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## Privately Employed Hearing Officers: Hearing Board Procedures of the New York Stock Exchange

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## PRIVATELY EMPLOYED HEARING OFFICERS:

### Hearing Board Procedures of the New York Stock Exchange\*

An exciting and important new phenomenon in the legal world today is the growing acceptance of professional hearing officers, employed by business corporations to resolve "in house" disputes — in short, the emergence of a new legal concept, Private Administrative Law.<sup>1</sup>

Like most legal innovations, the concept of private hearing officers is not really new. The New York Stock Exchange has retained hearing officers to preside over disciplinary proceedings since 1972.

The procedures developed by the Exchange are imaginative, combining as they do, elements of commercial arbitration, judicial trials and formal administrative hearings. The procedures are described in an Outline published by the Stock Exchange Hearing Board.<sup>2</sup>

Derived from the Constitution of the NYSE, the anonymous Outline<sup>3</sup> is intended for persons unfamiliar with the intricacies of Securities Law. It is, in the opinion of the Editors, a model of clarity and brevity, and is worth reading for its style alone. With the permission of the NYSE, it is reprinted below, substantially in its entirety.

To understand the Outline, it is sufficient to know that Stock Exchange hearings are generally concerned with stockbrokers accused of violating the rules of the Exchange. The rules broadly prohibit fraud, misrepresentation, conduct "inconsistent with just and equitable principles of trade," and acts "detrimental to the interest of the Exchange," as well as more specific wrongdoing. Participation in a fictitious stock transfer (e.g., for purpose of driving up the price of a stock), would be an obvious and extremely serious, violation of the rules.

For breaching these rules, the Stock Exchange may impose sanctions, including fines, expulsion, or the suspension of trading privileges. The Stock Exchange adjudicates rule violations, and imposes sanctions, in accordance with the internal procedures described below. It is only after a member has been sanctioned that the government becomes involved.

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\* The Editors are grateful to Jonathan M. Kastoff, Esq., Staff Counsel to the New York Stock Exchange, for supplying the information contained in this article.

<sup>1</sup> See also Schweiker v. McClure, 456 U.S. 188, infra.

<sup>2</sup> Outline: Hearing Board Procedures, Office of the Hearing Board, New York Stock Exchange, January, 1982.

<sup>3</sup> Drafted by the Legal Staff of the Exchange, including Mr. Kastoff, John F. Mulcahy, Jr., Chief Hearing Officer, and Vincent F. Murphy, Esq.

In accordance with the Securities Act of 1934, a sanction, once imposed, is reviewable, first by the SEC, and then by the federal courts. Needless to say, the fairness of the disciplinary procedures, as adopted by the Exchange, and the extent to which the procedures are followed by the Exchange, may well affect the outcome of administrative and judicial review.

Here follows the text of the Outline:<sup>4</sup>

#### INTRODUCTION

The Exchange's Constitution and Rules are the basic sources of information concerning disciplinary procedures and should be carefully studied by anyone involved in the disciplinary process.<sup>5</sup> Those parts of the Constitution and Rules relating to procedural matters in disciplinary hearings are included in the Appendix. Information on how to obtain the complete text of the Constitution and Rules and other materials is also contained in the Appendix.

This outline explains the procedures of the New York Stock Exchange Hearing Board and answers those questions most frequently asked about the disciplinary hearing process at the Exchange.

If after reading this outline you have any questions or would like additional information, please call the staff of the Hearing Board at one of the following numbers: (212) 623-6556 or (212) 623-8564.

#### HEARING BOARD MEMBERS

##### HEARING OFFICERS

The Chairman of the Exchange, subject to the approval of the Board of Directors, annually appoints to the Hearing Board various members and allied members of the Exchange and registered and non-registered employees of members and member organizations. Similarly, the Chairman appoints a Chief Hearing Officer and one or more other Hearing Officers selected from those Exchange employees who have no duties or functions relating to the investigation or preparation of disciplinary matters. (See Section 3 of Article XIV of the Constitution and Exchange Rule 476(b)).

The Hearing Board is an independent entity whose Hearing Panel decisions are reviewable within the Exchange only by the Board of Directors. The Hearing Board is not affiliated with any Exchange department; it is not responsible for investigating conduct or bringing disciplinary actions; it does not work in any way with the departments which do so; and it takes no part whatsoever in deciding whether such charges shall be brought.

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<sup>4</sup> Appendices omitted.

<sup>5</sup> See also Securities Exchange Act of 1934, Section 6.

## ORIGIN AND TYPES OF CASES

All cases received by the Hearing Board are brought to it either by the Exchange's Department of Enforcement or by the Exchange's Market Surveillance and Evaluation Department. (Hereinafter, both Departments will be referred to as "enforcement departments.")

Two distinct types of cases are brought to the Hearing Board:

1. Cases in which a Hearing Panel must make findings on allegations of fact and charges against a respondent<sup>6</sup> which have been set forth in a Charge Memorandum; and
2. Those cases involving a Stipulation of Facts and Consent to Penalty entered into between one of the enforcement departments and the respondent.

## THE CHARGE MEMORANDUM

A Charge Memorandum is a document containing a statement of alleged facts and charges against a respondent arising out of those allegations. The Charge Memorandum must be signed by an authorized officer or employee of the Exchange on behalf of the department bringing the charge or charges.

The Charge Memorandum should be specific, setting forth the name of the respondent and stating plainly, in separately numbered paragraphs, the facts upon which the charges are based. The charges should then be set forth with equal precision and clarity. This permits a respondent to know what he is accused of, it makes simpler the filing of a proper answer, and provides the panelists with a clear delineation of the issues.

## SERVICE OF THE CHARGE MEMORANDUM

The Charge Memorandum may be served in any one of the following methods:

1. Personal service on the respondent;
2. Leaving a copy at the respondent's last known office address during business hours; or mailing a copy to that address;
3. Leaving a copy at the respondent's last place of residence as reflected in Exchange records; or mailing a copy to that address.

Service by mailing is completed at the time the Charge Memorandum is deposited in a United States Postal Service Mail depository or is given to an authorized employee of the Postal Service. The date on which this event occurs is considered the date of service.

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<sup>6</sup> The person or organization against whom a disciplinary action has been brought is referred to as the respondent.

## THE ANSWER

The Answer is the document in which a respondent replies to the allegations of fact and charges contained in the Charge Memorandum. An answer shall be filed within 25 days of the date of service of the Charge Memorandum. A request for an extension of this time period should be addressed to the enforcement department bringing the charges. If the enforcement department declines to grant a request for an extension, an application may be made to the Chief Hearing Officer.

The Answer to the Charge Memorandum must be in writing but need not be typed or set out in any particular format. It should, however, be prepared in black or dark blue ink on white paper so that legible copies can be made. It must be signed by the respondent or by someone on his behalf, usually by an attorney or other authorized agent. It should be filed with the enforcement department which issued the Charge Memorandum.

The Answer shall indicate specifically which allegations of fact and which charges in the Charge Memorandum are denied, and which are admitted. The Answer shall also set forth any specific facts in contradiction of the charges and any affirmative defenses which the respondent intends to assert. A general denial without more does not satisfy this requirement and may be considered a failure to file an Answer. Any assertions of fact in the Charge Memorandum not specifically denied in the Answer may be deemed admitted.

## FAILURE TO FILE AN ANSWER

A failure to file an Answer may be deemed by the Hearing Panel to be an admission of any facts asserted in the Charge Memorandum. If the respondent has failed to file an Answer or if the facts and charges in the Charge Memorandum are not specifically denied, evidence — testimonial, documentary or other — may be limited to the determination of the penalty to be imposed. In the event a respondent who has failed to file an Answer appears at the hearing, he shall not be entitled to testify or to produce witnesses or other evidence against the facts or charges, unless the Hearing Panel determines that adequate reason exists to excuse his failure to file an Answer. If the Hearing Panel makes this determination, the hearing may be adjourned and the respondent directed to promptly file a written Answer.

Although not required, it is strongly recommended that the Answer be sent by certified mail, return receipt requested, or be personally delivered to the enforcement department which issued the Charge Memorandum.

## RIGHT TO LEGAL COUNSEL OR OTHER REPRESENTATIVE

A member, member organization, allied member, approved person, registered or non-registered employee of a member or member organization, or any other person has the right to be represented by legal counsel or other representative in any hearing or review (Rule 476(h)). The same right exists in any investigation before any committee, officer or employee of the Exchange. In connection with an enforcement department's investigation,

this right does not entitle a respondent or a potential respondent to be present, in person or by representative, when other witnesses are questioned or other investigative steps are being taken. Of course, the respondent and his counsel are entitled to be present at the hearing on the charges before a Hearing Panel and to cross-examine any witness who testifies at such hearing.

A respondent has the right to be represented by an attorney or other representative at any stage of the proceedings. This right to be represented may be claimed at any time. Similarly, the enforcement department has a right to be represented by counsel, whether or not the respondent is so represented.

#### PROCEDURAL QUESTIONS

Any party, prior to the hearing, may apply to the Chief Hearing Officer to resolve procedural matters relating to the case. After the hearing has begun such application should be made to the Hearing Officer assigned to the matter. In both situations such applications must be made through the Hearing Board staff with notice to all parties. Ex parte communications<sup>7</sup> with any panelist or Hearing Officer are forbidden. The Chief Hearing Officer or a Hearing Officer designated by him may permit a respondent to inspect and copy documents or records in the possession of the Exchange which are material to the defense or are intended for use by the enforcement department initiating the proceedings as evidence at the hearing. This does not authorize the discovery or inspection of reports, memoranda or other internal Exchange documents prepared by the Exchange in connection with the proceedings. Similarly, the respondent may be required by the Hearing Officer to permit access by the enforcement department to documents or records in his possession or control. A Hearing Officer may require a pre-hearing conference on any case. An appeal of procedural determinations of the Hearing Officer may only be made after a Panel has issued its decision on the merits of the entire case. (Rule 476(c))

The parties have such powers of subpoena as may be provided by the law of the place where the hearing is held. In addition, the Office of the Hearing Board has assisted at times in attempting to obtain at the hearing the presence of witnesses from the member firm community whose testimony is relevant and necessary.

#### COMPOSITION OF THE HEARING PANEL

The requirements governing the composition of all Hearing Panels are set forth in Section 4 of Article XIV of the Exchange Constitution and in Exchange Rule 476(b).

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<sup>7</sup> Communications by a party without the knowledge of the opposing side.

A Hearing Panel must consist of at least two industry members and the Hearing Officer, who serves as Chairman of the Panel. There is no requirement that the industry members have duties or experience similar to the respondent's.

#### SCHEDULING THE HEARING

When a case is ready for a hearing, the Hearing Board staff will contact the parties or their representatives to set a convenient date.

After the date of the hearing has been set, the Hearing Board staff selects at random a number of prospective panelists for the case. Their availability for the scheduled hearing date is first ascertained. They are then given the names of the respondent and his counsel, if any, the name of the enforcement department representative who will present the case, and are also informed of the nature of the charges and the substance of the respondent's Answer. These panelists are questioned by the Hearing Board staff to determine if they have a personal interest in the matter, or such knowledge of any of the parties, representatives, or events which would make their service inappropriate, or a predetermined opinion on the issues. If they do, they are disqualified and additional panelists are selected.

A notice is then sent to the parties listing the date, time and location of the hearing and furnishing the names of approximately six members of the Hearing Board as prospective panelists. Also included in the notice are the names of the Exchange Hearing Officers. The parties are told not to contact, either directly or indirectly, the prospective members of the Hearing Panel. The parties are given ten days from the date of the notice to object for cause to any of the industry members of the Hearing Panel or to any of the Hearing Officers. The Chief Hearing Officer, or a Hearing Officer designated by him, shall rule on all such challenges. Thereafter, two industry members of the Hearing Board are drawn at random from the initial list and a Hearing Officer is selected. Unless disqualified or otherwise unavailable, the Chief Hearing Officer will serve as the Hearing Officer on all cases. A final notice of hearing, listing the date, time and location of the hearing and the name of the Hearing Panelists who will serve on the case is then sent to all parties.

A notice of hearing will be sent by the Hearing Board staff to the parties using one of the methods provided for the service of a Charge Memorandum. Therefore, it is important that the respondent notify the Office of the Hearing Board of any change of address since the mailing of notices by the Hearing Panel to the last known address of the respondent satisfies the notice requirement.

#### LOCATION OF THE HEARING

Most hearings are held in New York, but Panels of the Hearing Board are also maintained in the following cities:

Atlanta	Minneapolis
Chicago	Pittsburgh
Dallas	San Francisco
Denver	Seattle
Los Angeles	St. Louis
Miami	

Not every case can be tried in all locations. For example, a sufficient number of members and allied members may not be available in a particular city and therefore a case involving a member, allied member or member organization respondent could not be tried there.

Requests for hearings outside New York must be in writing and should include the party's reasons why such request should be granted.

Cases involving a Stipulation and Consent are ordinarily heard in New York.

The location of all hearings will be determined by the Chief Hearing Officer.

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THE FOLLOWING SECTIONS ADDRESS THE PROCEDURES IN CASES  
BROUGHT TO CONSIDER THE ALLEGATIONS OF A  
CHARGE MEMORANDUM

THE HEARING

The respondents and their representatives are entitled to be present at the hearing.

The only documents which the Panel members have prior to the hearing are the Charge Memorandum, the Answer and any annexed exhibits. These documents are provided to the Panel members sufficiently in advance of the hearing date to give them adequate time for study.

The respective parties and their representatives are entitled to be present at the hearing and to present evidence to the Panel which will serve as the basis for the eventual decision on the merits of the case.

These hearings are private proceedings and spectators are not permitted. In addition to staff members from the Office of the Hearing Board, an Exchange court reporter is also present who will make a record of the proceeding



The transcript is available to the parties without cost on a normal delivery basis of approximately 7 to 10 days. If a party desires expedited delivery, such request should be made to the Hearing Board well before the date of the hearing so that the necessary arrangements can be made. The cost of this additional service will be borne by the party requesting it.

#### OPENING STATEMENTS

The parties, if they wish, may make opening statements. The first statement is made by the enforcement department, followed by that of the respondent.

The opening statement should be a brief outline of the nature of the issues involved and a summary of the facts which the party expects to present. The opening statement is not evidence. It is not the time for either party to prove his case. It should be a preview of what each party intends to prove through evidence to be introduced after the opening statements have been concluded.

#### THE EVIDENCE

Following the completion of opening statements the parties present their respective cases, first by the enforcement department and then by the respondent. Each party's case is presented through the submission of relevant documents and relevant testimony of witnesses.

The Hearing Panel is not bound by formal rules of evidence. The admissibility of testimony and documents into evidence is determined by the Hearing Officer after opportunity is given to the opposing side to object.

An oath or affirmation will be administered to all witnesses. Testimony of a witness should be elicited by asking him questions. Any witness may be cross-examined by the opposing side, and questioned by the members of the Panel.

At these hearings documents need not be marked "for identification" before they are offered in evidence. It is requested, whenever possible, that five copies of each exhibit be provided; the original to be marked in evidence, one for the opposing party and three for the members of the panel. It is the practice of the Hearing Board to retain all exhibits during and after the case. In cases involving substantial amounts of documentary evidence the marking of exhibits at a pre-hearing conference is encouraged. Rebuttal and surrebuttal testimony may be permitted, when appropriate, at the discretion of the Hearing Officer.

#### CLOSING STATEMENTS

After the parties have presented all their evidence and have rested, they have an opportunity to make closing statements, first by the respondent and then by the enforcement department. The closing statement is a summation

by the parties of the evidence already introduced at the hearing. The parties here may refer to, and highlight, the evidence which they feel is most helpful to their case. In the closing statements the parties might comment on the quality of their evidence, and of their opponent's, and urge upon the Panel those inferences which the parties think are most appropriate. The closing statement may be waived by either or both parties.

The Hearing Officer may, upon a request from either or both parties or on his own motion, direct that the parties submit legal memoranda or proposed findings of fact and conclusions of law to aid the Panel in its deliberations.

During the hearing, the Hearing Officer serves as Chairman of the Panel, making whatever rulings are necessary on evidentiary and procedural questions. He may at any time, upon a request from either side or on his own motion, order an adjournment of the hearing.

#### VERDICT ON THE CHARGES

Following closing statements the Panel deliberates and considers the specific charges against the respondent. As to each charge the Panel will determine whether the respondent is guilty or not guilty. Each member of the Panel, including the Hearing Officer, has an equal vote and a decision of a majority of the Panel shall be the decision of the Panel.

After the Panel reaches a decision on all charges, it will reconvene with the parties present. At that time the Hearing Officer will announce the verdict on each charge and will indicate whether it was by majority or unanimous vote. When the Panel finds the respondent not guilty on all charges, it may decide not to reconvene but to notify the parties in writing of the verdict.

#### VERDICT ON THE PENALTY

If a finding of guilty has been made on at least one charge, the Hearing Officer will ask the representative of the enforcement department to state the penalty the department recommends to the Panel and to set forth his arguments in support of that penalty. This recommendation does not bind the Panel. In support of this recommendation, the representative of the enforcement department usually cites prior Exchange disciplinary actions and may also at times refer to cases in other forums. Information on access to reports of prior Exchange disciplinary actions can be found in the Appendix.

The respondent is now given an opportunity to set forth his arguments and recommendations on the subject of penalty. He, too, may cite any cases he thinks appropriate and may also in his argument urge the Panel to consider mitigating factors which might persuade it that a lesser penalty than the one recommended by the enforcement department would be proper in this case.

Either party at this time may request the Panel to permit the presentation and introduction of evidence (including character witnesses) bearing solely on the question of the penalty to be imposed. It should be noted, however, that this is not the proper time for the presentation of further evidence relating to guilt or innocence on the charges because that stage of the proceedings has concluded.

After the completion of the penalty arguments by the parties, the Hearing Officer declares the hearing closed and excuses the parties. The Panel then has the responsibility of deliberating and deciding the penalty to be imposed. Once again, a majority vote will constitute the decision of the Panel. A written decision of the Hearing Panel will be issued. Mailing or other service of that decision starts the period in which a review may be requested.

#### CONDUCT OF THE HEARING: A FINAL WORD

It is important to remember that the decision of the Hearing Panel will be based on the evidence presented by the parties at the hearing. It is, therefore, important that each party's case be carefully and thoroughly prepared in advance of the hearing and that all documents and witnesses be available on the hearing date. This will insure that all relevant facts and evidence can be presented for the consideration of the Hearing Panel. It is extremely important that this preparation be completed prior to the first day of hearing because cases are often completed in one day.

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#### THIS NEXT SECTION REFERS TO CASES INVOLVING A STIPULATION OF FACTS AND CONSENT TO PENALTY

#### PROCEDURES AND HEARING

A Hearing Panel may also be asked to determine, on the basis of a written Stipulation and Consent between the respondent and an enforcement department, whether the respondent has committed an offense and whether the penalty agreed upon is appropriate in the circumstances. The Stipulation and Consent "shall contain a stipulation with respect to the facts, or the basis for findings of fact by the Hearing Panel; a consent to findings of fact by the Hearing Panel, including a finding that a specified offense had been committed; and a consent to the imposition of a specified penalty." (Rule 476(g))

A Stipulation and Consent may be negotiated after a Charge Memorandum has been issued, or in the absence of a Charge Memorandum. However, the negotiations do not involve or include the Office of the Hearing Board.

After the negotiations are completed and a Stipulation and Consent has been signed by both the respondent and an enforcement representative, it is sent to the Hearing Board to be scheduled for a hearing.

Notice of the hearing on this Stipulation and Consent is then sent to the parties, using one of the methods previously described for the service of a Charge Memorandum. At the hearing, the Panel members have before them the written Stipulation and Consent. Neither of the parties will be permitted to offer any argument which is inconsistent with the stipulated facts or to ask for the imposition of any penalty other than that agreed upon in the stipulation. The Panel may ask any question on the facts, penalty or other related matter, as it deems necessary and appropriate.

The Panel at this hearing has an obligation to determine on the basis of the Stipulation and Consent whether the respondent has committed an offense and, if it is so determined, whether the penalty contained in the Consent is proper. The Panel will issue a decision summarizing or setting forth the stipulated facts, reporting its finding that the respondent was guilty of the offense or offenses, and setting forth the penalty to be imposed. The Panel may impose the penalty agreed to in the Stipulation and Consent or any penalty which is less severe than the stipulated penalty. In addition, the Panel may also reject a Stipulation and Consent.

It is important that the Stipulation and Consent contain enough facts to enable the Panel to make its required finding that the respondent has committed the specified offense or offenses. Failure to supply sufficient information in the Stipulation and Consent may require a Hearing Panel to reject it.

In cases where the Panel believes the proposed penalty is inadequate, it does not have the authority to increase the penalty. In such event the Panel will reject the Consent and, in most cases, in its decision will recommend a penalty which it would find acceptable. Following the rejection of a Consent the parties may enter into a new Consent, or proceed to a contested hearing based on a Charge Memorandum and Answer, or request a review of the Panel's decision. Whenever possible, the Office of the Hearing Board refers the new Consent to the same Panel which rejected the prior one. If, on the other hand, the parties proceed to a contested hearing based on a Charge Memorandum and Answer the case will ordinarily be heard by another Hearing Panel, no member of which served on the Panel which rejected the Consent.

A majority vote will constitute the decision of the Panel. All hearings are held in the presence of a court reporter who prepares a transcript, available to the parties without cost. A written decision of the Hearing Panel will be issued. Mailing or other service of that decision starts the period in which a review may be requested.

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## PENALTIES

The penalties which a Hearing Panel may impose in both Charge Memorandum and Stipulation and Consent cases are set forth in Section 5 of Article XIV of the Constitution and Rule 476(a). These penalties are one or more of the following: Expulsion; suspension; limitation as to activities, functions, and operations, including the suspension or cancellation of a registration in, or assignment of, one or more stocks; fine (not to exceed \$25,000 per charge for a natural person, or \$100,000 per charge as to a person, other than a natural person); censure, suspension or bar from being associated with any member, member firm or member corporation; or any other fitting sanction. The Hearing Panel may remit or reduce any sanction on such terms and conditions as it shall deem fair and equitable.

## THE WRITTEN DECISION

Following every case a written decision is prepared in the Office of the Hearing Board under the direction of the Hearing Panel which heard the matter. When the Panel has agreed upon the decision it is sent to the parties, their representatives and to the members of the Exchange's Board of Directors. Thereafter, the Board of Directors may review the decision as hereinafter described.

## REVIEW RIGHTS

Provisions relating to the right of review by the Board of Directors in disciplinary proceedings are set forth in Section 5 of Article XIV of the Exchange Constitution and in Exchange Rule 476(e), (f) and (g). They may be summarized as follows:

- o In a Charge Memorandum case either party may request a review of the Panel's determination on the charges, or on the penalty imposed, or both.
- o In a Stipulation and Consent case, either party may request a review when a consent has been rejected. The enforcement department may request a review in a case in which the Panel has reduced the penalty in the Consent.
- o A member of the Board of Directors may request a review of any case.

The period within which a review may be requested is 25 days from the mailing or other service of the Hearing Panel's written decision. A request for review must be received by the Secretary of the Exchange within this 25 day period. Such request should be sent to:

The Secretary  
New York Stock Exchange, Inc.  
11 Wall Street  
New York, New York 10005

#### FINALITY OF THE DECISION

The determination of the Hearing Panel and any penalty imposed becomes final twenty-five days after notice thereof is served upon the respondent, unless a request is filed for review by the Board of Directors. Unless the Board of Directors otherwise directs, a determination and penalty, if any, in a reviewed case becomes final and conclusive after the review is completed. Provisions for review by the Securities and Exchange Commission and the courts are set forth in the Securities Exchange Act of 1934.

#### DISSEMINATION OF DECISIONS

Final decisions are reported to the Securities and Exchange Commission.

The Exchange is also required to make public all cases which result in a guilty finding. These decisions and summaries based upon them are circulated throughout the member firm community after the decisions become final. They are also sent to other self-regulatory organizations and to the press.

#### IN CONCLUSION

This outline was designed to answer the questions most commonly asked by respondents and their legal counsel about the disciplinary hearing process at the Exchange. If you have other questions or need any additional assistance, please call us. While we cannot serve as counsel for you or any other party during these proceedings, we do welcome your calls and will do all we can to respond to your inquiries and concerns.

The staff of the Hearing Board may be reached at the following telephone numbers:

Counsel to the Hearing Board  
(212) 623-6556

Staff Counsel  
(212) 623-8564

If you prefer to write, our mailing address is:

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