UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

MORTIMER N. HANLY, Petitioner, -against- SECURITIES AND EXCHANGE COMMISSION, Respondent.	:	No. 33178

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION TO THE MOTION OF PETITIONER FOR A STAY OF THE EFFECTIVENESS OF THE ORDER OF THE COMMISSION PENDING JUDICIAL REVIEW OF THAT ORDER BY THIS COURT

STATEMENT OF THE CASE

The Securities and Exchange Commission entered an order on December 31, 1968, barring Mortimer N. Hanly, petitioner herein, from "being associated with any broker or dealer" (Op. 16).[1/] The petition to review that order was filed in this Court on January 24, 1969, and on January 27, 1969, petitioner filed a motion to stay the effectiveness of the Commission's order. This memorandum is submitted in opposition to that motion.

1/ "Op. ___" refers to pages of the Findings, Opinion and Order of the Commission, attached as Exhibit A to Hanly's motion for a stay.

The Commission's Findings, Opinion and Order of December 31, 1968.

In the findings and opinion upon which the December 31 order was based, the Commission held that between September 1962 and August 1963 Hanly had wilfully violated the anti-fraud provisions of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, in the offer and sale of the stock of U.S. Sonics Corporation ("Sonics") (Op. 2) by means of fraudulent and extravagant representations and predictions as to said stock (Op. 6).

Specifically, the Commission found that as of the end of 1962, Sonics had "sustained a net loss of $671,944" for the year and that "its accumulated deficit [had] increased to $1,719,217" (Op. 3). It further found that on March 1, 1963, Hanly sold 300 shares of Sonics at 8 3/8 to one customer to whom he had represented "that Sonics had 'a new type of invention that would rock the world,' that it would merge with another company in the near future, and that the price of its stock would rise to 12 or 15 in a short time" (Op. 6). The Commission further found that "Hanly did not disclose Sonics' financial condition to [that] . . . customer or to another customer who, pursuant to . . . [Hanly's] recommendation, purchased 100 shares at 8 3/8 on the same date" (Op. 6). The Commission characterized Hanly's actions as "willful violations" of the anti-fraud provisions

of the federal securities laws (Op. 13).[2/] These findings followed extensive hearings and were based upon an independent review of the record by the Commission. As a result of these findings the Commission barred Hanly from association with any broker or dealer.

The Commission thereafter, by order of January 9, 1969, denied Hanly's motion for a stay of the Commission's Order of December 31, 1968, pending determination of a petition for reargument to be filed by him, or, in the alternative, that, if reargument should not be granted or should not be acted upon favorably, a stay be granted until he should file a petition for judicial review of such order.[3/] The Commission concluded that "in view of the serious nature of the violations by Hanly found by it, a sufficient showing had not been made to warrant a stay of the bar order."

2/ The Commission noted:

> ". . . the fraud in this case consisted [essentially] of the optimistic representations or the recommendations previously recited without disclosure of known or reasonably ascertainable adverse information which rendered them materially misleading. Thus, in connection with the optimistic or favorable representations or recommendations, the respondents who made them were under a duty to disclose the known or then reasonably ascertainable facts with respect to Sonics' deteriorating financial condition . . . . Such disclosure was necessary to enable the customer to assess the weight to be given to the optimism of the salesman and make an informed judgment on whether to purchase or retain the stock. Absent such disclosure, the customer was entitled to assume not only that the salesman had a reasonable basis for his representations and recommendations, but also that he had no knowledge of any adverse factors which might effect the customer's investment decision. It is clear that a salesman must not merely avoid affirmative misstatements when he recommends the stock to a customer; he must also disclose material adverse facts of which he is or should be aware" (Op. 7-8).

3/ A copy of this order of the Commission is attached as Exhibit B to Hanly's motion for stay.

STATUTES AND RULES INVOLVED

Section 17(a) of the Securities Act provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Rule 10b-5, promulgated under Section 10(b) of the Exchange Act, prohibits substantially the same conduct "in connection with the purchase or sale of any security" that Section 17(a) prohibits "in the offer or sale of any security."

Section 15(c)(1) of the Exchange Act, which applies specifically to a broker or dealer, prohibits the use of the mails or facilities of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security, otherwise than on a national securities exchange, by means of any "manipulative, deceptive, or other fraudulent device or contrivance." Rule 15c1-2 defines this phrase in language similar to the wording of Section 17(a) of the Securities Act and Rule 10b-5.

Section 15(b) of the Exchange Act, 15 U.S.C. 78o(b), gives the Commission disciplinary power over brokers and dealers registered with it. In particular, Section 15(b)(7) gives the Commission power to bar, or to suspend for a period not exceeding 12 months, any person from being associated with a broker or dealer, or to censure any person, if the Commission finds that such action is in the public interest, and that such person has, among other things, wilfully violated any provision of the Securities Act or the Exchange Act.

Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a), grants jurisdiction to the courts of appeals to review Commission orders and provides that the Commission's findings of fact shall be conclusive if supported by substantial evidence. Section 25(b), 15 U.S.C. 78y(b), provides that the commencement of court proceedings to review an order of the Commission "shall not, unless specifically ordered by the court, operate as a stay of the Commission's order."

ARGUMENT

HANLY HAS NOT SATISFIED THE HEAVY BURDEN IMPOSED UPON ONE SEEKING A STAY OF A COMMISSION ORDER PENDING JUDICIAL REVIEW

The decisions of this and other courts of appeals make clear that one seeking to stay the effectiveness of an administrative order pending judicial review bears a heavy burden. In order to obtain such a stay the petitioner must show each of the following:

(1) There is a strong probability that he will prevail on the merits of his appeal.

(2) Without a stay he will suffer irreparable injury.

(3) There will be no substantial harm to other interested persons.

(4). There will be no harm to the public interest.

Eastern Air Lines, Inc. v. Civil Aeronautics Board, 261 F. 2d 830 (C.A. 2, 1958); Hamlin Testing Labs. v. United States Atomic Energy Commission, 337 F. 2d 223 (C.A. 6, 1964); Associated Securities Corp. v. Securities and Exchange Commission, 283 F. 2d 773 (C.A. 10, 1960); Virginia Petroleum Jobbers Ass'n v. Federal Power Commission, 259 F. 2d 921 (C.A. D.C., 1958).

As the Court of Appeals for the Tenth Circuit stated in denying a stay of a Commission order revoking the registration of a broker-dealer in the Associated Securities case, supra, 283 F.2d at 775 (footnotes omitted):

> Irreparable injury to the petitioners is urged on the ground that they are excluded from the securities business and thus from earning their livelihoods in their chosen vocations. Serious as this personal injury may be, it is not of controlling importance as primary consideration must be given to the statutory intent to protect invesotrs. Exclusion from the securities business is a remedial device for the protection of the public.
>
> In the balancing of an injury to the individual by exclusion from the security business and of harm to the public by proscribed activities in security transactions the necessity of protection to the public far outweighs any personal detriment resulting from the impact of applicable laws. In each of the cases before us the Commission has found that the public interest is served by the actions which it has taken . . . . If we were to grant the requested stays and thus, temporarily at least, free . . . [petitioners] from the imposition of the Commission orders we would, in effect, be substituting our judgment as to the public interest for that of the Commission.

> The primary responsibility rests on the Commission and its determinations should not be upset by the courts except for cogent reasons. The United States Supreme Court has said that:® "Courts and administrative agencies are not to be regarded as competitors in the task of safeguarding the public interest."

Hanly has not made a sufficient showing to satisfy any of the applicable conditions for a stay, much less all of them.

1. Petitioner Has Not Demonstrated a Strong Probability of Success.

a. The Commission's findings were supported by substantial evidence.

At the outset it should be noted that Hanly does not appear seriously to contest the fact that he engaged in the acts found by the hearing examiner and by the Commission to be violations of the federal securities laws.[4/] The only claim of petitioner which questions the substantiality of the evidence upon which the Commission relied is the assertion by Hanly (p. 8) that the Commission should have considered it ". . . unlikely that Hanly would have said both that Sonics' new invention will 'rock the world' and that the price of Sonics would rise from 12 to 15 'in a short time'." (Emphasis added.)[5/] Hanly claims it was unlikely that a statement that an invention would rock the world would be coupled with a prediction of "such a limited non-'world-rocking' price rise." Hanly also claims (p. 7) that the Commission's findings

---

4/ Indeed, the petitioner, at page 8 of his motion, complains that the Commission did not give adequate weight to Hanly's mitigating conduct.

5/ The Commission's Finding and Opinion states (p. 6) that Hanly told a customer that, inter alia, the price of Sonics' stock would rise "to 12 or 15 in a short time" (Emphasis added). The customer had purchased Sonics' shares at 8 3/8.

that he made misrepresentations was against the weight of the evidence and that the findings implicitly recognized that Hanly did not admit to making such misrepresentations. But the hearing examiner expressly stated that ". . . Hanly admitted when he took the stand that he had told Mrs. R. O. that Sonics would or should go to from $12 to $15 within a few months. . . ."[6/] The hearing examiner, who heard the testimony of Mrs. R. O. as well as that of Hanly, and observed the demeanor of both, chose to believe her statements.[7/] The Commission, while not specifically referring in its Findings and Opinion to either Mrs. R. O.'s testimony nor Hanly's admissions, did not disagree with the hearing examiner, since it found Hanly had made such representations (supra, p. 2)

b. The sanction imposed by the Commission was well within its discretion.

Petitioner's principal claim appears to be that this case represents the first time that the sanction of a permanent bar has been "visited upon a salesman" under the precise circumstances here involved. But this in no way impairs the validity of the precedents

---

6/ Initial Decision of James G. Ewell at 46, attached as separately bound Exhibit C to Hanly's motion.

7/ The hearing examiner noted (id. at p. 51) that ". . . most, if not all, of the complaining investors were unacquainted with each other and yet gave testimony of similar import and effect, and indeed in some cases testified to identical figures of price appreciation and the like, from which it would appear that such unplanned and unrehearsed uniformity is entitled to greater weight and credence than the self-serving unsupported explanations of those charged with wrongdoing."

cited by the Commission in its opinion (pp. 7-8) to the effect that a securities salesman is guilty of fraud who sells securities (1) through optimistic representations "without disclosure of known or reasonably ascertainable adverse information which rendered them materially misleading," (2) through "predictions of specific and substantial increases in the price of a speculative, unseasoned security" or (3) through "predictions of a sharp increase in earnings with respect to such a security without full disclosure of both the facts on which they are based and the attendant uncertainties." Surely the Commission can bar such a salesman from the securities business.

As this Court held in Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8-9 (1965):

> Registration of broker-dealers is a means of protecting the public . . ., and the determination of the sanctions necessary to protect the public rests primarily within the competence of the Commission. "[W]here Congress has entrusted an administrative agency with the responsibility of selecting the means of achieving the statutory policy the relation of remedy to policy is peculiarly a matter for administrative competence . . . ." The Commission must have a very large measure of discretion in determining what sanctions to impose at a particular time in particular cases. Failing a gross abuse of discretion, the courts should not attempt to substitute their untutored views as to what sanctions will best accord with the regulatory powers of the Commission.

2. Irreparable Injury

Since the thrust of Hanly's motion for a stay is that the sanction of a permanent bar from the securities business was too severe, even should this Court rule that a lesser sanction is to be ordered, Hanly would be credited for the time during which he was barred and prompt prosecution of this appeal would appear to eliminate any injury to him.

While Hanly asserts that irreparable injury will befall him if he is not permitted to maintain his occupation in the securities business, he has filed no affidavit showing what efforts he has made to obtain other remunerative employment. At a minimum, he should advise this Court of his efforts during the month-long period that he has presumably been out of the securities business, in the light of the Commission's denial of a stay.

3. The Public Interest

Petitioner has not satisfied the burden of showing that there will be no harm to the public interest. Great weight must be accorded to the Commission's conclusion, based upon an independent review of the evidence adduced in the administrative proceedings, that the public interest would be harmed by allowing the petitioner to continue in the securities industry pending the outcome of this petition. Associated Securities Corp. v. Securities and Exchange Commission, supra, 283 F. 2d at 775. In the instant case the Commission's determination not to grant a stay was based, among other things, on the grounds that a serious violation of the federal securities laws had occurred and that the violation was willful. To overrule the Commission on its determination that a stay is inappropriate, without a substantial showing of merit by a petitioner, will only encourage those who have already perpetrated serious violations to bring frivolous appeals in order to delay the effect of the relief found necessary by the Commission.

For the foregoing reasons, petitioner's motion for a stay should be denied.

Respectfully submitted,

PHILIP A. LOOMIS, JR.
General Counsel

DAVID FERBER
Solicitor

PAUL GONSON
Assistant General Counsel

Securities and Exchange
Commission
Washington, D. C. 20549

February 6, 1969