

SELF-REGULATION AND DUE PROCESS AT THE AMERICAN STOCK EXCHANGE, INC.

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INTRODUCTION

The number and variety of dealings between the staff of the American Stock Exchange and counsel representing parties subject to the Exchange's regulatory authority have been increasing steadily. At the same time, and partially as a result of this increase, the Exchange's procedures for enforcement and resolution of other issues raised in these dealings have undergone substantial changes in the past year and a half. Generally speaking, these changes have been away from the somewhat informal methodology which thrust much of the burden upon the Board of Governors toward a more codified system which vests substantial initial authority in the staff of the Exchange. Although proceedings in the relatively informal manner of the past have withstood attacks on the ground of due process on a case by case basis, it has become necessary to formalize these processes and to define the rights and privileges of the parties.

The variety in the nature and number of contacts which counsel had with the Exchange are suggested by the following data. During the past two years the staff has reviewed with listed companies over 2,000 market situations which raised the question of the obligation of such companies to make prompt disclosure of material inside information; the staff has reviewed the applications of over 250 companies for listing, usually with the participation of counsel; it has also conducted over 100 delisting hearings, with appeals by company officials and their counsel; finally, the staff has conducted over 250 investigations into the conduct of member firms which necessarily involve discussions not only with the member firm but generally with its counsel. The Exchange has provided the forum for over 75 arbitration proceedings. In addition, the Exchange's Market Surveillance Department conducted 1400 studies of market activity involving dealings with compliance officials and attorneys representing member firms. In sum, at the American Stock Exchange alone there have been literally thousands of occasions during the past two years in which counsel for parties having agreements with the Exchange have consulted or participated in proceedings involving the staff of the Exchange and panels or committees established by the Exchange. Knowledge of Exchange rules and proceedings, particularly relating to the resolution of controversies, is essential to counsel in such situations.

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The same is true, of course, with all of the other major self-regulatory organizations.

The basic rules and procedures governing these situations before this Exchange are contained in the American Stock Exchange Guide [the Guide].¹ The Guide includes the constitution and the Rules of the Exchange, as well as detailed commentaries on the rules which have been approved by the Exchange and are in effect embodied in the rules themselves.

There is a broad spectrum of situations in which counsel may find themselves dealing with the Exchange in a context governed both in substance and procedure by Exchange regulations. Most common among these are:

1. Investigation of possible violations of the Exchange constitution and Rules by members or member firms of the Exchange, or by other persons employed by or associated with a member or a member firm.
2. Disciplinary proceedings instituted by the Exchange staff arising from allegations of misconduct on the part of members, member organizations, or others resulting from such investigations.
3. Formal or informal proceedings involving financial or operating problems of members or member firms.
4. Applications by corporations seeking to list securities for trading on the Exchange, including supplemental applications for listing of additional securities by corporations whose securities are already traded on the Exchange.
5. Controversies between the Exchange and listed corporations over the continued eligibility of a corporation's securities for listing and trading on the Exchange.
6. Questions regarding disclosure of "material inside information" by listed companies, who are by agreement with the Exchange subject to the obligation to make such information public in a timely manner.
7. Arbitration proceedings in which non-members assert claims against member firms under the provisions of the Exchange rules relating to arbitration of such claims.
8. Action by the Exchange on the application of persons or organizations for approval as members or member firms of the Exchange, or for approval as key employees of member organizations.

RECENT ADMINISTRATIVE CHANGES

In 1972, the Exchange's structure was extensively reorganized to enable it to meet more effectively its self-regulatory responsibilities. As a

¹The American Stock Exchange Guide is published by Commerce Clearing House.

part of this reorganization, many of the disciplinary and related powers formerly mandated to the Governors or to panels of the Board were delegated to the operational staff and to committees appointed to conduct administrative hearings in such cases where appropriate. For example, the Exchange's administration is now authorized to approve routine listing applications as well as applications for supplemental listing of securities to be issued by already listed companies. The staff is also authorized to make initial determinations concerning admission to registration and to act upon applications for approval of key employees. In the past all of these matters required consideration by the Board. No formal provision was made for representation by counsel at these proceedings, though in practice this right was generally afforded to parties who felt themselves in need of such representation. The Exchange has now formally acknowledged the need for recognition of a right to such representation, and formal procedures have been tailored to varying situations where decisions must be reached.

Similarly, the important area of disciplinary proceedings was made subject to formal procedures. Five principal innovations were implemented.

First, hearing panels were established. These were composed of three to five persons, one of whom is an "Exchange Official" designated as such by the Board of Governors or the Executive Committee, and the remainder of whom are members or allied members of the Exchange or employees of member organizations. These panels hear staff charges and have the power to sanction members in appropriate cases subject to appeal to the Board.²

Second, the right to counsel was explicitly recognized for all persons or organizations charged with violations of Exchange rules, and a procedure was adopted for the careful maintenance of a record in every step of the disciplinary proceedings.

Third, a procedure was also established for appeals to the Board of Governors or to a review committee. The provisions for timeliness of such an appeal are somewhat complex and vary from situation to situation, but in general the aim was to deal with these matters expeditiously as well as fairly.

Fourth, a special disciplinary committee was established to deal with minor infractions of Exchange rules, where the more formal procedures impose an unnecessary burden on Exchange members and parties.

Finally, in a new and significant departure, public disclosure of all major disciplinary actions was made mandatory, in an effort to acquaint

² The Board may delegate the actual hearing of such appeals to the Executive Committee.

both the membership and the public with the standards of conduct expected of Exchange members and their staff.

HOW THE NEW PROCEDURES WORK

Both the formal rules and their implementation and practice insure frank and uninhibited discussion of problems, beginning at the initial stage when an inquiry is begun, carrying through to the hearing before a panel, and again upon review, if the proceedings reach that point. A provision has been made for full disclosure of evidence to affected parties. Decisions of the panels and reviewing authorities are to set forth the basis for the conclusions which are reached. The representation by legal or other counsel is assured at all stages.

I have discussed in detail disciplinary proceedings before the Exchange since these involve the most formal procedure involving contacts by the Exchange and counsel. Other situations which I have enumerated earlier have been similarly structured in a manner geared to the nature of each proceeding. In many cases, the needs of the market place, especially the need for timely action, must govern. The most extreme instance in which this applies is the suspension in trading of securities pending clarification of rumors which render informed investment decisions impossible in the absence of such explanation. However, even in these cases the Exchange is careful to afford affected companies full opportunities for hearing and representation.

It is no news to the legal community that courts are reluctant to interfere with the judgment of regulatory bodies with an expertise in the field of their jurisdiction.³ Our own procedures have been carefully constructed to give full scope to that expertise, as well as to give recognition to the rights of affected parties. Even before the reorganization, Exchange practices in a disciplinary matter were upheld against an attack based on alleged lack of due process.⁴ Since the reorganization, in a continuation of the same controversy, the Exchange's procedures have again been tested and upheld.⁵ In the second *Crimmins* case the plaintiff, Mr. Crimmins, alleged that in the disciplinary proceeding initiated against him by the Exchange the panel wrongfully refused to issue subpoenas necessary for defense, that the standard of conduct which the Exchange charged had been violated was unconstitutionally vague, that the disciplinary panel's decision was contrary to law and the evidence, that the adverse decision of the panel constituted deprivation of property

³ See, e.g., the discussion in *Investment Company Institute v. Camp*, 401 U.S. 617 (1971).

⁴ *Crimmins v. American Stock Exchange, Inc.*, 346 F. Supp. 1256 (S.D.N.Y. 1972).

⁵ *Crimmins v. American Stock Exchange, Inc.*, 368 F. Supp. 270 (S.D.N.Y. 1973).

without due process, and, to round out the matter, that the conduct of the Exchange violated the Sherman Act. The plaintiff asked the court to enjoin the Exchange from taking action to carry out the decision of the disciplinary panel. However, the court granted the Exchange's motion for summary judgment.⁶

The *Crimmins* opinion is interesting in its discussion of the role of disciplinary bodies such as the Exchange:

For several important reasons, we strongly disapprove of resort to the courts in such matters except, perhaps, in cases of clearly arbitrary or unjust professional determinations, neither of which is presented by the proceeding at hand.

First, intra-professional discipline is best left to the reasoned consideration of the responsible professional administrative tribunals themselves. A long history of determinations by such bodies as the Stock Exchanges or Bar Associations, for example, makes it reasonable to assume that professionals may be expected in the vast preponderance of cases, to judge their colleagues with the same sense of fairness, regard for standards of conduct, attention to ethics and attention to the facts as the courts.

Moreover, such suits as the one at hand require an inordinate expenditure of time and resources for the court and parties and, most important, deprive disciplinary proceedings of finality and blunt their effectiveness.

Even if a court were presented with a considerably more compelling factual record than the one before us, we believe it would be required to grant summary judgement in favor of the defendant. We consider it the responsibility of an attorney to bring suits of this nature in the spirit of Rule 11, Federal Rules of Civil Procedure, only if he is convinced beyond professional doubt that his client has been denied the relevant elements of fairness embodied in the noble concept of due process.

Plaintiff's motion for summary judgement is denied. Defendant's motion for summary judgement is granted.⁷

Finally, it is appropriate to point out that of the hundreds of controversies handled by the American Stock Exchange every year, the overwhelming majority are satisfactorily resolved at the Exchange level through the procedures and facilities of the Exchange. Rarely has it been necessary for the parties to resort to legal action in the courts.

⁶ This case is presently being appealed by the plaintiff.

⁷ 368 F. Supp. at 281.