices of Lucius G. Hill Securities, Inc. (Registrant) to examine its books and records for compliance with the federal securities laws (Mahoney Declaration ¶¶ 5, 9, 13). The examination was scheduled in accordance with the Commission's policy of examining all new SECO broker-dealers in the first year after their registration. (Hochmuth Declaration ¶¶ 5-6; Mahoney Declaration ¶ 5). Although Lucius Hill, principal of the Registrant, was not present when Mr. Mahoney arrived on June 26, Mr. Mahoney had previously advised him to expect such an unannounced examination (Mahoney Declaration ¶¶ 3-4, 9).

Upon his arrival at the Registrant's office, Mr. Mahoney showed his Commission credentials to the woman who identified herself as Registrant's bookkeeper and asked to see the broker-dealer books and records. She left the room and appeared to make a telephone call. When she returned, she indicated that she had obtained permission for him to examine the records. Mr. Mahoney requested to see a number of documents related to Registrant's business, all of which were required to be maintained under Commission rules. After he had completed his examination of these records, Mr. Mahoney asked the bookkeeper to photocopy some of the documents for him, which she did. At no time did Mr. Mahoney view documents other than those the bookkeeper brought to him. Nor did he examine documents other than those of the Registrant (Mahoney Declaration ¶¶ 9-11).

Mr. Mahoney returned to the offices of the Registrant to complete his examination on the next day. When Mr. Hill arrived a short time later, Mr. Mahoney asked him a number of questions about his business operations. Mr. Hill answered all Mr. Mahoney's questions and gave him additional documents, including documents concerning an A.T. Bliss & Co. tax shelter offering. Later that day, Mr. Mahoney accompanied Mr. Hill to a bank, where Mr. Mahoney performed a box count of Registrant's securities. (id. ¶¶ 13-14).

At no time in June, 1980, or during their subsequent discussions regarding A.T. Bliss & Co., did Mr. Hill state or indicate that he believed Mr. Mahoney had acted improperly on either day of the examination (id. ¶ 15). It was not until May, 1981, after the staff had notified Mr. Hill and Registrant of a non-public 57/ Commission investigation of possible violations of the federal securities laws, that plaintiffs informed the Commission staff that they were alleging that Mr. Mahoney had acted improperly almost three years earlier (Harper Affidavit ¶ 2). 58/

57/ See 17 C.F.R. 202.5(a) and 203.2

58/ 17 C.F.R. In May 1981, when Mr. Hill was subpoenaed to testify in that investigation plaintiffs' counsel informally alleged that Mr. Mahoney had "ransacked" the firm's office; Charles C. Harper, head of the Commission's Miami Branch Office inquired into the allegation and determined that it was without merit (Harper Affidavit ¶¶ 2-3).

In May 1981, the Commission provided plaintiffs with copies and a list of all documents photocopied for Mr. Mahoney on June 26, 1980. Plaintiffs did not contest the accuracy of this list until the filing of this lawsuit (id. ¶¶ 5-6).

ARGUMENT

I. THE COMMISSION'S EXAMINATIONS OF REGISTERED BROKER-DEALERS' BOOKS AND RECORDS PURSUANT TO THE SECURITIES EXCHANGE ACT ARE REASONABLE UNDER THE FOURTH AMENDMENT.

Plaintiffs seek a declaratory judgment that the provision in Section 17(b) of the Exchange Act, 15 U.S.C. 78q(b), for warrantless broker-dealer examinations is unconstitutional under the fourth amendment (Complaint ¶¶ 1 and 21(a) and First Prayer for Relief). 59/ They also seek an order enjoining the Commission from applying Section 17(b) to them (Second Prayer for Relief). 60/

Section 17(b) authorizes the Commission to make "reasonable periodic, special, or other examinations" of registered broker-dealers' records as the Commission deems "necessary

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59/ Plaintiffs also allege that the Act deprives them of a due process right to privacy in violation of the fourth, fifth and fourteenth amendments (Complaint ¶ 21(b)). The constitutional right to privacy, however, is narrowly limited to certain familial interests. Paul v. Davis, 424 U.S. 693, 713 (1976). See Carey v. Population Serv. Int'l, 431 U.S. 678, 684-85 (1977). It does not protect commercial records, such as those examined under Section 17(b). The fourteenth amendment, of course, does not apply to the federal government. Cf., Hurd v. Hodge, 334 U.S. 24 (1948).

Plaintiffs also allege an Article I and III violation in so far as examinations are conducted without "a judicial determination [of probable cause] or . . . a neutral inspection scheme" (Complaint ¶ 21(c)). This allegation is legally the same as the fourth amendment claim; hence we do not address it separately.

60/ Plaintiffs' other requests for injunctive relief -- in essence a motion to suppress and for return of property (see third, fourth, and fifth prayers for relief) -- are discussed, infra, Part III.

or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Securities Exchange Act." 61/ Plaintiffs' contention that the Court should nullify this statute is without merit.

The touchstone of the fourth amendment is reasonableness. 62/ Although warrantless searches, as a general rule, may be unreasonable, the Supreme Court has upheld exceptions when the public interest requires a more flexible view. See United States v. Martinez-Fuerte, 428 U.S. 543, 555 (1976). In a series of cases decided since 1970, the Supreme Court has enunciated an exception for inspections of "pervasively regulated" industries. The Court has applied this exception to the liquor industry (Colonnade Catering Corp. v. United States, 397 U.S. 726 (1970)), to firearms dealers (United States v. Biswell, 406 U.S. 311 (1972)), and to the mining industry (Donovan v. Dewey, 452 U.S. 594 (1981)); cf. California Bankers Association v. Shultz, 416 U.S. 21, 52, 66 (1974) (provisions of the Bank Secrecy Act of 1970 requiring banks to keep records and report financial transactions do not violate the fourth amendment). In Marshall v. Barlow's, Inc., 436 U.S. 307, 313-14 (1978), the Court declined to

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61/ The books and records of other regulated institutions subject to the federal securities laws (such as the stock exchanges and their members) are also subject to Commission examination. See Section 17(a), Exchange Act, 15 U.S.C. 78q(a).

62/ See Delaware v. Prouse, 440 U.S. 648, 653-55 (1979).

apply the Colonnade-Biswell exception to all industries operating in interstate commerce because the exception would have swallowed the rule. However, as the Court carefully reiterated, 63/ the reasonableness of warrantless inspection programs must be resolved on a case by case basis by balancing "the specific enforcement needs and privacy guarantees of each statute." Marshall v. Barlow's, Inc., 436 U.S. at 321. The Colonnade-Biswell precedent teaches that this exception applies to an administrative agency's statutorily authorized examination when 1) there is a minimal expectation of privacy in the property to be inspected, 64/ and 2) Congress has reasonably determined that warrantless examinations are necessary to further a regulatory scheme.

As we demonstrate, broker-dealers have a long history of government oversight and are subject to such detailed federal regulation that the privacy interests at stake are non-existent or minimal. A warrant requirement would impose a heavy burden on the examination program, which is tailored specifically to the problems in this industry, and would seriously jeopardize enforcement of the investor protection scheme

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63/ See Colonnade, 397 U.S. at 77.

64/ See Rakas v. Illinois, 439 U.S. 128, 143 (1978). See also Katz v. United States, 389 U.S. 347, 353 (1967).

enacted by Congress. Thus, Congress's authorization in Section 17(b) for warrantless examinations of broker-dealer records satisfies both prongs of the Colonnade-Biswell test and should be sustained.

A. Warrantless Examinations of Broker-Dealers' Books and Records Under the Securities Exchange Act Do Not Infringe Any Legitimate Expectation Of Privacy.

1. Broker-Dealers, who have a long history of government supervision, are pervasively regulated by the Securities Exchange Act and its rules.

In Colonnade, 397 U.S. 76, the Court held that warrantless inspections to enforce liquor laws were not barred by the fourth amendment because Congress had long exercised control over the liquor industry and "has broad power to design such powers of inspection under the liquor laws as it deems necessary to meet the evils at hand." See also Donovan v. Dewey, 452 U.S. at 602-03. Regulation of securities brokers, like federal regulation of liquor in interstate traffic, is "deeply rooted in history." United States v. Biswell, 406 U.S. at 315. The statutory framework authorizing warrantless examinations of securities broker-dealers, like other warrantless inspection schemes that have been held to satisfy the fourth amendment, 65/ has been in place since the beginning of federal regulation of the securities industry (see supra, pp. 2-3).

65/ In addition to Colonnade, 397 U.S. at 75, see Frey v. Panza, 621 F.2d 596, 598 (3d Cir.) cert. denied, 449 U.S. 1035 (1980); Marshall v. Stroudt's Ferry Preparation Co., 602 F.2d 589, 593 (3d Cir. 1979), cert. denied, 444 U.S. 1015 (1980); cf. Biswell, 406 U.S. at 315.

In Biswell, the Supreme Court observed that any person who chooses to deal in a "pervasively regulated business and to accept a federal license does so with the knowledge that his business records * * * will be subject to effective inspection." 406 U.S. at 316. Securities broker-dealers are at least as pervasively regulated, and perhaps more so, as other industries in which "the federal regulatory presence is sufficiently comprehensive and defined" that the property owner has constructive notice that his property will be inspected. Donovan v. Dewey, 452 U.S. at 600.

Federal securities laws regulate every facet of a broker-dealer's business from its first day of operation (see supra, pp. 5-13). For example, any broker-dealer operating in interstate commerce must first register with the Commission and remains subject to federal regulation until the Commission approves its withdrawal (supra, pp. 5-7). Each of its employees handling securities transactions must be registered (supra, pp. 6, 13). It must make and preserve documentation of every securities transaction in which the firm engages (supra, pp. 11-12). These transactions are strictly limited by a comprehensive code of conduct designed to prevent fraud on customers or the appearance of unfairness (supra, pp. 9-11). The broker-dealer must make daily computations of its net capital and immediately notify the Commission if it approaches a violation; it must make detailed periodic and annual reports of its financial condition to the Commission (supra, pp. 7-8, 12).

Since there is simply no aspect of the brokerage business that is not regulated in some manner by the federal securities laws and rules promulgated thereunder, there is a sufficiently "predictable and guided federal regulatory presence" 66/ to bring this single industry within the Colonnade-Biswell exception. 67/

Further, the examination program Congress authorized in the Exchange Act concerns only the securities industry. Examination of SECO broker-dealers' books and records, the inspection program challenged in this case, involves only a small fraction of the businesses in this single industry. The routine SECO broker-dealer examination program includes less than 10% (550) of the 7,800 registered broker-dealers (Kwalwasser Declaration ¶ 3). Thus, the examination program mandated by Section 17(b) is far narrower than the searches of all employers in all industries and businesses in interstate commerce held unconstitutional in Marshall v. Barlow's, Inc., 436 U.S at 314. 68/

66/ Donovan v. Dewey, 452 U.S. at 604.

67/ Indeed, the Supreme Court has noted in another context that Congress has invested the Commission, "which is charged with protection of the public interest as well as the interests of share-holders," with "extensive" and "pervasive supervisory authority." U.S. v. Nat'l Ass'n of Securities Dealers, 422 U.S. 694, 732-33 (1975) (discussing Commission regulation of self-regulatory organizations).

68/ As of 1981, OSHA covered an estimated 4.5 million establishments. See U.S. Dept. of Labor, President's

(footnote continued)

However, broker-dealers enjoy far more than constructive notice of "the restrictions placed upon [them]." Marshall v. Barlow's, 436 U.S. at 313, quoting Almeida-Sanchez v. United States, 413 U.S. 266, 271 (1973). As previously noted (supra, p. 15), the Commission notifies new broker-dealer registrants that it inspects them on a routine, cyclical basis and specifically advises them that they are responsible for compliance with the federal securities laws (Kwalwasser Declaration, Exhibit A at 1; Exhibit B at 13). Indeed, Mr. Hill was notified personally at the post-effective conference held November 26, 1979, that the Commission would periodically examine his broker-dealer business records and that he should expect an unannounced examination within the next 12 months. (Mahoney Declaration ¶3).

68/ (footnote continued)

Report on Occupational Safety and Health: Calendar Year 1981 at 54. Examinations under the Exchange Act cover a much more limited group than do other warrantless inspections held not to violate the fourth amendment. As of 1979, there were approximately 180,000 registered firearms dealers covered by the law sustained in United States v. Biswell, 406 U.S. 311. Bureau of Alcohol, Tobacco & Firearms, U.S. Dept. of Treasury, Annual Report Publication No. 122 (May 1980) 19. As of 1979, there were almost 400,000 liquor dealers subject to the inspection scheme sustained in Colonnade Catering Corp. v. United States, 397 U.S. 72. Alcohol, Tobacco & Firearms Summary Statistics for Distilled Spirits, Wine, Beer Tobacco Enforcement Taxes, ATF Publication No. 1323.1 (July 1982) at 1-4. Cf. Donovan v.Dewey, 452 U.S. 594 (inspection of all coal mines; there were over 7,000 coal mines in 1981. Injury Experience in Coal Mining (1981), U.S. Dept. of Labor Informational Report No. 1138 (1982) 13).

In short, broker-dealers, especially those like plaintiff that elect to join the SECO program, are on notice that inspections will not be "so random, infrequent or unpredictable that the owner has no real expectation that his property will be inspected from time to time." U.S. Nuclear Regulatory Commission v. Radiation Technology, Inc., 519 F. Supp. at 1288. 69/

2. Warrantless examinations of books and records required to be kept by law involve no or little invasion of privacy.

Commission examinations under Section 17(b) are limited to examination of books and records required to be kept pursuant to Section 17(a) 70/ and the regulations thereunder, or other regulations that explicitly require records to be kept (Hochmuth Declaration ¶ 7; Mahoney Declaration ¶ 8).

69/ Certainty and regularity in administration of this examination program also provide adequate notice and hence a constitutionally adequate substitute for a warrant. See Marshall v. Barlow's Inc., 436 U.S. at 320-21, 323; Camara v. Municipal Court, 387 U.S. 523, 538 (1967); U.S. v. Missippi Power & Light Co., 638 F.2d 899, 907 (5th Cir.), cert. denied, 454 U.S. 892 (1981). The SECO examination program involves routine examinations of all new SECO brokers within the first twelve months, and on one and three year cycles thereafter (Kwalwasser Declaration ¶ 5; Hochmuth Declaration ¶ 6). Since the examination is limited to books and records required by law to be kept (see, infra, pp. 28-30), "it is difficult to see what additional protection a warrant requirement would provide." Donovan v. Dewey, 452 U.S. at 605.

70/ 15 U.S.C. 78q(a).

Accordingly, these records are not protected by the fourth amendment.

In Shapiro v. United States, 335 U.S. 1 (1948), the Supreme Court held that the Constitution does not protect records such as these that are required to be kept by law. 71/ See also California Bankers Association v. Shultz, 416 U.S. 21. Such records assume characteristics of public, or quasi-public, documents 72/ such that their custodians have "no reasonable expectation of privacy" in them. 73/

Subsequent to Shapiro, courts expressly considering the question have held that required broker-dealer records are not constitutionally protected. United States v. Mahler, 254 F. Supp. 581, 582 (S.D.N.Y. 1966). Cf. United

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71/ Observing that effective law enforcement depends upon government access to books and records, id. at 13-14, the Court ruled that "the privilege which exists as to private papers cannot be maintained in relation to records required by law to be kept." 335 U.S. at 33 (citations omitted).

While the Shapiro decision concerned the recordkeeping provisions of the Emergency Price Control Act, Justice Frankfurter in a dissenting opinion, recognized the applicability of the decision under all federal record-keeping statutes. 335 U.S. at 50-54.

72/ See, e.g., Donovan v. Mehlenbacher, 652 F.2d 228, 231 (2d Cir. 1981); United States v. Silverman, 449 F.2d 1341 (2d Cir.1971), cert. denied, 405 U.S. 918 (1972); Cooper's Express, Inc. v. ICC, 330 F.2d 338, 340 (1st Cir. 1964); United States v. Pine Valley Poultry Distributors Corp., 187 F. Supp. 455, 457 (S.D.N.Y. 1960).

73/ See, e.g., United States v. Snyder, 668 F.2d 686, 690 (2d Cir.), cert. denied, 102 S.Ct. 3494 (1982). See generally In re Grand Jury Proceedings, 601 F.2d 162, 168 (5th Cir. 1979), discussing 8 Wigmore, Evidence § 2259c (McNaughton rev. 1961).

States v. Kaufman, 429 F.2d 240, 247 (2d Cir.), cert. denied, 400 U.S. 925 (1970) (no fifth amendment protection under Shapiro for records a registered broker-dealer was required to make and keep); SEC v. Olsen, 354 F.2d 166 (2d Cir. 1965) (no fifth amendment protection under Shapiro for records a registered investment advisor was required to make and keep pursuant to the Investment Advisers Act of 1940, 15 U.S.C. 80-b4). 74/

Where, as here, there is either no or only a de minimis expectation of privacy, "the incremental protections afforded * * * by a warrant are so marginal that they fail to justify the administrative burdens that may be entailed." Marshall v. Barlow's, Inc., 436 U.S. at 322.

74/ Moreover, examinations of business records differ from searches of premises like the one at issue in Barlow's, in that they "do not infringe on individual rights to the extent that warrantless searches would if allowed." In re Grand Jury Proceedings, 601 F.2d at 168 n.1. The Commission's examination program does not involve, nor even contemplate, the use of any forcible entry; rather, the statutory scheme provides for resort to the federal courts if a compliance examiner is refused entry. The Commission, pursuant to Section 21(e) of the Exchange Act, 15 U.S.C. 78u(e), may seek an injunction requiring that the broker-dealer make its books and records available for examination. See, e.g., SEC v. Sloan, 535 F.2d 679 (2d Cir. 1976), cert. denied, 430 U.S. 966 (1977); SEC v. Midland Equity Corp., [1973] (CCH) Fed. Sec. L. Rep. 94,305 (S.D.N.Y. 1973); SEC v. Sharkey, 4 S.E.C. Jud. Dec. 574 (W.D Wash. 1945) (granting injunction in face of fourth amendment challenge to examination authority). See also Mahoney Declaration ¶ 6.

B. Warrantless Examinations Of Broker-Dealers Are Tailored To Serve Important Governmental Interests And Are Crucial To Effective Enforcement Of The Statute.

The Commission's statutory obligation is to protect and safeguard the investing public. See Section 2 of the Exchange Act, 15 U.S.C. 78b. 75/ The Commission strives to accomplish this goal in part through its congressionally-mandated broker-dealer examination program (see Touche Ross Co. v. Redington, 442 U.S. at 569-70), which "is specifically tailored to address the particular concerns that are unique" to the securities industry. U.S. Nuclear Regulatory Commission v. Radiation Technology, Inc., 519 F. Supp. at 1290. 76/ Indeed, as the Court of Appeals for this Circuit has recognized, "[t]he securities field, by its nature, requires specialized and unique legal treatment." Hughes v. SEC, 174 F.2d 969, 975 (D.C. Cir. 1949).

75/ Because of the substantial and immediate financial harm to investors and interstate commerce resulting from illegal broker-dealer trading practices and broker-dealer failures, the federal government has a valid and overriding interest in the regulation and examination of the nation's securities broker-dealers. "[I]nspection is a crucial part of the regulatory scheme," United States v. Biswell, 406 U.S. at 315, because it helps to ensure that funds and securities will be safeguarded. See Touche-Ross Co. v. Redington, 442 U.S. at 570.

76/ See Donovan v. Dewey, 452 U.S. at 603 (Mine Safety and Health Act is specifically tailored to address health and safety conditions peculiar to mines); Marshall v. Stroudt's Ferry Preparation Co., 602 F.2d 589, 593; U.S. Nuclear Regulatory Commission v. Radiation Technology, Inc., 519 F. Supp. 1266, 1288-1291.

Trading markets in securities are uniquely susceptible to broker-dealer fraud and manipulation which "may take on more subtle and involved forms" than in "cruder" businesses. Id., quoting Archer v. SEC, 133 F.2d 795, 803 (8th Cir.), cert. denied, 319 U.S. 767 (1943). Broker-dealers, like banks, may hold their customers' cash and securities. Examination of their books and records is designed specifically to determine whether the firms are complying with financial, operational and trading standards that are distinctive to the industry and have a significant impact on customers (see, supra, pp. 13-18). 77/

Congress recently reexamined and reconfirmed the necessity for these examinations in the wake of failures of numerous brokerage firms caused primarily by breakdowns in recordkeeping. 78/ In this "most searching reexamination"

77/ Broker-dealer failures associated with recordkeeping deficiencies may also cause a chain reaction of failures among other financial institutions. See Remarks of SEC Commissioner Bevis Longstreth before the New York Regional Group of the American Society of Corporate Secretaries (February 10, 1983) (attached as Exhibit A) (hereinafter Longstreth Remarks).

78/ SEC Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 229, 92d Cong., 1st Sess. 11, 28 (1971). "Since books and records of a broker-dealer represent the cornerstone of his operations," any errors or incompleteness "exposed customers to loss of their cash and securities," and threatened loss of public confidence in the securities markets. Id. at 11-12, 19. Broker-dealer failures or near failures have continued in more recent years. See Longstreth Remarks, supra note 77.

of the federal securities laws since the 1930's, 79/ Congress reaffirmed the Commission's power to examine records of broker-dealers under Section 17 80/. Congress further mandated, in Section 15(b)(2)(C), that all broker-dealers be examined for compliance during their first months of operation, noting that "early and frequent" examinations are "critically important to nip incipient problems in the bud." 81/ The House Report accompanying the final bill observed that "examination authority * * * is, of course essential to any effort by the Commission to discharge its responsibilities under the Act." H.R. Rep. No. 229, 94th Cong., 1st Sess. 119-20 (1975).

Courts also have recognized that the Commission must have unimpaired access to broker-dealer records to protect the public against abuse or incompetence. The records required to be made or preserved by Section 17(a) of the Exchange Act and the examination of those records authorized by Section 17(b) "provide the regulatory authorities with the

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79/ Conf. Rep. 229, 94th Cong., 1st Sess. 91 (1975).

80/ The examination provision previously included in Section 17(a) was re-enacted in Section 17(b) and language was added to require cooperation among regulatory agencies. See Touche Ross Co. v. Redington, 442 U.S. at 562 n.2. Congress also enacted a number of other measures strengthening regulation of broker-dealers. E.g., 15 U.S.C. 15(b)(7) and 15(c)(3).

81/ Securities Industry Study, Report of the Subcomm. on Com. & Fin. of the House Comm. on Int. & For. Commerce, 92d Cong., 2d Sess. 23 (1972).

necessary information to oversee compliance" with the federal securities laws, and to "monitor the financial health of brokerage firms and protect customers from the risks involved in leaving their cash and securities with broker-dealers." Touche Ross & Co. v. Redington, 442 U.S. at 569-70. Indeed, "how the Commission could carry on its task of protect[ing] the public investor without [such] financial information * * *" is difficult to apprehend. Boruski v. SEC, 340 F.2d 991, 992 (2d Cir.), cert. denied, 381 U.S. 943 (1965). See also In re Wanda O. Olds, 37 SEC 23, 26-27 (1956) (books and records requirements are "keystone of surveillance of registrants").

Moreover, warrantless examinations of broker-dealers are indispensable to enforcing the Exchange Act. First, as one Congressional Committee found with respect to examination authority challenged in this case, "[t]he prospect of an unannounced visit of a government inspector is an effective stimulus for honesty and bookkeeping veracity" S. Rep. No. 1760, 86th Cong., 2d Sess. 3-4 (1960). See also Hochmuth Declaration ¶ 8.

Second, since warrants would give broker-dealers advance notice of examinations, 82/ violations of Commission statutes

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82/ Advance notice of examinations would result from a warrant requirement even if warrants were obtained on an ex parte basis because the firm could simply refuse entry upon the compliance examiner's arrival. E.g., Donovan v. Wollaston Alloys, Inc., 695 F.2d 1 (1st Cir. 1982).

and rules could be easily disguised by falsification of records or transfers of cash and securities. (Kwalwasser Declaration ¶ 6; Hochmuth Declaration ¶ 8). For example, a broker-dealer could temporarily transfer funds from affiliated companies or provide a duplicate bank deposit slip when no deposit had been made, in violation of the net capital rule. Customer complaint files could be purged and non-current books and records could be brought up to date. These steps would conceal, rather than correct, statutory violations. Thus, "the prerequisite of a warrant could easily frustrate inspection." Biswell, 406 U.S. at 316. Cf. Marshall v. Barlow's Inc., 436 U.S. at 316 (where advance notice served to encourage employers to comply with OSHA). In view of the ease with which violations may be camouflaged, unannounced inspections are crucial to maintaining the financial and operational integrity of broker-dealers.

The alternative -- obtaining a warrant -- would be tremendously burdensome to the agency and would seriously impair its investor protection program. The Commission performs approximately 900 broker-dealer examinations each year (Kwalwasser Declaration ¶ 3,6). The volume of paperwork required to obtain warrants would severely drain scarce resources in a period of budget cuts and reductions-in-force (id. at ¶¶ 8-9). 83/ Diversion of staff resources to obtain

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83/ Moreover, the Commission's compliance examiners have many responsibilities in addition to conducting broker-dealer examinations (Kwalwasser Declaration ¶ 7).

warrants could force the Commission to reduce the number and scope of examinations at a time when the securities markets are expanding significantly in number and complexity (id. at ¶ 7). Moreover, it is probable that, having obtained a warrant and commenced an examination, the examiner would require additional records for which the Commission would have to seek still another warrant to complete the examination (Kwalwasser Declaration ¶ 9). This time-consuming and burdensome process could be used as a tactic by recalcitrant broker-dealers to impede and delay Commission examinations.

II. PLAINTIFFS CONSENTED TO THE EXAMINATION THEY NOW CHALLENGE.

A fourth amendment challenge to a search must be rejected when circumstances "show that permission to search was obtained from a third party who possessed common authority over or other sufficient relationship to the premises or effects sought to be inspected." United States v. Matlock, 415 U.S. 164, 171 (1974) (footnote omitted). "Common authority" includes mutual use or joint access such that "it is reasonable to" believe that the person giving consent is authorized to do so. United States v. Sells, 496 F.2d 912, 914 (7th Cir. 1974), quoting United States v. Matlock, 415 U.S. at 171 n.7.

In their complaint, plaintiffs in effect concede that Mr. Mahoney, the Commission's compliance examiner, reasonably inferred that Ms. McElveen consented to the examination. Ms. McElveen was responsible for Mr. Hill's bookkeeping and certain duties for the broker-dealer, including receiving visitors at its offices (Complaint ¶¶ 10,12). She obtained permission from Mr. Hill's accountant to show the brokerage firm's books and records to Mr. Mahoney (id. at ¶ 13), which she then did (id. at ¶ 14). 84/ Ms. McElveen obviously had access to the relevant books and records and, at the very least, she had implied permission to consent to the examination. United States v. Buettner-Janusch, 646 F.2d at 765. See United States v. Gradowski, 502 F.2d 563, 564 (2d Cir. 1974) (per curiam).

Thus, the facts alleged in plaintiffs' complaint provide sufficient basis to conclude that Mr. Mahoney could reasonably believe that the bookkeeper had the authority to consent to the examination and did so voluntarily. See United States v.

84/ Although the complaint does not expressly state that Ms. McElveen gave permission to Mr. Mahoney, her consent may be inferred from her conduct in providing and photocopying the records. E.g., United States v. Buettner-Janusch, 646 F.2d 759, 764 (2d Cir. 1981).

Moreover, the complaint does not allege facts that establish coercion. As the complaint recognizes, after Mr. Mahoney appropriately showed the bookkeeper his credentials, she was free to deny him access until she had satisfied herself, by contacting Hill or his accountant, that permission should be granted.

Sledge, 650 F.2d 1075, 1078 (9th Cir. 1981); United States v. Block, 590 F.2d 535, 539-40 (4th Cir. 1978); United States v. Sells, 496 F.2d 912, 914 (7th Cir. 1974). See generally United Staes v. Harrison, 679 F.2d 942, 947 (D.C. Cir. 1982). Accordingly, the complaint should be dismissed for failure to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6).

Alternatively, summary judgment should be entered on the Commission's behalf because the undisputed facts show that Mr. Mahoney reasonably concluded that Ms. McElveen had been authorized to grant him access to the records. In any event, Mr. Hill ratified her action the following day and thereafter by providing additional records and by not objecting to the examination.

As Mr. Mahoney's declaration establishes, he had every reason to believe that the bookkeeper could consent to the examination. After he told her that he was from the Securities and Exchange Commission and was there to examine the brokerage books and records, Ms. McElveen said that she kept the books (a statement confirmed throughout the day as she demonstrated familiarity with the records' location and general substance) (Mahoney Declaration ¶¶ 9-10). In response to Mr. Mahoney's request that Ms. McElveen contact Mr Hill, she left to make a telephone call and returned shortly thereafter stating that

she had obtained permission for Mr. Mahoney to begin the examination (id. ¶ 9-10). Later she told Mr. Mahoney that Mr. Hill would be in the office the following day (id. ¶ 12), thus confirming Mr. Mahoney's understanding that she had been in touch with the firm's principal. 85/

On June 27, Mr. Hill neither withdrew the permission nor in any way restricted Mr. Mahoney's additional examination (id. ¶ 13). Indeed, Mr. Hill personally provided additional information and made available copies of other broker-dealer documents (id. ¶ 13-14). 86/ Thereafter, neither Mr. Hill nor his counsel complained to Mr. Mahoney or his superior for over eleven months (Harper Affidavit ¶¶ 2-4; Mahoney Declaration ¶ 15). The Commission and its compliance examiner were entitled to rely on Mr. Hill's consent -- apparent from all objective appearances -- to the examination. Mr. Hill's

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85/ The following day, June 27, 1980, Mr. Hill greeted Mr. Mahoney as if he had been expecting the examiner to return (id. ¶ 13). This added further support to Mr. Mahoney's conclusion, reasonable under the circumstances, that Mr. Hill and the bookkeeper had conferred about the examination.

86/ In paragraph 16 of their complaint, plaintiffs make a generalized allegation that personal papers of Mr. Hill were taken on June 26, 1980. The only specifically described documents are "offering documents of A.T. Bliss & Co., Inc." copies of which, as Mr. Mahoney states, were in fact given to him by Mr. Hill on June 27, 1980 (Mahoney Declaration ¶ 13). Such documents are not, however private, since they are required by law to be kept. See 17 C.F.R. 240. 17a-4.

claimed subjective intention to the contrary -- not disclosed until after he learned that the Commission was investigating his firm -- must be rejected. United States v. Sledge, 650 F.2d at 1078.

Moreover, almost two years ago (in May, 1981), at plaintiffs' request, the Commission provided their counsel with a list and copies of all documents obtained by Mr. Mahoney on the first day of the examination (Harper Affidavit ¶ 5 and attachment thereto). Plaintiffs did not challenge the accuracy of the list until the filing of this action (id. ¶ 6). At this point, they must be deemed to have waived objections to the examination that took place three years ago. Cf. In re Grand Jury Investigation of Ocean Transportation, 604 F.2d 672, 675 (D.C. Cir. 1979) (attorney-client privilege held waived where demand not made for several years for return of documents that had been given to the government, allegedly by mistake).

III. CLAIMS FOR INJUNCTIVE RELIEF AGAINST USE OF DOCUMENTS REGISTRANT PROVIDED DURING THE EXAMINATION SHOULD BE DISMISSED FOR LACK OF JURISDICTION.

Plaintiffs seek to enjoin the Commission's use of documents Registrant produced during the first day (June 26, 1980) of the Commission's examination in any future enforcement proceeding (Third Prayer for Relief). They also seek return of the documents (Fifth Prayer for Relief) and

an order enjoining the Commission from forwarding them to other government agencies (Fourth Prayer for Relief). Even assuming, arguendo, that the purposes of the exclusionary rule were furthered by the suppression of evidence in civil cases, 87/ plaintiffs' claims are not justiciable at this time.

A. Plaintiffs' Claims Are Not Ripe For Judicial Review.

Claims not ripe for judicial review do not present a case or controversy as required by Article III, Section 2, of the Constitution. Absent a case or controversy, a district court lacks subject matter jurisdiction. In Abbott Laboratories v. Gardner, 387 U.S. 136 (1967), the Supreme Court identified the tests courts must apply to determine whether a controversy arising in an ongoing agency proceeding is ripe. These are (1) "the fitness of the issues for judicial decision," and (2) the potential "hardship to the parties of withholding court consideration." Id. at 149. 88/

87/ See, e.g., United States v. Janis, 428 U.S. 433, 447 (1976); Todd Shipyards Corp. v. Secretary of Labor, 586 F.2d 683, 689 (9th Cir. 1978) (questioning application of exclusionary rule to evidence obtained in warrantless OSHA search prior to Supreme Court decision in Marshall v. Barlow's, Inc., 436 U.S. 307).

88/ See Webb v. Department of Health and Human Services, 696 F.2d 101, 106 (D.C. Cir. 1982); Diamond Shamrock Corporation v. Costle, 580 F.2d 670, 672 (D.C. Cir. 1978).

The doctrine's purpose is to prevent courts from "entangling" themselves in agency action "until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties." Abbott Laboratories Gardner, 387 U.S. at 148-49; Citizens for a Better Environment v. Costle, 617 F.2d 851, 853 (D.C. Cir. 1980).

Plaintiffs' attempt to enjoin use of the documents is not fit for judicial resolution at this time. There has been no "final" agency determination to use the documents in any proceeding against plaintiffs or to forward them to another agency. See FTC v. SOCAL, 449 U.S. 232, 239-43 (1980); Hooker Chemical Co., Ruco Div. v. United States, 642 F.2d 48, 53 (3d Cir. 1981). Only after plaintiffs' charges are raised in the context of an administrative or judicial proceeding can a "final" determination be made on their admissibility. 89/

Plaintiffs also do not satisfy the second test of Abbott Laboratories. They do not allege that the production of their documents, without later use, has a "direct" or "immediate" impact upon their economic interest. The provision of documents to the Commission cannot result in sanctions against the plaintiffs; only if the Commission institutes and prevails in an enforcement action can the possibility arise that plaintiffs' economic interests will be directly and immediately affected. See FTC v. Socal, 449 U.S. at 242, 244; Hannah v. Larche, 363 U.S. 420, 442-43 (1960). "In the absence of hardship, only a minimum showing of counter-vailing judicial or administrative interest is needed, if any, to tip the balance against review." Diamond Shamrock v. Costle, 580 F.2d 670, 674 (D.C. Cir. 1978).

89/ A decision on admissibility would be subject to review at such time as an enforcement action were instituted and an adverse decision on the merits rendered against plaintiffs. See Section 21, Exchange Act, 15 U.S.C. 78t.

B. Even If The Court Had Equitable Jurisdiction, It Should Not Exercise It Because Plaintiffs Have An Adequate Remedy At Law.

Even if the court had equitable jurisdiction to suppress evidence or return property in an action in which the evidence is not sought to be introduced, the Court should exercise its discretion to deny such relief, as have the other courts that have considered such requests. Marshall v. Central Mine Equipment Co., 608 F.2d 719, 721 (8th Cir. 1979). 90/ Courts have denied such relief when the plaintiff has not "clearly demonstrate[d] that his constitutional rights [could not] be adequately adjudicated in the pending or anticipated enforcement proceeding against him." Marshall v. Central Mine Equipment Co., 608 F.2d at 721, quoting In re Worksite Inspection of Quality Products, 592 F.2d 611, 615 (1st Cir. 1979). Thus, in Marshall, the court declined to suppress the fruits of an administrative search in an ancillary proceeding. The court held that plaintiff had an adequate remedy at law as it could assert its fourth amendment challenge should the agency institute an enforcement proceeding. Id. at 721-722. The court noted that if the agency brought no proceedings, the movant would suffer no irreparable harm. Id at 722. See FTC v. Socal, 449 U.S. at 242, 244; Hannah v. Larche, 363 U.S. at 442-43.

90/ In re Worksite Inspection of Quality Products, 592 F.2d 611, 614-15 (1st Cir. 1979); Hunsucker v. Phinney, 497 F.2d 29, 34 (5th Cir. 1974). See Smith v. Katzenbach, 351 F.2d 810, 814-17 (D.C. Cir. 1965).

In this case, plaintiffs will have an opportunity to argue the admissibility of evidence they produced to the Commission should the agency bring an enforcement action against them. See Hunsucker v. Phinney, 497 F2d 29, 34 (5th Cir. 1974). Absent such a proceeding, plaintiffs suffer no legal harm. 91/

CONCLUSION

The Colonnade-Biswell doctrine authorizes warrantless inspections of broker-dealer books and records, as provided in Section 17(b) of the Exchange Act. The Court should, therefore, enter summary judgment for the Commission on plaintiffs' fourth amendment challenge to the Act and to the Commission's administration of the examination program mandated by the Congress. The fourth amendment claims arising from the particular examination of plaintiffs' brokerage records in June 1980 should be dismissed for failure to state a claim since the complaint establishes that plaintiffs consented to the examination. Alternatively, the Court should grant the Commission summary judgment on these claims since the undisputed record establishes that the Commission's examiner reasonably believed that plaintiffs' agent consented to the

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91/ Moreover, as noted, the Commission has provided them with copies of all the documents at issue (Harper Declaration ¶ 5 and attachment thereto).

examination and plaintiffs then ratified that consent. The remaining claims for injunctive relief, seeking to suppress evidence should be dismissed as premature since no action has been lodged against plaintiffs.

Respectfully submitted,

LINDA D. FIENBERG
Associate General Counsel

WHITNEY ADAMS
Assistant General Counsel

RUTH E. EISENBERG
Attorney

Attorneys for Defendants
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Telephone: (202) 272-2454

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