BRIEF FOR RESPONDENT

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 21,282

HOWARD JAMES HANSEN
DOING BUSINESS AS
H. J. HANSEN AND COMPANY and
HOWARD J. HANSEN, INDIVIDUALLY,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR REVIEW OF ORDER OF
SECURITIES AND EXCHANGE COMMISSION

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether findings of the Commission against petitioner were improperly made because the record included the record of a prior proceeding in which petitioner could have participated as a party but did not do so, when in the proceeding below petitioner was given the opportunity to, and in fact did, cross-examine the witnesses whose testimony was contained in the record of the prior proceeding.

2. Whether, by failing to file an exception with the Commission to the recommended decision of the hearing examiner based on the above record, as required by the Commission's Rules of Practice, and, by failing to have urged before the Commission the alleged inability of certain witnesses to remember facts, in the light of the requirement of Section 25(a) of the Securities Exchange Act that review might be had only of objections urged before the Commission, petitioner can now challenge the procedure followed.

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BRIEF FOR RESPONDENT

COUNTERSTATEMENT OF THE CASE

This is a petition for review of a Securities and Exchange Commission order of July 11, 1967 (J.A. 58-62, R. 10630-10632), which, inter alia, denied petitioner's 1/ application for registration as a securities broker and dealer and found petitioner to be a cause of the revocation of the registration of Atlantic Equities Company ("Atlantic") as a securities broker and dealer.

1/ "J.A. " refers to the Joint Appendix; "R. " refers to the record of the proceeding.

Petitioner's application for registration was filed on October 28, 1963 (R. 10280-10285). The denial proceeding was instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b), by the Commission on November 26, 1963, (R. 10286-10292) and was consolidated with a pending revocation proceeding pursuant to Section 15(b) which had been instituted in January 1963, involving Atlantic, seven other brokers and dealers, and twelve associated persons (collectively "participants") including petitioner, all of whom were charged with participating in a scheme to defraud and with manipulative activities in a June 1961 offering of 150,000 shares of common stock of Siltronics, Inc. That offering had been purportedly made pursuant to an exemption from the registration provisions of the Securities Act of 1933, 15 U.S.C. 77a, provided by Regulation A, 17 CFR 230.251 et seq., under that Act. A notification and offering circular had been filed under Regulation A and had named Atlantic as underwriter.

The Commission found that petitioner and the other participants variously participated in a scheme to defraud and to manipulate the market in Siltronics stock, inter alia, by withholding 30,000 shares (in separate blocks of 25,000 and 5,000 shares) from public investors for later sale at artificially inflated prices (J.A. 29-30, R. 10618) 2/

2/ This type of practice was found to violate the anti-fraud and registration provisions of the securities laws in Batten & Co., Inc. 41 SEC 538 (1963), aff'd, Batten & Co., Inc. v. Securities and Exchange Commission, 120 US App. D.C. 188, 345 F.2d 82, (1964), and in R. A. Holman & Co. Inc. Securities Exchange Act Release No. 7770 (1965), aff'd, R. A. Holman & Co. Inc. v. Securities and Exchange Commission, 366 F.2d 446 (C.A. 2 1966), petition for rehearing granted and former opinion amended, 377 F.2d 665 (1967), cert. denied, 36 U.S. L.W. 3228 (Dec. 5, 1967).

Pursuant to an agreement between petitioner, syndicate manager for Atlantic, and Ethel I. Weber, manager of Blair F. Claybaugh and Company ("Claybaugh"), which was a major participant in the offering, out of the 25,000 share block, 24,000 shares were purchased on the day of the offering through certain participants by two friends of petitioner (J.A. 30-31, R. 10618). 3/ The following day petitioner arranged the sale of 15,000 of these shares by the purchasers through other participants at prices which afforded his friends a substantial profit (J.A. 31-32, R. 10619). 4/ Most of these shares were purchased for Claybaugh and resold to the public at prices in excess of the offering price (J.A. 30-33, R. 10618-19).

A separate block of 5,000 shares was sold through Atlantic to a group designated by an officer of Siltronics pursuant to an arrangement to resell them to Claybaugh immediately thereafter at a pre-arranged higher price. Petitioner participated in this arrangement by preparing a draft of a letter which was provided to the members of this group to be used as a model in setting up their accounts (J.A. 34, R. 10620). The Commission found that "the apparent purpose of this arrangement was to make it seem that the accounts were ordinary customers' accounts not opened for the express purpose of purchasing a portion of the offering" (J.A. 34, R. 10620).

3/ The remaining 1,000 shares were retained as a "bonus" and were later sold at 3 to 4 3/8 by the broker through whom the purchases were made (J.A. 31, R. 10619).

4/ The Commission found that there had been no repayment of an "asserted loan" of 2,300 of these shares obtained by Hansen from the purchasers (J.A. 32, R. 10619).

The Commission found that "Hansen of Atlantic and Weber of Claybaugh were the architects of a scheme to defraud in the sale of the Siltronics 'hot issue' . . ." (J.A. 36, R. 10621). The Commission found that in addition to the withholding of the two blocks of stock as described above, the scheme to defraud "involved the stimulation of demand by optimistic and fraudulent representations and reductions in the number of shares ordered at the offering price" and "purchases and the insertion in the pink sheets of bids higher than the offering price before the distribution was completed" (J.A. 36-37, R. 10621). Accordingly, the Commission entered the order from which petitioner seeks review. 5/

Petitioner's only challenge to the Commission's findings and opinion is based on the fact that there was introduced into evidence in this proceeding the record of a prior proceeding involving some of the participants, including Atlantic. The prior proceeding against Atlantic had been terminated without prejudice prior to the institution of the present proceeding. Atlantic and other participants had moved that the prior proceeding be terminated in view of the decision of this Court in Amos Treat &Co. v. Securities and Exchange Commission, 113 U.S. App. D.C. 100, 306 F.2d 260 (1962). 6/ Briefly summarized, the facts surrounding the making, introduction into evidence, and use of the prior record are:

The prior proceeding against Atlantic included charges with respect to the Siltronics offering and the issue whether petitioner, among

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5/ The Commission also imposed sanctions upon most of the other participants; none of them has sought review.

6/ In that case this Court precluded the participation in the decisional process of a Commissioner who had formerly been a member of the staff. The same Commissioner had participated in the institution of the terminated proceeding; he did not participate in the proceeding under review.

others, was a cause of any sanction that might be imposed upon Atlantic (9813). Since this Court had held that an associate of a broker or dealer could not be made a party to a revocation proceeding against his will, Wallach v. Securities and Exchange Commission, 92 U.S. App. D.C. 108, 202 F.2d 462 (1953), the Commission followed the practice of notifying any associate who might be affected that the proceeding had been instituted and that he had a right to participate. 7/ Accordingly, petitioner was notified that he might be named a cause of any revocation of Atlantic and was advised of his right under the Commission's rules in effect at the time to elect to participate as a party in the proceeding (J.A. 12 , R. 9823). 8/

On the first day of the hearings in the prior proceeding, Blaine P. Friedlander, counsel for petitioner stated:

> "I am appearing especially for Mr. Hansen and in response to a subpoena. We are not participating in this case." (J.A. 98, R. 3227). [Emphasis added.] 9/

7/ The Securities Acts Amendments of 1964, 78 Stat. 565 (1964) have since authorized a proceeding directly against a person associated with a broker and or dealer. Section 15(b)(7) of the Securities Exchange Act, 78 Stat. 572.

8/ Rule 15b-9(b), 20 F.R. 7036 (1955), then provided in pertinent part and was quoted in part in the letter to petitioner as follows: "In any event . . . [an individual in his position] may inform himself of . . . developments by attendance at the hearings or examination of the record (whether the proceedings be public or private) or by arrangement with a party of record, so he can determine whether he desires to be heard at any time" (J.A. 11-12, R. 9822). This provision is now contained in Rule 9(b) of the Rules of Practice, 17 CFR 201.9(b).

9/ At the same time petitioner had instituted an action in the District Court seeking to enjoin the Commission from proceeding against him. This action was dismissed. Hansen v. Securities and Exchange Commission, (D.C. D.C. No. 3928- 63).

At the afternoon session on the same day, in response to the staff's motion for sequestration of witnesses and without objection by petitioner or his counsel, the Hearing Examiner ruled as follows:

> "All right, then I would ask Mr. Hansen to leave the hearing room until he is called as a witness. However, you have a counsel, and your counsel can remain here of course. Is the gentlemen who represents Mr. Hansen present? When he comes in we can apprise him of what has happened . . ." (J.A. 99, R. 3262). 10/

Later, petitioner was called as a witness and testified at length. At that time his counsel commented on petitioner's status:

> "He was given an option and he decided not to be a party." (J.A. 99, R. 7034).

At the opening of the hearings in the revocation proceeding under review counsel for petitioner again noted his election not to have been a party in the prior proceeding (J.A. 64, R. 12) and stated:

> "I am prepared to appear as a party in this proceeding on behalf of Mr. Hansen . . . . We accepted the given option not to be a party. We now accept the option to be a party." (J.A. 68-69, R. 15).

Subsequently, the staff offered the entire record of the prior proceeding comprising nearly 5,000 pages of testimony and including over 300 exhibits with the understanding that petitioner would have the opportunity to cross-examine any or all of the witnesses who had testified (J.A. 70, R. 179). 11/ The Hearing Examiner admitted the record into evidence

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10/ It does not appear that counsel attended the hearings thereafter until petitioner was called as a witness.

11/ All the participants were afforded the opportunity to cross-examine the witnesses. A similar motion had been made and granted with respect to the other participants (J.A. 48, R. 10625).

against Hansen over objection based upon his exclusion from the prior hearings and, after considering petitioner's application for review, the Commission sustained the ruling of the Hearing Examiner (J.A. 19-23, R. 10307-10308).

During the course of the hearings, numerous witnesses whose testimony was contained in the prior record were recalled, and petitioner cross-examined most of them. Petitioner filed no proposed findings with the hearing examiner as contemplated by Rule 16 of the Commission's Rules of Practice, 17 CFR 201.16. The hearing examiner thereafter entered a recommended decision, finding:

> "Regarding Hansen, the testimony overwhelmingly establishes, as previously indicated, that he played a leading role in the instigation and execution of the plan for the withholding and subsequent distribution of the 25,000 share 'give-up' block and likewise the 5,000 shares transaction with Silverman and the Investment Guild " (J.A. 23, R. 10567). 12/

Petitioner filed no exceptions to the recommended decision of the hearing examiner and, accordingly, did not renew before the Commission any objection to the introduction of the prior record into evidence.

12/ As the Commission noted, the hearing examiner, in recommending that the order of denial of registration as to petitioner should contain a provision that it would not bar his employment by other broker-dealers upon a showing of appropriate supervision, had referred to "Hansen's prior clean record and to the damaging impact of the proceedings upon Hansen who, despite his 'exceptional knowledge of the securities business,' was 'compelled to accept a job as a house-to-house book salesman '" (J.A. 56-57, R. 10629).

SUMMARY OF ARGUMENT

The record of the prior proceeding was properly admitted into evidence and the petitioner's rights were completely protected by his opportunity to cross-examine the witnesses who had testified in the prior proceeding. Nothing but delay would have resulted if the witnesses whose testimony was contained in the prior record had been required to answer the same questions that had been asked them at that time.

In any event, petitioner's contentions are not properly before this Court. Since petitioner filed no exceptions to the recommended decision of the hearing examiner, under the Commission Rules of Practice governing the proceeding, any objections, including objections to the admission of the prior record, were deemed to have been waived. Moreover, petitioner never urged before the Commission, the contention that the witnesses produced for cross-examination were unable to recall the facts. Under Section 25(a) of the Securities Exchange Act, 15 U.S.C. 78y(a), petitioner's failure to raise the objection before the Commission precludes its consideration by this Court.

ARGUMENT

I. THE COMMISSION'S DECISION WAS PROPERLY BASED IN PART UPON THE RECORD OF A PRIOR PROCEEDING.

While, as we show in Point II, infra, this Court does not have to reach petitioner's arguments because of his failure to raise them before the Commission, they are, in any event, without merit. Basically, what petitioner is objecting to was the elimination of needless delay

by the introduction of the prior record. As noted, this consisted of nearly 5,000 pages of testimony and over 300 exhibits. The staff in the proceeding under review could have called each of the 40 witnesses who had previously testified. Each witness could have been asked the same questions as previously, and, in the event the witness did not remember, his memory could have been refreshed by his prior testimony. Such a procedure would have achieved no different result from that obtained merely by introducing into evidence the transcript of the prior record and by permitting further cross-examination of the witnesses. While a situation that permits the use of prior testimony in this fashion does not arise frequently, the practice is approved. As pointed out in Garner v. Pennsylvania Public Utility Commission, 177 Pa. Super 439, 110 A.2d 907 (1955): "In the interest of saving time for all parties concerned, the record of the prior hearings should be admitted at the rehearing unless substantial harm will be done to any of the parties " 110 A.2d at 911. See also Paramount Cap Mfg. Co. v. NLRB, 260 F. 2d 109 (CA 8,1958); Railway Express Agency v. CAB, 100 U.S. App. D.C. 165, 243 F.2d 422 (1957); In re McNary, 83 F. Supp. 121 (N.D. N.Y. 1949).

Petitioner complains that the prior record was inadmissible because the witnesses were available to testify. Assuming this would have excluded use of the prior record under the traditional common law rules of evidence in jury trials, the common law restrictions are not necessarily applicable in administrative proceedings. Federal Trade Commission v. Cement Institute, 333 U.S. 683, 705-6 (1948). Thus, the Administrative Procedure Act allows the admission of any evidence, while at the same time

authorizing every agency to provide for exclusion of irrelevant, immaterial or unduly repetitious evidence, provided that sanctions are based upon substantial evidence in the record. Section 7(c), 5 U.S.C. 557(d); Section 10(e), 5 U.S.C. 706(2)(e). The basic requirements under the Commission's Rules of Practice are that the evidence be relevant and material. Rule 14(a), 17 CFR 201.14(a). The requirement of unavailability of witnesses in connection with the admissibility of a record of a prior proceeding urged by petitioner was historically applied under the common law as a result of the influence of the constitutional provision requiring confrontation in criminal cases. McCormick on Evidence, 492 (1954). The essential purpose of confrontation is to secure the opportunity for cross-examination. 5 Wigmore on Evidence § 1395 (3rd ed. 1940). 13/ While cross-examination is the essential and indispensable element of the hearsay rule, confrontation is subordinate and is dispensable. 5 Wigmore §§ 1362, 1365. 14/ Since petitioner had the opportunity to cross-examine the witnesses, the basic requirements of the exclusionary rule that he urges as ground for objecting to use

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13/ A secondary purpose of confrontation is to permit the judge and the jury to observe the witnesses' deportment. Here the same hearing examiner presided in both proceedings.

Confrontation is "not for the idle purpose of gazing upon the witness, or of being gazed upon by him, but for the purpose of cross-examination, which cannot be had except by the direct and personal putting of questions and obtaining immediate answers" 5 Wigmore at 123.

14/ See Rule 503 of the American Law Institute's Model Code of Evidence, which would allow hearsay evidence if the witness is unavailable or if present and subject to cross-examination.

of the prior record have been met. 15/ Thus, in Freight Consolidators Cooperative Inc. v. United States, 230 F. Supp. 692 (S.D. N.Y., 1964), it was held that planintiffs were not denied the right to cross-examine witnesses who had testified prior to the date when plaintiffs were brought into the case. The court stated:

> "Assuming arguendo that they were injured by the failure of the Commission to grant them a de novo hearing, then any harm ensuing could have been cured by them. They were afforded an opportunity to recall and cross-examine witnesses but declined to do so." 230 F. Supp. at 699.

Petitioner, who had had the right under the Commission's rules to elect to become a party and participate fully in the earlier proceeding, cannot be heard to complain that cross-examination in the later proceeding of the persons who had testified in the earlier proceeding was not as effective as he would have liked it to be. As this Court stated in Wallach v. Securities and Exchange Commission, supra, "the salesman who fails to take advantage of the opportunity offered by the Commission to intervene voluntarily in proceedings of the present sort . . . may later find that he has seriously prejudiced his own interests by his inaction " 92 U.S. App. D.C. at 110 n. 8, 202 F. 2d 466 n. 8. While we do not agree that in this proceeding petitioner did not have opportunity for effective cross-examination of the witnesses who had testified in the earlier proceeding, even if, as petitioner claims, some of them were unable to remember facts, any prejudice to petitioner results from his refusal to have made himself a party to the prior proceeding.

15/ Thus, Karick v. Cantrill, et al., 53 U.S. App. D.C. 346, 290 Fed. 321 (1923), cited by petitioner, is distinquishable since there was no opportunity to cross-examine in that case.

Petitioner's objection to the admission of the record on the basis of the claimed inability of the witnesses subsequently to remember the facts is non-specific and unsupported (Brief p. 7). Not every witness in this or any other proceeding offers a precise answer to every question put to him. Moreover, a witness' inability to remember some facts does not establish his inability to testify as to other facts. 16/ In any event here the testimony given in the proceeding under review after the record of the prior proceeding had been introduced shows that the witnesses were still able to testify as to the essential facts upon which the sanction against petitioner was based. Thus, for example, Mrs. Weber testified at length in the second proceeding about the arrangements to ear-mark and transfer 25,000 shares of Claybaugh's allotment to persons designated by petitioner (J.A. 91-96, R. 1863-70). Dr. Casalaro, one of petitioner's friends who purchased 12,000 of those shares testified that he had talked to petitioner about his proposed purchase and that petitioner told him that the shares would be available through John R. Wilson, Jr., Co. from whom he made his purchases. (J.A. 82-86, 88-90, R. 1320-24; 1345-46; 1381-82; 1393-94). Likewise, Wilson of that company testified that petitioner arranged for subsequent sale of the ear-marked shares the following day through Shawe & Co., Inc. (J.A. 75-79, R. 927-28; 933-36). Thus this testimony alone supports the

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16/ The witnesses Weber and Casalaro, who testified at length on the basic facts, could not, for example, be specific on some days or dates (J.A. 87, 96-97, R. 1348, 1890) or other details (J.A. 88, 89, R. 1353, 1383).

Commission's basic finding that petitioner engaged in withholding from the allegedly public offering blocks of stock "from public investors and thereafter sold [them] at artifically inflated prices" (J.A. 30, R. 10618).

II. PETITIONER'S OBJECTIONS TO THE ADMISSION OF THE PRIOR RECORD WERE WAIVED BY HIS FAILURE TO FILE EXCEPTIONS TO THE HEARING EXAMINER'S RECOMMENDED DECISION AND PETITIONER'S CONTENTION AS TO THE INEFFICACY OF CROSS-EXAMINATION, NOT HAVING BEEN URGED BEFORE THE COMMISSION, MAY NOT BE CONSIDERED BY THIS COURT.

Although petitioner objected to the introduction of the prior record, emphasizing that he had been excluded from the hearing when that record had been made, 17/ and appealed to the Commission from the hearing examiner's adverse decision on this evidentiary point, after the hearing examiner filed his recommended decision petitioner filed no exceptions thereto. Under the Commission's Rules of Practice any objection not saved by an exception to a recommended decision is "deemed to have been abandoned." 18/ While in its findings and opinion the Commission did oonsider objections of other participants concerning the use of the prior record, the argument petitioner now makes that the alleged error resulted in part from petitioner's exclusion from the prior proceeding (Brief p. 4) was not referred to in the Commission's opinion, presumably because of petitioner's failure to note his exception.

17/ Not being a party, however, petitioner was subject to sequestration as was any other witness and as noted he made no objection to his exclusion.

18/ Rule 17(b), 25 F.R. 6733 (1960), applicable to proceedings instituted prior to August 1, 1964, 29 F.R. 9487 (1964), provided in pertinent part:

(Cont'd)

The objection that the prior record did not become admissible because of the production of the witnesses for cross-examination because they allegedly were unable to remember was not urged by petitioner before the Commission. 19/ Accordingly, under Section 25(a) of the Securities Exchange Act, he is precluding from asserting it before this Court. Section 25(a) provides in part:

> "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission."

That section is construed by this Court to mean what it says. Gearhart & Otis, Inc. v. Securities and Exchange Commission, 121 U.S. App. D.C. 186, 189, 348 F.2d 798, 801 (1965).

18/ (Cont'd)

> "Any objections to a recommended decision not saved by exception filed pursuant to this section will be deemed to have been abandoned and may be disregarded."

The Rule, as currently in effect has been changed only to reflect the fact that the decision of the hearing examiner is now an "initial decision" rather than a "recommended decision" 17 CFR 201.17(b).

19/ Petitioner made a motion to the hearing examiner to strike the prior testimony of one witness, Pounds (J.A. 80, R. 1167), allegedly on the ground, as stated by petitioner (J.A. 81, R. 1169): "Now having produced the witnesses we find that I do not have an opportunity to cross-examine on their prior testimony because they can't remember." No motion was made, however, to strike the prior testimony of any other witness.

CONCLUSION

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

Respectfully submitted,

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