

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
: :
WARREN TREPP, Respondent :
: :

BRIEF OF WARREN TREPP
IN SUPPORT OF PETITION FOR REVIEW

William G. Hundley
Larry S. Gondelman
Daniel F. McInnis
Akin, Gump, Strauss, Hauer & Feld, L.L.P.
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 887-4000

Attorneys for Respondent
Warren Trepp

TABLE OF CONTENTS

TABLE OF AUTHORITIES	iii
I. INTRODUCTORY STATEMENT.....	1
II. PROCEDURAL HISTORY	3
III. STATEMENT OF FACTS	4
IV. ARGUMENT.....	9
A. The Judge’s Finding that Warren Trepp Knew of or Recklessly Disregarded an Illegal Parking Arrangement is Unsupported by the Record and is Contradicted by Other Findings of the Judge.....	9
B. The Cease and Desist Order Sought by the Division Against Mr. Trepp is a Penalty and, Therefore, Barred by the Five-Year Statute of Limitations in 28 U.S.C. § 2462.....	15
1. The Reasoning of the D.C. Circuit in <u>Johnson v. SEC Applies</u> to Bar a Cease and Desist Order Based on Alleged Misconduct Over Five Years Old	15
2. The Collateral Consequences Resulting from the Issuance of a Cease and Desist Order Make the Imposition of Such a Sanction a Penalty.....	18
3. The Division’s Reliance on Alleged Past Misconduct to Justify the Issuance of a Cease and Desist Order Proves that Such an Order is a Penalty.....	21
4. The Cease and Desist Order Would Serve No Remedial Purpose.....	23
5. Conclusion.....	23
C. The Cease and Desist Provision of the Remedies Act Cannot be Applied Retroactively.....	24
1. A Fundamental Principle of the Rule of Law is That Newly Enacted Statutes are Presumed Not To Have Retroactive Effect.....	24
2. When Congress Passed the Remedies Act of 1990, It Did Not Grant the SEC the Power To Impose Retroactive Cease and Desist Orders.....	25

3.	If the SEC Were To Issue a Cease and Desist Effect Order Based Solely Upon Conduct That Occurred Prior To the Enactment of the Remedies Act, the Order Would Necessarily Have Retroactive Effect.....	27
D.	The Commission’s Prior Fact Finding In Its Settlements With Reliance and Pankratz Prevents the Commission From Appearing To Be An Impartial Adjudicator	29
1.	The Findings of Fact by the Commission in Its Settlements with Reliance and John Pankratz Cast Doubt Upon the Commission’s Ability to Review Trepp’s Case De Novo	30
2.	Due Process Does Not Preclude the Commission From Asserting Its Claims Before An Impartial Article III District Judge	34
V.	CONCLUSION.....	36

TABLE OF AUTHORITIES

CASES:

<u>American Steel Foundries v. Tri-City Cen. Trade Council</u> , 257 U.S. 184 (1921)	27, 28
<u>Amos Treat & Co. v. SEC</u> , 306 F.2d 260 (D.C. Cir. 1962)	31, 32
<u>Andrus v. Glover Construction Co.</u> , 446 U.S. 608 (1980)	26
<u>Antoniou v. SEC</u> , 877 F.2d 721 (8th Cir.).....	31, 32
<u>Arch Mineral Corp. v. Babbitt</u> , 104 F.3d 660 (4th Cir. 1997).....	18
<u>Bowen v. Georgetown University Hosp.</u> , 488 U.S. 204 (1988)	24, 25
<u>Cinderella Career & Finishing Sch., Inc. v. FTC</u> , 425 F.2d 583 (D.C. Cir. 1970)	32
<u>Consolidated Rail Corp. v. Primary Indus. Corp.</u> , 868 F. Supp. 566 (S.D.N.Y. 1994).....	24
<u>Duplex Printing Press Co. v. Deering</u> , 254 U.S. 443 (1921)	27, 28
<u>Gersman v. Group Health Ass'n, Inc.</u> , 975 F.2d 886 (D.C. Cir. 1992)	25
<u>Gilligan, Will & Co. v. SEC</u> , 267 F.2d 461 (2d Cir. 1951).....	34
<u>Goldberg v. Kelly</u> , 397 U.S. 254 (1970)	31
<u>Hall v. Beals</u> , 396 U.S. 45 (1969)	27
<u>Johnson v. SEC</u> , 87 F.3d 484 (D.C. Cir. 1996)	passim

<u>Landgraf v. USI Film Prods,</u> 511 U.S. 244 (1994)	passim
<u>Meadows v. SEC,</u> 119 F.3d 1219	22
<u>Miller v. Florida,</u> 482 U.S. 423 (1987)).....	29
<u>In re Murchison,</u> 349 U.S. 133 (1955)	31
<u>Offutt v. United States,</u> 348 U.S. 11 (1954)	31
<u>Reynolds v. M' Arthur,</u> 27 U.S. (2 Pet.) 417 (1829)	24
<u>Rubin Quinn Moss Heaney & Patterson v. Kennel,</u> 832 F. Supp. 922 (E.D. Pa. 1993)	24
<u>Staton v. Mayes,</u> 552 F. 2d 908 (10th Cir.), cert. denied, 434 U.S. 907 (1977)	32
<u>In re Stuart-James Co.,</u> 50 S.E.C.468 (1991 WL 291802) (Jan. 23, 1991).....	34, 35
<u>Tennessee Valley Authority v. Hill,</u> 437 U.S. 153 (1978)	26
<u>Texaco, Inc. v. FTC,</u> 336 F.2d 754 (D.C. Cir. 1964), vacated and remanded per curiam on other grounds, 381 U.S. 739 (1965).....	31, 32
<u>United States v. St. Louis, S.F. & T. Ry.,</u> 270 U.S. 1 (1926)	24
<u>Wong Yang Sung v. McGrath,</u> 339 U.S. 33 (1950)	31, 35

STATUTES:

7 U.S.C. § 12a(2) (E)..... 20

18 U.S.C. § 77t(b) 34

28 U.S.C. § 2462.....16, 23

Cal. Securities Code § 24212 (d) (3)
 (Blue Sky Law Reporter (CCH) ¶ 11, 212A (1995)) 20

Maine Securities Code § 10313 (F) (4)
 (Blue Sky Law Reporter (CCH) at ¶ 29,053e (1997)) 20

Ohio Securities Code Rule 1301 20

Texas Securities Code § 14[581-14] (9) (D)
 (Blue Sky Law Reporter (CCH) at ¶ 55,114 (1995)) 20

RULES AND REGULATIONS:

17 C.F.R. § 229.401(f) (4), (5)..... 19

17 C.F.R. § 279.1 19

LEGISLATIVE MATERIALS:

H. Rep. 101-616 (1990), reprinted in 1990 U.S.C.C.A.N. 1379..... 25

Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L.
 No. 101-429, §§ 102, 203, 104 Stat. 931, __, __ (1990) (“Remedies Act”)..... 25

MISCELLANEOUS MATERIALS:

52 Washington & Lee L. Rev. 1299, 1305 (1995)..... 20

SEC Rel. No. 34-30629 at n.3 (1992 SEC LEXIS 948)..... 20

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 20, 1997

In the Matter of

WARREN TREPP, Respondent

BRIEF OF WARREN TREPP
IN SUPPORT OF PETITION FOR REVIEW

I. Introductory Statement

The Securities and Exchange Commission took nine years to initiate an administrative proceeding against Warren Trepp in connection with a series of trades between Mr. Trepp's employer, Drexel Burnham Lambert, Inc., and Reliance Group Holdings, Inc., a client of Drexel. The essence of the charges against Mr. Trepp is that these trades constituted an illegal parking arrangement that improperly enabled Reliance to recognize gains in its bond portfolio. The extensive delay between the trades, which took place in 1986, and the initiation of the proceedings in September 1995, ultimately led the Administrative Law Judge to dismiss the case against Mr. Trepp. The judge found that the attempt by the Division of Enforcement to bar Mr. Trepp from the securities industry was barred by the five-year statute of limitations applicable to

such a sanction. The judge also found that the passage of so much time without any evidence of any other wrongdoing by Mr. Trepp precluded the imposition of a cease and desist order.

Given these conclusions, there was no need for the judge to have made any other findings.¹ However, the judge did go further and find that there was an illegal parking arrangement between Drexel and Reliance, and that Mr. Trepp knew of or recklessly disregarded the illegal arrangement. Thus, the judge concluded that Mr. Trepp violated section 17(a) of the Exchange Act and Rule 17a-3 by aiding and abetting and causing Drexel's failure to keep accurate books and records. However, the judge rejected the contention of the Division of Enforcement that Mr. Trepp caused and aided and abetted the false filings of Reliance with the Securities and Exchange Commission in violation of section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 or section 17(a)(2) of the Securities Act.

The finding that Mr. Trepp knew of or recklessly disregarded an illegal parking arrangement is contradicted by the testimony of all of the factual witnesses in this case as well as several of the judge's own findings. This is the central factual finding that is the subject of this appeal.² Mr. Trepp also appeals the following rulings by the judge: (1) even though the Securities and Exchange Commission did not get authority to issue cease and desist orders until 1990, it is not an improper retroactive application of that authority to apply it to acts occurring in 1986; (2) a cease and desist order is not a penalty for purposes of the statute of limitations under the facts of this case; and (3) the fact that the Securities and Exchange Commission already made findings of fact adverse to Mr. Trepp in the settlement it reached with Reliance does not violate due process.

¹ Indeed, if the rules of the Securities and Exchange Commission provided for a motion for summary judgment, the judge would have entered judgment for Mr. Trepp prior to making any findings of fact.

² Other errors in the judge's findings of fact will be noted to the extent that they reflect on this central issue.

II. Procedural History

On October 23, 1992, the Division of Enforcement advised Mr. Trepp's counsel that it intended to seek authority from the Securities and Exchange Commission to file a civil injunctive action against Mr. Trepp for his participation in the transactions with Reliance. Mr. Trepp filed a Wells Submission with the Securities and Exchange Commission on December 7, 1992. (Respondent's Posttrial Brief, p. 42.) On February 17, 1994, the Securities and Exchange Commission entered into a Consent Decree with Reliance and one of its employees in connection with these same transactions. It was not until September 28, 1995, that the Securities and Exchange Commission finally entered an Order Instituting Public Proceedings and Notice of Hearing (OIP) against Mr. Trepp.

On February 5, 1996, Respondent filed a motion to dismiss the proceedings. This motion was premised on the fact that the Securities and Exchange Commission had made specific findings of fact in accepting a settlement with Reliance in connection with the very transactions at issue in this case. Respondent asserted that any review by the Securities and Exchange Commission of the factual findings in his case would present a serious due process violation because the Securities and Exchange Commission could not reasonably be considered to be impartial. Respondent noted that this prohibition did not preclude the Securities and Exchange Commission from taking action against him because it could have done what it originally threatened to do—file a civil injunctive proceeding in federal district court.

The Administrative Law Judge assigned to the case, Judge Carol Fox Foelak, held a hearing on this matter on February 13, 14, 15, 22, and 23, 1996. At the commencement of the hearing, she denied the motion to dismiss on the ground that it was premature. (Tr. 4). The initial round of posthearing briefing was completed on May 31, 1996. On July 22, 1996, the parties jointly moved for a stay of this proceeding in light of the decision of the United States Court of

Appeals for the District of Columbia Circuit in *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996). The judge granted the stay until August 31, 1996, and subsequently ordered simultaneous briefs on the impact of *Johnson* in this matter. The judge ultimately ordered additional briefing on the issue, which was completed on March 7, 1997. The Initial Decision was filed on August 18, 1997, and both parties filed a Petition for Review.

III. Statement of Facts

There is no dispute over the fact that Reliance sold a number of bonds to Drexel in both the second and third quarters of 1986, and Drexel ultimately resold most, but not all, of these bonds back to Reliance. Nor is there any dispute that there is nothing wrong with an entity selling bonds, indicating an interest in repurchasing them, and then repurchasing them. The Division's own high-yield bond expert and accounting expert admitted as much. (Tr. 286-87, 851-52). What is wrong and what the Division bears the burden of proving by a preponderance of the evidence is that there was an agreement that the securities would be repurchased, and they would be repurchased at a particular price.

The evidence showed that, sometime in the second quarter of 1986, either the Chairman of Reliance or its Chief Investment Officer directed John Pankratz, director of fixed-income securities, to realize gains that had accumulated in Reliance's securities portfolio. (Initial Decision, p. 11-12). The judge properly concluded that no finding could be made as to the reason that Reliance sought to recognize the gains that had accumulated in its portfolio. (Initial Decision, p. 12). Pankratz reviewed the portfolio and devised a plan to accomplish his goal. One aspect of that plan was to sell certain bonds and repurchase them within 31 to 40 days. He estimated the value of these bonds to be \$366 million with gains of \$29.7 million. (Respondent Ex. 6). The bonds he chose were the upper tier of the high-yield market and had high coupons.

As a result of this feature and the interest rate environment at the time, these bonds would have lower price volatility. (Initial Decision, p. 12, n. 10).

Mr. Pankratz then telephoned William Tobey, the salesman at Drexel who covered the Reliance account, to inquire whether Drexel would be willing to purchase selected bonds from Reliance before the end of the second quarter and then resell them to Reliance 31 to 40 days later. (Initial Decision, pp. 12-13). It is undisputed that the parties agreed that all transactions would be at market levels, and Drexel would receive the carry on the bonds, a “profit” that came to \$3 to \$4 million. (Initial Decision, p. 15). The judge found that there was no evidence to suggest that any prices were not within the market. Mr. Pankratz inquired whether any losses that might be sustained in the trading could be subsequently made up in unrelated trades. Mr. Tobey told Mr. Pankratz that he would have to get back to him.³

Mr. Tobey then went to Warren Trepp, the head trader in Drexel’s high-yield bond department. According to Mr. Tobey, he “believes” that he informed Mr. Trepp of all aspects of the proposal. He admitted that he did so only once and that was at the trading desk, which was very noisy. Mr. Tobey noted that “there were people constantly yelling at the trading desk and, specifically, at [Mr. Trepp].” (Initial Decision, p. 20, Tr. 214). The Administrative Law Judge noted that she observed “Mr. Tobey to be quite soft-spoken throughout his testimony over the course of two days.” (Initial Decision, p. 20). Mr. Trepp initially told Mr. Tobey that he would get back to him. Ultimately, Mr. Trepp told Mr. Tobey to go ahead with the program. Mr. Trepp recognized that the securities were upper-tier, high-coupon bonds (“cushion” bonds) that carried

³ The judge also found that Mr. Pankratz offered Drexel a fee of 1/16 per bond on these transactions. Mr. Trepp disputes this finding. See Argument, p. 15.

little risk for Drexel. He was happy to purchase these securities and hold them in Drexel's inventory. At this time, Drexel had an inventory of \$4 billion of bonds in its trading portfolio. Mr. Trepp had many positions in inventory that he was happy to hold, including \$280 million of SCI bonds, which he held for more than six months. Both Mr. Trepp and Mr. Tobey viewed these transactions as nothing more than harmless accommodations for a client. (Tr. 176, 199, 769).

Furthermore, none of the parties viewed this arrangement as creating an obligation by Reliance to repurchase the bonds. Mr. Trepp recalled that Mr. Tobey told him that "Reliance was interested in selling a series of securities over time and expresses, and their expressing an interest in purchasing them at a future date." (Tr. 769).⁴ Mr. Pankratz described a "hope" that Reliance would repurchase them. (Initial Decision, p. 14, Tr. 348).

When Mr. Trepp ultimately responded to Mr. Tobey, he merely told him to go ahead with the program. (Tr. 160-61, 216). Mr. Tobey then called Mr. Pankratz and told him that Drexel would engage in the program. Mr. Tobey reiterated that all trades would be at market levels. (Tr. 350). When Mr. Pankratz inquired about making up any loss to Reliance, Mr. Tobey **refused to agree**, stating only: "John, we'll simply have to see where it ends up." (Initial Decision, p. 14; Tr. 206, 217, 350-51).

The trading of the bonds selected by Mr. Pankratz began sometime in early May. On May 16, 1986, Mr. Pankratz wrote a memo regarding the gains program. This memo identified a number of the bonds in the program and is the only contemporaneous document that does so. In

⁴ Mr. Trepp's view of Reliance's intent as an "interest" as opposed to an "obligation" was reinforced by his knowledge that Reliance previously had made commitments to Drexel on which it had ultimately reneged. See Respondent's Posttrial Brief, p. 8, n.8; Tr. 692-93.

this memo, Mr. Pankratz noted that he already had sold two issues, i.e. Six Flags and Farley Northwest, “with the intent of repurchasing them.” He also noted that he had been asked by his superiors not to repurchase these, because they had undergone a rating change that would adversely affect Reliance’s reserves. Despite this clear indication that these bonds were no longer to be considered part of the program, the Division includes them in its artificial recreation of the bonds that supposedly were traded as part of the program. (Division Exh. 4, 5, 6, and 7).

These charts were created based on the criteria of a sale and a repurchase by Reliance within certain artificial time parameters, i.e. a sale by Reliance within 60 days before month-end and a repurchase by Reliance within 45 days after month-end. However, these time periods were not the time periods established by Mr. Pankratz, who testified that he wanted to repurchase the bonds within 31 to 40 days after the sale. (Initial Decision, p. 12; Tr. 347-348).

Furthermore, even though Drexel had agreed to purchase the bonds and understood that Reliance was interested in buying them back, Drexel treated the bonds as if they belonged to Drexel. Mr. Pankratz had a vivid recollection that some of the bonds that he wanted to repurchase were no longer in Drexel’s inventory at the time he sought to buy them back. (Initial Decision, p. 20; Tr. 359-60, 406).

As the Administrative Law Judge found, while not all of the bonds were returned to Reliance, over \$300 million in bonds were purchased and resold. (Initial Decision, p. 20). Due to a variety of factors, the prices on the bonds swung in both directions. The Division’s own attempt to recreate the program reveals that the prices went up for 20 out of the 33 issues and down in 13 of them. One of the biggest declines was Allegheny Ludlum which went down in price between five and six points and resulted in a loss to Drexel of \$250,000. Other large swings occurred with respect to Charter Medical Corp. (rise in price of two points for a gain to Drexel of

\$208,000), Farley/Northwest (a gain to Drexel of \$75,000), Illinois Central Gulf (drop in price of one point for a loss to Drexel of \$138,500), Iroquois Brands Ltd. (rise in price of three points for a gain to Drexel of \$90,000) MacAndrews & Forbes (again to Drexel of \$100,500), Mattel, Inc. (rise in price of one point for a gain to Drexel of \$87,500), Six Flags Corp. (a gain to Drexel of \$100,500), Tele-Communications Inc. (a loss to Drexel of \$83,573.75), United Cable Television (a gain to Drexel of \$50,844), and V.I.S. Corp. (a loss to Drexel of \$84,000).

While both Mr. Tobey and Mr. Pankratz testified that they each tracked the profits and losses on these transactions, **nobody ever shared this information with Mr. Trepp**. Mr. Tobey explicitly stated that he “did not advise Mr. Trepp of the running balance or that he was keeping an accounting.” (Initial Decision, p. 20). Mr. Trepp and Mr. Pankratz never had any business dealings. (Initial Decision, p. 14). And Mr. Trepp testified that he did not keep an accounting and would not have had time to do so. (Initial Decision, p. 20). Indeed, as the judge found, Mr. Trepp “was very busy, doing 250 to 1,000 transactions, amounting to some \$200 million to \$2 billion, a day. (Initial Decision, p. 10; Tr. 702).

Mr. Pankratz approached Mr. Tobey and asked him to engage in a similar program during the third quarter. This time, although the volume of the program was much smaller, Reliance suffered a loss of several hundred-thousand dollars. The judge found that the reason for this loss is unclear. She found that the prices could easily have been adjusted within market prices by less than one-half point in order to make the program come out even. (Initial Decision, p. 16). Mr. Pankratz attempted to convince Mr. Tobey to make up this loss by adjusting the prices of unrelated trades, which was done on one occasion. His endeavors to adjust several other unrelated trades were refused. (Initial Decision, p. 16). When asked why he was seeking make-ups in light of Mr. Tobey’s refusal to commit to this element of the program, Mr. Pankratz

explained that he was trying to use the loss as negotiating leverage. “I had nothing to lose by trying it.” (Tr. 356-57). While Reliance did engage in another profitable short-term trade in American Maize bonds at the instigation of Drexel, Mr. Trepp had nothing to do with that transaction. (Initial Decision, pp. 16-17 & n.16).

Mr. Pankratz asked Mr. Tobey to do a fourth quarter program. This request was made after the public announcement that Ivan Boesky had settled insider trading charges with the Securities and Exchange Commission and the United States Attorney’s office. Mr. Trepp refused to engage in the program. He testified that the primary reason for his refusal was the fact that, due to the Boesky announcement, Michael Milken was anticipating substantial turmoil in the high-yield market and had ordered Mr. Trepp to reduce Drexel’s trading account. (Tr. 705).

IV. Argument

A. The Judge’s Finding that Warren Trepp Knew of or Recklessly Disregarded an Illegal Parking Arrangement is Unsupported by the Record and is Contradicted by Other Findings of the Judge.

The critical factual issue in this case is whether the arrangement between Reliance and Drexel included an agreement to come out even. If it did, Drexel was required to reflect this agreement on its books and records. On the other hand, if there was no agreement that the trading would result in no loss for Reliance, the sale/repurchase program constituted an arms-length transaction and there was no impropriety by either Drexel or Reliance.

The judge found that the program between Drexel and Reliance included an agreement to come out even, relying heavily on the fact that “Tobey did not affirmatively assure Mr. Pankratz that they would come out even” (Initial Decision, p. 14). Rather, Tobey told Pankratz that “John, we’ll simply have to see where it ends up.” (Tr. 206, 217, 350-51). While most people would assume that Tobey meant what he said, the judge stretched to incredible lengths to find that the

refusal actually “indicates an understanding that they would come out even.” According to the judge, the refusal to commit in advance is not actually a refusal, but merely an indication that the program would come out even if the trades were priced properly. Why Mr. Tobey did not say this if it is what he meant is not explained. The judge also does not explain why she ignored Mr. Pankratz’s direct testimony that in his mind he could not and did not “get a commitment from Tobey that he would agree to some mechanism, perhaps, if there was a loss that it could be made up in unrelated trades.” (Tr. 351). This failure is particularly troubling in light of her general comment that, to the extent that there were credibility issues between Mr. Tobey and Mr. Pankratz, Mr. Pankratz had less reason “to refrain from admitting to acts which might constitute wrongdoing.” (Initial Decision, p. 11).

The judge also concluded that an agreement had been reached because Mr. Tobey and Mr. Pankratz kept a running total of the results of the trades. Such a tabulation would have been unnecessary, she concludes, except to see if the program came out even. While it is true that a tally was necessary to see if the parties came out even, it sheds no light on whether there was a **commitment** by Drexel and Reliance to take steps to ensure the program came out even or whether it was just a natural follow-up to Mr. Tobey’s comment that they would have to see where it ended up.

This line of reasoning reveals the fatal flaw in the Initial Decision. Mr. Tobey’s refusal to commit is explained away by the judge on the ground that Drexel was pricing the securities in such a way as to ensure that they came out even. In order to carry out this scheme, the person who was setting the prices must have been aware of the running balance of the trades. Mr. Trepp was the person who set the prices for these transactions. Therefore, the judge found that Mr. Trepp “had some knowledge of the balance of accounts between Reliance and Drexel.” (Initial

Decision, p. 21). Knowledge of the balance was critical because it was that knowledge that supposedly enabled him to adjust the prices within the market range to ensure that the program came out even. Without knowledge of the running balance, he could not have affected the prices to bring the balance to zero, and it would be a mere coincidence if the trading resulted in a zero balance.

The problem for the judge is that she cites nothing in the record to support her statement that Mr. Trepp had some knowledge of the balance. There is a very good reason for this glaring void in her opinion. The judge previously had noted that “Mr. Tobey did not advise Mr. Trepp of the running balance or that he was keeping an accounting. (Tr. 198, 693). Mr. Trepp also testified that he did not keep an accounting and would not have had time to do so. Tr. 694.” (Initial Decision, p. 20).

Lacking any evidence that Mr. Trepp was aware of the balance, the Division and the judge try to infer this knowledge based upon the generalization offered by the Division’s high-yield bond expert that a trader tries to maximize profits. (Initial Decision, p. 16). Their reasoning is that, because a trader tries to maximize profits, the trading of these securities should have resulted in a profit to Drexel. The failure of Drexel to make a profit in the second quarter must therefore be a result of his fixing the prices.

The simplistic statement about maximizing profits, however, does not prove that Mr. Trepp either knew of or kept his own version of a running balance. It certainly does not amount to proof by a preponderance of the evidence that Mr. Trepp either had that knowledge or was reckless in avoiding the truth. It merely proves that Mr. Trepp was subject to the whims of the marketplace just like anyone else. For example, one issue in the second quarter was Allegheny Ludlum. This company suffered a serious credit decline after Drexel purchased the bonds that

resulted in a loss to Drexel of a quarter of a million dollars. No amount of maximization of profit by a trader was going to change that fact.

Furthermore, the analysis undertaken in an attempt to prove that the trading came out even is not based on a contemporaneous listing of the bonds involved in this program, as no such list exists. Thus, the conclusion that the second quarter program did, in fact, come out even rests upon the accuracy of the charts created many years after the fact by a Division witness. These charts were based solely on the criteria of a sale and repurchase by Reliance within 60 days before month-end and a repurchase by Reliance within 45 days after month-end. The effect of utilizing these parameters is the inclusion of several issues well beyond the 31 to 40 day period sought by Pankratz. It also resulted in the use of two bonds, Farley Northwest and Six Flags, that appear on the only contemporaneous listing of some of the issues to be sold and repurchased. Respondent Exhibit 2 reflects Pankratz' understanding of the arrangement with Drexel. In this memo, he noted that he already had sold two issues "with the **intent** of repurchasing them." He did not state that he agreed to repurchase them or that he was obliged to repurchase them. He also noted that Farley Northwest and Six Flags had undergone a rating change in the insurance industry for reserve purposes. Thus, Pankratz was explicitly asked **not to repurchase them** because of the effect on Reliance's reserves. Pankratz ultimately did repurchase these two bond issues, but 61 and 86 days later. The trading in the second quarter does come out even if these issues, as well as a fee of 1/16 (\$175,000) for Drexel, are included in the program. Conversely, if the contemporaneous memo is taken at face value and the repurchases of Farley Northwest and Six Flags are not included within the program, the overall trading did not come out even but resulted in a loss to Drexel of \$175,000.

It is also significant to note that Mr. Tobey, the Division's star witness, does not recall noting whether the second-quarter program came out even. (Tr. 236-37). And, while Mr. Pankratz recalls that the second-quarter program did come out even (Tr. 408), he does not recall offering the fee of 1/16 to Mr. Tobey. (Tr. 396). Given all of these inconsistencies, it is impossible to conclude that the Division has established by a preponderance of the evidence that the second-quarter program came out even, let alone that it came out even as a result of deliberate pricing decisions by Mr. Trepp.

The entire issue of whether the trading in the second quarter came out even is further undercut by the inconsistencies and unreasonableness of the judge's finding that there was a fee of 1/16 paid to Drexel as part of the program. The only person who testified that there was a fee was Mr. Tobey. Mr. Pankratz does not recall it, and stated that "I would think that if it was part of the calculation, I would recollect it." (Initial Decision, p. 15; Tr. 355). Previously, as noted infra at p. 11, the judge had found that Mr. Pankratz had less reason to lie than Mr. Tobey. The judge then went on to ignore this finding by adopting Mr. Tobey's version of the fee as opposed to Mr. Pankratz'.

Mr. Pankratz' version is further supported by his recollection of the fee issue in connection with similar transactions between Reliance and Merrill Lynch. Mr. Pankratz had approached Drexel first about the sale/repurchase program. He then went to Merrill Lynch to sell and repurchase investment grade bonds. It was uncontroverted below that Mr. Pankratz did not initially offer a fee to Merrill Lynch, but that Merrill Lynch asked for the fee. (Tr. 388-90). It makes no sense for Mr. Pankratz to have gratuitously offered a fee of \$175,000 to Drexel, but not to Merrill Lynch. This discrepancy is especially significant because he was already losing \$3 to \$4 million to Drexel in the carry. Neither the Division nor the judge offered any reason why he

would have thrown in an extra \$175,000 on his own. The Merrill Lynch scenario makes much more sense. However, even Mr. Tobey does not contend that either he or Mr. Trepp asked for the fee.

Finally, the existence of an agreement to come out even is undercut by the fact that the third quarter resulted in a substantial loss to Reliance. The judge was unable to explain why the third quarter did not come out even. According to the Initial Decision, “[t]he reason for the imbalance is unclear.” (Initial Decision, p. 16). Indeed, the judge noted that “a less than one-half point adjustment would have removed the imbalance.” One is left to wonder why, if Drexel and Mr. Trepp were able to adjust prices to have over \$300 million in trades come out even in the second quarter, they were unsuccessful in the third quarter where the total trades involved only \$120 million.

While the judge stated that the reason for the “imbalance” in the third quarter “is unclear,” she laid stress on the fact that “attempts were made to redress it” and particularly noted “the profitable short-term trading in American Maize bonds.” The American Maize transactions typify the complete failure of the Division’s case against Mr. Trepp. These are arguably the only two trades in the whole case that are outside market prices. However, the uncontroverted evidence is that Mr. Trepp was cruising through the Panama Canal when they occurred. Furthermore, someone forged his initials on these trade tickets. It is also significant that it was Mr. Pankratz’ vivid recollection that Mr. Tobey initiated both American Maize transactions. Mr. Tobey’s adamant denial of any involvement in these questionable trades further undermines Mr. Tobey’s credibility, but was completely ignored by the judge.

The bottom line is that the testimony of all three factual witnesses in the case (Mr. Tobey, Mr. Pankratz and Mr. Trepp) corroborates the fact that there was never an agreement to come out

even. Mr. Tobey told Mr. Pankratz, “we’ll have to see how it comes out.” Mr. Pankratz understood that to mean he had no agreement. Mr. Trepp testified no such agreement ever existed. These are the three people who did all the transactions in issue in this case. No amount of selectively constructed Division charts or selectively chosen Division expert witnesses can alter the fact as testified to by all the fact witnesses that there was no agreement to come out even.

All of these arguments also apply to the alternative finding by the Administrative Law Judge that Mr. Trepp was “reckless in not knowing these features in view of his position in the organization and his role in executing the program. A failure to listen carefully to Mr. Tobey or to question Mr. Tobey or Mr. Milken shows a conscious avoidance of learning key facts.” (Initial Decision, p. 21). As Mr. Tobey testified, he offered Mr. Pankratz no assurance that the program would come out even. Mr. Pankratz testified that Mr. Tobey specifically refused to commit to that proposed feature of the program. Thus, had Mr. Trepp pursued the issue of an agreement to come out even, he would have learned that no commitment was made. Furthermore, the same defects noted above in the judge’s finding that there was an agreement to come out even apply to the issue of Mr. Trepp’s supposed recklessness.

B. The Cease and Desist Order Sought by the Division Against Mr. Trepp is a Penalty and, Therefore, Barred by the Five-Year Statute of Limitations in 28 U.S.C. § 2462.

1. The Reasoning of the D.C. Circuit in *Johnson v. SEC* Applies to Bar A Cease and Desist Order Based on Alleged Misconduct Over Five Years Old

The D.C. Circuit’s decision in *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), precludes the issuance of a cease and desist order against Warren Trepp, because such an order constitutes a “penalty,” which is barred by the five-year period of limitations imposed by 28 U.S.C. § 2462.

Section 2462 is a general statute of limitations that applies to “the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise.” In *Johnson*, the D.C. Circuit determined that this bar applied to the Securities and Exchange Commission, and the Commission could not impose the “penalty” of a censure and suspension based upon events outside the five-year limitations period of 28 U.S.C. § 2462. 87 F.3d at 485.

The D.C. Circuit’s definition of penalty is broad: It is “a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond **remediating** the damage caused to the harmed parties by the defendant’s action.” *Id.* at 488. (emphasis added). The D.C. Circuit also noted that, under common usage, a “penalty” is “the suffering in person, rights or property which is annexed by law or judicial decision to the commission of a crime or public offense.” *Id.* at 487 (quoting Webster’s Third New International Dictionary 1668 (1976)). Accordingly, for a form of relief to be a penalty, the D.C. Circuit requires that three criteria be met: (1) the relief must punish, (2) on account of past acts, and (3) not be merely remedial.

In *Johnson*, for example, the D.C. Circuit found that the S.E.C.’s proposed censure and six-month suspension “clearly resemble punishment in the ordinary sense of the word,” *Id.* at 488, as it was sought because of “Johnson’s violation . . . of the Exchange Act,” *id.* at 492, as opposed to “correcting or undoing the effects of Johnson’s allegedly faulty supervision,” *id.* at 491. Moreover, the Court recognized that the collateral consequences of such a sanction—such as forever bearing the stigma of having been found to have violated the securities laws—are “punishment-like.” *Id.* at 489-90. The Court also rejected as “pro forma” the “SEC’s assertion . . . that the sanctions were imposed not as punishment for past dereliction, but primarily because of [the defendant’s] present danger to the public.” *Id.* at 490.

Here, Judge Foelak tersely rejected Mr. Trepp’s argument that a cease and desist order is a penalty to which § 2462’s limitations period applies. (Initial Decision, p. 7). The judge’s opinion merely states that a “prospective cease and desist order that Respondent not violate the securities laws in the future is not a penalty.” *Id.* The only support for Judge Foelak’s conclusion is one sentence that states that “[a] respondent is not entitled to break the law.” *Id.* In sum, Judge Foelak neither analyzed the nature of a cease and desist order nor addressed the arguments made by Mr. Trepp on its punitive nature.

Judge Foelak erred in ignoring the punitive nature of the Division’s proposed sanction and implicitly accepting the proposition that a cease and desist order is a form of remedial relief. A cease and desist order based on the facts in this controversy meets all three criteria of a penalty as defined by the D.C. Circuit. The Division is seeking to stigmatize Mr. Trepp by imposing an order that will forever mar his reputation in the securities industry. As the Division has developed no evidence in the record of any other misconduct by Mr. Trepp,⁵ the relief would be based solely upon his past activities at Drexel. Finally, neither the Division nor Judge Foelak has been able to point to a victim or harm that the cease and desist order would remedy. In sum, as explained in more detail below, a cease and desist order falls within the *Johnson’s* broad definition of a “penalty”—as opposed to remedial relief—and, thus, the Division’s long delayed request for such an order is also barred by § 2468.

⁵ In fact, the OIP does not even allege a threat of future violations.

2. The Collateral Consequences Resulting from the Issuance of a Cease and Desist Order Make the Imposition of Such a Sanction a Penalty.

Judge Foelak apparently found that the Division’s requested relief was not “punishment,” because the cease and desist order would merely require that Mr. Trepp obey the law—a duty he is already obligated to meet. This myopic view of the effects of the cease and desist order is erroneous. Even if a cease and desist order would have no direct consequences, the collateral consequences would impose a substantial stigma upon Mr. Trepp and likely hamper any of his future activities related to the securities business. Under D.C. Circuit precedent, these secondary impositions are enough to make a form of relief “punishment-like.” *See Johnson*, 87 F.3d at 488 (holding that degree and extent of the sanction must be considered as a relevant factor in determining whether the sanction is a penalty); *see also Arch Mineral Corp. v. Babbitt*, 104 F.3d 660, 669-70 (4th Cir. 1997) (holding that listing defendant on “violator” database, which would preclude defendant from seeking further licenses from agency, was a penalty).

Johnson specifically recognized that collateral effects could make a sanction “punishment.” 87 F.3d at 489. As the D.C. Circuit found, a censure and suspension were “punishment-like” because of the “longer-lasting repercussions on [Johnson’s] ability to pursue her vocation.” *Id.* According to the Court, “[s]uspended brokers must forever after disclose the sanction, and it becomes part of their permanent public file.” *Id.* As an example of how such a sanction operates to penalize in the future for actions committed in the past, the Court drew attention to the fact that Congress requires securities associations such as the NASD to set up toll-free numbers for investors and other members of the public to see whether brokers or brokerage employees have been the subject of any disciplinary proceedings. *Id.*

Here, Mr. Trepp could suffer from many of these same collateral consequences. As the subject of a cease and desist order, he would have to “forever after disclose the sanction” that would be part of his permanent public file. These collateral consequences attach regardless of whether, in any given case, they bear any relationship to the conduct upon which Mr. Trepp’s enforcement proceeding was predicated. For example:

- Form U-4, the form securities broker-dealers must use to register a person who is associated with the firm, requires disclosure of all SEC or CFTC enforcement proceedings resulting in a cease and desist order.⁶
- Form ADV, the form on which investment advisers must register, also requires disclosure of any violation of any SEC or CFTC statute or regulation by any “advisory affiliate” of the investment adviser.⁷ Thus, the order becomes part of the public file of all subsequent investment adviser employers.
- The Commission’s rules require disclosure of a cease and desist order in the public filings of any reporting company of which such person is a director, director nominee, or executive officer for a five-year period to the extent material to an evaluation of the ability or integrity of such person.⁸
- Schedule D, which defines the criteria for listing on NASDAQ, recently was amended to provide greater discretionary authority to the NASD to deny, revoke or suspend the listing of a company’s securities on NASDAQ. The accompanying explanatory

⁶ Question 22D(5) of Form U-4, Uniform Application For Securities Industry Registration or Transfer, requires disclosure of instances in which either the Securities and Exchange Commission or the Commodity Futures Trading Commission has “ordered you to cease and desist from any activity.” (emphasis added)

⁷ Form ADV, 17 C.F.R. § 279.1, Part I, Item 11(C)(2), requires disclosure of whether the SEC or CFTC has “found the applicant or an advisory affiliate to have been involved in a violation of its regulations or statutes.” An “advisory affiliate” is “any current employee except one performing only clerical, administrative, support or similar functions.” Form ADV, Part I, Item 11 (definitions.)

⁸ See Item 401(f)(4) and (5) of Regulation S-K, 17 C.F.R. § 229.401 (f) (4) and (5):

(f) Describe any of the following events that occurred during the past five years and that are material to an evaluation of ability or integrity of any director, person nominated to become a director or executive officer of the registrant.

- (5) Such person was found by . . . the Commission to have violated any Federal or State securities law, and the judgment in such civil action or finding by the Commission has not been subsequently reversed, suspended, or vacated.

release makes clear that the NASD could take such action against any company that is controlled, managed or influenced by an individual who has been the subject of a cease and desist order.⁹

- The name of a recipient of a cease and desist order issued by the SEC is likely to be entered onto the Central Registration Depository (CRD), a computerized database maintained by the NASD and state securities regulators that contains information regarding the disciplinary histories of all securities brokers. Once the information is entered into the system, it is effectively public and “can have a substantial effect on an individual’s business reputation and livelihood.”¹⁰
- In many states, the “blue sky” or securities regulatory authority may initiate its own proceeding against the disciplined person based on the Commission’s cease and desist order.¹¹

It goes without saying, therefore, that a person who has been the subject of a Commission cease and desist order is likely to encounter substantial difficulty in obtaining further employment in the securities industry -- regardless of the formal terms of the order. In fact, given that the Division contends that Mr. Trepp was virtually unemployable in the industry after Drexel’s

⁹ See NASD Manual, Schedule to the By-Laws, Schedule D, Part II, Sec. 1 (CCH) P 1803-05; SEC Release No. 34-34151 (1994 SEC LEXIS 1692).

¹⁰ *Anne H. Wright, Form U-5 Defamation*, 52 Washington & Lee L. Rev. 1299, 1305 (1995) (“Many states, however, treat the information as public, and release the full contents of an individual’s CRD file on request. As a consequence, in addition to being widely circulated among regulators, the contents . . . sometimes can be obtained by members of the public, including a representative’s current or potential customers. Adverse information reported on the form therefore can have a substantial effect on an individual’s business reputation and livelihood.”) (internal citations omitted). *See also* SEC Rel. No. 34-30629 at n.3 (1992 SEC LEXIS 948) (explaining how the name of a recipient of a cease and desist order would be entered onto the CRD).

¹¹ *See, e.g.*, Cal. Securities Code § 24212 (d) (3) (Blue Sky Law Reporter (CCH) ¶ 11,212A (1995)); Ohio Securities Code Rule 1301; 6-3-19 (D) (2) (Blue Sky Law Reporter (CCH) at ¶ 45,540); Maine Securities Code § 10313 (F) (4) (Blue Sky Law Reporter (CCH) at ¶ 29,053e (1997)); Texas Securities Code § 14[581-14] (9) (D) (Blue Sky Law Reporter (CCH) at ¶ 55,114) (1995).

Persons who have been the subject of a Commission order are also likely to encounter similar difficulty in obtaining further employment in other regulated businesses. *See, e.g.*, Section 12a(2) (E) of the Commodity Exchange Act, 7 U.S.C. § 12a(2) (E) (the Commodity Futures Trading Commission may refuse to register a person subject to a Commission bar as a futures commodities merchant based on a Commission’s cease and desist order issued in a case involving fraud). *See also* Form 8-R Question 14A of the CFTC and the NFA application (specifically asks whether “you or any firm, corporation or other organization which you control or have controlled ever: . . . in an action or proceeding brought by or before: . . . the Securities and Exchange Commission.”).

bankruptcy **merely because of his association with Drexel** (*Division's Posttrial Reply Brief* at 5), it can hardly dispute the consequences to Mr. Trepp of the entry of a cease and desist order.

3. The Division's Reliance on Alleged Past Misconduct to Justify the Issuance of a Cease and Desist Order Proves that Such an Order is a Penalty.

The facts of this case also meet the second criteria of *Johnson*: the sanction is backwards looking. *See* 83 F.3d at 489-90. All the Division's evidence here is based upon the alleged past bad acts that are the subject of this proceeding, all of which are outside the limitations time period. No evidence about the present has been tendered. (Initial Decision, p. 28) (finding that "the violations occurred nine years before this proceeding was instituted, there is no evidence to suggest recurrent violations during the interim, and the Respondent has not been in the securities business since 1992."). The Division's only argument is that Mr. Trepp's past acts show that he is likely to violate the securities laws in the future and, thus, presents a threat to the market place.¹²

This same argument was made and rejected in *Johnson*. In response to the SEC's attempt to focus on Johnson's current competence or the degree of risk she posed to the public, the Court found that, the "SEC cite[d] not a single piece of evidence in the record explicitly supporting its

¹² The Division, in its Posttrial Brief, states: "Although he professes to have no current brokerage business activity, he is relatively young and possesses financial resources and skills that would afford him an opportunity to be active in the securities business." (*Division Posttrial Reply Brief* at 43) "The failure to enter a cease and desist order and a bar in light of this conduct would embolden [Trepp] (and others) by his escaping restraint and remedial sanctions." (*Id.*) Such conclusory statements, based on absolutely no evidence and containing no citation to the record, certainly are insufficient to support any finding of fact that Warren Trepp poses any threat to violate the securities laws. As the *Johnson* court held, in an identical context, "we conclude that any inquiry into Johnson's current competence or the danger she posed to the public (and the SEC cites to no such inquiry) was at most pro forma." 87 F.3d at 490.

The Division also alleges that Trepp lied under oath at the hearing in this matter. (*Division Posttrial Reply Brief* at 43). This feeble attempt to bootstrap ten-year-old events into a current violation justifying a cease and desist order is similarly unavailing.

finding that suspension of Johnson was necessary due to Johnson's current unfitness to be a supervisor." 87 F.3d at 490. As the D.C. Circuit recognized, where the Division has little or nothing more to point to than the defendant's past conduct as its evidence of future dangerousness, an inference is raised that the Division's alleged forward-looking sanction is but a sham. *Id.* To avoid being a covert penalty, proof of future dangerousness must be based upon current, concrete facts, such as actual evidence of present competence. *Id.*

In this case, the Division did not even bother to propose a finding of fact relating to Mr. Trepp's propensity to violate the securities laws or his present risk to the securities industry. The Division was forced to take this position because it recognized that it would be incredible to argue that Mr. Trepp poses any present threat based solely on events that took place ten years ago. *Cf. Meadows v. SEC*, 119 F.3d 1219, 1228 n. 20 (5th Cir. 1997) (noting in dictum that imposition of bar is less penal in nature where ALJ made specific findings of petitioner's present unfitness to serve investing public). This lack of evidence is particularly telling given the intense scrutiny of Mr. Trepp's activities at Drexel by both the Division and the United States Attorney's office. Perhaps even more telling is the fact that the SEC heavily relied upon Warren Trepp's expertise and experience in winding up the affairs of Drexel.¹³

In sum, any argument in this case about a future threat should generate the same incredulity expressed by the D.C. Circuit in *Johnson*: "If the SEC really viewed Johnson as a clear and present danger to the public, it is inexplicable why it waited more than five years to begin the proceedings to suspend her." *Id.* at 490 n. 9 (emphasis original). This justifiable

¹³ This fact alone belies the hyperbole of the Division's statement that "Trepp is a person who from start to finish is untrustworthy and a risk to the investment community." (Division's Supplemental Brief, p. 14.)

skepticism should be doubled by the ten-year delay present in this case. Even more importantly, a reviewing Court would be forced to wonder how the SEC could have knowingly acquiesced in Mr. Trepp remaining at Drexel from 1990 through 1992 in charge of liquidating Drexel's portfolio for the benefit of its creditors, the largest of which was the SEC itself. (Tr. 646-648, 651-652). Accordingly, the Division's evidence of future dangerousness is merely a restatement of its belief in Warren Trepp's past bad conduct, a legally insufficient ground to resurrect a time-barred penalty.

4. The Cease and Desist Order Would Serve No Remedial Purpose

The final *Johnson* criteria is that the sanction "goes beyond remedying the damage caused to the harmed parties by the defendant's actions." 87 F.3d at 488. The *Johnson* Court noted that "where a legal action is essentially private in nature, seeking only compensation for the damages suffered, it is not an action for a penalty." *Id.* at 487. Under the commonly understood meaning of remedy, the relief must be directed toward correcting or undoing the effects of the alleged violation. *Id.* at 491. Here, neither the Division nor Judge Foelak has been able to identify a victim, a harm, or the remedial effect of the cease and desist order. As Judge Foelak noted, (Initial Decision, p. 7), the order the Division seeks only mandates that Trepp not violate the law. In other words, it imposes no obligation beyond that which already exists. Thus, it remedies nothing. A sanction of this nature is, therefore, a penalty within the meaning of 28 U.S.C. § 2462.

5. Conclusion

The explicit holding of the Court of Appeals in *Johnson* and the reasoning behind it preclude the issuance of a cease and desist order. Because no sanction is available as a matter of

law, the Commission must dismiss the case against Trepp. *See In the Matter of Graystone Nash, Inc.*, et al., Administrative Proceeding File No. 92 (Initial Decision of Administrative Law Judge Lillian A. McEwen, June 27, 1996) at 36 (“I conclude that the holding in *Johnson v. SEC* . . . also applies to the instant case. It requires dismissal of the charges against Respondent.”); *see also Consolidated Rail Corp. v. Primary Indus. Corp.*, 868 F. Supp. 566, 577 (S.D.N.Y. 1994) (statute of limitations “is a legislative limit on a party’s ability to bring an action”); *Rubin Quinn Moss Heaney & Patterson v. Kennel*, 832 F. Supp. 922, 934-35 (E.D. Pa. 1993) (“statute of limitations bars an action commenced after the statutory period for that action has expired”).

C. The Cease and Desist Provision of the Remedies Act Cannot Be Applied Retroactively

1. A Fundamental Principle of the Rule of Law Is That Newly Enacted Statutes Are Presumed Not To Have Retroactive Effect.

The presumption against retroactive legislation is deeply rooted in American jurisprudence and embodies a legal doctrine centuries older than our Republic. *Landgraf v. USI Film Products*, 511 U.S. 244, 265 (1994).¹⁴ Accordingly, the Supreme Court has recognized that statutes are presumed only to have prospective application absent a plainly expressed Congressional mandate otherwise. *See id.* at 268 (holding that Congress must make its “intention clear” when it “has determined that the benefits of retroactivity outweigh the potential for disruption or unfairness.”). Of course, the simplest way for Congress to express its will is to state its intent in the plain language of a statute. *See, e.g., Bowen v. Georgetown Univ. Hosp.*, 488 U.S.

¹⁴ “It is a principle which has always been held sacred in the United States, that laws by which human action is to be regulated, look forwards, not backwards; and are never to be construed retrospectively unless the language of the act shall render such construction indispensable.” *Reynolds v. M’Arthur*, 27 U.S. (2 Pet.) 417, 434 (1829) (Marshall, Ch. J). Justice Brandeis, a century later, stated: “That a statute shall not be given retroactive effect unless such construction is required by explicit language or by necessary implication is a rule of general application.” *United States v. St. Louis, S.F. & T. Ry.*, 270 U.S. 1,3 (1926).

204, 208 (1988) (“[C]ongressional enactments . . . will not be construed to have retroactive effect unless their language requires this result.”); *Gersman v. Group Health Ass’n, Inc.*, 975 F.2d 886, 897 (D.C. Cir. 1992) (quoting *Bowen*’s language with approval). Thus, the language of a statute is the starting point for interpretation. *Landgraf*, 511 U.S. at 280.

2. When Congress Passed the Remedies Act of 1990, It Did Not Grant the SEC the Power To Impose Retroactive Cease and Desist Orders.

The Commission’s authority to issue cease and desist orders was enacted as part of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, §§ 102, 203, 104 Stat. 931, __, __ (1990) (“Remedies Act”). The plain language of the Remedies Act, however, prohibits the retroactive application of the Commission’s new cease and desist authority.¹⁵ On its face, the statute states, in relevant part, that “[e]xcept as provided in paragraph (2) and (3), the amendments made by this Act will be effective upon enactment [October 15, 1990].” *See* Pub. L. No. 101-429, § 1(c)(1)(2), 104 Stat. 931, 932 (1990) *codified at* 15 U.S.C.A. § 77g, note (West 1997). Paragraph (2)(A) provides that “no civil penalty may be imposed pursuant to the amendments made by this Act on the basis of conduct occurring before the date of enactment of this Act.” *Id.* The statute then states in paragraph (2)(B) that paragraph (2)(A) “shall not operate to preclude the Securities and Exchange Commission from ordering an accounting and disgorgement pursuant to the amendments made by this Act.” *Id.*¹⁶ Because imposition of a cease and desist order is a civil penalty under the D.C. Circuit’s recognized

¹⁵ “While there is no need to rely upon the Remedies Act’s legislative history as its language is plain, it is notable that the legislative history, as contained in the relevant House report, contains no explicit or implicit discussion of the Remedies Act that suggests that the cease and desist power should have retroactive application. *See* H. Rep. 101-616 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379.

¹⁶ The text of paragraph (3) is irrelevant to this appeal.

definition of that term, *see infra* at 17-27, the plain language of the Remedies Act prohibits its application to “conduct occurring before enactment of this Act.” *Id.*

Moreover, regardless of whether a cease and desist order is a “civil penalty,” this Commission is prohibited from giving this form of relief retroactive effect. By generally making the Remedies Act effective after a specified date, Congress followed a practice judicially recognized to prohibit retroactive effect. In *Landgraf* the Supreme Court analyzed a similar clause in a civil rights statute and held that “[a] statement that a statute will become effective on a certain date does not even arguably suggest that it has any application to conduct that occurred at an earlier date.” 511 U.S. at 257. The absence of stronger language here likewise precludes a finding that Congress intended to grant retroactive cease and desist power.

The accepted canons of statutory construction also support this construction of the statute. Paragraph (2)(B) expressly exempts “accounting or disgorgement” from the enactment date of subparagraph (A). The inclusion of this specific exemption means that the SEC is authorized to order **only** accounting and disgorgement from individuals for “conduct occurring before the date of enactment of this act.” *See Andrus v. Glover Constr. Co.*, 446 U.S. 608, 616-17 (1980) (“Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.”); *Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 188 (1978) (recognizing the canon of “*expressio unius est exclusio alterius*”). If Congress had wanted to impose retroactively the newly granted remedy of a cease and desist order, as well as the traditional equitable remedies of accounting and disgorgement, it was obligated to do so directly. Its failure to include that exception, especially in light of the Supreme Court’s requirement that retroactivity be clearly and

expressly mandated in the statute, establishes that Congress did not intend for the cease and desist order to issue against individuals for “conduct occurring before the date of enactment of this act.”

3. If the SEC Were To Issue a Cease and Desist Effect Order Based Solely Upon Conduct That Occurred Prior To the Enactment of the Remedies Act, the Order Would Necessarily Have Retroactive Effect

Judge Foelak failed to address whether Congress had intended that the Remedies Act have retroactive effect. Instead, the judge followed Commission precedent and held that the Commission’s cease and desist power was analogous to an injunction, a form of relief that the judge stated does not fall within the prohibition against retroactivity. (Initial Decision, p. 6); *see also In the Matter of Richard H. Morrow*, 1995 WL 133391 (S.E.C. March 17, 1995) (holding that cease and desist order was not “retroactive in application” because it is a “future, forward looking relief” comparable to an injunction). The case upon which the judge relied, however, does not support the broad conclusion that any injunction would not entail retroactive application of its authorizing statute. Only when injunctive relief is based upon present events does it escape the prohibition against backwards looking punishment.

The dictum of *Landgraf* relied upon by the judge does not create an “injunction exception” that allows the SEC to impose retroactive punishment based upon pre-enactment events merely by classifying it as “prospective relief.” *Landgraf*’s brief dictum merely provides that “[w]hen the intervening statute authorizes or affects the priority of prospective relief, application of the new provision is not retroactive.” 511 U.S. at 273. In support of this proposition, the Court cited several of its past decisions: *Hall v. Beals*, 396 U.S. 45 (1969); *American Steel Foundries v. Tri-City Cen. Trade Council*, 257 U.S. 184 (1921); and *Duplex*

Printing Press Co. v. Deering, 254 U.S. 443 (1921). The only significant exposition of these cases in *Landgraf* is a partial quote from *American Steel Foundries*, which in turn was quoting *Duplex Printing Press Co.*: “In remanding the suit for application of the intervening statute, we observed that ‘relief by injunction operates in futuro’ and that the plaintiff had no ‘vested right’ in the decree entered by the trial court.” 511 U.S. at 273-74 (quoting *American Steel Foundries*, 275 U.S. at 201).

The problem with the judge’s meager analysis of this issue is that the injunctive relief sought in those three cases was based upon the **defendant’s on-going activities** at the time the relief was sought. *See Hall*, 396 U.S. at 48 (holding that at time of review, amendment to state voting requirements statute no longer burdened complainant’s ability to vote, thus rendering appeal moot); *Duplex Printing Press Co.*, 254 U.S. at 462-63 (plaintiff sought to enjoin an on-going secondary boycott of its factory); *American Steel Foundries*, 257 U.S. at 193 (seeking to enjoin striking workers from continuing to engage in violence and other illegal acts). Indeed, the full quotation from *Duplex Printing Press* is: “Obviously, this form of relief operates only in futuro, **and the right to it must be determined as of the time of the hearing.**” 254 U.S. at 464 (emphasis added). Thus, these cases merely hold that an injunction based on present events does not run afoul of prohibition against retroactivity. In each of these cases, the relief sought had no backwards-looking component, and, thus, involved activity subsequent to the effective dates of the statutes.

Here, the Division has sought to impose a cease and desist order solely because of events that occurred prior to the enactment of the Remedies Act. In fact, the Division takes the position that it need not prove a likelihood of future violations making it clear that it seeks a cease and

desist order solely for acts committed prior to the enactment of the Remedies Act.¹⁷ Such use of its cease and desist authority, however, would have improper retroactive effect. As the Supreme Court explained in *Landgraf*, a statute has retroactive effect when it “takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or **attaches a new disability, in respect to transactions or considerations already past . . .**” *Landgraf*, 511 U.S. at 269 (quoting *Society for Propagation of the Gospel v. Wheeler*, 22 F. Cas. 756, 767 (No. 13,156) (C.C.D. N.H. 1814) (Story, J.) (emphasis added); see also *Miller v. Florida*, 482 U.S. 423, 430 (1987) (“A law is retrospective if it ‘changes the legal consequences of acts completed before its effective date.’” (quoting *Weaver v. Graham*, 450 U.S. 24, 31 (1981))).

Here, Mr. Trepp is no longer engaged in security trading and, therefore, the Commission’s order could only be based upon Mr. Trepp’s alleged past bad acts. There are simply no present facts on which relief can be granted. Instead, the Division’s order is a thinly veiled attempt to attach to Mr. Trepp the label of securities law violator. As explained above, see infra at 20-23, this scarlet letter of securities law would have a negative impact on Mr. Trepp’s ability to engage in the securities industry and other related activities, and would constitute a “new disability.” In sum, by looking backwards to assign blame for the alleged parking scheme at Reliance, the Division is not seeking relief “in futuro” but is seeking to punish Trepp for past conduct.

D. The Commission’s Prior Fact Finding In Its Settlements With Reliance and Pankratz Prevents the Commission From Appearing To Be An Impartial Adjudicator

¹⁷ This is the basis for the Division’s Petition for Review in this matter.

1. The Findings of Fact by the Commission in Its Settlements with Reliance and John Pankratz Cast Doubt Upon the Commission's Ability to Review Trepp's Case De Novo

The crux of this controversy revolves around the factual determination of whether market risk passed from Reliance to Drexel in connection with securities that were later repurchased by Reliance. The Commission, however, has already made that determination adversely to Mr. Trepp in settlements entered into by the Commission with Reliance and Pankratz. By making those factual determinations, the Commission committed itself to one view of this controversy. Now, as the Commission is in the position of re-adjudicating those facts vis-à-vis Warren Trepp, the question arises whether the Commission may fairly and impartially consider the record before it and, if need be, deviate from its prior conclusions. Whatever the answer, the fact that it is a fair and obvious question establishes that the Commission cannot reasonably be considered to be impartial. As the due process requirements of the United States Constitution mandate the Commission to be impartial both in fact and appearance, the Commission must dismiss this proceeding and, if it so chooses, continue its prosecution of Trepp before an Article III judge free from the taint of pre-determination.

Judge Foelak rejected Mr. Trepp's due process argument on two grounds. The judge concluded that SEC precedent as well as the Administrative Procedure Act ("APA") allow the agency to act as both an administrator and adjudicator consistent with due process, including when it considers settlements in multi-party investigations. (Initial Decision, p. 8). The judge also noted that Mr. Trepp's claim was premature, as courts ordinarily do not entertain due process claims from administrative proceedings until such proceedings are final.¹⁸ *Id.* However,

¹⁸ As the judge, however, did address the merits of Trepp's argument, it is unclear which of the judge's holdings are mere dictum.

as the dispute is now before this Commission, which had entered into the prior third-party settlement, the question of the Commission's prejudgment is ripe. And, as this Commission is required to uphold the Constitution, including the due process clause, this Commission must consider whether it is violating its duties under that constitutional requirement.

It is well settled that the Constitution's strictures of due process apply to administrative adjudications. *Antoniu v. SEC*, 877 F.2d 721, 724 (8th Cir.)1989, *cert. denied*, 494 U.S. 1004 (1990); *see also Amos Treat & Co. v. SEC*, 306 F.2d 260, 264, 267-68 (D.C. Cir. 1962) (applying due process standards against SEC and vacating SEC decision because of prejudgment).

According to the United States Supreme Court, "[a] fair trial in a fair tribunal is a basic requirement of due process." *In re Murchison*, 349 U.S. 133, 136 (1955). Fairness not only "requires an absence of actual bias in the trial of cases," *id.*,¹⁹ it mandates that, "justice must satisfy the appearance of justice," *id.* (quoting *Offutt v. United States*, 348 U.S. 11, 14 (1954)). Thus, an administrative hearing, in order to satisfy due process, must: (1) be objectively fair and (2) appear to be fair. The appearance of prejudgment bias, or, more specifically as it applies to this case, the predetermination of adjudicative facts, offends these fundamental notions of due process.²⁰

The D.C. Circuit has had several opportunities to enforce the due process requirement that administrative agencies not engage in unnecessary fact finding that creates the appearance of prejudgment. In *Texaco, Inc. v. FTC*, 336 F.2d 754, 760 (D.C. Cir. 1964), *vacated and remanded*

¹⁹ *See also Goldberg v. Kelly*, 397 U.S. 254, 271 (1970); *Wong Yang Sung v. McGrath*, 339 U.S. 33, 45-46 (1950).

²⁰ For a general reference, *see* 2 Kenneth Culp Davis and Richard J. Pierce, Jr., *Administrative Law Treatise* § 9.8 at 78 (3rd ed.1994) (hereinafter "Davis")("An adjudicatory decisionmaker can be disqualified because she prejudged disputed issues of adjudicative fact . . ."). Professor Davis defines "adjudicative fact" as, "issues of who did what, where, when, how, why and with what motive or intent." *Id.*

per curiam on other grounds, 381 U.S. 739 (1965), for example, the D.C. Circuit explained the fundamental principles of due process as they relate to the predetermination of adjudicative facts by a fact-finder. Texaco had moved to disqualify FTC Chairman Dixon on the grounds that a speech he made prior to an administrative hearing implicated Texaco in the very wrongdoing that was in question at the hearing. The D.C. Circuit initially quoted *Amos Treat* for the proposition that: “[a]n administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness. Only thus can the tribunal conducting a quasi-adjudicatory proceeding meet the basic requirement of due process.” *Id.* at 760 (quoting *Amos Treat*, 306 F.2d at 267.). The Court went on to hold that, “Chairman Dixon’s participation in the hearing amounted . . . to a denial of due process” which invalidated the order under review, as his “speech . . . plainly reveals that he had already concluded that Texaco and Goodrich were violating the Act,” *Id.*; see also *Antoniu v. SEC*, 877 F.2d 721, 726 (8th Cir. 1989) (holding that SEC determination was tainted by participation of Commissioner who had made public statements that showed prejudice); *Cinderella Career & Finishing Sch., Inc. v. FTC*, 425 F.2d 583, 590-91 (D.C. Cir. 1970) (holding that agency chairman should have recused himself in light of his public statements indicating prejudice of the case). In sum, what lies at the heart of these cases is the denial of due process as a result of statements on the merits by those who must make factual determinations on contested fact issues . . . where the fact finding is critical.” *Staton v. Mayes*, 552 F.2d 908, 914 (10th Cir.) (as amended), *cert. denied*, 434 U.S. 907 (1977).

Here, the SEC has gone even farther than the individual commissioners in *Texaco*, *Antoniu*, and *Cinderella*. In the *Offer of Settlement in In re Reliance Group Holdings, Inc. and*

John Pankratz, (File No. 3-8293) the SEC made formal findings of specific adjudicative facts that are central to the issue of liability. These findings were unnecessary to effectuate the settlement and, hence, were purely gratuitous. In *In re Reliance Group Holdings, Inc. and John Pankratz*, the Commission stated that it “makes the following findings:”

- (1) the gains taken by Reliance in the Third Quarter, “should not have been accounted for as resulting from the sales of securities because the transactions -- sales and repurchases of the same securities -- eliminated market risk. Therefore these transactions were not entitled to be treated as sales and gains and should not have been recognized under generally accepted accounting principles,” *Offer of Settlement* at 2;
- (2) Pankratz reached an arrangement “which eliminated market risk from the sale and repurchase transactions,” *id.* at 3;
- (3) the high yield bond salesman in this case “told Pankratz that the brokerage firm agreed to the proposal “that is under scrutiny by the SEC, *id.* at 4;
- (4) the high yield bond salesman involved in this case and Pankratz “effected a similar program of sales and repurchases. . . in Reliance’s third quarter ending September 30, 1986 . . .” *id.*;
- (5) Pankratz and the broker-dealer in this case “as per the arrangement . . . adjusted prices in subsequent unrelated transactions in an effort to make up Reliance’s loss,” *id.*;
- (6) “Reliance’s accounting for the transactions as sales and the recognition of \$39.1 million of gains was not in accordance with GAAP,” *id.* at 5;
- (7) “[t]he arrangements with the broker-dealers precluded the transactions in the second and third quarter programs from being accounted for as sales because Reliance retained ownership of the bonds ‘sold’ to the broker-dealers,” *id.*
- (8) “[a]t the time the transactions were initiated, the outcome had been agreed to; therefore, there was no economic substance to the transactions,” *id.*;
- (9) “[t]he transactions described above did not involve an exchange because, as a result of the arrangements, Reliance did not divest itself of the risks and rewards of ownership. Because there was no exchange, no revenue should have been recognized,” *id.*;
- (10) “Reliance’s financial statements included in its Form 10-K for the year ended December 31, 1986, and in its quarterly reports on Form 10-Q for the second and third quarters of the 1986 recognized \$39.1 million of capital gains which should not have been recognized in accordance with GAAP because the arrangements with the broker-dealers eliminated risk. Accordingly, Reliance’s income statements in its financial statements included in its Form 10-K for the period ended December 31, 1986, and in quarterly reports on Form 10-Q for the periods ending June 30 and September 30, 1986, materially overstated net income by

\$30.3 million in the second quarter, by \$8.8 million in the third quarter, and by \$39.1 million for the year end.” *Id.*

The Commission has plainly found that the transactions in question “eliminated market risk,” and had “no economic substance.” Even if these findings were made only for purposes of settlement with Reliance and Pankratz,²¹ a “disinterested observer” would reasonably conclude that the agency has “in some measure adjudged the facts as well as the law of a particular case in advance of hearing it.” *Gilligan, Will & Co. v. SEC*, 267 F.2d 461,469 (2d Cir. 1959); *See also In re Stuart James Co.*, 50 S.E.C. 468,___, [1991 WL 291802, at *2 (Jan. 23, 1991) (“[T]here can be no prejudgment unless an agency has in some measure adjudged the facts in advance of hearing them.”). In sum, the Commission is precluded by the U.S. Constitution’s due process strictures from acting as judge in a case in which it has taken a pre-hearing, public position diametrically opposed to the defendant now before it.

2. Due Process Does Not Preclude the Commission From Asserting Its Claims Before An Impartial Article III District Judge

Dismissal is not a drastic remedy at this late stage of the proceedings. While dismissal of these proceedings at this late stage would mean that some time and effort will be lost, this is the price required by the U.S. Constitution. Moreover, the Commission did not lack a remedy even if it is precluded from acting as judge in the matter of Warren Trepp. The Commission was free to seek a civil injunctive order by filing a claim in a U.S. district court. See, 18 U.S.C. § 77t(b). In

²¹ The Commission, in an apparent but fruitless effort to circumvent this argument notes in footnote 1 in the *Offer of Settlement*, that, “[t]he Commission’s findings herein are not binding upon any person in any other proceeding.” This is nothing more than an obvious statement of the law of collateral estoppel and res judicata and has nothing to do with the principles of due process and fundamental fairness. The Commission’s disclaimer, therefore, means nothing as long as a disinterested observer might conclude that the Commission has predetermined adjudicative facts in the case at bar.

such a proceeding, the district judge, appointed under Article III, would have been an impartial adjudicator, free of the appearance of predisposition.

Moreover, this Commission would not tie its hands in future cases by recognizing that there are some cognizable due process limits to its ability to make self-serving statements about its enforcement efforts. In the future, the Commission simply may refrain from issuing chest-thumping press releases and orders that find facts that may be re-adjudicated by third parties in other proceedings. Such findings are not statutorily directed. And, in so much as they serve an indirect purpose of educating the securities bar and industry on the Commission's enforcement decisions, then such statements are indeed fact findings and the Commission should not argue otherwise.

In sum, it is not too much to ask the Commission "to assess, in each and every adjudication, whether the 'risk of unfairness' to the respondent in that case has reached a level that is unacceptable even if not 'intolerably high.'" *In re Stuart-James Co.*, 50 S.E.C. 468, ___, [1991 WL 291802, at *13 (Jan. 23, 1991) (Fleischman, Comm'r, concurring) (quoting *In re J.P. Linahan, Inc.*, 138 F.2d 650, 653 (2d Cir. 1943)). "The Commission owes itself the expenditure of that effort. The very commitment to that expenditure would be beneficial. . . ." Id. "In that extra expenditure the Commission would assure itself, and in assuring itself it would assure each respondent and each reviewing Court of Appeals, that this Commission takes every care in the performance of its adjudicatory function not to succumb to the ever-present temptation . . . to decide that it has proved its own case" Id. (quotation marks omitted).

V. Conclusion

While the Administrative Law Judge properly dismissed the case against Mr. Trepp, her findings that there was an illegal parking arrangement between Reliance and Drexel and Mr. Trepp had knowledge of it are internally inconsistent and not supported by the record. Furthermore, the Commission cannot review these findings without denying Mr. Trepp a fair and impartial adjudication consistent with principles of due process. The Commission's findings in *In re Reliance Group Holdings, Inc. and John Pankratz* have tainted the appearance of fairness in this matter. Thus, the Commission must vacate the factual findings of the Initial Decision. It should then dismiss these proceedings since the entry of a cease and desist order is barred by the statute of limitations and would be an improper retroactive application of a remedy not granted to the Commission until 1990.

Respectfully submitted,



William G. Hundley
Larry S. Gondelman
Daniel F. McInnis

AKIN, GUMP, STRAUSS, HAUER
& FELD, L.L.P.
1333 New Hampshire Avenue, N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000

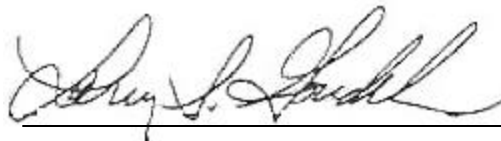
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Brief of Warren Trepp In Support of Petition for Review was delivered on October 20, 1997, via messenger, to:

William Kuehnle
Securities and Exchange Commission
450 Fifth Street, N.W.
Mail Stop 4-2
Washington, D.C. 20549

Carol Fox Foelak
Administrative Law Judge
Securities and Exchange Commission
450 Fifth Street, N.W.
Mail Stop 11-6
Washington, D.C. 20549

Jonathan G. Katz
Office of the Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Mail Stop 6-9
Washington, D.C. 20549

A handwritten signature in cursive script, appearing to read "Larry S. Gondelman", written over a horizontal line.

Larry S. Gondelman