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New York State Bar Association

One Elk Street, Albany, New York 12207 • 518/463-3200

July 3, 1998

Jean W. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Proposed Revisions to Part 10, Rules of Practice

Dear Ms. Webb:

The Committee on Commodities and Futures Law of the New York State Bar Association is pleased to have the opportunity to comment on the Commission's notice of proposed rule making concerning amendments to Part 10 of the Commission regulations published in the April 3, 1998 Federal Register (Vol. 63, No. 64).

The Bar Association of the State of New York is comprised of approximately 60,000 attorneys licensed to practice in New York, and the Committee is comprised of 50 attorneys in private practice, government, corporations, and academia. They represent or have an interest in commodity and derivatives industry institutions and individuals, including futures commission merchants, floor brokers, floor traders, customers, commodity pool operators, commodity trading advisors, banks, investment banks, and commercial operators in the cash and futures business. The views expressed in this comment letter are those of the Committee and should not be imputed to the Association as a whole.

In general, the Committee agrees with the changes proposed by the Commission and anticipates that they will expedite hearings without prejudicing the rights of respondents, except as noted below. Efforts to streamline what has become a lengthy and costly process for litigants are beneficial to respondents and the Commission alike.

This comment letter will make one general observation about the proposed amendments to the Commission's Rules of Practice and then will offer specific comments and suggestions on particular proposed rule changes.

The Committee takes exception to what it regards as an inherently inconsistent and unfair approach in modeling the discovery rules on selected portions of both the Federal Rules of Criminal Procedure and the Federal Rules of Civil Procedure. The criminal procedure paradigm tends to minimize discovery and disclosure, short of compromising Constitutional rights. In so doing it allows defendants to protect their strategy and evidence from premature disclosure. This careful balance provides certain advantages to defendants who start from the disadvantageous position of having to litigate against a party that has had effectively unlimited time to prepare its case[1].

The civil procedure paradigm, on the other hand, is designed to put the parties on equal footing and to provide for complete and full disclosure prior to the hearing. The proposed rules manifestly borrow from both models, to the detriment of respondents, an example of which is found in Rule 10.42.

The proposed discovery rule changes imposing obligations on the Division of Enforcement appear to be a codification of what the courts currently require of a prosecutor, while those imposing obligations on respondents require them to engage in disclosure that would not be required in a criminal context. While the proposed rules ostensibly create symmetry, they in fact work to prejudice respondents.

In its comments in support of the proposed changes to Rule 10.42(a) that would require the disclosure of the identity and residence of witnesses, as well as a summary of the matters to be covered by the witnesses' expected testimony, the Commission cites for support the Federal Rules of Civil Procedure. On the other hand, for support for proposed changes to Rule 10.42(c), which requires the production of "Jencks Act" material, the Commission cites the Federal Rules of Criminal Procedure. The Committee respectfully submits that the Commission cannot have it both ways. If the Commission chooses to follow the criminal

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[1] The investigative power of the Division of Enforcement as a practical matter is equivalent to that of a prosecutor. Moreover, the severity of the sanctions available to an administrative law judge and the Commission also evokes the criminal paradigm. To be able to revoke a registration of an industry participant and to impose monetary penalties of hundreds of thousands of dollars causes an equivalent kind of disruption and notoriety in a person's life.

paradigm, it should not disrupt the balance of rights between respondents and the Division of Enforcement that has been established over decades of experience. If, however, the Commission embraces the civil model, then respondents should be given more discovery rights, including depositions, interrogato-ries (contention and fact), and so on.

This propensity of "cherry picking" from the criminal and civil procedure rules creates inconsistencies that work an inequitable hardship on respondents. For example, Rule 10.24(a) as proposed would allow the Commission to amend its complaint at any time, a concept that derives from the criminal procedure law.[2] In the civil paradigm, however, unless done before a party's time to file a responsive pleading has expired, a pleading may not be amended without leave of court. Before granting leave a court will allow the opposing party an opportunity to show prejudice or otherwise demonstrate why the motion to amend should not be granted.

To allow the Commission this peremptory right will unfairly prejudice respondents, for a respondent should be able to prepare his or her defense and strategies in a case on the basis of known charges and exposure. To allow the Commission to use a complaint as a discovery device to flesh out defenses or fashion additional charges would be an unjust use of the amendment right. And while there may be circumstances when amending a complaint should be allowed, it should not be done without providing a respondent an opportunity to argue against amendment.

If, as the proposed rules would allow, the Commission can alter or supplement a complaint at will, respondents will be put at a discovery disadvantage. In recent history Administrative Law Judges have demonstrated rigid adherence to discovery schedules established in pre-trial orders, notwithstanding potential prejudice to a party. Proposed Rule 10.24(a) provides an explicit and absolute right to amend, but does not require an ALJ to alter such pre-trial order provisions in ways that will avoid prejudice to respondents. Accordingly, the Committee suggests that at the very least the language of the second sentence of subparagraph (a) be amended to state that, "... the Administrative Law Judge *shall* adjust the scheduling of the proceeding *or any pre-trial discovery*

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[2] The Committee understands that the Commission's likely intention in this rule amendment proposal is to allow the Division of Enforcement to make non-substantive changes to a complaint without involving the Commission and assumes that the Commission believes it has the right to amend a complaint at anytime. The Committee, however, believes that such a power raises due process rights and therefore should not be codified without more clear direction to the Administrative Law Judge.

so as to avoid any prejudice to any of the parties to the proceeding."

RESTITUTION

The Committee has generalized concerns about the proposed restitution rules, as well as more specific comments.

The Committee understands that the Commission contemplates a bifurcated procedure in most proceedings, although the rules provide that they may be combined into a single proceeding. Although without experience with these rules it is difficult to assess their impact on respondents, the Committee suspects that respondents will feel compelled to participate in the restitution phase -- even in a bifurcated proceeding -- to insure that (a) restitution is imposed only in appropriate cases and (b) that calculations of damages are proper. Because of its concern for the additional expense these rules may cause to respondents, the Committee urges that the Commission make clear in its release of the final rules that the cost of administering a restitution program come from the restitution fund and not from the funds of respondents.

In addition to those generalized concerns, the Committee notes certain loopholes created by the proposed restitution rules. Sections 14 and 22 of the Commodity Exchange Act, 7 USC §§ 18 and 25, impose a two year statute of limitations on private actions and reparations proceedings under the Act. The Commission, however, is not so limited. Thus under the proposed rules a customer whose claims against a respondent would be barred by Sections 14 and 22 of the Act might claim to be entitled to recover through the proposed restitution rules. To avoid this inherent inconsistency the Committee recommends that the final proposed rule make clear that customers whose claims would be barred by Sections 14 and 22 will not be entitled to recovery under these restitution rules.

The Committee also notes that in a fraud case a customer must demonstrate reliance to recover against a respondent, but that the Division of Enforcement need not make such a showing in its enforcement proceeding. Requiring the Division of Enforcement to demonstrate reliance for each customer would detract materially from performance of the Division of Enforcement's basic mission and could add substantially to the expense of the process both to the Commission and respondents, particularly in cases involving large numbers of customers. On the other hand, payment of restitution to customers who may not have relied on the misrepresentations of respondents would provide a legally insupportable windfall to

customers[3], and it would be inconsistent with legislative mandate. The Committee believes that the final rules should be consistent with the Reparations rules requirements for restitution.

As a final comment on the restitution rule amendments, the Committee believes that paragraph (b)(3) of Rule 10.84 is misplaced. Current Rule 10.84, and indeed all of the proposed rule except for paragraph (b)(3), address procedural issues such as the need for an initial decision, when a decision becomes final, notification, and so on - all procedural points. Paragraph (b)(3), on the other hand, sets forth the substantive criteria for an Administrative Law Judge's decision to order restitution. Accordingly, the Committee believes that proposed paragraph (b)(3) should be transferred to proposed Subpart I - Administration of Restitution Orders. The Committee suggests that it be made a separate rule, perhaps 10.110 (with attendant renumbering of the remaining rules in the Subpart) and that the title of the Subpart be amended to reflect the inclusion of this new rule.

PROPOSED DISCOVERY RULES

The Committee supports the Commission's decision to limit the number of Requests to Admit a party may serve. The Committee is aware of cases where requests to admit have been abusive in number and content. The proposed rules should eliminate that practice without restricting expanded use of this discovery device when an adequate showing has been made. The Committee believes that unnecessary motion practice could be avoided if the final rule contained criteria to be met for expanded use of requests to admit. Alternatively, guidance could be provided in the comments to the final rules.

Proposed Commission Rule 10.42(b)(5) provides that unless the parties can agree, investigatory materials of the Division of Enforcement that are subject to the production requirements of the rule shall be made available where they are ordinarily maintained. This provision can work a real and un- necessary hardship for certain respondents. Trade practice cases may involve individual respondents whose financial resources are strained by the disciplinary process. Although these cases often have trials that will take place in New York or Chicago, where the Commission has its regional offices, the cases are run out of the Washington headquar-

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[3] The Committee also believes that the final rules should make clear that a person who has privately sought or secured recovery against the respondent should not be entitled to restitution arising out of the enforcement proceeding.

ters. The requirement that attorneys for the individual respondent travel to Washington to inspect this documentation can cost a respondent substantial sums.

The Committee believes that in the absence of agreement between the parties, the Commission should make this documentation available in its regional office where the trial is scheduled to take place, or where the respondent or his counsel is located. The burden of production in this situation should rest on the Division, which is able to transmit these documents to its regional office at substantially less expense than would be required of a respondent who would have to send his or her representative to Washington. Accordingly, the Committee believes that the first sentence of subparagraph (5) of proposed Rule 10.42(b) should be changed to read, " ... at the Commission office where *the trial is to be held, at the regional office nearest to where respondent or his counsel is located,* or any other location agreed upon by the parties in writing."

Proposed rule 10.42(b)(6) provides that failure of the Division of Enforcement to comply with the disclosure will not result in a rehearing or reconsideration of the matter already heard or decided unless the respondent can demonstrate prejudice. The Committee believes that the burden should rest on the Division to show the absence of prejudice, for the party at fault should assume the burden. Accordingly, the Committee suggests that the language of the section be amended as follows, " ...pursuant to this section, *a rehearing or reconsideration of the matter already heard or decided shall be required, unless the Division of Enforcement demonstrates that no prejudice to the respondent has been* caused by the failure to make the documents available."

Proposed Rule 10.42(b) calls for the production of transcripts of investigative testimony. Proposed Rule 10.42(c) defines witness statements as (a) transcripts of investigative depositions, trial, or similar testimony given by a witness, (b) signed written statements, or (c) substantially verbatim notes of interviews. The Committee believes that the scope of these production obligations is too narrow. An interviewer may summarize a statement of a witness which, while not constituting the witness' "exact words", fairly and accurately represents the witness' version of events. Any such record should be discoverable. Accordingly, the Committee recommends proposed Rule 10.42(b)(1)(ii) be amended as follows: " All transcripts *or summarizations* of investigative testimony and all exhibits to those transcripts *or summarizations.*" and that Proposed Rule 10.42(c)(iii) similarly be amended as follows: "Substantially verbatim notes of interviews with the witness *or summarizations of interviews*, and all exhibits to such transcripts, statements, notes, *and summarizations.* For the purposes of this paragraph (c) 'substantially verbatim notes'

means ... , *and 'summarizations' means any writing that fairly and accurately represents the witness' statements.*"

The Commission's comments in support of new Rule 10.42(c) note that the Commission will continue to require the production of witness statements before the start of the hearing, at a time to be fixed by the ALJ. The Committee believes that the Commission should provide more guidance to the ALJs as to the timing of the disclosure of witness statements. In particular, the Committee believes that witness statements should be turned over well enough in advance of the hearing to permit the parties to analyze and integrate the information in to their trial strategies. Accordingly, the Committee recommends that the first sentence of subsection (c)(1) be amended as follows, " ... make available to the other parties, *90 days prior to the hearing,* any statement of any person ...."

The Committee also suggests that the compilation of a privilege or work product log, mentioned in paragraphs (c)(3) and (b)(4) of proposed Rule 10.42, be automatically required, rather than only at the request of a party. This requirement would be consistent with Rule 26 of the Federal Rules of Civil Procedure, and including such a requirement will obviate the need for both parties to pursue the preparation (and attendant expense) of a motion in what would likely be a common practice.

The Committee is concerned that the proposed rule 10.42(f) will create hardship on responding parties, if not opportunities for abuse. As written, the proposed rule gives a party twenty days to object to the authenticity or admissibility of a document. While the idea of disposing of any objections to the authenticity or admissibility of documents in advance of the hearing is one the Committee supports, it is concerned that the Division of Enforcement could present a respondent with a large volume of documentation which a respondent would have a difficult time processing in twenty days. This process of "authenticating" a document in trade practice cases can be complicated by the absence of the original document, which usually is in the hands of the Division of Enforcement. Often times the handwriting and ink on a document is a material consideration in the evaluation process, and it becomes necessary to view the original documents. If these documents are not readily available, time will be required to make arrangements for inspecting them.

The Committee believes that additional time should be allowed for determining authenticity and admissibility, or that the rules should expressly allow for the expansion of the deadline upon application of a party. The Committee suggests that the rule should contain a 50 day time limit, with express provision for adjustment upon application by a party. Accordingly, the Committee recommends that the first sentence of paragraph (2) of subsection

(f) be amended to read, " ... *Within 50* days after service of the list described in paragraph (f)(1) of this section, *or such other time as the Administrative Law Judge may, upon application by a party, determine*, each party upon whom ...."

The Commission's comment in support of the proposed amendments to Rule 10.42(f) observes that the new rule is modeled on Rule 26(a)(3) C) of the Federal Rules of Civil Procedure. However, unlike Rule 26(a)(3)(C), proposed Rule 10.42(f) would apparently result in a waiver of all objections not raised, including the right to object to relevance, prejudice, confusion, or waste of time at the hearing. Fed. R. Civ P. Rule 26(a)(3)(C) by reference to Rules 402 and 403 of the Federal Rules of Evidence expressly reserves for trial the right to object to documents on the grounds of relevance, undue prejudice, confusion of issues, needless presentation of cumulative evidence, or waste of time. The Committee believes that proposed Rule 10.42(f)(2) should be amended as follows to expressly reserve objections reserved in Fed. R. Civ. P. 26(a)(3)(C): " ... on the list. All objections not raised may be deemed waived, **except objections based upon relevance, undue prejudice, confusion of issues, needless presentation of cumulative evidence, or waste of time.**"

The Committee supports the provision of proposed Rule 10.68(a)(2) that provides for the issuance of subpoena duces tecum returnable at any time or place prior to the hearing. Devices that facilitate pre-hearing preparation will speed the hearing and avoid potential prejudice to parties.

The Commission proposes to add a subparagraph (2) to Rule 10.102(a), which would grant to a party the right to file a notice of cross-appeal within fifteen (15) days of the date of service of the other party's timely filed notice of appeal. The Commission does not give any reason or rationale for this proposal, and the Committee can perceive no benefit. In fact, to the extent that the provision gives a party a reprieve from the consequences of lapses in its handling of the case, it would appear to be inconsistent with the stated objective of improving the efficiency of the administrative process. It would also raise due process issues by creating a disincentive to appeal by setting up a risk of a cross-appeal when one would not otherwise have been filed. Accordingly, the Committee recommends that the Commission not implement the provisions of the proposed subparagraph (2) of Rule 10.102(a).

APPLICABILITY OF RULE AMENDMENTS

The release does not make clear how the proposed rule changes will be made applicable. It is not clear if they will be applicable only to cases that are filed after the rules are made effective, or whether they will also be applied to pending cases. The Committee believes that the Commission in its final release

should be clear on the intended applicability of the rule changes. The Committee suggests either that the rule changes not be applicable to pending cases, or that if they are to be applied to pending cases, the Commission should be clear that the Administrative Law Judges should be liberal in insuring that respondents are not prejudiced by their imposition and that respondents should have the benefit of the prior discovery rules.

MISCELLANEOUS

The Committee believes that the language of proposed Rule 10.101(b)(1) should be improved to eliminate a possible ambiguity. The section provides that an application for interlocutory review may be filed within a specified period of time, except if a request for certification has been filed. The next sentence begins with a reference to "such a request." Since an application for interlocutory review is discretionary with the Commission, such an application could be construed as a request. Consequently, the use of the word request in the second sentence might be argued to refer back to the application for interlocutory review, rather the intended request for certification. This possible ambiguity could be eliminated by replacing the language "such a request" in the second sentence with "*a request for certification.*"

Proposed Rule 10.102(a)(1) contains language adjusting the time by which a notice of appeal is to be filed if service of the initial decision or other order terminating the proceeding is effected by mail or commercial carrier. This language duplicates identical language in Rule 10.12, which applies to all Part 10 rules, and accordingly the Committee believes that it is should be deleted as redundant.

The language of proposed Rule 10.106 appears to be drafted in a way that creates confusion as to when a bond will be required for a stay pending appeal. Paragraph (b)(2) of the section establishes three criteria for issuance of a stay: likelihood of success on the merits, irreparable harm, and no harm to public interest or that of the other party. The next paragraph, paragraph (b)(3), prescribes the requirements for a bond, but oddly mentions that it is required only "If neither the public interest or the interest of any other party will be adversely affected." The Committee presumes that the Commission intends to require a bond in all circumstances when a stay is granted. If the Committee's assumption is correct, more accurate language would eliminate any ambiguity as to the circumstances in which a bond is required. Accordingly, the Committee suggests that the language of paragraph (b)(3) be changed as follows, "*If the applicant has demonstrated compliance with the standards of paragraph (b)(2) hereof*, the Commission shall ...."

Finally, the Committee recommends that the Commission take this opportunity to amend the provisions governing the review of initial decisions (§§10.102 and 10.104) by obligating the Commission to provide notice and the opportunity to be heard to the respondent anytime the Commission is inclined to make a finding of liability or impose a sanction upon review that was not made in the initial decision and not raised by the Division on appeal. The Commission's *sua sponte* imposition of sometimes significantly larger sanctions without notice to the respondent and an opportunity to be heard offends notions of fundamental fairness and raises due process issues.

We appreciate the opportunity to comment on the Proposed Rules and would be pleased to discuss these issues further with the Commission or its staff. Please call me at (212) 545-1900 if you have any questions or if we can provide assistance in connection with the Commission's consideration of the Proposed Rules.

Sincerely yours,

Samuel F. Abernethy
Chairman

SFA/ed

MENAKER & HERRMANN
A LIMITED LIABILITY PARTNERSHIP
10 EAST 40TH STREET
NEW YORK, NEW YORK 10016-0301

(212) 545-1900

email: mhlaw@att.net

FACSIMILE
(212) 545-1656

RICHARD G. MENAKER
ROBERT F. HERRMANN
SAMUEL F. ABERNETHY
DAVID M. RUBIN

MICHIEL A. BLOEMSMA
CHERYL L. DAVIS
LAURA B. GILBERT
PAUL M. HELLEGERS
ANN M. KING

COUNSEL
LOUIS LAUER
MICHAEL J. LEVIN

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BY TELEFAX

Ms. Jean W. Webb
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Proposed Revisions to Part 10, Rules of Practice

Dear Ms. Webb:

Transmitted herewith is a comment letter on the proposed revisions to Part 10 of the Commissions's regulations from the New York State Bar Associatioin Committee on Commodities and Futures Law. I am also send by overnight courier the original of this letter.

Sincerely yours,

Samuel F. Abernethy

SFA/ed

Documents to follow .....