American Stock Exchange and National Association of Securities Dealers Investigations: Fifth Amendment Implications

Sharon O'Grady
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I. INTRODUCTION

The securities markets, composed of the stock exchanges and the over the counter (OTC) market, play an important role in the United States economy. Trading on the exchanges, in establishing the price level of listed securities and affecting securities prices generally, is seen as an indicator of our nation's economic health.

This trading is directly regulated by the exchange organizations and, in the OTC market, by the National Association of Securities Dealers (NASD). These self-regulating organizations (SROs) are subject to the regulatory power vested in the Securities and Exchange Commission (hereinafter Commission or SEC) by the Securities Exchange Act of 1934 (hereinafter Exchange Act or ACT). SROs must enforce among their members the provisions of the Exchange Act, rules and regulations promulgated under the Act, and the SRO's internal rules.

To effect this legislative mandate the exchanges and the NASD are delegated certain governmental powers. Included

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Stock Exchanges perform an important function in the economic life of this country. They serve, first of all, as an indispensible mechanism through which corporate securities may be bought and sold. To corporate enterprise such a market mechanism is a fundamental element in facilitating the successful marshalling of large aggregations of funds that would otherwise be extremely difficult to access. To the public the exchanges are an investment channel which promises ready convertibility of stock holdings into cash. The importance of these functions in dollar terms is vast.

Id. at 349-50.


5. Id. §§ 78f(b)(1), 78o-3(b)(2) (1976).

is the power to discipline members, and certain nonmembers permitted access to SRO facilities, through disciplinary proceedings. These proceedings are governed by the rules and constitution of the SRO, and by the Exchange Act.

Because the exchanges and the NASD play a vital role in the securities area, loss of SRO membership or privileges is correspondingly serious. In recognition of this fact, the courts and Congress have found that persons subject to SRO disciplinary action must be afforded basic constitutional rights.

The SROs, in response to judicial and legislative pressure,
have extended greater constitutional protections to the targets of their investigation than had formerly existed.\textsuperscript{11} Not all of their present practices, however, are protective of individual rights. The three major self-regulatory organizations are the New York and American Stock Exchanges (NYSE and AMEX) and the NASD. The internal rules of two of these, the AMEX and the NASD, provide that a member or affiliate who refuses to testify or furnish information to the SRO may be suspended or expelled from membership or, in the case of an affiliate, lose that status.\textsuperscript{12}

\textbf{11.} For example, the American Stock Exchange (AMEX), the NASD and the New York Stock Exchange (NYSE) have all abolished rules prohibiting subjects of disciplinary proceedings to be represented by counsel at the disciplinary hearings. \textit{AM. STOCK EX. CONST.} art. V, § 1(a), [1978] 2 \textit{AM. STOCK EX. GUIDE} (CCH) 2153; \textit{NEW YORK STOCK EXCH. CONST.} art. XIV, § 23, [1978] 2 \textit{NYSE GUIDE} (CCH) 1103; \textit{NASD BY-LAWS} art. VII, § 4, [1973] \textit{NASD MANUAL} (CCH) ¶ 1504. See Poser, \textit{Reply to Lowenfels}, 64 \textit{CORNELL L. REV.} 402 (1979).

\textbf{12.} The AMEX constitution provides:

If a member, member organization or approved person is required by the Board, by the Chairman or by any committee authorized by the Board or by the Constitution, to submit his or its books, papers and records or the books, papers and records of any partner, director of officer of such member organization, or to furnish any information to, or to appear and testify before, or to cause any of such employees, partners, directors or officers to appear and testify before, the Board, the Chairman, any such committee, or such officers, employees or representatives of the Exchange as may be designated by the Chairman of such committee, and such member, member organization or approved person shall be adjudged guilty in a proceeding under this Article or having refused or failed to comply with such requirement, such member or member organization may be suspended or expelled from membership, and such approved person may have his approval withdrawn.

\textit{AM. STOCK EX. CONST.} art. V § 4(k), [1978] 2 \textit{AM. STOCK EX. GUIDE} (CCH) 2161. The Rules of Fair Practice of the NASD provide:

For the purpose of any investigation, or determination as to filing of a complaint or any hearing of any complaint against any member of the Corporation or any person associated with a member made or held in accordance with the Code of Procedure, any Local Business Conduct Committee, any District Business Conduct Committee, or the Board of Governors, or any duly authorized member or members of any such Committees or Board of any duly authorized agent or agents of any such Committee or Board shall have the right (1) to require any member of the Corporation or person associated with a member to report orally or in writing with regard to any matter involved in any such investigation or hearing, and (2) to investigate the books, records and accounts of any such member with relation to any matter involved in any such investigation or hearing. No member or person associated with a member shall refuse to make any report as required in this Section, or refuse to permit any inspection of books, records and accounts as may be validly called for under this Section.

\textit{NASD RULES OF FAIR PRACTICE}, art. IV, § 5, [1975] \textit{NASD MANUAL} (CCH) ¶ 2205.
Consequently, a member or affiliate under investigation by the AMEX or the NASD is presented with two unattractive alternatives. He may refuse to testify and upon that ground alone lose his membership or affiliation, or he may testify at the risk that his testimony may be used against him in a subsequent criminal prosecution.\(^\text{13}\) To compound the problem, the Commission has the authority to compel an investigation through a writ of mandamus,\(^\text{14}\) in which case the investigation may be a little more than a device to coerce a potential defendant into waiving his fifth amendment privilege against self-incrimination.\(^\text{15}\) Finally, the penalty for refusal to testify is magnified by the authority of other SROs to expel or suspend the recalcitrant party solely on the ground that the party was expelled or suspended by the AMEX or

NASD Resolution of the Board of Governors further provides:

1. The President is hereby directed and authorized to notify members of the Corporation who fail to provide information with respect to their business practices and/or who fail to keep membership application and supporting documents current and/or who fail to furnish such other information or reports or other material or data duly requested by the Corporation pursuant to the powers duly vested in it by its Certificate of Incorporation, By-Laws and such other duly authorized resolutions and directives as are necessary in the conduct of the business of the Corporation, that the continued failure to furnish duly requested information, reports, data or other material, constitutes grounds for suspension from membership.

2. After (15) fifteen days notice in writing thereof, and continued failure to furnish the information, reports, data or other material as described above in paragraph 1, the President is hereby directed and authorized to suspend the membership of any such member on behalf of the Board of Governors, and to cause notification thereof in the next following membership supplement, to the effect that the membership has been suspended for failure to furnish such duly requested information.

3. Prior to such notice, in writing to the member, the Executive Committee of the Board of Governors shall be notified in writing of such contemplated action by the President.

4. The President shall advise the member concerned, in writing, of the suspension.

Id.

15. See 8 CONN. L. REV. 725 (1976). The fifth amendment provides, in relevant part: "No person shall . . . be compelled in any criminal case to be a witness against himself . . ." U.S. CONST. amend. V, cl. 5. The scope of this comment is limited to investigations affecting individual fifth amendment rights, as the protection against self-incrimination is unavailable to corporations and other organizations. U.S. v. White, 322 U.S. 694, 699 (1944).
the NASD. In addressing this problem, this comment will first explore whether SRO disciplinary proceedings constitute state action, thus triggering the fifth amendment protections. The author will examine the criteria by which constitutional protections are imposed on ostensibly private conduct, and will then apply the criteria to AMEX and NASD proceedings, concluding that these proceedings should be deemed governmental for fifth amendment purposes.

The author will next consider whether the AMEX Constitution article V section 4(k) and article IV section 517 of the NASD rules of Fair Practice constitute a coercion of self-disclosure in violation of the fifth amendment. This analysis will include a discussion of economic coercion as violative of the privilege against self-incrimination. Finally, the comment discusses the arguments concerning application of the privilege to SRO disciplinary action and concludes that the AMEX and the NASD provisions imposing sanctions on refusals to waive the fifth amendment privilege are constitutionally defective.

II. STATE ACTION AS APPLIED TO AMEX AND NASD DISCIPLINARY PROCEEDINGS

Because the fifth amendment is a restraint upon the state and not upon private parties, its proscriptions would apply to AMEX and NASD disciplinary proceedings only if state action is present. To the extent the AMEX and the NASD exercise powers or functions of a governmental character they should be subject to fifth amendment proscriptions.

17. See note 12 supra.
A. Criteria for Determining When Private Conduct Constitutes State Action

In *Jackson v. Metropolitan Edison Co.*, the Supreme Court set forth several factors, none of which is alone determinative, for the courts to consider in determining when federal involvement is sufficient to subject ostensibly private conduct to constitutional limitation imposed on the federal government. One factor is the degree of governmental regulation of the nominally private conduct. The courts are more likely to find state action in a closely regulated area. In assessing this criterion, the courts consider whether the activity of the regulated entity is so closely connected with the state that the entity’s action “may fairly be treated as that of the State itself”.

Another relevant factor is the extent to which the private entity is a monopoly. The monopolistic status of the private enterprise is relevant if there is a significant relationship between that status and the challenged conduct. If the existence of a monopoly makes the activity more threatening, a court is more likely to find government action present.

A third criterion is the existence of a symbiotic relationship between the state and the private action. If the government and the private entity are so interdependent that they are essentially joint participants in a single enterprise, a court is likely to subject the ostensibly private conduct to constitutional restrictions upon the state.

The governmental character of the nominally private action is another factor to be considered. State action is pre-

24. 419 U.S. at 351-52.
27. 419 U.S. at 352-54 (1974); *Evans v. Newton*, 382 U.S. 296, 301-02 (1966);
sent in "in the exercise by a private entity of powers traditionally, exclusively reserved to the State." Thus, private entities providing services essentially governmental in character may be subject to constitutional restraints. Using this test, the Supreme Court had found state action in nominally private conduct involving elections, company towns, and municipal parks.

A final criterion to be assessed is whether the government has sanctioned the challenged activity. Where such approval exists in fact or in appearance, the conduct of the private entity will be closely examined.

The ultimate consideration is that of fairness. In Public Utilities Commission v. Pollak, the Supreme Court held the fifth amendment applicable to a private street railway company. The Court stated, "[W]hen authority derives in part from Government's thumb on the scales, the exercise of that power by private persons becomes closely akin, in some respects, to its exercise by Government itself."

Constitutional limitations apply to government conduct and not private conduct in "the recognition that unchecked governmental power threatens individual rights and liberties in a manner qualitatively different from unchecked private power." The same rationale supports the application of con-

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36. Id. at 462 n.8 (quoting American Communications Ass'n v. Douds, 339 U.S. 382, 401 (1950)).
institutional limitations to private or semi-private entities, whose authority, deriving "in part from Government’s thumb on the scales," 38 poses a greater threat than is posed by purely private enterprises.

B. State Action Criteria Applied to AMEX and NASD Proceedings

1. Degree of government regulation.

Government regulation pervades AMEX and NASD operations. The Exchange Act is directly enforced by the SROs, with the Commission in a supervisory capacity. 39 The Commission must approve, 40 and may prescribe 41 or amend, 42 AMEX and NASD rules. AMEX and NASD must register with the SEC, 43 and the Commission has the power to deny, suspend or revoke registration of an SRO. 44 An exchange may not delist a security without applying to the SEC. 45 AMEX and NASD members are closely regulated by the Commission, 46 and their disciplinary actions are subject to SEC review. 47 Finally, the Commission may instigate an exchange investigation, 48 and subsequently obtain records of the investigation for use in proceedings by the Commission. 49

As a result of the Commission’s extensive regulation of the exchanges, the SROs are so closely connected with the SEC that disciplinary action by the AMEX and the NASD "may fairly be treated" as that of the Commission itself. 50


The AMEX and the NASD occupy a substantially mo-
nopolistic position. They possess a limited antitrust immunity and as a result are permitted to participate in practices which, in another industry, would constitute a refusal to deal in violation of the Sherman Antitrust Act. For example, under the Exchange Act a self-regulatory organization may require members to cease doing business, in whole or in part, with a particular security. Further, an SRO may suspend or expel a party who has been suspended or expelled from another SRO. This monopolistic status is substantially related to AMEX and NASD disciplinary procedures in that, because of the SRO’s peculiar status, and AMEX or NASD disciplinary sanction in effect reverberates throughout the securities industry.


The AMEX and the NASD comprise a part of the enforcement machinery of the SEC. The general policy of the Exchange Act is enforcement through self-regulation coupled with oversight by the Commission. The exchanges form an integral part of this self-regulation as both the principal markets for securities and the principal regulators of broker-dealers using those markets. This system of self-regulation is essential to achieve the goals of the Exchange Act: open and orderly markets and fair dealing and fair pricing of securities with economically efficient transaction costs. The Commission’s heavy involvement in AMEX and NASD matters, could


54. 15 U.S.C. §§ 78f(d)(1), 78o-3(h)(1), (2) (1976). An exchange may also limit the number of its members, access to the floor of the exchange, and competition. Id. §§ 78f(c)(4)(A), (B).

55. Id. §§ 78f(d)(3), 78o-3(h)(3).

56. See notes 23 & 24 and accompanying text supra.

57. See note 39 supra. See also S. Rep. No. 94-75, supra note 1, at 22-33.


60. See notes 39-49 and accompanying text supra.
pled with the SRO's participation in the enforcement of the Exchange Act, makes the AMEX and the NASD, in effect, subagencies of the SEC. Thus, the SROs and the Commission are truly joint participants in the enforcement of the Exchange Act.

4. Governmental character of the challenged activity.

The Exchange Act delegates to the AMEX and the NASD governmental powers pursuant to its scheme of self-regulation. These powers include the ability to impose disciplinary sanctions on members and affiliates, to deny membership to an applicant, and to require members to terminate business relations, entirely or in a specified way, with certain nonmembers or with respect to a particular security.

This delegation of power permits the AMEX and the NASD to enforce not only the legal requirements of the Exchange Act, but ethical standards as well. Because the police power of the AMEX and NASD extends beyond their members and because the sanctions they impose are, in fact, industry-wide, their disciplinary proceedings are essentially


62. S. REP. No. 94-75, supra note 1. "Industry regulation and government regulation are not alternatives, but complementary components of the self-regulatory process." Id. at 22. "The self-regulatory organizations exercise authority subject to SEC oversight. They have no authority to regulate independently of the SEC's control." Id. at 23.

63. S. REP. No. 94-75, supra note 1. See notes 6 & 7 supra.


65. S. REP. No. 94-75, supra note 1, at 23. See note 63 supra.

66. This is because the SROs may require their members to terminate business relations with a nonmember or with respect to a security. S. REP. No. 94-75, supra note 1, at 24. See note 7 supra.

67. This is because 1) they can require members to terminate business relations with nonmembers and with respect to specified securities, and 2) persons suspended or expelled by one SRO may be summarily suspended from any other SRO. See, e.g., art. V, § 5(a) of the AMEX Constitution:

Whenever a member or member organization is suspended or expelled from any other securities exchange or any national securities association, or is suspended or barred from being associated with any member of such exchange or association, or is suspended or barred by any governmental securities agency from dealing in securities or being associated
governmental in nature. 68

5. Government sanction of the challenged activity.

Commission sanction of AMEX and NASD disciplinary procedures is apparent: the Exchange Act requires that the Commission approve SRO rules and the Commission is empowered to amend those rules. 69 Because of this imprimatur, AMEX and NASD rules regarding disciplinary action should be closely scrutinized. 70

C. The Congressional View

Congress has clearly recognized the quasi-governmental character of the SROs: "[T]he exchanges... are delegated government power in order to enforce, at their own initiative, compliance by members of the industry with both the legal requirements laid down in the Exchange Act and ethical standards going beyond those requirements." 71 Legislative history of the 1975 amendments to the Exchange Act demonstrates Congress' clear intent to impose due process requirements on AMEX and NASD proceedings: "Recognizing that the self-regulatory organizations utilize governmental-type powers in carrying on their responsibilities under the Exchange Act highlights the fact that these organizations must be required to conform their activities to fundamental standards of due process." 72

D. The Judicial View

The Supreme Court has not expressly addressed the applicability of fifth amendment due process requirements to SRO actions. In Silver v. New York Stock Exchange, 73 However, the Court held that the threshold question in determining exchange antitrust immunity was whether its procedures were fair. 74 Silver held the New York Stock Exchange had ex-
ceeded its statutory authority by withdrawing private wire connections without opportunity for notice and hearing; thus its action was not immune from antitrust liability. Because of the NYSE's close relationship with the SEC, and its economic importance, the exchange was required to provide procedures comporting with due process if it wished to preserve antitrust immunity.\footnote{Id. at 361-63.} The Court noted the intensive regulation of the exchanges by the SEC.\footnote{Id. at 352-53 & n.7.}

The lower courts have generally read Silver as determining that the exchanges' activities are so intertwined with those of the state that they constitute state action for fifth amendment purposes. One court stated:

It is now beyond dispute that the Fifth Amendment due process requirements as to federal action apply to the disciplinary hearings conducted by the Exchange. Such hearings are conducted under the self-regulatory power conferred upon it by a federal agency, the Securities & Exchange Commission. In Silver... the court stated that the Exchange Act of 1934 imposed upon the Exchange the requirement that it comply with traditional notions of 'fair procedures'...\footnote{Villani v. New York Stock Exch., 348 F. Supp. 1185, 1188 n.1 (S.D.N.Y. 1972), aff'd sub nom. Sloan v. New York Stock Exch., 489 F.2d 1 (2d Cir. 1973). See Intercontinental Indus., Inc. v. American Stock Exch., 452 F.2d 935 (5th Cir. 1971): [T]he Exchange's position that constitutional due process is not required since the Exchange is not a governmental agency is clearly contrary to numerous court decisions. See Burton v. Wilmington Parking Authority, 365 U.S. 715... (1961), Colon v. Tompkins Square Neighbors, Inc., 294 F. Supp. 134 (S.D.N.Y. 1968); McQueen v. Druker, 438 F.2d 781 (1st Cir. 1971). The intimate involvement of the Exchange with the Securities and Exchange Commission brings it within the purview of the Fifth Amendment controls over governmental due process. Id. at 941 (footnote omitted). The Intercontinental court noted the pervasive government regulation of the exchanges. Id.}

Similarly, in Intercontinental Industries, Inc. v. American Stock Exchange,\footnote{452 F.2d 935 (5th Cir. 1971).} the Fifth Circuit noted that a need for flexibility did not justify the exchange rules' failure to provide the necessary elements of constitutional due process. The court determined that the AMEX's intimate involvement with the SEC brought it within the purview of fifth amendment due process,\footnote{Id. at 941.} but went on to find that the petitioner had received
a hearing comporting with due process requirements.

A departure from these determinations that SRO investigations constitute state action sufficient to require liaise with the fifth amendment, was the Second Circuit's decision in United States v. Solomon. The Solomon court held that an NYSE interrogation was not state action for purposes of the fifth amendment self-incrimination clause. Solomon had been requested to testify regarding his alleged understatement of operating expenses. Under the NYSE constitution as it then existed, Solomon could have been suspended or expelled for refusal to testify. The exchange forwarded Solomon's testimony to the SEC, which used it to subsequently indict and convict him for "creating and maintaining false record."

The Solomon court based its decision on the unfavorable consequences of immunizing the subject of an exchange investigation from later criminal prosecution. The court apparently believed that a finding that the fifth amendment privilege applied to exchange disciplinary proceedings would effectively give the NYSE the power to confer immunity. This, however, is not an inescapable conclusion. The court could simply have found the NYSE's suspension or expulsion of members refusing to testify to be unconstitutional. Subsequent to the Solomon decision, the Exchange Act was amended to require SROs to provide certain procedural protections; in addition, the amendments sharply increased SRO involvement with the SEC. In light of this legislative development, the Solomon court's finding that state action is not present in SRO investigations for purposes of the fifth amendment privilege may no longer be good law.

Extensive federal involvement in AMEX and NASD proceedings is demonstrated by pervasive government regulation,
the SRO’s limited antitrust immunity, the close interrelation between the Commission and the SROs, the governmental character of the disciplinary proceedings, and by Commission sanction of these proceedings. In light of this overwhelming evidence of “Government’s thumb on the scales,” fairness would dictate that AMEX and NASD proceedings be treated as state action for constitutional purposes. Consequently, the fifth amendment privilege against self-incrimination should adhere to SRO investigations unless properly waived. The ensuing section will discuss the coercive nature of AMEX and NASD disciplinary actions as invalidating a purported waiver of the fifth amendment privileges.

III. AMEX AND NASD DISCIPLINARY PROCEEDINGS: COMPULSORY SELF-DISCLOSURE VIOLATIVE OF THE FIFTH AMENDMENT PRIVILEGE

The privilege against self-incrimination has been criticized on the ground that it shields guilty persons from justice and is not needed by innocent persons. This criticism ignores the basic underpinning of the privilege that, regardless of guilt, a person should not be forced to prove the government’s case against him: in essence, to convict himself.

88. See text accompanying notes 18-38 supra.
89. See note 36 and accompanying text supra.
As to its intrinsic merits . . . may we not express the general opinion in this way, that the privilege is not needed by the innocent, and that the only question can be how far the guilty are entitled to it?
Id. at 86.

Terry, Constitutional Provisions Against Forcing Self-incrimination, 15 YALE L. J. 127 (1906).
The rule of our law, which is embedded in our constitutions, that no one shall be compelled to criminate himself, ought to be abolished, at least in criminal cases. The reasons for it have ceased to exist, and it is now merely a protection to rogues against justice.
Id. at 127.


The securities area illustrates why constitutional protections are necessary. There are indications that the public is unsympathetic toward persons accused of violating the securities laws. Responding to a challenge that the SEC was violating fundamental rights, an SEC official stated that such practices were justified because, "[T]hese are the fat cats we are dealing with." It is incongruous to suggest that persons accused of murder, robbery, or rape should be protected under the fifth amendment, while a broker accused of an Exchange Act violation should be denied similar protection.

A. Background

Provided state action is present, the privilege against self-incrimination may be raised in any proceeding: criminal, civil, administrative, adjudicatory or judicial. The proscription, however, applies only to testimony tending to subject the speaker to criminal liability. It cannot be raised to avoid "the personal disgrace or opprobrium attaching to the exposure of . . . crime." SRO proceedings have not themselves been found to be penal in nature, but have been held to exist

U.S. 616, 631-32 (1885).
96. Id. at 605. The Court added: "[I]f the proposed testimony is material to the issue on trial, the fact that the testimony may tend to degrade the witness in public estimation does not exempt him from the duty of disclosure." Id. The proceedings need not be criminal, but the information must expose the witness to a criminal charge. Id. See also In re Daley, 549 F.2d 469 (7th Cir. 1977).
for the protection of the public, rather than for the punish-
ment of the offender. Although the actual proceedings are
not criminal cases within the language of the fifth amend-
ment, the subject of an AMEX or NASD investigations may
also find himself facing criminal charges arising from his mis-
conduct. Therefore the privilege, unless waived, should ap-
ply to SRO proceedings.

Determining when testimony has, in fact, been compelled
is the most troublesome area of the privilege. It is fundamen-
tal that the state may not coerce a waiver of the privilege. Compulsion may take many forms, not the least important of
which, economic coercion, is particularly serious in the con-
text of SRO proceedings.

B. The Economic Coercion Cases

In Union Pacific Railroad Company v. Public Service
Commission, the Supreme Court established that a state
must do more than merely claim voluntary waiver of a constitu-
tional right. The Public Service Commission of Missouri

97. A.J. White & Co. v. SEC, 556 F.2d 619 (1st Cir.), cert. denied, 434 U.S. 969
(1977). But see Kozerowitx v. Florida Real Estate Comm'n, 289 So. 2d 391 (Fla.
1974), where the Florida Supreme Court held a revocation or suspension hearing
before the Florida Real Estate Commission to be a criminal case.
98. E.g., United States v. Solomon, 509 F.2d 863 (2d Cir. 1975).
The witness' testimony may be used against him in an SEC action to withdraw
his broker's license or in a civil injunction action brought by the SEC. 15 U.S.C.
§§78f(d)(1), 780-3(h)(1) (1976) requires exchanges and registered securities associa-
tions to keep record in disciplinary proceedings, and 15 U.S.C. §21(b) (1976) gives the
Commission access to such records. The testimony may also be used in a criminal
action brought by the United States Attorney's Office. FED. R. CRIM. P. 17(c).

[C]onvictions following the admission into evidence of confessions which
are involuntary, i.e. the product of coercion, either physical or psycho-
logical, cannot stand. This is so not because such confessions are un-
likely to be true but because the methods used to extract them offend
an underlying principle in the enforcement of our criminal law: that ours
is an accusatorial and not an inquisitorial system—a system in which
the State must establish guilt by evidence independently and freely se-
cured and may not by coercion prove its charge against an accused out
of his own mouth.

Id. at 541.

While reliability of information is an evil which the proscription addresses, it is
not the privilege's raison d'etre. See Blackburn v. Alabama, 361 U.S. 199, 206-07
(1960); Spano v. New York, 360 U.S. 315, 320-21 (1959); Rochin v. California, 342
U.S. 165, 172-74 (1952); Lisenba v. California, 314 U.S. 219, 236 (1941); Chambers v.
Florida, 309 U.S. 227, 228 (1940). See also Watts v. Indiana, 338 U.S. 49, 54-55
(1949).
100. 248 U.S. 67 (1918).
had charged the Union Pacific Railroad nearly $11,000 for a certificate authorizing the company to issue bonds. The Union Pacific paid the charges, but challenged the fee as an unconstitutional interference with interstate commerce. The Missouri Supreme Court found that the railroad, by paying the charges “voluntarily,” could not challenge the payments on constitutional grounds.¹⁰¹ The United States Supreme Court reversed finding that the company had not waived the right to challenge the constitutionality of the fee. The Court reasoned that since conduct under duress always involves a choice however difficult, the government could always override constitutional provisions by providing intolerable alternatives for non-acquiescence, if acquiescence were found to effect a waiver.¹⁰²

The Supreme Court subsequently addressed economic coercion in the context of the fifth amendment privilege, in a series of cases involving threatened loss of employment. *Garrity v. New Jersey*¹⁰³ involved interrogation of police officers in the course of an investigation into the fixing of traffic tickets. The Court held that the threat of removal from public office under a forfeiture of office statute rendered the statements involuntary and therefore inadmissible. “Where the choice is ‘between the rock and the whirlpool,’ duress is inherent in deciding to ‘waive’ one or the other.”¹⁰⁴

Similarly, the Court in *Spevack v. Klein*¹⁰⁵ held that an attorney cannot be disbarred for asserting his fifth amendment privilege. The Court found that the threat of disbarment was as coercive as the use of legal process.¹⁰⁶ The Court stated, “the 5th Amendment guarantees . . . the right of a person to remain silent unless he chooses to speak in the unfettered exercise of his own will, and to suffer no penalty . . . for such silence.”¹⁰⁷

More recent Supreme Court opinions indicate that the principle propounded in *Garrity* and *Spevack* is still valid.

¹⁰¹ Id. at 69.
¹⁰² Id. at 70. See Atchison, Topeka & Santa Fe Ry. Co. v. O'Connor, 223 U.S. 280 (1912); United States v. Rothstein, 187 F. 268 (7th Cir. 1911).
¹⁰⁵ 385 U.S. 511 (1967) (companion case to *Garrity*).
¹⁰⁶ Id. at 516.
¹⁰⁷ Id. at 514 (citing Malloy v. Hogan, 378 U.S. 1, 8 (1964)). The Court defined “penalty” as any sanction making assertion of the privilege costly. Id. at 515 (citing Griffin v. California, 380 U.S. 609, 614 (1965)).
One year after Garrity and Spevack the Court held, in Gardner v. Broderick, that a policeman could not be fired for refusing to waive his privilege against self-incrimination. A variation on Garrity, which related to the use of the compelled testimony, Gardner addressed the consequences of a refusal to submit to the coercion. The Court indicated that a police officer could be dismissed for refusing to answer questions concerning his official duties if not required to surrender his constitutional privilege.

Uniformed Sanitation Men Association v. Commissioner of Sanitation, a companion case to Gardner, held that New York City sanitation employees could not be compelled to choose between surrendering their privilege against self-incrimination or their jobs. The Court reiterated that the employees could be discharged for failure to account for their conduct as public employees, but only if not required to relinquish their fifth amendment privilege.

Similarly, Lefkowitz v. Turley held economic coercion to be a sufficient compulsion to invalidate a purported waiver of the privilege. The decision found the privilege applicable to official inquiries into the job performance of government contract holders. The Court found no constitutional distinction between the threat of loss of employment and the threat of contract loss to a public contractor. It determined that disqualification from contracting with government agencies for a period of five years was a sufficiently substantial economic sanction to render a purported waiver secured under its threat involuntary. The Court held that the proscription could not be overridden by state interest; immunity must be granted if testimony is to be compelled.

109. Id. at 277-78.
111. Id. at 285. "[P]etitioners, being public employees, subject themselves to dismissal if they refuse to account for their performance of their public trust, after proper proceedings, which do not involve an attempt to coerce them to relinquish their constitutional rights." Id.
113. Id. at 83-84.
114. Id. at 78.
115. Id. at 84. It is important to remember that the information sought may be compelled if use immunity is granted. Gardner v. Broderick, 392 U.S. 273, 276 (1968); Murphy v. Waterfront Comm'n, 378 U.S. 52, 79-80 (1964); Ullman v. United States, 350 U.S. 422, 430-31 (1956); Brown v. Walker, 161 U.S. 591 (1896). Thus, state interest need not be wholly sacrificed for the protection of individual rights.
In 1977, the Court decided *Lefkowitz v. Cunningham*, the latest of the employment compulsion cases. In that case, an attorney was divested of his state political party offices pursuant to a New York statute when he refused to waive his privilege in an appearance before a grand jury. The Court held the statute violative of the attorney's fifth amendment right to be free from compelled self-incrimination: "[O]ur cases have established that a State may not impose substantial penalties because a witness elects to exercise his Fifth Amendment right not to give incriminating testimony against himself."

The positions that the attorney lost were unsalaried, yet the Court found the sanction significant enough to constitute coercion.

It is true, as appellant points out, that our earlier cases were concerned with penalties having a substantial economic impact. But the touchstone of the Fifth Amendment is compulsion, and direct economic sanctions and imprisonment are not the only penalties capable of forcing the self-incrimination which the Amendment forbids.

In finding compulsion, the Court noted the prestige and influence of Cunningham’s party offices, the predictable damage to his professional standing and general reputation, and his disqualification from potential compensated political and public offices.

Certain guidelines emerge from the economic coercion cases. First, in each case the test of involuntariness was the existence of a substantial economic sanction. In determining when a penalty has a "substantial economic impact," the line should probably be drawn somewhere between *Cunningham* or *Turley* and *United States ex rel. Sanney v. Montanye*, in which the Second Circuit found that loss of a job held by an itinerant laborer for two days was not a sub-

117. Id. at 805.
120. Id. at 807.
121. Id. at 806.
123. 500 F.2d 411 (2d Cir. 1974).
stantial economic sanction rendering petitioner's statement involuntary. 124

Further, in each of the economic coercion cases the failure to testify, without more, was sufficient to trigger the sanction. 125 In contrast, the Supreme Court in Baxter v. Palmigiano, 126 addressing the issue of procedural due process in the context of prison disciplinary hearings, held that an adverse inference may be drawn in a civil case from a refusal to testify when such refusal was only one of several factors to be considered by the trier of fact. 127

Finally, the economic coercion cases reject the argument that an overriding state interest may justify the constitutional infringement. In each case important state interests were at stake: the public interest in an honest police force 128 and civil service, 129 and in the integrity of state contracting practices 130 and political process. 131 Under these cases, however, state interest need not be sacrificed. The state does not have to choose between an accounting from, or a prosecution of, a party—the availability of use immunity adequately protects the public interest: 132 "[U]se immunity . . . permit[s] the state to prosecute appellee for any crime of which he may be guilty . . . provided only that his own compelled testimony is not used to convict him." 133 Consequently, the state does not forfeit the opportunity to prosecute on the basis of independent evidence.

C. AMEX and NASD Proceedings and the Fifth Amendment: The Arguments

1. Loss of SRO membership constitutes a substantial economic sanction.

124. Id. at 415.
127. Id. at 317.
The position of AMEX and NASD members and associates is similar to that of the aggrieved parties in the economic coercion cases. Loss of membership is analogous to loss of employment because without access to the SROs, it would not be feasible for a broker-dealer to remain in business.\textsuperscript{184} As the Court in Turley recognized, an independent contractor is substantially affected when access to an important market is terminated.\textsuperscript{185} Broker-dealers are similarly affected when access to the securities markets is terminated.\textsuperscript{186}

In both Turley and Cunningham the Court also considered indirect effects of the imposed sanction. In Cunningham these effects included the politician’s ineligibility for future political or public office and loss of reputation and professional standing.\textsuperscript{137} The statute held unconstitutional in Turley provided for both the cancellation of present government contracts and ineligibility for future government contracts as sanctions for failure to testify.\textsuperscript{138} The Court also recognized that the plaintiffs might encounter difficulty in obtaining future employment because no firm could hire them and remain eligible for government contracts.\textsuperscript{139}

The suspended AMEX or NASD member faces even greater economic problems. The SROs dominate the securities area, and while the architects in Turley might have survived on work in the private sector, a broker-dealer could hardly remain in business without access to the securities markets.\textsuperscript{140} The SRO’s monopolistic position renders loss of membership far more disabling than mere loss of present employment because it also greatly restricts the availability of future employment. The AMEX and the NASD may bar the nondisclosing party from employment, in any capacity, with any AMEX or NASD member firm.\textsuperscript{141} Additionally, the expelled or suspended party may find himself summarily suspended from

\begin{itemize}
\item \textsuperscript{134} See, e.g., Freeman, Administrative Procedures, 22 Bus. Law. 891 (1967).
\item \textsuperscript{135} Lefkowitz v. Turley, 414 U.S. 70, 83 (1973).
\item \textsuperscript{136} A broker-dealer suspended from one SRO may lose access to the facilities of the other SROs. See 15 U.S.C. §§ 78f(d), 78o-3(h) (1976).
\item \textsuperscript{137} Lefkowitz v. Cunningham, 431 U.S. 801, 807 (1977).
\item \textsuperscript{138} Lefkowitz v. Turley, 414 U.S. 70, 71 n.1 (1973).
\item \textsuperscript{139} Id. at 84 & n.4.
\end{itemize}
other SROs with whom he holds membership, on the basis of his suspension from the AMEX or the NASD. 142

2. Refusal to testify is the sole ground for imposing the sanction.

As in the Garrity line of cases, the sanctions provided by the AMEX and NASD rules may be imposed solely upon a member's or associate's refusal to testify. Article V section 4(k) of the AMEX Constitution 143 provides that, if a member is required by an authorized party 144 to submit records, furnish information, or appear and testify, and he refuses or fails to comply, he may be suspended or expelled from membership. An approved person who fails to comply with section 4(k) requirements may have his approval withdrawn. 145

Similarly, the NASD Rules of Fair Practice provide that an authorized party 146 may require a member or associate to report orally or in writing with respect to any matter involved in an investigation. 147 By resolution of the Board of Governors, the president of the NASD is authorized to suspend

142. 15 U.S.C. § 78f(d)(3) provides:
A national securities exchange may summarily (A) suspend a member or person associated with a member who has been and is expelled or suspended from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization . . . (C) limit or prohibit any person with respect to access to services offered by the exchange if subparagraph (A) . . . is applicable to such person . . . .

Similarly, 15 U.S.C. § 78o-3(h)(3) provides:
A registered securities association may summarily (A) suspend a member or person associated with a member who has been and is expelled or suspended from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization . . . or (C) limit or prohibit any person with respect to access to services offered by the association if subparagraph (A) . . . is applicable to such person . . . .

See note 7 supra.

143. See note 12 supra.

144. Authorized parties include the chairman of the Board of Governors, the Board of Governors, or any committee authorized by the Board or the constitution. AM. STOCK EX. CONST. art. V, § 4(k), [1978] 2 AM. STOCK EX. GUIDE (CCH) 2161.

145. Id.

146. Authorized party is defined as "any Local Business Conduct Committee, any District Business Conduct Committee, or the Board of Governors, or any duly authorized member or members of such Committees or Board . . . ." NASD RULES OF FAIR PRACTICE, art. IV, § 5, [1975] NASD MANUAL (CCH) ¶ 2205.

147. The information may be required "[f]or the purpose of any investigation, or determination as to filing of a complaint or any hearing of any complaint against any member . . . or any person associated with a member made or held in accordance with the Code of Procedure . . . ." Id.
members who refuse to furnish the requested information. Because a member's refusal to testify is the only ground necessary for suspension of membership, Baxter v. Palmigiano is inapplicable.

Baxter held it permissible to draw adverse inferences from an inmate's silence at a prison disciplinary hearing. Since the case involved prisoners who necessarily sacrifice, to a certain extent, their constitutional rights upon incarceration, it is not necessarily applicable in the context of AMEX and NASD proceedings. The case has, however, been followed in cases involving proceedings to discipline attorneys and physicians, as well as other administrative and civil proceedings. The Supreme Court itself has given Baxter a broad reading but has emphasized the fact that failure to testify was not determinative: "Respondent's silence in Baxter was only one of a number of factors to be considered by the finder of fact in assessing a penalty, and was given no more probative value than the facts warranted . . . ." Cases applying Baxter emphasized that the Garrity-Lefkowitz decisions are restricted to situations where failure to waive the privilege, "standing alone and without regard to other evidence," triggers the sanction. SRO proceedings clearly fall

151. DeVita v. Sills, 422 F.2d 1172 (3d Cir. 1970). The court stated: "There is nothing in the rules or the court order from which we can conclude that the plaintiff's failure to testify will be held a ground for disbarment or forfeiture of office." Id. at 1177. See Sternberg v. State Bar, 384 Mich. 588, 185 N.W.2d 395 (1971).
within the Supreme Court’s apparent requirement that the sanction flow from the refusal to waive the privilege against self-incrimination alone.  

3. Public interest cannot justify infringement upon the privilege.

Because of the importance of the exchanges and the securities associations to the securities industry, and therefore to the nation’s economic health, a strong public interest supports preserving the integrity of these organizations. Enforcement of the securities laws may arguably be hampered by requiring full constitutional protections in SRO proceedings. Clearly the enforcement system operates most efficiently and expeditiously with minimum constitutional protections.

The difficulty with this argument is that it could be applied with equal force to criminal proceedings. Law enforcement in general would be more efficient if no privilege against self-incrimination existed, but constitutional protections should not be sacrificed to expediency. "The immediate and potential evils of compulsory self-disclosure transcend any difficulties that the exercise of the privilege may impose on society in the detection and prosecution of crime."

In the economic coercion cases, the Supreme Court has expressly rejected the argument that an overriding state interest may justify an infringement of the fifth amendment privilege. It would be difficult to argue that SRO proceedings advance a higher state interest than that present in Garrity and Gardner v. Broderick: the interest in an honest police

156. See notes 132-34 and accompanying text supra.
158. Poser, Reply to Lowenfels, 64 CORNELL L. REV. 402 (1979). [T]he advantages of the self-regulatory system—expertise, speed, and the enforcement of ethical as well as legal standards—are vital today as they were in 1934. If SRO disciplinary proceedings were to become merely a copy of those of the SEC, an important justification for having a system of self-regulation would disappear.
force.

A related argument, advanced in United States v. Solomon, is that to extend constitutional protection in SRO proceedings would render self-regulation in all areas unworkable. Solomon, the only circuit court case to squarely address the applicability of the privilege to SRO proceedings, held no state action for purposes of the fifth amendment privilege was present. In so doing, the court minimized the extensive regulation in the securities area and found that the exchange was not an agency of the legislative government, on the dubious ground that the government had not totally preempted self-regulation. In light of the increased government intervention in the securities area as a result of the Securities Acts Amendment of 1975, the continued validity of this holding is questionable. In passing the new legislation, Congress expressly recognized that the exchanges utilize governmental power, and required the exchanges, in disciplining members, to conform to procedural due process requirements that the NASD was already subject to.

The Solomon court emphasized the practical difficulties of extending the protection of the privilege to the subjects of SRO investigations. The court suggested that a decision in favor of Solomon would give the exchanges the power to grant immunity. The SEC, in response, would have to order the exchanges to either refrain from asking potentially incriminating questions, or abandon "the only effective sanction possessed

164. Id. at 868-69.
165. The exchanges' "traditional process of self-regulation" was not displaced. . . . Rather the SEC was given the power and the duty to make sure that the responsibility was diligently and effectively used . . . . It is not enough to create an agency relationship that Solomon's conduct violated both a rule of NYSE, thereby subjecting him to disciplinary action by that body, and federal law, with consequent liability to civil and criminal enforcement proceedings by the Government.

Id. at 869 (footnote omitted).
166. Securities Acts Amendments of 1975, Pub. L. No. 94-29, 98 Stat. 97 (codified in scattered sections of 15 U.S.C.). The amendments prescribe minimum procedural requirements that exchanges must observe in their disciplinary proceedings, 15 U.S.C. § 78f(d) (1976), impose restrictions on the ability of exchanges to limit their membership, Id. § 78f(c), and set fixed commission rates, Id. § 78f(e), increase Commission oversight over exchange rules, Id. §§ 78s(b), (c), and establish SEC review of exchange disciplinary action, Id. §§ 78s(d)-(f). See note 87 and accompanying text supra.
by a private body not endowed with the power to compel testimony.\textsuperscript{169} This analysis fails to take into account a middle course like that taken in Baxter v. Palmigiano\textsuperscript{170} which would permit adverse inferences to be drawn from a failure to testify, but which would not permit the failure to testify to be determinative.\textsuperscript{171}

The court in Solomon overstated the importance to the SROs of the suspension sanction for failure to testify. The NYSE demonstrated that the rule is not essential to securities industry self-regulation when it deleted its provision imposing that sanction for failure to testify by amendment to its constitution in 1978.\textsuperscript{172} As noted previously,\textsuperscript{173} serious conflicts with public policy can be minimized through the use of immunity:\textsuperscript{174} that device could ensure that both public interest and individual rights are protected.\textsuperscript{175}

4. Consent to AMEX and NASD rules does not constitute a waiver of the privilege.

It has been contended that upon joining the AMEX or the NASD a member agrees to be bound by its rules and constitution, and therefore has contractually consented to disciplinary proceedings delineated in the SRO's constitution and rules.\textsuperscript{176} While this theory justifies AMEX or NASD jurisdiction over a member, it does not support waiver of a constitutional privilege because of the unequal bargaining power of the parties involved. Since an applicant's failure to consent would result in denial of his membership application, any purported waiver of his fifth amendment privilege would be involuntary and therefore invalid under the economic coercion

\textsuperscript{169} United States v. Soloman, 509 F.2d 863, 870 (1975).
\textsuperscript{170} 425 U.S. 308 (1976).
\textsuperscript{171} See Arthur v. Stern, 560 F.2d 477 (1st Cir.), cert. denied, 434 U.S. 1034 (1977); DeVita v. Sills, 422 F.2d 1172 (3d Cir. 1970); text accompanying notes 150-63 supra.
\textsuperscript{172} NEW YORK STOCK EX. CONST. art. XIV, [1979] 2 NYSE GUIDE (CCH) 1091. Compare NEW YORK STOCK EX. CONST. art. XIV § 9, [1957] NYSE GUIDE (CCH) 1659.
\textsuperscript{173} See text accompanying notes 135-40 supra.
\textsuperscript{175} Id.
cases.\textsuperscript{177}

Court’s addressing the consent issue in the context of SRO proceedings have recognized constitutional limitations. In \textit{Robert Stark, Jr., Inc. v. New York Stock Exchange},\textsuperscript{178} a federal district court held that, while exchange members subject themselves to exchange jurisdiction, the exchange must exercise its power fairly. In \textit{Villani v. New York Stock Exchange},\textsuperscript{179} the court found that plaintiffs had knowingly and intelligently consented to be bound by the exchange’s constitution and rules, but added: “Were the . . . procedures more suspect from a constitutional viewpoint, we might be inclined to give less weight to this argument.”\textsuperscript{180} The consent theory also ignores legislative acceptance of the applicability of constitutional protections to SRO proceedings discussed above.\textsuperscript{181}

\section*{D. AMEX and NASD Disciplinary Actions: The Future}

The Supreme Court has not yet resolved whether fifth amendment privilege waiver in the context of AMEX and NASD disciplinary action is coercive and hence invalid. Because the costs of litigation and even temporary loss of SRO membership is high, there is tremendous pressure on members and associates to settle disputes at the SRO level.\textsuperscript{182} As a result there is relatively little litigation in the area. When the issues do reach the courts, the courts have tended to require only minimal constitutional protections.\textsuperscript{183}

\begin{footnotes}
\item[177] See text accompanying notes 107-40 \textit{supra}. Cf. \textit{Union Pac. R.R. Co. v. Public Serv. Comm’n}, 248 U.S. 67 (1918) (no consent to waiver of constitutional right when allegedly unconstitutional fee was paid so that company could issue bonds).
\item[180] \textit{Id.} at 1192.
\item[181] See text accompanying notes 71-72 \textit{supra}.
\item[183] Although courts have generally recognized that SRO investigations must comport with due process, they have tended to construe constitutional requirements narrowly. It has been held that the target of an SRO investigation has no right to demand answers to interrogatories. \textit{Crimmins v. American Stock Exch.}, \textit{368 F. Supp. 270 (S.D.N.Y. 1972), aff’d}, 503 F.2d 560 (2d Cir. 1974). \textit{See also NLRB v. Interbor Contractors, Inc.}, \textit{432 F.2d 854 (2d Cir. 1970), cert. denied, 402 U.S. 915 (1971)}; \textit{Villani v. New York Stock Exch.}, 348 F. Supp. 1185 (S.D.N.Y. 1972), \textit{aff’d sub nom. Sloan v. New York Stock Exch.}, \textit{489 F.2d} 1 (2d Cir. 1973). One court found there was no sixth amendment right to counsel in SRO disciplinary hearings. \textit{Crimmins v. American Stock Exch.}, \textit{368 F. Supp. 270 (S.D.N.Y. 1972), aff’d}, 503 F.2d 560 (2d Cir. 1974). NYSE, AMEX and NASD, however, have abolished their no-counsel rules. \textit{See note} 11 \textit{supra}. Another case held that subjects of exchange disciplinary proceedings
\end{footnotes}
The reforms in the area of procedural protections have tended to come from Congress and the SROs themselves. The NYSE has now deleted its rule providing for suspension or expulsion from membership for refusal to testify. The AMEX and the NASD should follow the lead of the NYSE, or alternatively amend their rules to denominate a member's refusal to testify as merely one factor to be considered in determining whether a disciplinary sanction is appropriate. If the AMEX and the NASD continue to fail to provide fair disciplinary procedures, the judiciary, Congress or the SEC should require compliance with the fifth amendment proscription against compelled self-disclosure.

IV. CONCLUSION

AMEX and NASD disciplinary proceedings should be given state action treatment because, as a result of "Government's thumb on the scales," they pose a greater threat to individual liberties than does purely private conduct. Thus, these organizations must afford protection to their members from involuntary waiver of their fifth amendment privilege.

The present AMEX and NASD rules infringe upon members' fifth amendment privilege against self-incrimination. These constitutionally defective rules must be struck down, or amended, if not by the organizations themselves then by the Commission, the Congress, or the courts.

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had no constitutional right to cross examine exchange officials or staff. Intercontinental Indus., Inc. v. American Stock Exch., 452 F.2d 935 (5th Cir. 1971).

184. Congress has mandated procedural due process requirements in SRO disciplinary actions. See notes 173-75 and accompanying text supra.

185. For example, all three major self-regulatory organizations have abolished their no-counsel rule, despite court decisions holding no sixth amendment right to counsel in SRO disciplinary hearings. See notes 11 and 93 and accompanying text supra.

186. See note 179 and accompanying text supra.