REMARKS OF

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BEFORE THE
AMERICAN BAR ASSOCIATION

COMMITTEE ON
FEDERAL REGULATION OF SECURITIES

BUSINESS LAW SECTION

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***The views expressed herein are those of Commissioner Schapiro and do not represent those of the Commission, other Commissioners or the staff.**

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I. INTRODUCTION

Thank you for your kind introduction. It is a great pleasure for me to have been asked to join you this evening. I value the relationship we at the SEC have with the Section on Business Law, particularly with the Committee on the Federal Regulation of Securities and its various ad hoc committees and task forces. Obviously, the ABA is influenced by both private, commercial interests, as well as wider, public goals in the positions it takes. Even when I disagree with your specific positions on issues before the Commission, however, I am always impressed by the long hours you devote to bar activities, and the dedicated service you provide in formulating your views on a wide variety of topics, and sharing those views with the Commission.

II. PROGRESS OF THE TASK FORCE

As said, I have had the privilege of chairing a Task Force on the Commission's Administrative Proceedings, which Chairman Breeden

created the summer before last. Our charge was to review the rules and procedures relating to administrative proceedings brought before the Commission, to consider whether litigants have adequate information about the Commission's processes, and to determine whether new rules or procedures would be appropriate to improve the effectiveness of the administrative process. The organizational meeting of the Task Force was held in August, 1990. Although the Congress had not yet passed the Securities Enforcement Remedies and Penny Stock Reform Act -- also known as the Remedies Bill -- we anticipated its passage.

In October the Remedies Bill was signed into law, and we expanded the scope of our work to consider issues raised by the Bill. In particular, this meant recommending procedural rules to facilitate the conduct of temporary cease and desist proceedings, and adapting existing rules of practice to account for the possibility of post-trial proceedings with respect to the distribution of disgorgement funds.

I do want to share with you some of the thinking of the Task Force on substantive issues. But first, perhaps I can answer the question I have already been asked several times in conversations tonight, "how far along is the Report?" The credo of the Task Force on Administrative Proceedings has been, "Justice Delayed is Justice Denied." So too, of course, for task force reports. My fondest hope when we began this process last summer was that a report and recommendations would be out within a year. When the Remedies Bill was passed, and the budget stalemate put a hold on our work for much of the Fall, I still anticipated that our Report would be complete by now.

A discussion draft was circulated to the Commission in August, just about the time Salomon Brothers was announcing that it had violated Treasury bidding rules. Unfortunately, though very understandably, the government securities market investigation, the related calls for legislative reforms and unexpected issues relating to banking and financial services reform have delayed Commission consideration of the Report.

Also, while the draft Report may be interesting -- to devoted securities practitioners, at least -- it is not a quick read. Not surprisingly, given the arcane nature of the subject matter, the draft is long -- over 400 pages. The existing Rules of Practice comprised almost 90 typed pages. The redlined version of the proposed new rules of practice, which include explanatory notes, are twice that length. I am still hopeful, however, that the Report will be considered by the Commission this year and issued early next year.

Because the Report is only in draft, the standard SEC disclaimer is particularly apt: the comments I have on the administrative process should be regarded as mine alone. I myself have not committed to particular positions in some areas. I want to hear in greater detail the views of the Chairman and my other colleagues on the Commission, as well as members of the staff before the report is released for comment.

While Commission consideration of the Report has not been completed, we have not waited to take steps to improve the

administrative proceedings process. Those steps are already having effect. The Chairman, the Commission and the staff have placed renewed emphasis on reducing the backlog of pending adjudicatory matters, and improving the efficiency of the administrative proceeding process. Preliminary recommendations made by the Task Force to the Chairman last January focused on the need to assign additional attorneys to work on adjudicatory matters. As a result of the increased staff, in the fiscal year just ended on September 30, the Commission issued 24 adjudicatory opinions, a 33 per cent increase over the 18 opinions issued in fiscal year 1990. In the first month of the new fiscal year we have already issued 4 opinions, approximately 6 more opinions have already been drafted and will be considered by the Commission in the coming weeks. A large number of additional opinions are in the pipeline. If changes continue to be implemented, this year should bring continued, and marked improvement in the Commission's timely disposition of cases.

My assessment is not entirely upbeat, however. Ironically, the increased efficiency and the increased resources committed to the

preparation of adjudicatory opinions by the Office of the General Counsel have further highlighted the Commission's own shortcomings in deciding, revising and issuing opinions in timely fashion once they reach our desks.

III. PROBLEMS OF DELAY

The Task Force reviewed over 200 administrative proceedings decided by the Commission over the eight fiscal years from 1983 through 1990. With a few exceptions, in which regulatory matters were at issue, these proceedings concerned Commission enforcement actions or self regulatory organization ("SRO") disciplinary proceedings. We considered issues of fairness as well as efficiency. We found, however, that the principal deficiency in the Commission's administrative process was the undue delay which attends both the resolution of cases brought by the Commission and those before the Commission for de novo review of a disciplinary decision by an SRO.

Since the mid-1980s, in the Commission's own administrative proceedings the average time from institution of a case to final decision by the Commission was over 1,000 days. For SRO disciplinary cases reviewed by the Commission the average time from filing of appeal to a final decision by the Commission is approximately 800 days.

While the problems with the administrative hearing process are real, and numerous changes have been and should be implemented to reduce delay, the effect of any deficiencies in the current procedures should not be overstated. The problem of delay has been largely confined to those administrative proceedings that are actually litigated -- under four percent of all the more than 1,000 administrative actions brought by the Commission and 9,000 actions brought by SROs over the past eight fiscal years.

As I mentioned, the Task Force advised the Chairman that a principal cause of the undue delay in the Commission's adjudicatory program was an insufficient number of attorneys assigned to the

Office of Adjudication. That office was cut from nine attorneys to four between 1977 and 1982. Since late 1989 the number of attorneys has been increasing; as a result of additional hiring ordered by the Chairman based upon the Task Force's suggestions. The Office will have ten attorneys by the end of the year. We have also created a new associate general counsel position to head up the Adjudication Office, and created additional senior staff positions within the Office, so there will be sufficient leadership and management skills to improve the productivity of that office on a permanent basis. In addition, I asked for the creation of a position for a law clerk to the Administrative Law Judges and authorization for the hiring of additional clerks as necessary. This has been done.

The Office of the General Counsel also assigned responsibility for reviewing the record in one SRO proceeding to each of 20 staff attorneys, working under the close supervision of the senior OGC staff and members of the Adjudication Group. This effort has made a big difference; it is a program I hope will be institutionalized. Assigning the initial review of an SRO matter to an attorney who, though

experienced, does not generally work on opinion writing provides diversity for the attorney, and valuable insight and fresh thinking to the Adjudication Group.

Of course, hiring additional staff, especially in the short run, is a relatively easy step to take. Someone with a cynical bent might even point out that in future years nothing prevents those staff from being assigned to legislative matters, litigation or some other area with more visibility than adjudication. I do not disagree. The hard task is one which has not been faced. That task is to change the subtle bureaucratic balance by which adjudicatory matters -- which have no externally generated, immutable deadlines, such as a federal court trial date -- have been for at least twenty five years too easily pushed to the bottom of the Commission's agenda.

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Another area where we have acted based on preliminary recommendations is with respect to the wider dissemination of the orders and opinions of our administrative law judges. Not long after

creation of the Task Force was first announced Dick Phillips organized an ad hoc ABA committee to meet with me to discuss the bar's perspective on administrative proceedings. This meeting was extremely useful, and since then there have been a number of less formal opportunities to communicate on the work of the Task Force. One of the most practical suggestions made was that the Commission should be publishing the procedural orders of our administrative law judges.

Prior to October 1990, orders dealing with matters of procedure, such as motions concerning the production or use of evidence, were not published. As a result, proceedings were slowed by the need for counsel to re-brief recurring procedural issues. In addition, lack of published precedent on various procedural matters injects uncertainty, adding cost and delay because counsel cannot predict how recurring trial issues are likely to be resolved. Finally, the lack of published precedent impaired the openness and transparency with which administrative trials should be conducted.

Since October 1990, we have been publishing in the SEC Docket important procedural orders and the initial decisions of the administrative law judges. The orders and decisions are available on both WESTLAW and LEXIS. To provide additional guidance on procedural matters, the Task Force is preparing for publication in the Docket approximately 400 orders, issued by the administrative law judges from 1964 through 1990.

These orders -- 800 pages in length, had to be typeset and proofed. Proofed and corrected orders are at the typesetters, after which they will be printed for distribution in a special SEC Docket issue in early 1992.

IV. REVISIONS TO EXISTING RULES OF PRACTICE

Staffing and management issues are only part of our concern. The Rules of Practice were given equal scrutiny. Certain provisions of the Commission's Rules of Practice have been amended over the last 30 years. However, some rules are seriously out-dated and the

various amendments over the years have left many of the rules out of any logical sequence. One rule still refers to statutory provisions which were eliminated by the 1975 amendments. The Task Force report proposes revisions to virtually all of the Commission's Rules of Practice. These changes serve various purposes: to adapt the language of existing rules to account for the possibility of temporary cease and desist proceedings and other new remedies; to conform the rules to changes in litigation practice before the Commission and under the Federal Rules of Civil Procedure; to reflect technological developments in the preparation of transcripts and methods for service; to improve readability; and to make the administrative process more efficient.

The existing Rules of Practice reflect years of neglect. Outdated procedures delay cases and discourage, fair, transparent litigation. Revision of the Rules of Practice will facilitate faster, fairer hearings. Let me share with you some of the principal changes to the existing rules discussed by the Task Force.

First, are normative guidelines. Several of the existing rules have normative guidelines for the completion of specified administrative hearing phases. We found, however, that while useful in theory, the guidelines were too flexible and too easily evaded to effectively advance the process. Let me give you an example.

One rule states that the administrative law judges are to complete initial decisions within 30 days of the service upon them of the record, or issue an order explaining why additional time is necessary. The Task Force believes this approach -- to proceed or disclose why not -- can be effective in spurring attention to reasonable deadlines. Of course, we assume that someone, at the Commission or in the public, is monitoring adherence to the normative standard, and that the standard is implemented properly.

In the case of the 30 day rule, however, the standard was actually no standard at all, because the official, certified copy of the record was not served upon the ALJs until their opinions were complete. An ALJ can comply with the literal, 30 day requirement of

the rule, even though an initial decision is issued a year and half after the hearing is concluded and final briefs are filed.

This situation is no reflection on our current law judges; they are doing a superb job. This, incidentally, is not only my view, but also a view reflected in comments made by members of your ad hoc committee at our meeting. The situation does suggest a need for new guidelines, and also a fair degree of modesty about what effect any guidelines can have. The Commission that approved the 30 day rule never envisioned that it would eventually operate as it has. Moreover, even had they worked better, the existing guidelines did not address a sufficient number of the key steps in the administrative hearing process; for example, there is no guideline with respect to completion of interlocutory appeals by the Commission.

The guidelines suggested by the Task Force are based on the amount of time different steps have actually taken, on average, over the past eight fiscal years. We underscore that the guidelines are intended only as guidelines. There are cases in which it will be

appropriate to exceed the time periods suggested in the Rules for the completion of particular steps. However, in the overwhelming majority of cases, these guidelines should be followed.

The guidelines are intended to provide an important reference point to the judges and to the Commission in deciding when to grant extensions, or what priority to give to pending matters. The guidelines are also intended to provide a public statement of the priority which the Commission will give administrative proceedings. As such, they also provide a standard against which to measure the efficiency of the administrative process. It will be up to the Bar and the public, as well as the Commission itself, to see that these standards, if adopted, are met.

Second, the Task Force is recommending three significant changes in discovery procedure. First, under the existing rules, subpoenas duces tecum, requiring the production of documents or tangible evidence, are returnable only at the time and place of hearing. This is terribly inefficient because a party who only receives

documents as the hearing begins needs an adjournment to examine, select and copy documents to be introduced at the hearing. Under the proposed rule subpoenas duces tecum would be returnable prior to hearing.

Second, we are proposing a codification of the existing policy of voluntary production of all relevant investigative documents, which is followed by the Division of Enforcement and most, but not all, regional offices. Under this policy, the staff routinely turns over to respondents prior to the hearing all investigatory documents not privileged or otherwise protected from disclosure which are relevant to the allegations made in the order for proceedings.

Third, we propose modifying the circumstances under which depositions may be taken prior to a hearing. Under the current rules depositions may only be taken if it appears to the law judge that the testimony to be elicited will be material, the witness will be unable to appear at the hearing, and the testimony is necessary in the interests of justice. The only purpose of depositions is to preserve testimony

for the hearing, not to conduct discovery. Under this standard, depositions are rarely taken, a result which, we believe, is appropriate given that Commission administrative hearings arise after an extensive investigation, the results of which are available to respondents through document production, including transcripts, Jencks Act production and Brady materials.

We are proposing, however, that pre-hearing depositions, for purposes of discovery, be allowed in two circumstances: where all parties consent and in cases where a temporary cease and desist order has been granted. Normally the staff can conduct full discovery prior to institution of proceedings, and the fruits of this investigative discovery would be turned over to the respondents pursuant to the open files rule. Because of the emergency nature of temporary cease and desist order cases, the staff would not be able to complete discovery prior to entry of the order instituting.

The ad hoc ABA committee that met with me when the Task Force first started argued strongly for permitting deposition discovery,

subject to the supervision of an ALJ. We considered this suggestion very seriously, talking at length to other agencies which have tried such an approach, talking to the staff the Administrative Conference of the United States and evaluating how we could make such a proposal work. However, there was almost universal agreement within the Task Force that there has not been a demonstrated need for allowing pre-hearing discovery depositions, compelled by subpoenas in ordinary cases. The discovery model used for civil court proceedings is based on a commitment to notice pleading which presumes that the plaintiff has not had the opportunity for in-depth inquiry, much less the kind of meticulous law enforcement investigation conducted by the SEC -- usually for years -- before proceedings are brought. We concluded that the analogy to civil practice in the Federal Courts is inapposite, and more importantly, that routine, pre-trial deposition discovery was not necessary, or even a positive factor in insuring maximum fairness.

V. NEW RULES TO IMPLEMENT POWERS UNDER THE REMEDIES ACT

In addition to the existing rules, after October, 1990, it became clear that new rules would be necessary to effectively implement the temporary cease and desist provision of the Remedies Act. While the provisions for temporary cease and desist orders were the most controversial part of the Remedies Bill, the Commission has had summary, temporary suspension power for many years in three other areas. In a provision very similar to temporary cease and desist proceedings, the Commission can temporarily suspend a broker-dealer pending completion of a hearing to determine whether to suspend or revoke a broker-dealer license. The Commission has used this authority about 30 times, though it has not been used since the early 1980s. The Commission can also issue a temporary suspension of a Reg A offering and can temporarily suspend the right to practice under Rule 2(e).

The existing Rules of Practice already include some procedures for use of the Commission's summary suspension power. We considered these existing procedures, and have suggested standards for temporary cease and desist practice that would apply, insofar as logical, to these other summary suspension proceedings.

The current thinking of the Task Force is to recommend rules that provide for the issuance of temporary cease and desist orders ("temporary orders" or "TCDOs") in a manner analogous to the way in which courts issue temporary restraining orders, but which recognize the statutory setting applicable to SEC proceedings.

Simultaneous with a staff request for a temporary order, the staff would file essentially the same documents that would be required for a TRO in most jurisdictions. These include: a motion for a temporary order, a proposed order, an affidavit signed by a member of the staff setting forth the factual basis underlying the request for emergency action, and, if needed, a memorandum of points and authorities. These documents are necessary in most cases in order to provide the

Commission a non-arbitrary, non-capricious and reviewable basis on which to enter a temporary order.

Second, the Task Force discussed what recommendations should be made so temporary orders are effectively used, but limited in use to the statutory purpose of maintaining a status quo pending a final determination on the merits. One new rule would make the existing expedited review procedures which apply to temporary suspension of broker-dealers under Section 15(b)(5) applicable in TCDO cases. In addition, it is my personal view -- but one on which my colleagues on the Commission have not expressed any opinion -- that after a temporary order has been entered by the Commission, and an ALJ has issued an initial decision with respect to a permanent cease and desist order, the Commission should establish a time limit, after which, if Commission review of the initial decision is not completed, the temporary order ordinarily expires. Without such a rule, a temporary order may become permanent simply by Commission inaction. I believe that the Government should bear more of a burden of going forward with its case.

Third, the Task Force has examined procedures to handle disgorgement cases. No new rules may be necessary in this area -- there are no specific rules, for example, under the Federal Rules of Civil Procedure relating to how disgorgement is ordered or a disgorgement pool should be administered. However, procedures are certainly necessary, and the Task Force has explored how disgorgement should be ordered, collected and paid out.

My own preference would be to see procedures roughly analogous to those used in a court setting. The ALJ would order disgorgement, if appropriate, upon a finding of liability. A respondent, or the Division, could appeal. Once the amount of the disgorgement, if any, became final, the ALJ would order the parties, or one party, to submit a disgorgement plan, would hold a hearing on the plan, and then oversee the actual disgorgement.

There are many internal controls and technical record keeping issues involved if the Commission actually takes custody of funds, which it later intends to pay out to the victims of a fraud. Where an

appropriate security interest and oversight could be arranged, I would prefer to see disgorgement paid out directly by the respondent.

We have also explored the need for obtaining some security interest, such as a bond, to assure that monies available for disgorgement at the time an order for disgorgement is entered by an ALJ are available after an appeal has run its course. If the Commission cannot obtain adequate security after identifying ill-gotten gains, and, establishing a likelihood of success on the merits through a hearing before an ALJ, there may be pressure on the Commission to routinely seek temporary cease and desist orders at the outset of a case, aimed at limiting the dissipation of assets.

VI. CONCLUSIONS

There are, of course, many more areas considered by the Task Force which I would like to discuss. Important improvements have been made in the Commission's handling of administrative cases. Obviously, we must complete our Report, however. Once the Task

Force Report is agreed to and issued, I expect additional changes to be implemented.

At the same time, I am well aware that there is a huge gap between making recommendations and achieving real change. There have been several past task forces on administrative proceedings, each with very capable and very talented people, each given the same charter we have been given to improve the administrative process and speed the disposition of cases. In a memorandum we discovered from the mid-1960s the then Chairman decried the unacceptably long time it took to complete administrative proceedings. Some time after each Task Force concludes its work, disposition times started creeping up.

Attempts to eliminate undue delay by Task Forces past have been too reliant on calls for better management and stronger resolve. That approach has not worked. Based on our analysis of the causes of delay, we believe that to enact a viable solution the Commission must change various regulations to strike a better balance between

delegated functions and those retained by the Commission. Because there are rarely sustained or compelling external factors requiring that attention be given to the adjudication program, we also recommend procedures that put adjudicatory matters onto the Commission calendar at regular intervals, and that provide the adjudication group sufficient visibility within the Commission bureaucracy to obtain and maintain the necessary staff to do its job.

The purpose of more efficiency and better rules is not an abstract statistical exercise. More efficiency, the elimination of unwarranted delay and clearer rules are important in themselves. They are important so that we are fair to respondents; but they are equally important so that we protect the public. Securities violators should not be allowed to postpone their day of reckoning, or fritter away ill-gotten gains, because the Commission's bureaucracy takes years to decide their cases. A speedy, fair and vigorous administrative adjudication program is a necessary complement to a speedy, fair and vigorous enforcement program. By taking the steps to begin turning around the adjudicatory process, the Commission

has been able to strengthen both administrative practice and the protection of investors.

I am encouraged by the support the bar has given to the Task Force and look forward to constructive comments when the Report is issued. Thank you.

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