repeated disclaimers have not succeeded in erasing that impression. The Committee therefore recommends that there be prominently displayed on formal orders of investigation and on letters transmitting subpoenas a statement that the initiation of an investigation does not mean that the Commission has concluded that a violation of law has occurred. A disclaimer along these lines would tend to diminish any injury to reputation that might otherwise result from a staff investigation.

Although an investigation may have some adverse effect on the interests of the party being investigated, it is not litigation. No rights are adjudicated in the course of an investigation. The scales, therefore, are tipped decisively in favor of speed and breadth of inquiry on the part of the investigator. The wide powers exercised by investigative agencies have repeatedly received legislative and judicial confirmation. The Committee believes that the conduct of an investigation should remain within the control of the Commission. The Committee suggests, however, that where circumstances permit, the Commission should as a general practice give a party against whom the staff proposes to recommend proceedings an opportunity

to present his own version of the facts by affidavit or testimony under oath.

Investigations are often protracted and their existence frequently becomes a matter of public knowledge. During the pendency of an investigation uncertainties are likely to be created in the minds of the investigatees and those with whom they have business or other dealings. Although the Commission may terminate an investigation without ordering the commencement of an action or proceeding against one or more of the parties named in the investigative order, it does not usually notify any such party that the investigation has been concluded. Although circumstances may warrant continuation of the current practice in some cases, the Committee recommends that the Commission adopt in the usual case the practice of notifying an investigatee against whom no further action is contemplated that the staff has concluded its investigation of the matters referred to in the formal order and has determined that it will not recommend the commencement of an enforcement proceeding against him. Where appropriate, there can be an admonition with respect to conduct concerning which the investigation was initiated.

A. Authority to Commence Formal Investigations

At the present time, all orders for formal investigation are authorized and issued by the Commission. Requests for such orders are initiated by staff attorneys either in one of the divisional offices in Washington or in a regional office when it appears doubtful that an investigation can be successfully pursued without the use of subpoenas. The staff attorney will typically draft (1) a memorandum in which he outlines the evidence obtained to date, the potential violations and the reasons necessitating an investigative order and (2) a copy of the proposed order. These documents are then submitted to a Branch Chief, who examines them and may discuss the particulars with the initiating attorney. If the documents originate in a regional office, they are submitted by the Branch Chief to an Assistant Regional Administrator for further review. If he concurs in the recommendation, they are submitted in turn to the Associate Regional Administrator and the Regional Administrator. Along the line, refinements are made, and after review by the Regional Administrator the memorandum and draft order are put into final form. There-

after, they are sent to the appropriate Division in Washington where they are reviewed at least twice before they are submitted to the Commission for approval.

Similar review procedures apply to requests for investigative orders that originate in the Divisions.

The Committee believes that these review procedures are unnecessarily time-consuming and often unnecessarily duplicative. Most requests for formal orders do not involve novel or unusual factual or legal situations, and practically none are denied. Frequently the proposed recipient of a subpoena will have indicated a willingness to comply with a request for information but wants a subpoena to avoid possible liability to third parties.

The Committee recommends that the Commission delegate to its Division Directors and Regional Administrators the authority to issue investigative orders (and therefore the power to issue subpoenas) in routine classes of cases. We recommend that the delegation not include cases where novel or unusual questions are likely to be involved or the power to authorize a public investigation. If the Commission should adopt our suggestion,

a procedure should be established under which the officer authorizing an investigation would notify the Commission or designated members of the staff that an order has been issued and in memorandum form describe generally the nature of the investigation contemplated. This would assure adequate notification that an investigation is underway and oversight over the nature and direction of staff investigations. This procedure would also eliminate the possibility that the public might erroneously believe that the Commission had already determined the issues.

B. Supervision and Review of Investigative Procedures

The Committee, during its inquiry, received some complaints that Commission subpoenas are too broadly drawn, investigations too protracted, staff counsel ill-prepared, discourteous or abusive toward witnesses or their counsel and documents furnished to the staff needlessly retained. In some cases, of course, counsel for respondents or their clients are provocative.

To guard against the possibility that complaints about the conduct of the Commission's staff might be justified the

Committee recommends that the Commission give continuing attention to the conduct of investigations.

Various methods of overview were suggested ranging from interlocutory administrative review during the course of an investigation to the installation of some kind of ombudsman.

After consideration of all suggestions received the Committee recommends that the Commission formalize the procedure for auditing the investigative practices and techniques of its enforcement personnel on a continuing basis. To this end the Committee proposes that the Commission designate an official, who would perform a "staff" as distinguished from a "line" function and be responsible directly to the Commission, whose function would be, on a post-audit basis, to determine whether the Commission's policy of fairness, promptness and efficiency in investigative procedures is being observed.

Such an official should be someone who has had wide experience in problems related to investigation and enforcement. Ideally, he would be an experienced person of demonstrated good judgment who has served on the Commission's staff and who is respected by and enjoys the confidence of the staff.

Such an official would not be an ombudsman to whom the public would be invited to complain. Rather he would be a person who could provide the Commission with an independent and continuing appraisal as to how well the Commission's policies are being carried out.

Examples of work assignments for such an official would be (i) informal reports on the merits of complaints made against a staff member arising from an investigation or proceeding, (ii) inquiries into the reasons for protracted investigations, (iii) observation of training programs, (iv) spot checks of subpoenas and investigative records and (v) visits to regional offices and discussions with the Division Directors, Regional Administrators and their principal assistants.

C. Training of Enforcement Personnel

Although a week-long training program for enforcement personnel has been conducted annually in the past several years, the Commission has continued to rely primarily on on-the-job training. The Commission does not have any full time training personnel or special training facilities, nor does it have

a separate budget for training purposes.

The Committee recommends that the Commission substantially upgrade the training program for its enforcement personnel. Because the Commission cannot investigate every complaint or prosecute every violator, economy of effort is essential. By improving the skills and perspectives of its investigative staff and introducing sophisticated techniques, the Commission would increase its efficiency and the overall effectiveness of its enforcement program. Training also serves another valuable purpose. It would tend to assure fair treatment to persons who become involved in Commission investigations and proceedings. A substantial portion of the complaints we referred to earlier are attributable in our view to inexperience and inadequate training in proper investigative techniques.

We suggest that enforcement training be included as a separate item in the Commission's budget and that an allowance be sought for the salaries of a program director, lecturers, and other persons whose assistance may be required. This budget item would also include funds for travel for

regional office personnel and for materials used in connection with the program. A suggestion, which we think has merit, is that the Commission, either by itself or in cooperation with other interested agencies, arrange for the production of films and other visual aids specially designed for training purposes. These would cover such matters as brokerage house operations, investigative techniques and trial preparation and would be available for repeated use both at the headquarters office and in the field.

Inspection and enforcement manuals are important training tools that can also be used as guides in doing field work. The staff has recently completed a new manual for the inspection of broker-dealers and is currently preparing a manual for inspecting investment advisers. Work is also underway on a comprehensive revision of the instruction manual for enforcement personnel. This document, which has not been revised for many years, is a reference guide for, among other things, conducting investigative work, interrogating witnesses, drafting recommendations for action by the Commission and preparing

pleadings. The development of these handbooks is a major step in the right direction. If they are to serve their intended purpose, however, they must be read and applied in practice by field personnel and should be periodically updated and redistributed. There should also be guidance in the use of the manual since any manual will cover a number of subjects not involved in a particular inspection or investigation.

V. Enforcement Actions

The Commission authorizes the institution of an injunction action or administrative proceeding or approves a criminal reference on the basis of a staff memorandum setting forth the findings resulting from the staff's investigation and a recommendation that a formal proceeding be commenced alleging certain violations. In some, but not all, cases the memorandum will have annexed to it a draft of the proposed complaint or order for proceedings.

At the authorization stage the Commission does not attempt to determine factual issues or adjudicate liability. Its function is merely to determine whether a sufficient basis has

been shown for alleging a violation of law. Even if it appears that a violation has occurred, however, the Commission has the discretion to determine whether or not a formal proceeding should be commenced and the form the proceeding will take. When an administrative proceeding is authorized, the Commission must also determine whether it will be public or private. Commencement of a formal enforcement proceeding is a matter that is likely to be of very great consequence to the person or entity named in the proceeding. If the party named, for example, is a corporation whose shares are publicly owned or a large brokerage firm, shareholders, employees or other persons who are themselves in no way responsible for any unlawful conduct may be adversely affected. Moreover, the relief sought by the Commission, even if granted, may not be as significant or as onerous a sanction as the publicity attendant upon the commencement of the proceeding.

Although administrative proceedings are frequently conducted privately, a number are publicly announced. Public proceedings alert investors to possible private rights of action, inform participants in the securities industry of practices considered

by the Commission to be of particular concern and increase public awareness of the Commission's enforcement activities. In cases where those considerations do not apply proceedings may be private without adversely affecting the public interest.

While the public interest often may require that a formal proceeding be commenced and that it be publicly announced, we recommend that the Commission give due consideration in cases which appear to involve honest mistake or good faith efforts at compliance to exercising its discretion against bringing a formal proceeding notwithstanding the appearance of a violation. We also recommend that the Commission adopt a procedure whereby it would issue a formal, but non-public, reprimand in those cases where public investors have not been injured and the Commission is satisfied that the conduct which may have constituted a violation will not recur. We do not expect that the reprimand procedure would be applicable in a significant number of cases or that it would supplant vigorous enforcement of the securities laws or public condemnation of improper conduct. We view it, however, as an additional enforcement tool that should be employed in appropriate cases.

A. Authorization of Proceedings

Pursuant to a 1970 Commission directive, staff memoranda recommending the commencement of an administrative proceeding or injunctive action are required to set forth separately any arguments or contentions on either the facts or the law that have been advanced by the prospective defendant or respondent. This procedure is intended to afford the Commission an opportunity to consider the position of the prospective defendant or respondent on any contested matters prior to the authorization of a proceeding. We are informed that since 1970, staff memoranda have often, but not always, contained a summary of the adverse party's contentions. In some cases attorneys have been permitted to submit, and the Commission has considered, extensive briefs on the law and facts. Although the staff will in some cases advise an attorney of the opportunity to submit his client's contentions, these procedures are generally followed only if the attorney takes the initiative in requesting that his client's views be submitted to the Commission. As a practical matter, only experienced practitioners who are aware of the opportunity to present their client's side of the case

have made general use of these procedures.

The Committee believes that the policy reflected in the 1970 directive is desirable and should be continued. We recommend that, except where the nature of the case precludes, a prospective defendant or respondent should be notified of the substance of the staff's charges and probable recommendation in advance of the submission of the staff memorandum to the Commission and be accorded an opportunity to submit a written statement to the staff which would be forwarded to the Commission together with the staff memorandum. Where such an opportunity has not been afforded, the staff memorandum should so indicate and the reasons therefor. We suggest, however, that the Commission impose appropriate limitations on the number of pages allowed in the adverse party's statement and on the time within which it could be submitted to the staff. In fairness to all persons who may become involved in Commission proceedings, however, we strongly recommend that the procedure adopted be reflected in a rule or published release. Since a prospective defendant or respondent would not be required to present a submission, we do not foresee any substantial question

of prejudgment arising from the Commission's adoption and implementation of the suggested procedure.

The Committee commends, as a means of expediting the adjudication of administrative proceedings, the Commission's policy of requiring that a draft of the order for proceedings be completed prior to, and accompany, the submission of the staff recommendation. The allegations in an order for proceedings state in precise unvarnished terms what the staff is asking the Commission to authorize. To be able to prepare such a document, the staff will have substantially completed the development of its case. Having taken those steps prior to the submission of its recommendation, the staff should be in a position to move ahead promptly with a hearing on the merits after authorization of the proceeding. To facilitate the procedure for presenting the contentions of the prospective respondent the Committee believes that in the ordinary case it would be appropriate for the staff to exhibit a draft of the proposed order for proceedings to the adverse party or his attorney at the time he is advised of the staff's intention to submit a recommendation.

B. Settlement of Matters before the Commission

The Committee recommends that the Commission revise its procedures to facilitate and encourage settlement of Commission proceedings. Opportunity for settlement is mandated by the Administrative Procedure Act, and, generally speaking, settlement is advantageous both to the Commission and the party named in the proceeding. From the Commission's point of view, settlement avoids delay and unnecessary expenditure of staff time and frequently achieves the same regulatory or enforcement effect as an order entered after a hearing. Settlement is also desirable from an adverse party's point of view, because, apart from the costs and expenditure of time involved, a prolonged proceeding is likely to result in repeated adverse publicity and may have other undesirable and, possibly, unintended effects.

In 1970 the Commission altered by internal directive its staff procedures for negotiating settlements. In general, that directive provides that the staff should not initiate settlement discussions or negotiate the terms of an offer of settlement before an action or proceeding has been authorized by the Commission. The staff is also precluded from indicating to

the prospective defendant or respondent the particular recommendation that the staff intends to make to the Commission. We understand that this change from prior practice reflected concern on the part of the Commission that, if a settlement were negotiated prior to the authorization of a proceeding, the Commission might find its discretionary authority regarding the institution of proceedings substantially impaired. Although the Commission could always reject a proposed settlement if the terms did not appear appropriate or if it concluded that a proceeding should not be commenced, we agree that in most cases it would not be satisfactory for the Commission to conduct its affairs on that basis. On the other hand, we believe that the Commission should reconsider its 1970 directive and recommend that it adopt procedures permitting discussions of settlement prior to the authorization of a proceeding. We think that frank discussions between the staff and opposing counsel concerning the staff's conclusions and probable recommendation to the Commission would encourage settlements. We recommend further that, where a settlement is negotiated prior to Commission authorization of a proceeding, direct responsibility for supervising negotiations be placed on the Division Directors

and Regional Administrators and that each offer of settlement receive their approval or comment prior to submission to the Commission.

Offers of settlement negotiated by the regional offices, even in routine cases, are referred to the interested Division before they are presented to the Commission for approval. In a significant number of cases this procedure involves an unnecessary duplication of effort and, on occasion, leads to disagreement between the regional office and the Division and results in withdrawal of the offer. Since the regional office is more familiar with the facts of the case and the circumstances surrounding the settlement, the Committee recommends that the Commission authorize the Regional Administrators to refer offers of settlement in cases not involving novel or difficult issues directly to the Commission. We suggest that a copy of the proposed settlement be forwarded to the interested Division separately and that, with the exception of matters requiring immediate attention, sufficient time be allowed the Division so that it could submit its views to the Commission on any significant policy questions raised by the settlement proposal.

C. Conduct of Proceedings

Unduly protracted administrative proceedings have been a cause of dissatisfaction both to the Commission and to respondents. The Committee believes that modification of certain procedures relating to the conduct of these proceedings would eliminate unnecessary delays without jeopardizing Commission control of proceedings or the rights of respondents. The changes we recommend would facilitate the prompt exchange of information between parties at the pre-hearing stage and would enlarge the control of hearing examiners over the conduct and disposition of proceedings. None of the recommended changes would require legislation.

The failure to exchange information concerning the evidence which the parties intend to rely on at an administrative hearing impedes settlement negotiations and is a material factor in delaying completion of the hearing. When the staff refuses to disclose its evidence or the theory of its case to the respondent's attorney before the hearing, the attorney, not knowing what his client faces, may be unable or reluctant to recommend settlement. A hearing is then required, usually

preceded by various motions or other steps designed to assist counsel in the preparation of his client's case. During the hearing delays are also occasioned while respondent's counsel examines the Division's exhibits and material which under the Jencks Act he may be entitled to use for cross-examination. Upon completion of the Division's case, an adjournment is required in order to afford respondent's counsel time to prepare his client's defense against evidence that may have been brought to his attention for the first time during the staff presentation.

The Committee believes that provision should be made for a pre-hearing exchange of information between the parties under the supervision of the hearing examiner. Although use of discovery procedures of the kind permitted in civil actions under the Federal Rules of Civil Procedure has been suggested as a solution, we suggest a more restrictive approach as a first step toward adoption of wider discovery procedures recommended for administrative agencies by the Administrative Conference of the United States. We recommend that the Commission adopt a procedure under which evidence to be introduced at a hearing, the identity of witnesses and the legal

theories the staff intends to rely on would normally be made available at the request of a respondent, unless good cause were shown to the hearing examiner for the refusal of such disclosure. We suggest that consideration also be given to requiring the exchange of pre-trial memoranda between the parties in which the staff would outline its case and the respondent would respond with an outline of his defense.

Pre-hearing conferences have not fully served their potential to expedite the disposition of proceedings because the provisions of the Administrative Procedure Act ("APA") do not authorize the simplification of issues without the consent of the parties. However, since the Commission has in our view ample authority concerning the conduct of administrative proceedings before it, we believe that the Commission may authorize its hearing examiners to dispose of an issue summarily where no substantial dispute is involved, at least where the rights of third parties are not affected. We also believe that some benefit might be derived by amending Rule 8(d) of the Commission's Rules of Practice. In its present form Rule 8(d) tends to emphasize the limitations imposed on pre-hearing conferences by the APA. We recommend that the rule be rewritten to emphasize

the opportunity for settlement or simplification of the issues at the pre-hearing stage. While a change in the practice rules could not override any statutory requirement of consent, the parties might be more inclined to utilize the pre-hearing conference as a means of achieving positive results.

During the course of a hearing in a multi-respondent proceeding, presentation of evidence by the staff frequently causes questions to be raised concerning the identity of the respondent or respondents against whom the evidence is being offered. Although the evidence in most instances is offered against all respondents, there are a number of instances when it is directly applicable only to one respondent. Since other respondents have no way of evaluating the direct impact of the evidence being adduced, counsel for these respondents usually remain present during the entire hearing. We suggest that consideration be given to the adoption of a rule requiring that in a multi-respondent proceeding the Division, where practicable, indicate at least one day prior to the presentation of evidence the identity of the respondents against whom such evidence is offered. Such a rule might further provide (1) that

a respondent could absent himself during the time that evidence not directly affecting him is presented and (2) that he could recall any witness at his own expense prior to the close of the hearing. Consideration should also be given to a rule by which the Commission or hearing examiner could grant a severance with respect to a particular respondent who is only peripherally involved.

Under Rule 8(a) of the Rules of Practice, provision is not now made for consideration of an offer of settlement by the hearing examiner during the course of a proceeding. Offers of settlement are submitted to, and considered by, the interested Division. While mandatory involvement of a hearing examiner in settlement negotiations would appear to be neither feasible nor desirable, circumstances could arise where the parties themselves might wish to have the impartial views of the hearing examiner for their own benefit or for the benefit of the Commission in its consideration of the offer. We recommend, therefore, that consideration be given by the Commission to amending Rule 8(a) to provide that, upon agreement of the parties, the hearing examiner may be consulted and requested

to express his views regarding the appropriateness of any proposed offer of settlement. The rule we envision would also provide that the hearing examiner could, in his discretion, decline to express any view on the proposed offer.

The present restrictions in the Rules of Practice on the authority of hearing examiners to rule on certain motions and applications unnecessarily encumber and delay the disposition of proceedings. We recommend that consideration be given to eliminating the restrictions on an examiner's authority to rule on motions to amend an order for proceedings or to dismiss the proceeding, in whole or in part, against one or more of the respondents. Frequently in a Commission proceeding the principal respondents will have been eliminated at a preliminary stage by settlement or entry of a default order. If the presiding examiner could entertain a motion to dismiss the proceeding against any remaining respondent and, upon a showing of good cause, act favorably on it, a substantial reduction in the number of proceedings now required might result. We also recommend that limitations on the examiner's power to grant postponements, adjournments and extensions of time to file pleadings

be eliminated. The amendments we suggest would increase the authority of the Commission's hearing examiners and enhance their status in the eyes of the parties without detracting from the Commission's overall control of proceedings. Parties to these proceedings would continue to be protected from erroneous rulings by an examiner through their right to petition for review, and, in appropriate cases, the Commission could review the matter on its own motion.

The Committee believes that the Commission could usefully dispense with writing its own separate opinion in some cases. The Committee recommends that, where the petitioner has not shown circumstances warranting a review de novo or where there is no substantial policy question involved, the Commission should affirm summarily the initial decision of a hearing examiner. This practice is permitted by Rule 17(d) of the Rules of Practice.

D. Sanctions

It is the ideal of law -- certainly that of the administration of justice -- to let the punishment fit the crime. Nothing is more difficult to do. The best that conscientious and

continued effort can do is to arrive at a range of approximations.

The Commission and the staff are always facing the question of what is even-handed enforcement of their powers. As we have indicated above, the ideal of fair and equal enforcement is called into play from the moment a complaint or report is received and questions are raised concerning possible violations of law. We have discussed, in context, the investigative stages, the initiation of proceedings or litigation, and the conduct of the proceedings. We now deal with sanctions.

In broker-dealer proceedings instituted under Section 15 of the Securities Exchange Act of 1934 the Commission may by order censure, suspend or revoke the registration of a respondent if it finds that he has been guilty of certain misconduct and determines that the sanction is in the public interest. Broker-dealer proceedings are generally conducted privately, but a public release is issued by the Commission if the decision is adverse to the respondent. A substantial number of these proceedings are settled by consent prior to any hearing. In

very few of the remaining cases has the respondent ultimately prevailed.

Although any published decision adverse to a respondent will, if nothing more, tarnish a respondent's business reputation, a suspension or revocation may preclude a respondent from engaging in business as a broker-dealer either for a period of time or indefinitely. The suitability of a suspension for any particular number of days cannot be measured by looking solely to the nature of the violation. The suspension of a sole proprietorship for a 10-day period may have the effect of putting the proprietor out of business permanently. The suspension of a large brokerage firm for an equivalent period might not have nearly the same economic impact on the proprietors, but it could involve serious consequences for hundreds of employees who were innocent of any misconduct. Because a suspension would otherwise be an indiscriminate remedy, the Commission generally tries to tailor its sanctions in both settled and adjudicated cases to the circumstances as it finds them. This may mean imposing sanctions on particular individuals as well as the firm, on a particular branch office in lieu of the firm as a whole or prohibiting only certain types of transactions