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Securities and Exchange Commission Historical
Society

Oral Argument U.S. Court of Appeals for the District
of Columbia Circuit

September 9, 2005

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P R O C E E D I N G S

THE CLERK: Case number 304-964. National Association of Securities Dealers, Incorporated, Petitioner versus the Securities and Exchange Commission. Mr. Lawhead is the Petitioner, Mr. Summergrad is the Respondent.

THE COURT: You may proceed, Counsel.

MR. LAWHEAD: Good morning. May it please the Court. I am Alan Lawhead, attorney for Petitioner, the National Association of Securities Dealers. We request 2 minutes of rebuttal time.

NASD asks this Court to remand the SEC's decision to the Commission with instructions to apply the correct legal test. This morning, NASD will address the issue of whether the SEC's decision examined the purpose of the alleged manipulator's actions.

This case involves a --

THE COURT: You need to -- you need to do a lot talking, at least for me, anyway, about standing, how you're here.

MR. LAWHEAD: Yes, Your Honor.

1 THE COURT: A lot of years under this
2 statute, it's never happened before. Right?

3 MR. LAWHEAD: In the context of a
4 disciplinary appeal, that's correct, Your Honor.

5 THE COURT: In the context of an
6 adjudicatory action.

7 MR. LAWHEAD: That's correct, Your Honor.

8 THE COURT: Because there are two review
9 sections, what was it, 25(A) and (B)?

10 MR. LAWHEAD: That's correct, Your Honor.

11 THE COURT: One clearly is about
12 rulemaking, one is about adjudication. B, I think,
13 is the rulemaking. The language is different, the
14 legislative history makes it clear that your
15 organization would be among the parties who could
16 challenge an agency action, right?

17 MR. LAWHEAD: That's correct, Your Honor.

18 THE COURT: 25(A) has completely different
19 language. Aggrieved party?

20 MR. LAWHEAD: No, Your Honor.

21 THE COURT: I mean, what is the -- remind
22 me -- the language in 24(A) is -- ?

1 MR. LAWHEAD: Person aggrieved.

2 THE COURT: Person aggrieved, right. And
3 we, historically in this country unless there's
4 something to the contrary, we don't assume that the
5 lower tribunal can be aggrieved with respect to a
6 decision taken by the higher tribunal that clearly
7 has plenary authority, and the lower tribunal is
8 created by statute, endorsed by statute and clearly
9 subject to the authority of the high tribunal.

10 So, it is not within our system of
11 jurisprudence, as a normal matter, that a lower,
12 Congressionally created or recognized tribunal is an
13 aggrieved party, or an aggrieved person, to
14 challenge the decision of the higher tribunal, and
15 you have two entirely different statutory
16 provisions, here, and legislative history on one
17 that supports your standing, and absolutely nothing
18 except bad history on the other -- history of
19 jurisprudence in the United States, so I don't know
20 how you're here. And you have no history under the
21 statute to support your being here. None.

22 And then, let me just give you the last

1 piece of it, and then I need to hear you respond.
2 Your basic notion on injury -- which is terribly
3 curious to me -- is that, "Well, gee, if we win,
4 we'll get the fine." That's a perverse notion, to
5 suggest that you're injured if you can collect a
6 fine, an adjudicated fine which is subject to the
7 plenary review of the SEC. The SEC determines what
8 the law is, subject to Court review.

9 So, those are my concerns. I don't know
10 how you're here.

11 MR. LAWHEAD: Thank you, Your Honor.

12 Let me start by addressing the question of
13 the statutory text --

14 THE COURT: Right.

15 MR. LAWHEAD: -- between Section 25(A),
16 which applies to this case, a person aggrieved by
17 final order of the SEC in a disciplinary action,
18 similar to the one brought by NASD in this case.

19 The language in 25(B), which applies to
20 SEC rules, and which is, as we discussed, and I'll
21 brief the basis for two petitions for review that
22 NASD has argued against the SEC in this Court, is

1 that a person adversely affected by a rule of the
2 Commission can seek petition in this Court. The
3 difference between the language, "a person adversely
4 affected," and, "a person aggrieved," is of no
5 consequence.

6 THE COURT: No, I don't think so at all.
7 Especially when you tie it to the legislative
8 history. "Adversely affected," is a broader notion.
9 Aggrievement, I think you can argue, is a tighter
10 notion, especially in an adjudicatory provision.
11 One's coming from rulemaking, one's from an
12 adjudication. You have to put it in context, and
13 you have to -- this is where legislative history is
14 helpful. The legislative history clearly points to
15 the fact that NASD would be among the parties who
16 would be adversely affected by a rulemaking of the
17 Agency.

18 And it makes sense. It makes all of the
19 sense in the world. It makes no sense in the world
20 that, as a party who does the first step in an
21 adjudication, under 25(A), you're somehow aggrieved.

22 Because we don't think of tribunals -- lower

1 tribunals -- as being aggrieved if they're reversed.

2 MR. LAWHEAD: Yes, Your Honor. NASD is
3 not appearing before this Court to vindicate its
4 interest as a lower tribunal. NASD's interest as a
5 party to the appeal to the SEC and the party that
6 would collect the fine, and the party that is either
7 allowed to expel these members from NASD membership,
8 or not.

9 The two cases that NASD finds persuasive
10 on this matter are the -- exist under the
11 Commodities Exchange Act -- the Chicago Board of
12 Trade v. The CFTC case and the New York Mercantile
13 Exchange v. The CFTC case. In both of those cases,
14 the courts, in examining Article 3 standing, found
15 that those self-regulatory organizations, who have
16 self-regulatory authority over futures markets,
17 demonstrated both that they had an economic
18 interest, and an interest in self-regulation in
19 seeking to appeal an adverse determination by the
20 government agency that oversees them.

21 In the Board of Trade case, decided by the
22 Northern District of Illinois in 1989, the Court

1 found that the Chicago Board of Trade, that SRO, had
2 Article III standing because the CBOT suffered
3 monetary injury; the \$50,000 fine that it had --

4 THE COURT: That's a Court of Appeals
5 case?

6 MR. LAWHEAD: No, Your Honor, it's a
7 District Court case. The \$50,000 fine that was a
8 result of the disciplinary process within the
9 Chicago Board of Trade was vacated on appeal to the
10 Commodities Futures Trading Commission. The Court
11 found that this fine was the kind of economic
12 interest that had supported constitutional standing
13 under Article III.

14 In addition, the Court went on to find --

15 THE COURT: Normally, with respect to
16 someone who is recognized by Congress as the
17 adjudicator --

18 MR. LAWHEAD: Yes.

19 THE COURT: -- and subject to the rules,
20 in the context of adjudication of the higher
21 tribunal.

22 MR. LAWHEAD: Yes, Your Honor, unlike --

1 THE COURT: -- of course, economic
2 betterment is normally con -- or loss of it, is
3 considered to be injury in Article III, but you're
4 taking it out of context of an adjudicatory process
5 that's set up by Congress, and the SEC is clearly
6 the higher tribunal. And the CADC is subject to the
7 SEC's final determination on the law.

8 MR. LAWHEAD: Unlike the lower tribunal,
9 the fine in this instance is payable to NASD. The
10 collection efforts, to collect that \$50,000, would
11 be undertaken by NASD. A lower tribunal --

12 THE COURT: If upheld.

13 MR. LAWHEAD: If upheld. That's correct,
14 Your Honor.

15 THE COURT: I thought your argument was
16 the NASD was not challenging the decision as the
17 adjudicator, but that it had a broader interest in
18 protecting the integrity of the market, and that
19 this decision of the SEC undermined that interest.

20 MR. LAWHEAD: Yes, Your Honor, that's also
21 correct.

22 THE COURT: Isn't that your position?

1 MR. LAWHEAD: Yes, Your Honor.

2 THE COURT: Why don't you talk about that
3 a little bit?

4 THE COURT: Is that 25(B)?

5 MR. LAWHEAD: No, this is 25(A) interest
6 that we're asserting, Your Honor.

7 NASD submitted an affidavit from its vice
8 president in charge of the legal section of NASD's
9 Market Regulation Department. This Department has
10 authority for bringing this type of case. Mr.
11 Richard Wallace's declaration states that, "an
12 inability to appeal the SEC's decision in this case
13 would undercut NASD's market regulations ability to
14 bring similar cases.

15 "Manipulation cases that the Market
16 Regulation Department is encountering in this age --
17 "

18 THE COURT: That's a strange -- I mean,
19 that's a strange argument. You're not the agency as
20 -- I mean, the organization as an adjudicator in the
21 Congressional scheme. It doesn't exist apart from
22 the SEC; it exists subject to the SEC. And so, it's

1 not like 25(B), where this grand participatory
2 scheme, which is typical in rulemaking, where
3 everybody contributes and the Agency is forced to
4 listen and then they come up with policies. We are
5 in the context of an adjudication, prescribed by
6 Congress. And I -- it's a perversion of notions of
7 injury beyond anything I've ever seen. That's why,
8 I think, the case has never come up.

9 MR. LAWHEAD: Your Honor --

10 THE COURT: The 2nd Circuit gets a lot of
11 these cases, right?

12 MR. LAWHEAD: Your Honor, we've never
13 filed such an appeal before this Court, there's no
14 adverse --

15 THE COURT: I can understand why. It
16 makes no sense. There's no case I've ever seen.
17 This is a perversion -- I understand you have a
18 District Court case -- which doesn't move me, in the
19 slightest -- but there isn't any case law to support
20 this. None. I've looked; I can't find anything.
21 It's such a perverse notion in the context of a
22 Congressionally prescribed adjudication.

1 Not in the rulemaking; I understand your
2 interest there.

3 THE COURT: Can you -- I'm sorry. Can you
4 describe the relationship between the NASD as a
5 regulator, and the SEC? And what I'm getting is,
6 does the NASD have any authority outside of that SEC
7 umbrella to bring disciplinary actions? Or is your
8 authority to do that derivative?

9 MR. LAWHEAD: Respectfully, Your Honor,
10 our authority is not derivative. The review
11 provisions assume that the self-regulatory
12 organization creates its own enforcement program,
13 hires its own enforcement lawyers, and brings cases
14 through a tribunal. The review section says, once
15 there's a final decision of NASD, then it is
16 appealable to the SEC. NASD's decision on which
17 cases to bring, its allocation of resources in terms
18 of how many cases it brings, and the authorization
19 to file those complaints, the briefing before the
20 NASD have no involvement with the Securities and
21 Exchange Commission whatsoever.

22 THE COURT: Well, I guess what I'm asking

1 is, as I understand the way this is organized, the
2 SEC could be directly the regulatory agency, or it
3 could have this intermediary, which it does have.
4 But the authority that's being exercised, it seems
5 to me, ultimately belongs to the SEC. Now you're --
6 obviously you take issue with that.

7 MR. LAWHEAD: The statutory scheme of the
8 Securities Exchange Act envisioned self-regulatory
9 organizations policing their membership beyond the
10 requirements of law, and beyond the requirements of
11 merely the 1934 Act. A bedrock rule in the NASD
12 arsenal in bringing cases is that member firms must
13 abide by just and equitable principles of trade.
14 The case law demonstrates that NASD is able to bring
15 those cases -- which can involve business practices
16 that NASD by rule, or by case law, has deemed
17 unethical, and bring them against members, seek to
18 collect fines, or suspend or expel those members,
19 and those violations aren't the enumerated sections
20 of the 1934 Act.

21 THE COURT: And why would the decision
22 here affect that?

1 MR. LAWHEAD: Your Honor, because this
2 decision is -- NASD found that there was a violation
3 of Section 10(B). That element of the --

4 THE COURT: No, but why would --

5 MR. LAWHEAD: -- is not a --

6 THE COURT: -- why would it affect -- why
7 would it adversely affect NASD's ability to apply
8 its own ethical standards? For just and equitable
9 here?

10 MR. LAWHEAD: That's not the scope of our
11 argument before this Court. It's that the
12 interpretation of Section 10(B) as promulgated in
13 the SEC's decision is binding on NASD, and NASD's
14 national adjudicatory council would be required to
15 follow the Allegheny decision, and would therefore
16 sweep away a significant subset of manipulation
17 cases, which involve --

18 THE COURT: So what to the law? Your
19 organization doesn't establish the law. Your
20 organization acts within the law, and the SEC has --
21 and the legislative history dealt with this whole
22 argument. I mean, self-regulatory organizations

1 exercise authority subject to SEC oversight. They
2 have no authority to regulate independently of the
3 SEC's control. End of conversation. There's no
4 confusion, I mean, I found this case so curious, I
5 kept looking around -- there's no confusion on that
6 point. You don't have an independent interest apart
7 from the SEC on the matters that we're talking
8 about. I have no doubt that you have an interest in
9 what they do, and you may be annoyed with some of
10 their rulings, but that's of no moment.

11 MR. LAWHEAD: Your Honor, to return to
12 your point that the difference between NASD's
13 interest in a rulemaking and its interest in
14 adjudication should be determinative in this case;
15 the interests are similar. In the appeal that NASD
16 took to this Court in 1986 involving Instanet, the
17 SEC's ruling was that the fees that NASD proposed to
18 charge Instanet were too high, and struck down those
19 fees. And they do that pursuant to their authority
20 under Section 25(b) for rulemaking.

21 One of the responsibilities of self-
22 regulatory organization and NASD's responsibility,

1 at the time, was to run the NASDQ stock market. The
2 corresponding responsibility of self-regulatory
3 organizations is to police -- is to be the front-
4 line organization that polices the conduct of its
5 members. That interest -- the interest of being
6 able to have Court review over whether the SEC's
7 determination of defining manipulation is correct or
8 not, is the issue that NASD would like reviewed by
9 this Court.

10 THE COURT: Well, it seems to me that's a
11 Congressional matter. Because the scheme that
12 they've put in place will not admit of it in some
13 instances.

14 MR. LAWHEAD: Your Honor, the language
15 supporting section 25(A) defines the term person,
16 which NASD fits within. A person includes a
17 corporation, NASD is a Delaware non-profit --

18 THE COURT: Except that you're not called
19 a corporation under the statute. You're called,
20 what? A self-regulatory -- what is the word?

21 MR. LAWHEAD: That is correct, a self-
22 regulatory organization.

1 THE COURT: That's what I'm looking at.
2 And a self-regulatory organization, the legislative
3 history is identified precisely under 25(B), not
4 under 25(A).

5 MR. LAWHEAD: None of the statutory
6 provisions, nor the rules clarify that the word
7 "aggrieved person" should be -- that self-regulatory
8 organization should be excluded from that
9 definition. Congress has used the broadest possible
10 term to include all aggrieved parties to give them
11 an opportunity to appeal.

12 THE COURT: It's absolutely clear there's
13 nothing that's cold in this case when you look at
14 the language. It isn't absolutely -- neither one of
15 you can win just looking at the language, so you
16 have to put it in a context. And the context here,
17 is we don't allow lower tribunals to challenge
18 higher tribunals who have authority over them in an
19 adjudication. We just don't.

20 And so, what is it here that changes that
21 history in our country? Nothing that I can find.

22 MR. LAWHEAD: NASD status changed from the

1 adjudicator to a party interested in the dispute
2 when its decision was appealed. It was able to
3 participate in the briefing of the case as a party
4 before the SEC and if it prevailed, as a private
5 party does, it would have been able to seek
6 collection of the award that it had an interest in.

7 THE COURT: Let me ask you this, I keep
8 looking back at the Wallace affidavit, here. You
9 say, he says it would -- he said this decision would
10 undercut NASD's mission because it impairs its
11 ability to self-regulate by expelling or otherwise
12 disciplining brokerage firms.

13 Now, is that effect on NASD's ability to
14 perform its mission any broader than this decision
15 itself?

16 MR. LAWHEAD: Yes, Your Honor.

17 THE COURT: Well, would you -- that's what
18 I want you to explain.

19 MR. LAWHEAD: Mr. Wallace's declaration
20 explains that in his experience, market manipulators
21 constantly involve the schemes that they use to
22 attempt to manipulate the market.

1 NASD's understanding of this decision is
2 that other than a domination and control
3 manipulation, the SEC says evidence demonstrating
4 that a market maker is publishing fictitious quotes
5 is not sufficient because of the short duration and
6 other factors, that this kind of manipulation, a
7 smaller scale, short-term manipulation, is --
8 pursuant to the Allegheny decision -- not a
9 violation of Section 10(B). That affects a segment
10 of NASD's enforcement program that surveils the
11 market and develops the evidence to bring cases that
12 there was manipulation.

13 THE COURT: You mean, because you won't be
14 able to bring cases like this one?

15 MR. LAWHEAD: Yes, Your Honor.

16 THE COURT: Because they don't see it as a
17 violation of the law?

18 MR. LAWHEAD: Right, yes.

19 THE COURT: Well, gee, that's what
20 happens. The higher authority decides what the law
21 -- the confines of the law are and then those of us
22 who are in the regulated area have to live with

1 that.

2 MR. LAWHEAD: Similar to a respondent
3 being able to appear before this Court as petitioner
4 and have the Court review whether the SEC applied
5 the correct law or not, NASD -- in its capacity as
6 attempting to regulate its market -- would like a
7 similar -- asks this Court for a similar review,
8 whether the legal standard applied by the SEC was
9 correct, or not.

10 THE COURT: Okay, your time is up. I'll
11 give you little time on rebuttal. Thank you.

12 MR. LAWHEAD: Thank you, Your Honor.

13 MR. SUMMERGRAD: May it please the Court.
14 I am Eric Summergrad, representing the Securities
15 and Exchange Commission.

16 THE COURT: Any Court of Appeals ever
17 decided this before? This ever come up?

18 MR. SUMMERGRAD: No. This is a completely
19 novel issue. The NASD has been in existence for
20 almost 70 years and they've never sought to bring a
21 petition for review to reverse an SEC disciplinary
22 decision. They have brought some cases, including

1 three in this Court, involving their status as a,
2 basically, their commercial status, such as charging
3 fees for information, matters having nothing to do
4 with disciplinary proceedings, or where the
5 Commission has authorized actions by a potential
6 competitor, I think, with banks in one case, that
7 would conflict with, and compete with commercial
8 undertakings by their members. And, in that case
9 they were granted representational status.

10 But, this is an extraordinary expansion of
11 -- attempt to expand their authority to come into
12 court.

13 THE COURT: Is there any difference
14 between this case and the one in Chicago that led to
15 the District Court decision?

16 MR. SUMMERGRAD: The -- District Court
17 decisions before this, involving the CFTC --

18 THE COURT: Yeah.

19 MR. SUMMERGRAD: First of all, only
20 involved the issue of injury in fact. Something
21 we're not disputing here, not that we necessarily
22 agree that there's any injury in fact, but it

1 doesn't seem worthwhile to get into a detailed
2 analysis of that since prudential standing is so
3 clearly unavailable to the NASD. In those cases,
4 the CFTC -- for what reason I don't know, perhaps
5 their statutory structure is different --

6 THE COURT: Mm hm.

7 MR. SUMMERGRAD: Didn't raise anything
8 beyond injury in fact.

9 THE COURT: Let me ask you this. Suppose
10 NASD didn't have this adjudicatory function.
11 Suppose the adjudicatory function was carried out by
12 SEC administrative law judges through the Agency's
13 own enforcement mechanism, okay?

14 MR. SUMMERGRAD: Mm hm.

15 THE COURT: And NASD is a membership
16 organization just like it is; it runs NASDQ.

17 MR. SUMMERGRAD: Right.

18 THE COURT: And this same decision had
19 been issued by the SEC. Would it be a person
20 aggrieved?

21 MR. SUMMERGRAD: It certainly wouldn't be
22 a person aggrieved --

1 THE COURT: Why is that?

2 MR. SUMMERGRAD: The Commission -- well,
3 they wouldn't even be involved in the case. If the
4 Commission brought a manipulation case --

5 THE COURT: Why wouldn't they be a person
6 aggrieved? Because their argument would be that
7 this decision undermines its ability to regulate
8 NASDQ and ensure ethical and honest behavior.

9 MR. SUMMERGRAD: If they had regulatory --
10 if they had some sort of adjudicative authority --

11 THE COURT: No, no. They don't. No, my
12 hypothetical is that they don't have an adjudicatory
13 authority.

14 MR. SUMMERGRAD: Mm hm. No, I don't think
15 that they would be a person aggrieved.

16 THE COURT: Why?

17 MR. SUMMERGRAD: Well, you have to look
18 back at the history of the statute --

19 THE COURT: Well, you put it in a -- if
20 they were allowed to intervene --

21 MR. SUMMERGRAD: Yes.

22 THE COURT: -- then they would be a party

1 aggrieved who could come to court. Because your
2 answer -- I'm trying to make sure I understand what
3 your answer is, and how we're framing this
4 hypothetical off. They have no self-regulatory
5 authority under the statute to adjudicate. The
6 interesting question would be, could they -- in the
7 adjudication -- insist that the SEC allow them to
8 intervene?

9 MR. SUMMERGRAD: Right.

10 THE COURT: And, if so, presumably, they
11 would have the ability to appeal to court because
12 they intervened in the proceeding. The question is,
13 whether they would be allowed to intervene.

14 MR. SUMMERGRAD: Well, if they were
15 allowed to intervene, I can't imagine why they would
16 be allowed to intervene. To merely duplicate what
17 the SEC is doing independently.

18 THE COURT: If they were allowed, I don't
19 know what the answer --

20 MR. SUMMERGRAD: If they -- well, no. I
21 don't necessarily agree, because the mere fact that
22 they have party status before the SEC doesn't mean

1 that they have the authority to challenge the SEC's
2 determination. And, I guess, at this point, it's as
3 good as any, I wanted to bring to the Court's
4 attention a case -- and I bring it to your attention
5 with some reluctance, because we didn't cite it in
6 our brief, and perhaps the NASD could be allowed to
7 submit a letter post-hearing. But, in 1955, and
8 this is a case that is still good law, in a case
9 called Lee v. Civil Aeronautics Board, the cite is
10 225 F.2nd 950, this Court held that the
11 administrator of civil aeronautics, who was a party
12 before the Civil Aeronautics Board, and had filed an
13 enforcement proceeding with the Civil Aeronautics
14 Board to revoke pilot's licenses, and that case was
15 dismissed by the CAB, this Court held that the
16 administrator was not allowed -- did not have
17 standing to appeal that to this Court.

18 THE COURT: Okay, that's like Newport
19 News.

20 MR. SUMMERGRAD: It is not because, now,
21 one of the --

22 THE COURT: We don't have that -- we don't

1 have that, here. We don't have a government agency.

2 MR. SUMMERGRAD: One of the -- well,
3 first, one of the distinctions between this case the
4 Newport News is that the person seeking to appeal is
5 a party. And one of the points that the NASD made,
6 they said we were a party before the Commission in
7 this proceeding, how come we can't seek review? And
8 I think this case makes clear that the lack of
9 standing doesn't only apply to non-parties.

10 But the -- these cases -- this case, and
11 Newport News -- involve government entities. But
12 this case is about as close as you can get to that,
13 without actually involving a government entity.

14 THE COURT: Well, but that's a pretty big
15 difference. Because in Newport News, I mean, as you
16 read the decision, it's very clear that what the
17 Supreme Court was worried about there was having the
18 Federal courts involved in interagency or intra-
19 agency policy disputes.

20 MR. SUMMERGRAD: Yes.

21 THE COURT: We don't have that, here.

22 MR. SUMMERGRAD: Well, we have something

1 that is --

2 THE COURT: Well --

3 MR. SUMMERGRAD: -- as close to that as
4 you can get, and perhaps even of great --

5 THE COURT: -- but it isn't that --

6 MR. SUMMERGRAD: well, perhaps even of
7 greater --

8 THE COURT: And why is that?

9 MR. SUMMERGRAD: Well, you have to look at
10 the history of the way the NASD came about. In
11 1938, Congress adopted the Maloney Act creating
12 securities associations, the NASD was the only --
13 and they vested in the securities association what
14 they have repeatedly referred to as "government
15 authority." Now, they're not a government actor,
16 and it's the difference between the test, like,
17 under Lynn Braun as to who was a government actor,
18 and whether somebody is exercising government
19 authority.

20 Now, what you had was --

21 THE COURT: But, you see, but there -- I
22 understand all of that. But there -- and, because

1 we don't have a lot of time -- their argument is,
2 you know the government -- the government's interest
3 here and -- they're saying, "Look, this is different
4 from a subordinate adjudicator challenging a
5 superior -- a senior adjudicator's decision, because
6 here the interests are different. The SEC's
7 interest is in enforcing the law. The Association's
8 interest, here, it runs NASDQ; it has a different
9 interest than the government.

10 And so, it's argument is that this
11 decision -- we're not challenging -- we're not
12 appealing to challenge the SEC's reversal of our
13 decision, per se, we're challenging it because of
14 its adverse effect on our ability to manage and run
15 NASDQ properly.

16 MR. SUMMERGRAD: Then, I believe, they
17 misunderstand what their status is. Because in this
18 regard, Congress made it clear that it was vesting
19 in them, government authority to discipline. And
20 the reason why it was vesting government authority -
21 -

22 THE COURT: But at that time it didn't run

1 NASDQ.

2 MR. SUMMERGRAD: -- was they -- but they -
3 - they don't claim -- they don't claim --

4 THE COURT: They didn't run NASDQ at that
5 --

6 MR. SUMMERGRAD: -- that this has anything
7 to do with NASDQ.

8 THE COURT: They didn't run NASDQ at that
9 time?

10 MR. SUMMERGRAD: At that time it was -- at
11 the time that they were created, the over-the-
12 counter market was done over the telephone.

13 THE COURT: Right.

14 MR. SUMMERGRAD: But, the -- what the
15 debate was in 1938, was should this power be vested
16 exclusively in the SEC, or should it be vested in a
17 private organization? And the determination was
18 that it was more efficient to put the initial matter
19 in the hands of a private organization. They would
20 decide who to charge, they would do the
21 investigation, they would bring the charges, they
22 would reach an initial decision.

1 But it was also of concern, one, that
2 because they were going after their competitors,
3 that there might be some element of bias in their
4 proceedings, but more importantly, there's a
5 significant constitutional question as to how a
6 private organization comes to exercise government
7 power.

8 And three courts, the 2nd and 3rd Circuit,
9 have looked at this since 1952, and all of them held
10 that the only reason why they were upholding the
11 constitutionality of this power was because the SEC
12 was standing there -- as Justice Douglas put it in
13 his memorable phrase -- "the well-oiled shotgun
14 behind the door ready to ride herd." And as the
15 legislative history from 1975 that we quote in our
16 brief says, that the SEC's function is to make sure
17 that the NASD doesn't do something that is contrary
18 to the public interest, or that's unfair to the
19 people it prosecutes.

20 So, as a result, the SEC was vested with
21 enormous power over the NASD. We had to approve
22 their rules, we have to approve their rule changes

1 dealing with their proceedings, and we not only have
2 authority to review what the NASD does, but we
3 review independently, both as to facts and to law.

4 THE COURT: But doesn't Newport News at
5 least suggest that even a government agency -- an
6 agency that's clearly governmental -- might have an
7 ability to bring a suit where it's a market
8 participant or, in other words, is participating
9 outside that role? And isn't that what is being
10 argued here?

11 MR. SUMMERGRAD: No. That's not what they
12 -- they do not argue that they have a commercial
13 interest. As I said, previous cases they brought in
14 this court, they clearly did have a commercial
15 interest.

16 What they argue is that, in the affidavit
17 they submit in their brief and their entire argument
18 is that, the SEC -- by reversing them -- is
19 impairing their ability to protect the public
20 interest by going after manipulators.

21 THE COURT: I mean, par it down, this case
22 is really, "You reversed us."

1 MR. SUMMERGRAD: Yes.

2 THE COURT: And so you put it in that
3 context. That's all they're saying. That there are
4 collateral -- there may be all kinds of collateral
5 consequences, but the only reason is -- they're
6 here, is not on some broad rulemaking notions, "You
7 reversed us in this adjudicated matter. You
8 reversed us."

9 MR. SUMMERGRAD: Yes.

10 THE COURT: "And we, the lower tribunal,
11 are angry that you did that, because we had a
12 different view on the case."

13 THE COURT: Yes.

14 THE COURT: I thought Newport made it very
15 clear, there may be cases where we'll allow that,
16 but it better be very clear in the statute.

17 MR. SUMMERGRAD: Yes.

18 THE COURT: And I don't see any clarity in
19 the statute.

20 MR. SUMMERGRAD: I think Congress intended
21 exactly the opposite. And --

22 THE COURT: Then that 25(B) then, is a

1 different -- but 25(B) allows them full
2 participation in all of the rulemaking --

3 MR. SUMMERGRAD: I think the history --
4 yes.

5 THE COURT: -- petition for rulemaking --

6 MR. SUMMERGRAD: Yes.

7 THE COURT: -- and they can participate in
8 rulemakings and they can state their views --

9 MR. SUMMERGRAD: Yes. And they have, I
10 think, in other cases.

11 The -- what is remarkable about their
12 argument, and I think we almost viscerally reacted
13 to it, is that they posit themselves as the
14 protector of the public interest, and that we are
15 somehow interfering with them exercising their role,
16 never acknowledging that that is our function, also.

17 THE COURT: I have a question on the
18 merits.

19 THE COURT: -- function as a plenary
20 matter. That's what's curious about this case. And
21 the legislative history you point to make it clear
22 that it's not a partnership. And they're allowed to

1 adjudicate initially, but subject to your clear
2 plenary authority and review.

3 MR. SUMMERGRAD: Yes, that's correct.

4 THE COURT: Let me ask you a question on
5 the merits.

6 MR. SUMMERGRAD: Yes.

7 THE COURT: Can you give me any
8 explanation at all for Elgin E.'s behavior that's
9 innocent?

10 MR. SUMMERGRAD: Yes.

11 THE COURT: Please do that.

12 MR. SUMMERGRAD: It was an extraordinarily
13 active market. And this is not -- the Commission
14 didn't decide this, but this was part of his
15 explanation. He said he came in, the market was as
16 extraordinarily busy as he had ever seen it. And he
17 said -- leaving aside this excess spread rule and
18 whether he believed that that still applied or --

19 THE COURT: Which didn't apply. Which
20 didn't apply.

21 MR. SUMMERGRAD: It didn't apply, but it
22 had just been changed a few months earlier.

1 THE COURT: But it didn't apply.

2 MR. SUMMERGRAD: Yes. But that -- but the
3 Commission --

4 THE COURT: And -- and he lied -- and he
5 lied about his computer, right?

6 MR. SUMMERGRAD: That's right.

7 THE COURT: Okay. So, now what's the
8 explanation?

9 MR. SUMMERGRAD: The explanation is, he
10 said -- and this hasn't been disputed -- that it was
11 far easier, technically, for him to raise his offer
12 and his bid at the same time.

13 THE COURT: But he said that was driven by
14 the excess --

15 MR. SUMMERGRAD: No, he said two things.
16 He said one, that it was driven by the excess spread
17 rule. Second, he said that it was technologically,
18 on his cranky computer --

19 THE COURT: Because he lied about the
20 computer. There is no explanation for what he did.

21 MR. SUMMERGRAD: No, he lied -- what he
22 lied about was, one, whether the excess spread rule

1 applies -- maybe he knew, maybe he didn't, but
2 that's beside the point -- two, he definitely lied
3 about his computer warning him --

4 THE COURT: Okay, so what's the --

5 MR. SUMMERGRAD: -- but he also said that
6 all he had to do to raise the offer and the bid
7 simultaneously was to push one button. And you have
8 to remember, this was an extraordinarily busy market
9 and this all supposed fictitious bids were made
10 right after he came in, in the mid-morning of
11 October 9th.

12 You know, he also -- I mean, I could
13 speculate as to other reasons. He may have thought
14 that regardless of whether he could propose a wider
15 spread that it would look suspicious to the market;
16 that it would tip off that he really didn't think
17 much of this stock, which in and of itself --

18 THE COURT: Excuse me, is that in the
19 SEC's decision?

20 MR. SUMMERGRAD: No, no. I'm just saying
21 the SEC --

22 THE COURT: Well, I was asking --

1 MR. SUMMERGRAD: -- did not --

2 THE COURT: -- all right --

3 MR. SUMMERGRAD: -- did not offer any
4 reason, but that wasn't its job. Its job was to
5 determine whether he had engaged in manipulation.
6 Not to explain what his innocent reason was. We're
7 not his lawyers, we, you know, don't have to --
8 don't have to do that. But unless the NASD can show
9 that the only reasons could have been he manipulated
10 or he had this excess spread explanation, and that
11 having disproved the excess spread explanation --

12 THE COURT: But that's what the NASD --

13 MR. SUMMERGRAD: -- and that he
14 necessarily manipulated.

15 THE COURT: But that's what the NASD's
16 decision did. The NASD's decision --

17 MR. SUMMERGRAD: No. It didn't discuss
18 these other explanatory reasons. Now -- and they
19 didn't really posit them or discuss them before the
20 Commission.

21 THE COURT: What, the excess spread rule?

22 MR. SUMMERGRAD: They just explained that

1 -- that one explanation. They focused on his one
2 false explanation, but as they point out, he gave a
3 lot of explanations, and they never debunk any of
4 the others.

5 THE COURT: Like which ones?

6 MR. SUMMERGRAD: Like the fact that it was
7 -- he didn't have to -- he would have had to program
8 his computer differently in order to widen the --

9 THE COURT: Which you just conceded he
10 lied about.

11 MR. SUMMERGRAD: No. Maybe I'm having
12 difficulty explaining it. One was, what he lied
13 about was whether the computer automatically
14 notified him that he was posting an excess spread.
15 This was an explanation that, even if it didn't warn
16 him, he -- it was difficult -- he had to do more
17 than just push a single button in order to widen the
18 spread. And that he was -- he was lazy, basically.

19 THE COURT: Time is up. Any more
20 questions?

21 THE COURT: No.

22 THE COURT: Okay, thank you.

1 How much time?

2 THE CLERK: [Inaudible.]

3 THE COURT: I'll give you a minute,
4 Counsel.

5 MR. LAWHEAD: Thank you, Your Honor.

6 Judge Tatel, on your point, NASD's
7 position is that the Commission's failure to
8 discuss, at all, the fact that the trier of fact
9 found Al Gindy had no credibility, is reversible
10 error in and of itself, particularly in this case,
11 when the issue was, what was his intent in entering
12 those false, high bids. And the Commission's
13 decision doesn't discuss at all what the finder of
14 fact determined, judged the credibility of his
15 explanation to be.

16 Let me return to one point from the
17 declaration we've submitted in support of our
18 standing. Richard Wallace's declaration reiterates
19 that NASD's mission is to bring integrity to the
20 market and confidence to investors. That's the
21 interest that NASD seeks to have this Court review,
22 in deciding which cases to bring, and in having

1 those cases ultimately dismissed. NASD's reputation
2 and its effectiveness as a regulator of markets is
3 undermined when its cases ultimately result in a
4 defeat.

5 Similar to a respondent who could appear
6 before this Court --

7 THE COURT: That's true of any lesser
8 tribunal. To say, "My gosh, we keep getting
9 reversed, we just don't look good in the public's
10 eyes."

11 MR. LAWHEAD: That's correct.

12 THE COURT: We don't normally allow them
13 to come into appeal.

14 MR. LAWHEAD: Similar to --

15 THE COURT: All kinds of hurt-feeling ALJs
16 out there who have to live with it.

17 MR. LAWHEAD: Similar to the respondent's
18 ability to appear before this court and have the
19 Court determine whether the SEC applied the correct
20 law, or not, NASD should be given the same right,
21 based on its status as a party before the SEC and
22 its interest in bringing integrity to markets.

1 THE COURT: I don't -- 70 years later, all
2 of a sudden somebody got the idea? It doesn't make
3 sense.

4 MR. LAWHEAD: Thank you.

5 THE COURT: You're welcome. The case is
6 submitted.

7 [Whereupon, the Court was adjourned.]

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