

**Securities and Exchange Commission Historical Society**  
**Oral History Project**  
**Interview with David Doherty**  
**Conducted on April 8, 2010, by Kenneth Durr**

**KD:** Interview with David Doherty, April 8th, 2010, in Falls Church, Virginia, by Kenneth Durr. Let's begin with your education. Where are you from, where did you go to school?

**DD:** I grew up in the Berkshires in Massachusetts. I went to college up in Vermont, St. Michaels College. I had a lot of fun up there skiing and doing all the cold winter sports. I came down to Washington to Georgetown Law School in 1962 and graduated from Georgetown in 1965. At that point, I went directly to the SEC in the Washington Regional Office, which at that time was in sort of a shabby old building on, I think, 6<sup>th</sup> Street, a few blocks from the Georgetown Law School, which actually was the site of the SEC building just before the new building. It was on the same site, so it was close to the law school.

**KD:** Did you have a professor at Georgetown who steered you toward the SEC? How did that work?

**DD:** No, not particularly. I had taken some courses and found the securities laws interesting and I thought I would give it a try. Alex Brown was there at the time. He was the administrator. I worked there for a few years starting at the grand salary, I recall,

of \$6,030 a year [laughter]. We moved a few times. We moved from there out to Crystal City, and then we moved over to Ballston.

**KD:** What kind of work did a young lawyer do for the Washington Regional Office?

**DD:** We did a lot of fun stuff. The regions, of course, really at that time – Stanley was just starting to build the national enforcement program – so the regions really were the first line and would do everything that was required. They'd go out and do the inspections, and if there were problems with a firm, that was in the enforcement program. We would bring the cases that were the net capital rules or whatever. We had some very interesting cases. I know I, as a young lawyer, went up to New York and tried a case against three over-the-counter broker dealers who we alleged were manipulating a variety of stocks and the pink sheets, the old pink sheets.

That was really quite an interesting case, and I got up there with a couple of years of experience under my belt and was met with ten fancy lawyers, Milton Gould and some of New York's finest, and we had a knock-down drag-out fight for several weeks, and that was appealed with the Commission and we won and so on, so that was an exciting time. We really did everything. We looked at the fraud cases, the market cases, the financial and operational-type problems with the firms, and we were out with some of the old sales practices things out in West Virginia interviewing customers out there who had been the victim of some local brokerage firm that overreached and so on, so we had a wide variety of kinds of things.

**KD:** How did you end up in New York City dealing with these fancy lawyers, since you're down here in Washington?

**DD:** Well, because at least two of the three over-the-counter firms, it was Allesandrini & Co. and Budin & Co., I'm sure they're not around anymore, that were located in New York City. It was an administrative proceeding, and we brought the charges and that was the location. We really dealt with anything and everything.

**KD:** But, generally, enforcement-type things.

**DD:** Yes. I was on the enforcement side, so I was doing enforcement work.

**KD:** How did you end up on the enforcement side?

**DD:** That was my interest. I was a lawyer, and I wanted to investigate and try cases, so that was the slot that I went into at the regional office.

**KD:** Who was running the regional office at this point?

**DD:** Alex Brown. He had been around since the beginning of time, and he was quite a character. He ran the office for many years. I transferred after three years or so over to headquarters, and he ran the office for sometime after that, and then he retired.

**KD:** Why were you interested in transferring to the headquarters?

**DD:** Well, I thought that that's where the action was, the big action. I could see that Stan Sporkin was starting a process—it hadn't really begun—establishing a national enforcement program. It was bringing resources in, and it was clear to me that he was looking for the trends, and the big emerging cases. He also, at that time, since we were getting into bigger cases and all decided that the headquarters should start a trial unit because we were trying cases and we were coming up against more and more of the high-powered outside firms. He felt we had to develop a real internal expertise, a unit dedicated exclusively to trying the tough cases.

My initial, since I had, in my three years at the Washington Regional Office, had ended up trying two or three cases, I had reached out, and he said, "Sure, come on over. You can work with Bob LaPrade." Bob, whom you may know, was a very senior fellow there and had tried a lot of cases. I was going to work with Bob, and we were the beginning, the core of the trial unit.

**KD:** How did that work out?

**DD:** It worked fine. We started doing some cases, and then the next thing I knew, a branch chief position came open and Stanley said, "Would you like to do that? I would like you

to if you would." I did that. From there, I became an assistant director and associate director and so on.

**KD:** What was the branch chief position? What was your portfolio there?

**DD:** The branch chief position that I initially had, interestingly, was the organized crime branch. We no longer have such a branch, but at the time, we felt we needed some expertise in that area. There were a number of public companies that had bought casinos. There was a good bit of shenanigans going on in that area. We had this branch that had an expertise in that area. We'd established relationships with the Nevada Gaming Commission, and we went out and toured casinos. This was the branch also that had the strongest liaison with the Justice Department, dealing with criminal matters. That was our focus, but we also did other things as well. We also dealt with the general matters that were on the Commission's plate.

**KD:** Might there be issues of broker dealers with organized crime?

**DD:** Oh, yes. There could well be that.

**KD:** Did you work on some notable cases?

**DD:** I'm trying to recall some of the names. I know there was one case we brought, and I don't recall the name of it, but it was really kind of shocking because the head of the public

company that was primarily, principle asset was the casino, had managed to siphon funds from the company and fund one of his real estate ventures. This had been approved by the board, which wasn't much of an independent board. I know we brought a case there, and got some significant relief.

**KD:** I would suppose you worked with Justice on that.

**DD:** No. That, initially, was our case. I do not think Justice took an interest in that one, but we did work on a lot of cases with Justice. One very interesting case—it wasn't particularly organized crime—but one of the cases I illustrated what we tried to do over there. As I said, the regions really were kind of flat out dealing with all of the matters that they had to deal with. They didn't have a lot of discretion as to whether they'd bring the net capital case or not if they had the resources to do it. Part of Stanley's theory in building the national program was to have something resembling a reserve squad that you'd kind of sit back, you'd try to see the problems developing.

As you saw a problem, you would throw a lot of resources at it, try to get ahead of it, and try to fix the problem before it developed into too big a problem. We were trying not to be completely reactive, which enforcement is fundamentally reactive, but we were trying not to do that as much as possible. There was a case—we started getting complaints in the early-to-mid 70s, a series of complaints out of the south, the Memphis area, about dealers down there selling municipal bonds and overreaching customers. The Commission had had virtually no experience with municipal bonds.

They are exempt from registration for sale, certainly, and at the time, dealers who dealt exclusively in municipal bonds were exempt from any regulatory jurisdiction of the Commission. We went down and, again, threw resources at it. We conducted several quick investigations into various different firms. We found just classic boiler-room stuff. I mean, it was selling, high-pressure sales tactics, untrained employees selling marginal quality municipal bonds to little old ladies and buying them one day for fifty and selling them the next day for one hundred. The markups were absolutely shocking. The whole situation was shocking. I went down to file my charges in federal court down there.

As is our custom, I stopped in to brief the local U.S. Attorney in Memphis, and that was always our practice because, for all intents and purposes, the U.S. Attorneys do represent the federal government in court. It's very much the exception that the SEC can go in and file its own lawsuit. As a courtesy, we would stop in and brief them. I stopped in to brief the U.S. Attorney and told him about these outrageous markups and all this overreaching, and he said to me, "Son, you don't have a case here." He said, "Selling municipal bonds is just like selling used cars. You sell them for as much as you can get." [Laughter].

Despite that admonition, I went ahead and filed the case anyway, and we actually tried the case, and we won, and we got a great decision.

**KD:** Even though these are municipal bonds and they're not subject to SEC regulation, how was it that you would go in and do this?

**DD:** 10b-5. That was one of the issues that the defendants claimed, that securities laws don't apply to municipal bonds, and it was our view that you may not be regulated by the Exchange, they may not be registered for sale, but 10b-5 was 10b-5, and they're a security, and if there's fraud, that's 10b-5. The court held that, and we prevailed, and it was a very good decision. We brought a couple more quick cases in that area, and then we went to Congress and said, "Look at the record that we have established of this abuse," and Congress, at our request, amended the securities law and required these dealers to be registered as broker dealers.

**KD:** Did that go into the '75 Act amendments?

**DD:** I believe it did.

**KD:** When you say you took it to congress, how does that work? Do you go to the Commission?

**DD:** Oh, yes. We would go to the Commission and say, "Here's the record of abuse that we've established, and we would recommend that the Commission go to congress and recommend that an amendment be passed to regulate these dealers." We did, and congress agreed, and the problem went away. I think that's a good example of how we would try to get ahead of a new and growing problem, and try to fix it, and we did fix it that time. The division then was much smaller. This is in the late seventies. I think

Stanley left in about 1980. Right about then, there were only three associate directors. There was myself, and I ran about half the division, and Ted Levine kind of ran the other half. Ted Sonde, he was the third associate and he ran the trial unit. That was pretty much the program. I would say there were somewhere between 150 and 200 people in the entire enforcement division at that time.

**KD:** One of the things that's coming in must've been, at least from an outsider's perspective, was the whole foreign corrupt payments thing.

**DD:** Right, right.

**KD:** Which seemed, from an observer's point of view, seemed to take over enforcement in the late seventies.

**DD:** Well, that would be an understatement to say it was a major program in the division. It was very exciting. I recall discussing with my colleagues in the division at one point that the only person in the management of the division at that time that was over forty was Stanley. It was a very, very young group, and we were all very excited, and wearing white hats, and doing good and all that, and Stanley was a great leader, so it was an exciting time.

The foreign payments cases—clearly we were breaking new ground developing theories as to how this sort of conduct of this major corporation has this off-the-books slush fund

to make foreign payments or political contributions or whatever they might've been. Why is that? Why does that violate the federal securities laws? Certainly from an accounting and purely economic point of view, the little slush funds were miniscule compared to assets and so on. We had this theory that it reflects on the integrity of management, it reflects on the integrity of the books and records, and reflects on the quality of the company's business. I mean, who knows what kind of business they would have if they weren't bribing foreign officials. There's always a risk dimension to it as well, if that's how you get business. Maybe it could disappear quickly.

These theories really kind of developed over time as we found different cases. The Commission, initially, didn't seem too thrilled about them. Over time, I think they really did come to believe in the program and authorized the cases. You can't go to court if the Commission doesn't authorize you to go to court. Stanley had to argue pretty hard, sometimes at the table, to get authorization to proceed. I think it was a good program—a lot of corporate America was mad at the SEC.

**KD:** How did this work out? Did your group handle a lot of them, or did Ted Levine's group? How did you ride that out?

**DD:** I probably had more than Ted, but there were so many that it really got spread around. It was a very hot topic, it was all the PLI programs, and everyone was discussing it. Then, of course, you had all the sub-issues that were involved, such as is the name of the foreign official that got bribed a material fact to be disclosed in the complaint and so on,

so there were whole kind of series of sub-issues as to what aspect of all of this is material in terms of 10b-5.

**KD:** Do you remember the first case you got involved in?

**DD:** It could've been Gulf Oil, but there were so many. The luminaries that would come in to represent these companies were all very impressive. Clark Clifford was in, Abe Fortas, Bill Rogers, the former Secretary of State. It was a pretty exciting time dealing with all of these guys.

**KD:** They must've been a little put off to have to come in and talk to you under-forty guys.

**DD:** I have mentioned a number of times, I always thought it was interesting, Clark Clifford. I guess at the time, I was either an assistant or an associate by the time we got into these cases. Clark Clifford, whenever he came in, he would be the nicest to the junior attorney on the case, which was smart, because the junior attorney writes up things, and he investigates things, and he or she has a lot of influence over the development of a case, even if it's relatively closely supervised.

I just used to marvel and kind of admire his approach because he would be so nice to that junior attorney on the case, and they would be impressed by that. Others had a different style. "Why do I want to talk to you? I want to talk to the director." That's not a smart approach.

**KD:** Because you're doing all the work.

**DD:** That's right.

**KD:** You talked about the reception. It took the Commission a while to get used to the idea. Was the Commission split?

**DD:** It wasn't a political thing at all, I don't think. I think they were just trying to do the right thing. I think they were struggling with the course of conduct that everyone was put off by, but struggling to see whether it was the securities laws that were the right way to address the problem, and whether they fit. I think it wasn't long till they came around to believing that that was the right thing to do.

**KD:** One of the cases having to do, something in that area anyway that I came across, was having to do with Citibank.

**DD:** Citibank. Yes, I remember Citibank.

**KD:** Which appears to have had a very complicated run-through. Can you take me through that?

**DD:** Yes. Citibank had engaged in practices, as I recall, that resulted in their avoiding foreign taxes. So it wasn't your typical foreign payoff. It was kind of a tax dodge effort, we felt, in enforcement. We had started the case while Stanley was there, and he went off to the CIA, so I was running the case after he left. John Fedders was the director after Stanley. We believed the theories as to why this was a violation were pretty much the same theories that we believed the foreign payoff cases were violations as well, affected the books and records and so on. We, actually, worked out a settlement with CitiGroup, and they had agreed, tentatively, to settle. I don't recall the terms of it now, but we had a deal. We went to the Commission with it, and John Fedders did not support it, and I knew he didn't support it.

**KD:** Did you know that was going to be the case when you took this thing in?

**DD:** Yes, I knew that. I said, "Here's the case. We've got a deal. I think we ought to send it up, anyway, I understand you don't agree, but I think we ought to send it up anyway and let the Commission decide." He agreed. We sent it up, and the Commission rejected it. There had been, I think it all started with a whistle blower in Citicorp, and somehow, he had reached out to congress. Once the Commission rejected it, congress then called for hearings and they had hearings on the issue. I went up to testify, Stanley went up to testify. It got a fair bit of notoriety, and that was that.

Congress was of the view, at least you got the sense they were of the view that a case should've been brought. The Commission got a little bit of bad press from congress at the

time, but the Commission's concern was it's just not economically material, whatever this was, maybe it was 3 million or something.

**KD:** This comes at an important time too, though. Apparently, the case would've been started under Harold Williams or in the late seventies, and then John Shad and Fedders come in, and there was a well remarked-upon change in outlook at the Commission. Was that part of what was going on here?

**DD:** That could have been part of it. John Shad, I liked very much. He came from the Street, as I recall, and he was a lawyer, but I don't think he'd ever practiced law. It was tough to convince him to charge a company, particularly a Wall Street firm. He seemed to have the view that people do these things, so you ought to charge people, and there was logic to that. I do think that he always did what he thought was the right thing to do. He wasn't trying to shut down enforcement. He wasn't trying to get in bed with the Street. He just had a different view, and you could convince him sometimes. I think he was a fine guy. He just had a more conservative view of these things. He would sometimes say, "Well, why do we have the expertise to go in and tell a Wall Street firm how to run its business?" He'd say, "We mandate what books and records they keep, we regulate them, we do know a lot about them and so on." He had that point of view. He did what he thought was the right thing to do, I think.

**KD:** You talked about, earlier on, mid-to-late sixties, early seventies, this idea that the headquarters enforcement was going to be the shock troop, somebody you could send in.

Clearly, they developed that when it came to the foreign corrupt payment stuff. How did that work out in other areas?

**DD:** I know Ted Levine got into a lot of takeover cases. That was another area that we got into, and that was an area he dealt more with. We got into a lot of cases. Stanley had this access theory which was there are certain important players that really have control over access to the marketplace, and that we should hold those players to a high degree of accountability. Those were, certainly, the underwriters, and the member firms, and the accountants and the lawyers. I know there were efforts in that area. I know we brought cases that would deal in those. Those would be the kinds of things that we would look for and try to deal with.

**KD:** National Student Marketing was one of the big –

**DD:** Yes, Ted Sonde did that case.

**KD:** Anything else that we should touch on from your time at enforcement?

**DD:** I think those are the highlights. It was great working with Stanley and Irv Pollack before him. As the headquarters enforcement program grew, there did develop the tension that you might expect with the regional offices that had always been the front line for the enforcement work. Initially, the regional directors reported directly to the chairman. They didn't report through enforcement. They felt that they didn't work for the

headquarters enforcement division, and that if there was a case that came along that they wanted to do, they felt that they were entitled to do it. There was this tension, and there still is to some degree.

I think it's just the nature of it. Everybody wants the big case and the hot case and so on. Overall, I think that was managed pretty well. We would work closely with the region. Sometimes we'd do a case together and so on. There never was any real open rebellion about it. Eventually, as I recall, the Commission was structured so that the regional directors reported through the director of enforcement, at least for purpose of enforcement matters.

One of the jobs I had as an assistant director at headquarters was to review all of the regional enforcement matters that came into the Commission. I had a unit that would review any enforcement matter that came in, and we would have a dialogue with the regions, and I would usually go to the table to present the regional office cases to the Commission. If there was a major one or one that was controversial, we would bring in the regional office people to represent their own case at the Commission.

**KD:** Would you ever take a look at this and go back to the region and say, "Hey, what about this?"

**DD:** Yes. There was a lot of dialogue. It wasn't just a matter of being sure it was written clearly. We did a substantive review, and we would have a dialogue with them and

recommend certain things, and that worked out well because they knew we were trying to help them. We weren't trying to get in their way; we were trying to be helpful. That unit, I'm sure is still there because it played a valuable role. We would go out and visit the regions and be sure they were up to speed on policy and so on.

**KD:** I suppose there was a lot you could learn from the regions as well.

**DD:** Oh, yes. No question. They were the guys that are out there in the brokerage firms doing their reviews and checking books. They knew that stuff. We learned from them. And also, they were good sources of information as well. We had a good relationship with the regions.

**KD:** Okay. Most of the time, I'm looking at folks who have gone through with the SEC mostly in their younger years, and they go off to a big law firm or something like that, or Wall Street. You took a different path. I wonder if Stanley Sporkin had anything to do with the CIA connection.

**DD:** Well, he did. Bill Casey had asked him to come over and be general counsel. I stayed on for a year and a half, maybe, after that. Then I decided that I was going to leave. But I wasn't interested in going to a law firm. That never piqued my interest. I was, basically, wanting to do something that was interesting and worthwhile. Around that same time, Stanley called to say, "Hey, I'd love to have you come over here if you're thinking about making a move. We've got a good spot for you, and I'm sure you could do great."

**KD:** So what was the spot, exactly?

**DD:** It was an associate general counsel. There were a few associates. There was a deputy, but the deputy was not so much a substantive deputy as he administered things as well. I was, basically, dealing with the spy guys.

**KD:** Right. There must've been quite a learning curve.

**DD:** Oh, yes. It's a whole different world. A whole different world. They have a really talented group of people in the office there in the legal staff. But it's a whole different world. It made the SEC's jurisdiction seem so narrow [laughter]. We were dealing with any issue that you could imagine, including whether the President has to sign a piece of paper to authorize somebody to do something. Big-deal stuff. Some routine, but a lot of big-deal stuff.

**KD:** How long did you stay with that?

**DD:** Well, I was the associate for a couple of years, and then Stanley became a judge, and then Bill Casey asked me if I would be general counsel. I was general counsel for a couple more years, and then I went from the world of no disclosure if you can help it, back to the world of full disclosure. That was exciting. It's the best legal job in the federal government.

**KD:** The CIA?

**DD:** If you don't mind craziness.

**KD:** You didn't stay too long, though. Was it the challenge?

**DD:** When you become so senior in the government—I knew when I took the general counsel's job that I would move on after a couple of years. It's not a career position. Maybe you could make it that way, but it seems when administrations change, that people want their own general counsel, understandably, I think. I knew I would move on in a couple of years.

**KD:** Did anything in particular precipitate your move to the Exchange?

**DD:** I was, again, at the point where I thought, "It's time to start thinking about making a move," and they reached out to me. One of the people that I had worked with at the SEC had gone to the Exchange to head their examination program.

**KD:** Who was that?

**DD:** That was Ed Kwalwasser. The Exchange's enforcement director at that time had left, and so he reached out to me and asked whether I would be interested in coming up. I thought,

“Well, it sounds interesting. Might be fun to live in New York for a while. The Stock Exchange has always had a good reputation,” and I thought it might be fun. Talked to my wife, and she said, "Hey, that might be fun." So we did it. Actually, at the same time Jim Clarkson had called me because the regional office in New York had opened up as well. The director had gone, so he said, "Come up and be my –" I said, "I don't think I can move to New York on a government salary, Jim."

**KD:** How much did you know about the Stock Exchange? Granted, you'd worked in the SEC, but the nature of this job is pretty different.

**DD:** I knew a fair bit about it. I knew it was an SRO, and I knew the dynamics of an SRO and how that worked. I was very concerned going up there that I wanted to be able to run a tough program and make the kinds of calls that I needed to make, and I had no interest in going up there and being shut down in terms of trying to get the job done. I was assured that I could build the kind of program that I thought needed to be built. The SEC had come down hard on them, I think, in the late eighties. They wanted to build a program that did the job.

**KD:** Who gave you the assurances? Who were you talking to?

**DD:** Well, first I talked to Ed, of course, I can explain to you how it was built. The regulatory program has three main departments. His was Member Firm Regulation, and there was Market Surveillance and Enforcement. He was head of the member firm department at

that point. I talked to John Phelan. He was the chairman at the time. He assured me that he was going to give me the budget, and I'd be able to build the kind of program that I needed to build to get the job done.

**KD:** That gets to the question of what did you want to change? What did you want to build that was new or different somehow?

**DD:** Well, the exchange had not had a reputation for, particularly in enforcement, being a vigorous enforcer. I think the member firm regulation division was pretty well regarded. The folks that go out and do the exams, and they're mostly accountants over there and examiners. Net capital, all that stuff. Then they do the sales practice. It's the largest regulatory unit. Enforcement had just gotten hit by the SEC for not doing a very good job. The Exchange was prepared to step up to the plate and do it.

I wanted to get up there and show them that we could really bring the big cases against the important member firms, and we weren't going to shy away from doing that, and we did.

**KD:** Why do you think that the enforcement had shied away from doing that in the past? You must've experienced some of the pressures and seen how the system worked.

**DD:** Yes. It's a self-regulatory organization, and there are conflicts inherent in that. You have an Exchange that has member firms, and they want to do business and make money.

Then you have the regulators housed in the same organization who are a cost center and, from time to time, come along and say to their important member organizations, “We think you're violating the law, and we're going to sue you and we're going to fine you and we're going to publish it and make you look bad.” You then get into who's going to get their way.

I think it was about fifteen years ago the SEC oversight group brought a case against the NASD and concluded that the NASD was allowing the interests of the members to override the interests of the public. They pointed to several things in the structure of the NASD that they required to be changed. One was that the NASD board was virtually all members. Another was that in order for the regulatory people at the NASD to bring a charge against anyone, they had to go to a committee that was comprised of all industry people and get permission. When they did have a hearing, it would go before a hearing panel that was also composed of all industry people. The SEC said, “That's a lousy system, that doesn't permit the regulatory people to do what they need to do,” and they made them change it. Our system at the Exchange at that time didn't resemble that. Our board of directors were 50 percent public investors.

**KD:** That was when you got there, that's the way it was?

**DD:** Right. When I got there. Our hearing panels were three-member hearing panels, two industry members, but a professional lawyer, judge hearing panelists who ran these things that was independent from us and independent from the industry. They worked for the

Exchange, but they were appointed, and they could be objective. On the issue of whether or not we could bring a case and file a charge, that was determined solely within the regulatory group. We didn't have those issues. We had a structure that permitted us to do our job. Now you have to add to that, in order for the SRO concept to work, a competent vigorous staff that's going to get resources, and then you have to have the structure that I just mentioned.

If you have that, and it's coupled with vigorous oversight by the SEC, I think that's an important component because the SRO needs to understand that the SEC's looking to be sure that they're fulfilling their self-regulatory responsibilities, which is to enforce the '34 Act and their own rules against their members and associates. If you get all those components together, I think the SRO model works well, and you can deal with the inherent conflicts that are involved. In some ways, I think an SRO can do the job better than the SEC, and there's value to them there.

One of the principle values—and the SEC has even acknowledged this in various filings, I think maybe the NASD suit I mentioned, but they saw three advantages to an SRO. One is that the self-regulators are the local cops on the beat. They're right there. They have a feel for what's going on. They can react quickly and so-on. The other big advantage is they supplement the resources of the government. When I left, we had, in regulation, something like 560 people devoted exclusively to regulation.

It's about a third of the entire staff of the Exchange, with a budget of over \$140 million, and doing the kind of work that the SEC or someone else would have to do had we not done it. The other big advantage of an SRO, and I think it's missed a lot, is that we not only enforce the '34 Act, but we have ethical rules, "conduct inconsistent with just and equitable principles of trade," "acts detrimental," and "failure to adhere to the principles of good business practice" and so on, that permits us to reach misconduct that the SEC cannot reach under the federal securities laws, and conduct that should be redressed, so that's a big advantage.

**KD:** Give me an example of that.

**DD:** Well, one simple example is if you have a back office clerk who steals money from another back office clerk, or steals his credit card or something, the SEC can't do anything about that. There's no securities transaction involved there. There are a number of cases. We brought a manipulation case against a firm, and we charged 10b-5 and "conduct inconsistent." We said the firm manipulated the market. It was appealed to the SEC, and the SEC said it's not 10b-5 because the Exchange did not prove scienter, and so without scienter, there's no 10b-5, but they said, surely, it's "conduct inconsistent." Again, it's a case where the Commission was saying this might be a manipulation, but it's not something you can reach through 10b-5, but it is of such ethical concern that you would think it is a violation of the Exchange's rule against "conduct inconsistent," and "just and equitable principles of trade." So that's an example.

**KD:** Right. In this case, you found a firm that was doing this manipulation, and so you're going to apply this conduct inconsistent thing, which is sort of the Exchange. They used to make a big deal of this way back when, the idea that they have the power to, basically, do anything they want to do. What would the next step be then? You're not working with the SEC because that's out of their bailiwick. Does that go to the Exchange board, or how does that work?

**DD:** In terms of a disciplinary proceeding?

**KD:** Yes.

**DD:** I should take you through, and give you a little background. That might make sense. Before I do that, let me give you another example of the “conduct inconsistent.” Just before I left, we, along with the SEC, and the NASD and the states and everyone brought this big research analyst case, which involved virtually all of the major member firms. The fundamental problem was that there was a conflict of interest. The investment banking part of the firm unduly influenced the research analyst and the research they produced. Conflicts abound everywhere. The SEC has potential conflicts. They investigate cases, they prosecute cases, and they're the judge on the cases that they investigate and prosecute.

But they take steps to manage the conflict so that it makes sense. The fundamental allegation on these research analyst cases is that, yes, there was this – clearly, you have

investment analysts, investment banking and you have research analysts and they're not going to see things the same way, and so there's a potential conflict, but as a business operation, you have to take reasonable steps to manage that conflict so that you run your operation in a fair and sensible way.

That was the fundamental allegation in those cases where we generated over a billion dollars in payments and so on. The allegation that applied to that particular conduct was not the federal securities laws. That was "conduct inconsistent." That was our ethical rules. There were a sprinkling of other conduct that involved a particular SEC rule, but the fundamental charge in those cases was "conduct inconsistent," or one of our ethical rules. Now the SEC can charge that as well in a joint case as we did here.

**KD:** So they can support your charge.

**DD:** Yes. They can include it in their charge. The only way they could, traditionally, have ever included an SRO charge in an SEC enforcement action is, basically, when the SRO refused to bring the charge. Then they would bring it.

**KD:** How about the NASD? Did they have a similar sort of thing?

**DD:** Yes. They have a similar rule, and they were part of this as well, and they have an ethical rule as well that is comparable to ours. But it's something, I think, a lot of people are missing. The fundamental charge in that case that enabled us to reach what we reached

was the conduct – our ethical rules. We didn't say, and we didn't charge that all of this stuff spawned fraud. It was the conflict that was not adequately managed, was the fundamental charge. Do you want me to kind of explain to you how the division is set up?

**KD:** Yes, how the process worked. I think that would be terrific.

**DD:** First in terms of staffing, over the time I was there, we doubled or tripled the staff, and we at least tripled the number of enforcement cases that we brought. We were bringing in the vicinity of 200 or more enforcement cases a year. We had a very experienced staff. I got a lot of people from the SEC, I got a lot of people from outside law firms, a lot of people from D.A.'s offices. I had about 140 people, and they were virtually all lawyers with an average of over a dozen years of legal experience. It was a different makeup in terms of from the SEC kind of staff. I had complete support. Nobody interfered with what I needed to do in cases I felt I needed to bring.

Let me give you kind of how the regulatory group was set up. There were over 500 people by the time I left, three basic divisions. There's the member firm regulation division. They are the accountants, the largest group. There were probably 250 of them, and they go out and do periodic exams of the member firms, and they go in and look at all the financial and operational compliance issues, and they want to look for sales practice issues. They're an experienced, able group and well-recognized by the SEC, I think, for doing a good job.

We then have a market surveillance group. There were probably 125 of them, analysts and investigators. Their job was to surveil the trading activity on the floor, and they have computers, and every stock has an historical fingerprint, and it's monitored in real-time basis in terms of its volume and price and volatility and so on. If something kicks out, then they say, "Gee, why did that happen? Did we make an announcement?" If not, then they'll do preliminary inquiries and so on.

**KD:** This must've been getting more and more sophisticated, too, over this period.

**DD:** Oh, yes. The Exchange pumped many millions of dollars into the technology on the floor. They looked at floor compliance, manipulations, market activities and so on. Then we have the enforcement division. We had about 140 people, mostly lawyers, experienced group and so on. We would get our cases—we got cases from outside sources. Customers would complain and so on. The member firms are required to make filings with the Exchange when certain events occur, like they settle a case with a customer over a certain amount of money, or they fire a salesman for cause, and they have to make filings. We also get a lot of cases from our other divisions. Examiners would send cases, the market surveillance would send cases. We get a few from the SEC, we read newspapers and so on.

We carried an inventory of about 700 cases, and we would open and process about 500 cases a year, we'd bring a couple of hundred enforcement actions a year. Our

investigations were like the SEC's in a lot of ways, and not like the SEC's in a lot of ways. We would both go out. We would go out to get the facts, interview witnesses, request documents from firms, took a lot of investigative testimony, 700 or 800 depositions a year. But the SEC's jurisdiction is much broader than ours. We're limited to member firms and people associated, but the SEC isn't. They have subpoena power, and we didn't.

There were some cases that we just could not do well because of our limited jurisdiction. Some cases, for instance, let's say an insider case that involved a lot of public company executives, and lawyers, and bankers and so on, we can't –

**KD:** There're no member firms involved.

**DD:** Right. Even if they were involved, we could only compel the member firms to do things, and the others, we would have to say, "Hey, would you come in and talk to us." If they got anything, if they have any involvement, they're going to say, "Take a hike." That kind of a case, we would refer to the SEC. A lot of market surveillance, insider trading cases that they picked up got referred down to the SEC. We did a lot, too, but some of them we just couldn't do. They have that broader jurisdiction and subpoena power. We didn't have subpoena power, but with respect to our member firms and people associated, we had something better, which was we have a rule which says, "You have to comply with our request."

If they don't comply with our request, the usual process says we'd bring an enforcement action, and they would get thrown out of the business. It's a pretty substantial tool. It was our view that assertion of the Fifth Amendment privilege was not an acceptable position to take when we requested information. The cases support that. We say, "You take the Fifth, and you're out of the business." The reason for that is we do have limited jurisdiction. In one sense, we already have one hand tied behind our back since we don't have subpoena power and we can't go wide. If you want to be in the business, then you need to testify if we ask for information. Even the member firms support that. They don't want their people to not be able to do that and not cooperate with investigations.

**KD:** This is the nature of a member organization that you can do that.

**DD:** That's right. We also held a view, and the case will support it, that our investigations are not subject to a statute of limitations. A number of SEC cases, certain categories of SEC cases, do have a five-year statute of limitations. It has been our view and policy that first there is no existing statute of limitations that applies to SROs, and we're not the government, so whatever case law there was, it doesn't apply to us. The policy behind it, I think, is really sound. These people are not just your typical man on the street, like the SEC. These are people who are licensed. They're fiduciaries. They're licensed to deal with customers' funds and securities. If a salesman steals money from his customer's account, and we don't find out about it until six years later, it's still not okay.

The issue really is fitness. Are they fit to continue in the business? We hold the view that that person is not fit, even if it is six, seven years old. That said, we don't like old cases. We prioritize the more current ones and so on. If a case needs to be brought, we're prepared, we're prepared to bring it. Those are some differences between our investigations and SEC investigations.

When we complete an investigation, we then make a determination as to whether there's a violation and whether it's sensible to bring a case, and what kind of a case should be brought. That decision, as I said, is made completely within the regulatory group. We, at that point, either file our case or we go – we have a process much like the SEC's where we kind of go through this Wells process where we go back to the person or the firm, as a general matter, and say, "All right, we're going to bring a case. This is what we see, this is what we think you've done. Shall we file a case, or do you want to talk about trying to resolve it?" We go through that process.

**KD:** How often would they want to resolve it?

**DD:** I would say we tried about 25 percent of our cases. It was probably a higher percentage than the SEC used to try.

**KD:** So 75 percent of the time, they'd say, "Yes, okay."

**DD:** Yes. Most of the time, you worked out a settlement. You'd grind to a halt if you had to try every case. Our enforcement cases are done through an administrative disciplinary panel that's within the Exchange. It's very comparable to the SEC's administrative proceeding. Again, we have the law judge and two peers. Assuming it's a contested case, we file our charges, the respondents answer, we have pretrial motions. We have a trial, call witnesses, take testimony. The hearing officers have some discretion. They rule on evidence and so on. But, basically, the rules of evidence pretty much apply. They then will render a decision. It's published. It can be appealed to the Board of Directors of the Exchange, and really comparable to an appeal to the Commission. The appeal is, basically, an oral argument. You don't have another trial. You appear before the Board or a committee of the Board, and argue your case as the SEC does before the Commission. Then the Board issues a decision. Then that decision can be appealed to the Court of Appeals and, ultimately, to the Supreme Court directly. The decisions are, when final, they're published and public.

**KD:** How often would somebody get to the board, and how often would the board go against something that had been decided lower down?

**DD:** On a contested case, it wouldn't be unusual for someone to appeal to the Board. I think I skipped a step. From the Exchange's Board of Directors, the appeal goes to the SEC and then to the Court of Appeals. It wouldn't be unusual for someone to appeal to the Board from a contested proceeding. The Board, assuming it was a well-reasoned decision and so on, generally would affirm the hearing, although there were occasions when we would

appeal a hearing panel decision to the Board. There were a few occasions where we got it reversed as well. It's a pretty good process. It works reasonably well. Now at a settlement, which happens, as I said, probably 75 percent of the time, that also is submitted to the hearing panel, and they need to approve the settlement. It's unusual if they tinker with it at all, but it does have to go through that process. There's a hearing panel involved in every formal disciplinary proceeding.

**KD:** Your clarification answers a question because I'd noticed some instances in which the SEC seemed to sort of overturn what the Exchange had done in a disciplinary case, which seems really curious.

**DD:** Yes. They can do that. There was one case, and I'm still scratching my head about it because it would sometimes just come out of left field, but we had brought a case that was old. There was a reason for it to be old because we learned about it late, but then you can always do things faster as well. We had a substantial trial on it, and the fellow did some bad things. It went to the Commission, and they just reversed it and said that it was too old. [Laughter]. They didn't say the statute of limitations had run or anything. I guess they just thought it was too old. It wasn't a model of legal clarity. I was commiserating with the SEC's enforcement director at the time, and he says, "Oh, they've done it to me too." [Laughter]. But it can. The Commission, they're independent.

**KD:** So had resources been an issue at any point? It sounds to me like you've got most of what you needed.

**DD:** Yes. You're never going to find an enforcement person who's going to say I have more resources than I can use. That's just not going to happen. The Exchange was very supportive of the enforcement program. They get a bad rap, but I have found them very supportive. We've got resources, we had no interference with cases we wanted to bring, no subtle pressure, no bathroom talks. It just wasn't there. We really built the program, and I'm very proud of the program we built in support.

The Exchange's enforcement division was housed in the World Trade Center. We had 65,000 feet there on the 28<sup>th</sup>, 29<sup>th</sup> and 30<sup>th</sup> floor. Most of us were there that fateful day, and fortunately, we all got out of there. But everything was vaporized. Everything you had had in your office, all your professional stuff, all your case files were just vaporized, it was gone. And the Exchange was terrific.

Within two weeks, we had temporary space on 20 Broad Street next to the Exchange. We were rolling some tables and so on, but we all had computers, and we had things we needed to keep operating.

**KD:** You lost all your records then.

**DD:** Everything. Fortunately, we had all our computer information backed up offsite, so that's what saved us. The member firms were cooperative if we needed to get another copy of the records and so on, they delivered and so on. The Exchange had us up and running

within a couple of weeks with everything we needed to keep going. Within a year, we had another 60,000 square feet of nice new office space across the street at 14 Wall.

They were supportive of the enforcement program. Resources weren't a problem, and no one was interfering with what we had to do. I think that our program, the enforcement program was highly regarded by the SEC enforcement people, and the oversight people, and the member firm community, the legal folks there, and the outside bar. I think if you talk to them, they'll tell you that we had a first class program, and knew what we were doing.

**KD:** A fairly regular refrain from some is the whole idea of, "Well they always go after the little guys; the big firms, not so much." Was that something that you thought about and tried to counteract?

**DD:** The answer's yes. One of the principal focuses of our program was firm and management responsibility for misconduct. Our view was that we can't do it all, the SEC can't do it all, and the member firms have to be the first line of defense in the self-regulatory process. We felt that by holding the firms and management to a high degree of accountability for misconduct within the firm -- that was not strict liability -- but we looked at those issues in every investigation. We looked at the supervisory issues, and the management, and firm responsibility issues in every investigation that we brought. The result was that, in at least 25 percent of the cases we brought, those cases involved charges against either firms or management officials of firms, at least 25 percent.

**KD:** Is this what's known as failure to supervise?

**DD:** Yes. We looked at the supervisory issues, but sometimes, instead of a supervisory charge, there's a substantive charge against the firm, so it wasn't always just a supervisory charge, but often a substantive charge, but it serves the same policy issue. By doing that, you hope to induce them to run a more disciplined business organization.

**KD:** The opposite of what John Shad said.

**DD:** Yes.

**KD:** Which was blame people, not the institution.

**DD:** That's right. When we brought cases, we tried to not just bring a case, but to fix the problem. We would often require firms, and the SEC has done a lot of these things too, but we put independent directors on a board of directors. We required a lot of firms to have independent outside reviews done, to come in and look at their procedures and change the procedures where necessary. We've reallocated stocks from specialists firms and so on. Once we dealt with the problem, going forward we were hoping it would be fixed. We often tried to work that into the requirement of the settlement. We definitely were not into just going after the little guy.

**KD:** Something that raises — you talked about how your jurisdiction was narrow, and it was the member firms. But you don't have the listed companies.

**DD:** Right.

**KD:** How much would you have been involved, would enforcement or regulation have been involved with talking to companies, or looking at standards for listing?

**DD:** That wasn't our program. We enforced the '34 Act. The listing agreements and so on were done on a whole other part of the Exchange.

**KD:** I noticed when you were talking about the supervision, I noticed the failure to supervise seemed to be something that got kind of hot.

**DD:** Absolutely.

**KD:** What was behind that?

**DD:** Well, me, largely. It was just my view that it isn't individuals go out and engage in misconduct, but within the context of the securities business, the firms have not only a statutory responsibility on the federal securities laws, but a responsibility under our rules to supervise their business and run their business in compliance with the rules. You could go around suing individuals all day long and you wouldn't accomplish much unless

you look at the organization and the management of the organization. For that reason, we really took that on as really one of the primary program areas.

**KD:** In some sense, you talked about in the SEC you were sitting around thinking about theories. In some sense, you're doing the same thing here.

**DD:** Yes. Absolutely. No question.

**KD:** I guess that's something enforcement people are going to do anyway.

**DD:** We probably carry it with us wherever we go. It really is a way—you do get more bang for the buck when you do that—but if your objective is to cause the member firm community to operate in compliance with the rules, which then, of course, instills confidence in the marketplace and so on, you have to hold the member firms and the management people accountable. As I say, it's not a strict liability thing, but they really have to do their jobs. If they know they may be accountable, then they're more likely to get tough and run a tight ship.

**KD:** The last thing on my list is I want to walk through one of the last big sort of incidents between the specialist's firm and talk a little bit about how that came up on your radar screen. I know that, again, you're talking about involving a lot of players and how that process worked itself out.

**DD:** Of course, this was all related to activity on the floor of the Exchange by the specialist firms. I indicated that the Exchange market surveillance people have all sort of computer programs that surveil trading and look for price gyrations and so on. This stuff didn't kick out. My understanding is that the price differentials were, while it was vast, the price differentials were so small that the system didn't kick it out. The problems continued for some length of time, but it was discovered by, and I can't tell you exactly how, but a market surveillance analyst saw something suspicious, and then he looked further and it became more suspicious. When this was brought to his management's attention, they were concerned and really cranked up a heavy-duty investigation.

**KD:** Was Ed Kwalwasser doing that? Or no, he was with member firms.

**DD:** By then, Ed had become head of the regulatory group. I'm sure they ran it up to Ed, and they cranked up the investigation, and I'm sure on this sort of thing, they probably alerted the SEC as well, which would be the practice. A major investigation was conducted primarily on the market surveillance side. When it got to a certain point in terms of being advanced, then it got sent over to enforcement, and then we pursued it further, and put all sorts of people on the case, and I think I assigned twenty-five lawyers or something to it.

**KD:** What did you need to do that wasn't replicating what market surveillance had already done?

**DD:** It was an ongoing thing. It was really a major case. We tend to take a lot of testimony and so on, much more so, then they kind of nailed down responsibility. Then, of course, when we do investigations, we really relate -- on a major thing like this, we stick very close to the SEC, and we work with them. Sometimes they want to do something joint. Occasionally, they want to take it. Sometimes we just keep them in the loop. On this one, it was a major case, and there were both enforcement people, and the oversight people were very much in the loop on how this developed.

**KD:** SEC people?

**DD:** SEC, yeah. Lori Richards and Steve Cutler. It developed. It was a major effort and developed into a major case. Ultimately, the SEC was not happy with the way the Exchange had managed the specialists. They brought a case against the Exchange where the focus was really on the market surveillance aspect of it where this thing got spawned. It was a tough case. It was disappointing to see this sort of stuff had gone on.

**KD:** The extent of what the specialists were doing.

**DD:** Yes. Of course, there was a major consequence to them. It was surprising to see what had gone on, and the length of time and so on.

**KD:** That gets to one last really big issue, which is the fact that the structure of the New York Stock Exchange was it had been in place for a long time. Having human beings as the

intermediaries was looking old fashioned. Was there a sense that this system was approaching some significant change in the nineties? And was that feeding into the kinds of things that you saw happening, as far as specialists and participants?

**DD:** I think there probably was a sense that things were evolving, but I don't see any connection between that and any misconduct on the floor. I would just say in closing that I think one of the things I had always said to my people, and I think my people always felt they could go out and do what they had to do. They had backup. We had their backs. They could be tough and talk to a director who was with a member firm and say we're going to sue you and so on. I also said, "Look, you need to be tough. You need to be aggressive. You need to insist on timely compliance with your reasonable requests. But you also need to be fair."

I said, "There's nothing inconsistent -- I just want you to know -- there's nothing inconsistent with your going out there and being a tough enforcement person and being fair. And I expect you to do both." That was really a theme that we had in our program, and I think we ended up with an effective and a vigorous enforcement program that had the respect of the community.

**KD:** So there is some sense that there had to be balance.

**DD:** Well, sure. You have to treat people fairly. That doesn't mean you can't be tough.

**KD:** Anything else that we should talk about?

**DD:** I don't think so, Ken.

**KD:** Well, we've gotten everything on my list.

**DD:** Okay.

**KD:** Terrific. Thanks a lot.

**DD:** Good.

[End of Interview]