

1 UNITED STATES COURT OF APPEALS

2 FOR THE SECOND CIRCUIT

3 August Term, 2003

4 (Argued: March 18, 2004 Decided: August 16, 2004)

5 Docket No. 03-4882

6 -----

7 MFS SECURITIES CORP.,

8 Petitioner,

9 - v -

10 SECURITIES AND EXCHANGE COMMISSION,

11 Respondent,

12 NEW YORK STOCK EXCHANGE,

13 Intervenor.

14 -----

15 Before: SACK and RAGGI, Circuit Judges, and TRAGER, District
16 Judge.*

17 Petition, pursuant to 15 U.S.C. § 78y(a) (1) and
18 5 U.S.C. § 702, for our review of an opinion and order of the
19 Securities and Exchange Commission dismissing petitioner's
20 application for review of its termination by the New York Stock
21 Exchange as an Exchange member organization. The Commission
22 rejected the petitioner's argument that the Commission was
23 institutionally biased against the petitioner and therefore
24 required to recuse itself in favor of an independent arbitrator

* The Honorable David G. Trager of the United States District Court for the Eastern District of New York, sitting by designation.

1 when considering review of the petitioner's termination.
2 Although the Commission conceded that the petitioner was not
3 terminated in compliance with the Exchange's notification and
4 hearing rules, it nonetheless dismissed petitioner's application
5 on the grounds that petitioner had failed to exhaust the remedies
6 made available by the Exchange.

7 Petition denied; order of the Commission affirmed.

8 DOMINIC F. AMOROSA, New York, NY, for
9 Petitioner.

10 MARK PENNINGTON, Assistant General
11 Counsel, Securities and Exchange
12 Commission (Giovanni P. Prezioso,
13 General Counsel; Eric Summergrad, Deputy
14 Solicitor; Meyer Eisenberg, Deputy
15 General Counsel, of counsel),
16 Washington, DC, for Respondent.

17 JAY N. FASTOW, Weil, Gotshal & Manges
18 LLP (Jonathan Bloom, of counsel), New
19 York, NY, for Intervenor.

20 SACK, Circuit Judge:

21 Petitioner MFS Securities Corp. ("MFS") seeks review of
22 an order of the Securities and Exchange Commission (the "SEC" or
23 the "Commission") dismissing MFS's application for review of its
24 termination as a member organization by the New York Stock
25 Exchange (the "NYSE" or the "Exchange"). MFS urges that (1) the
26 Commission was, as an institution, biased with respect to MFS and
27 was therefore required to recuse itself and appoint an
28 independent arbitrator to consider the petition; (2) the Exchange
29 was similarly biased and required to recuse itself in the matter;
30 and (3) the Commission erred in dismissing the petitioner's

1 application for review for failure to exhaust administrative
2 remedies.

3 **BACKGROUND**

4 Many of the facts underlying this petition are set out
5 in our opinion in an earlier, related appeal in MFS Securities
6 Corp. v. NYSE, 277 F.3d 613, 615-17 (2d Cir. 2002) ("MFS II").
7 We rehearse them here only insofar as we think necessary to
8 explain our resolution of the petition.

9 MFS was an independent floor broker and member
10 organization of the Exchange, a self-regulatory organization
11 ("SRO") subject to Commission oversight pursuant to 15 U.S.C.
12 §§ 78c, 78f, 78s.¹ MFS employed Mark Savarese and John Savarese
13 (the "Savarese brothers"), who were both members of the Exchange,
14 as floor brokers.

15 On February 25, 1998, the Savarese brothers were
16 arrested on charges that they had traded for an account in which
17 they had an interest in violation of Section 11(a) of the
18 Securities Exchange Act of 1934, 15 U.S.C. § 78k(a)(1), and SEC
19 Rule 11a-1, 17 C.F.R. § 240.11a-1. On the same day, they were
20 summarily suspended from Exchange membership. As far as we can
21 tell from the record, the Savarese brothers did not challenge
22 their suspensions.

¹ For a discussion of the NYSE's status and structure as an SRO, see Silver v. NYSE, 373 U.S. 341, 352-54 (1963); Barbara v. NYSE, 99 F.3d 49, 51 (2d Cir. 1996).

1 The arrests and suspensions of the Savarese brothers
2 were based on allegations that they had, inter alia, engaged in
3 stock "flipping" or "trading for eighths," a practice whereby a
4 broker effects a purchase or sale of a security for a customer
5 followed by its immediate sale or purchase, respectively, in
6 order to capture the spread between the stock's bid and ask
7 prices. Brokers who engage in "flipping" typically receive
8 either a share of the profits thus earned or a per-trade
9 commission that approximates half of the profits made through the
10 transaction. The practice was viewed by the Exchange at the time
11 of the suspensions as a violation of Section 11(a) and Rule 11a-1
12 inasmuch as it consisted of trading, contrary to those
13 provisions, for an account in which the broker had an interest.

14 During much of the 1990s, the Exchange was apparently
15 aware that some of its member-brokers were engaged in "flipping"
16 in the course of their trading activities on the floor of the
17 Exchange. On March 4, 1993, the Exchange's "Quality of Markets
18 Committee" established an ad hoc "Advisory Committee on Intra-Day
19 Trading Practices." Its mission was to

20 review, and, as appropriate, make
21 recommendations regarding, a trading practice
22 on the Exchange whereby Floor brokers and
23 specialists represent both buy and sell
24 orders in the same stock for a customer, and
25 attempt to execute them in a manner that
26 captures for the customer the spread between
27 the bid and offer prices in that stock on the
28 Exchange, [i.e., "flipping"].
29 New York Stock Exchange Advisory Comm. on Intra-Day Trading

30 Practices, Report on Intra-Day Trading Practices 1 (1993). "The

1 advisory committee was given the mandate to determine whether
2 [such] intra-day trading interferes with public participation in
3 the agency-auction market and is a practice that is detrimental
4 to the best interests of the Exchange." Id.

5 The ad hoc committee eventually issued a "Report on
6 Intra-Day Trading Practices," recommending that restrictions be
7 placed on intra-day trading because it gave at least the
8 impression that the intra-day traders associated with Exchange
9 member floor brokers received a competitive advantage over the
10 general investing public. Id. at 10-12. But the report's
11 recommendation was not adopted. MFS alleges that, despite the
12 report, the Exchange encouraged "flipping" in order to augment
13 the fees it collected based on floor brokers' commissions and to
14 increase the daily trading volume of the Exchange, bolstering its
15 apparent liquidity as compared to other stock exchanges. MFS
16 further alleges that the Savarese brothers performed "flipping"
17 transactions on behalf of an MFS customer, the Oakford
18 Corporation, in reliance on the NYSE's permissive view of the
19 practice.

20 On February 25, 1998, the Savarese brothers were
21 suspended by the Exchange for, inter alia, engaging in "flipping"
22 transactions for Oakford's account. At the time of their
23 suspension, the Savarese brothers were the only officers or
24 employees of MFS who were Exchange members. MFS was therefore no
25 longer then associated with an Exchange member, a requirement for
26 MFS to maintain its status as an Exchange member organization.

1 See NYSE Const. art. I, § 3(i), (k), available at
2 <http://www.nyse.com/pdfs/constitution.pdf> (last visited Aug. 9,
3 2004). The Exchange thereupon declared MFS's status as a member
4 organization terminated and disconnected its phone lines on the
5 Exchange floor. The Exchange effected MFS's suspension and
6 termination without first providing notice to MFS or an
7 opportunity for it to be heard.

8 The propriety of thus terminating MFS is doubtful in
9 light of NYSE Rule 475(a), which proscribes a person's denial of
10 access to services offered by the Exchange "unless the Exchange
11 shall have notified such person in writing of, and shall have
12 given such person, upon not less than 15 days prior written
13 notice, an opportunity to be heard upon, the specific grounds for
14 such prohibition or limitation." NYSE Rule 475(a). But neither
15 the Savarese brothers, nor MFS in its initial, February 26, 1998,
16 communication to the Exchange relating to its termination,
17 complained about the Exchange's possible violation of Rule
18 475(a). MFS told the Exchange, instead, that MFS was attempting
19 to hire another Exchange member as a broker to enable MFS to
20 maintain its membership in the Exchange. MFS asked the Exchange
21 to permit MFS to maintain its status as a member organization in
22 the interim pursuant to NYSE Rule 312(f), which provides that,
23 upon application, the Exchange "may" grant a member organization
24 whose sole member has died or ceased to be a member to continue
25 as a member organization for up to 90 days, "provided such action

1 is consistent with the protection of investors and the public
2 interest." NYSE Rule 312(f).

3 On March 2, 1998, the NYSE's Member Firm Regulation
4 Division (the "Division") denied MFS's request for a Rule 312(f)
5 extension. On the same day, MFS informed the Division that MFS
6 had indeed hired an Exchange member. MFS requested that, on that
7 basis, MFS be permitted to continue as a member organization. On
8 March 4, 1998, the Division nonetheless notified MFS that, its
9 new member-employee notwithstanding, it was no longer an Exchange
10 member organization.

11 Two days later, on March 6, 1998, MFS protested its
12 termination to the NYSE Board of Directors (the "Board"),
13 requesting review of its treatment by the Division. MFS then,
14 for the first time, argued that its termination without notice
15 and an opportunity to be heard violated NYSE Rule 475(a) and 15
16 U.S.C. § 78f(d)(2). In response, on April 2, 1998, the Board
17 remanded MFS's complaint to the Division. According to the
18 Board, the remand was for the purpose of

19 promptly affording [MFS] a reasonable
20 opportunity to present additional facts.
21 Appropriate written notice shall be given by
22 the Division and an appropriate record shall
23 be made. The present status of [MFS] remains
24 the same until the Division renders a
25 decision, which decision shall be rendered as
26 promptly as practicable.

27 MFS Sec. Corp., NYSE Board Order (Apr. 2, 1998).

28 But MFS chose not to make further submissions to the
29 Division. Instead, on July 27, 2000, MFS brought suit against

1 the Exchange in the United States District Court for the Southern
2 District of New York alleging that the Exchange's termination of
3 MFS constituted an unlawful group boycott in violation of the
4 Sherman Act, 15 U.S.C. § 1, and a breach of contract. The
5 district court (Jed S. Rakoff, Judge) granted the Exchange's
6 motion under Federal Rule of Procedure 12(b)(6) to dismiss MFS's
7 complaint as to both claims on the merits. MFS Sec. v. NYSE, No.
8 00 Civ. 5600, 2001 WL 55736, at *1, 2001 U.S. Dist. LEXIS 420, at
9 *2 (S.D.N.Y. Jan. 23, 2001) ("MFS I").

10 MFS appealed to this Court. By opinion dated January
11 24, 2002, we affirmed the district court's dismissal of MFS's
12 breach of contract claim against the Exchange, concluding that it
13 was barred under the doctrine of quasi-governmental immunity.
14 MFS II, 277 F.3d at 617. As for the Sherman Act claim, however,
15 we vacated the district court's dismissal. Recognizing that the
16 SEC had "jurisdiction to consider many of the questions embedded
17 in MFS's complaint and believ[ing] that administrative review
18 w[ould] be of material aid to the district court in resolving the
19 claim brought by MFS," id. at 620 (internal quotation marks
20 omitted), we remanded the action to the district court with
21 directions for it to "stay the proceedings until such time as the
22 SEC may have acted upon a promptly filed application for review,"
23 id. at 622. We did recognize, however, that "[i]t w[ould] be up
24 to the SEC, in the first instance, to consider whether such an
25 application is timely." Id.

1 On February 1, 2002, MFS filed an application for
2 review with the Commission based on jurisdiction bestowed on the
3 Commission by 15 U.S.C. § 78s(d) (providing for review of SRO
4 disciplinary actions by "the appropriate regulatory agency"). On
5 May 9, 2002, the SEC's then-Chairman Harvey Pitt, who, when he
6 had been a lawyer in private practice, had represented the
7 Exchange in an SEC investigation relating to the practices
8 underlying this case, recused himself from consideration of the
9 application. That being, in MFS's view, insufficient protection
10 for a fair hearing before the Commission, on December 13, 2002,
11 it requested that the Commission disqualify itself entirely from
12 considering the matter and appoint an independent arbitrator to
13 do so instead. Later, William H. Donaldson was named Pitt's
14 replacement as Chairman. Donaldson had previously served as
15 Exchange Chairman during the early 1990s and in that capacity had
16 received communications relating to the practice of "flipping."
17 He also recused himself from the MFS proceedings. Nevertheless,
18 MFS's view was that the agency was "hopelessly conflicted"
19 because of the incoming and outgoing Chairmen's "deep[]
20 involve[ment] in misconduct at the NYSE." Letter from Dominic F.
21 Amorosa to Margaret H. McFarland, Deputy Secretary, SEC, Dec. 13,
22 2002, at 1.

23 The Commission, Chairman Donaldson not participating,
24 then addressed MFS's application for review on the merits. MFS
25 Sec. Corp., Exchange Act Release No. 47626, 79 S.E.C. Docket
26 2780, 2003 WL 1751581, 2003 SEC LEXIS 789 (April 3, 2003) ("MFS

1 III"). It first noted that MFS had filed its application for
2 Commission review on February 1, 2002, long after the thirty days
3 in which a person aggrieved by an SRO must ordinarily seek
4 Commission review. See 15 U.S.C. § 78s(d)(2). The Commission
5 decided, however, that our decision and the district court's stay
6 of proceedings upon remand allowing the Commission to consider
7 MFS's complaint presented "extraordinary circumstances"
8 justifying an after-the-fact extension of time for MFS to file
9 its application with the Commission. MFS III, 2003 WL 1751581,
10 at *3, 2003 SEC LEXIS 789, at *13.

11 The Commission then considered and rejected MFS's
12 request that the Commission recuse itself with respect to the
13 dispute in favor of an independent arbitrator. The Commission
14 noted that it was the only agency possessing statutory authority
15 to review the adverse disciplinary actions of the Exchange. The
16 Commission, citing FTC v. Cement Institute, 333 U.S. 683, 701
17 (1948) (explaining that the entire Federal Trade Commission could
18 not be disqualified based on an asserted conflict of interest
19 from hearing a matter within its mandate where Congress had not
20 provided for any other agency to hear the kind of complaint at
21 issue), reasoned that if the Commission could not hear the case,
22 no one could. It then concluded that, in any event, there was an
23 insufficient conflict of interest to require recusal of the
24 entire Commission. Outgoing Commissioner Pitt's and incoming
25 Commissioner Donaldson's decisions to recuse themselves cured not

1 only any possible conflict, but also any appearance of
2 impropriety.

3 The SEC then turned to MFS's core grievance. The
4 Commission concluded that the NYSE's termination of MFS's status
5 as a member organization was "without any process at all." MFS
6 III, 2003 WL 1751581, at *5, 2003 SEC LEXIS 789, at *19. The
7 Commission noted, however, that the Board had ruled that MFS was
8 entitled to a hearing and had thereafter remanded the case to the
9 Division to permit MFS to provide further information relating to
10 MFS's grievance. Acknowledging that "the procedure crafted by
11 the Board was not identical to the procedure specified by NYSE
12 Rule 475," id., 2003 WL 1751581, at *6, 2003 SEC LEXIS 789, at
13 *24, the Commission nonetheless concluded: "It appears that the
14 proffered hearing would have provided fair procedures in
15 accordance with [the] Exchange Act." Id., 2003 WL 1751581, at
16 *5, 2003 SEC LEXIS 789, at *20.

17 The Commission observed, however, that MFS had not
18 availed itself of the opportunity to participate in those further
19 proceedings before the Exchange, opting instead to file its
20 lawsuit in federal district court. The Commission noted that it
21 had "previously refused to consider arguments on appeal from
22 applicants who failed to avail themselves of an SRO's
23 procedures." Id., 2003 WL 1751581, at *5, 2003 SEC LEXIS 789, at
24 *21-*22. Emphasizing the importance of utilizing such remedies
25 in order to generate a record for review, the Commission

1 dismissed MFS's application on the ground that it had failed to
2 exhaust the procedures provided by the Exchange.

3 MFS thereupon petitioned us for review of the SEC's
4 decision pursuant to 15 U.S.C. § 78y(a)(1) and 5 U.S.C. § 702 on
5 three grounds. First, MFS argues that the Commission was
6 required to recuse itself entirely from consideration of MFS's
7 petition because of Donaldson's and Pitt's conflicts of interest.
8 Second, MFS asserts that the Exchange also should have recused
9 itself. Although as far as we can tell from the record before
10 us, MFS raised no such claim when it appealed to the Exchange
11 Board, it now argues that the Board was "laboring under an acute
12 conflict of interest" because of the involvement of Richard
13 Grasso, then the Exchange's Chairman of the Board, in the
14 development and promulgation of the NYSE's interpretations
15 permitting and encouraging, inter alia, "flipping." Petitioner's
16 Br. at 22. Third, MFS contends that the Commission failed to act
17 rationally in exercising its discretion to dismiss MFS's petition
18 for failure to exhaust Exchange remedies.

19 We disagree on all counts and therefore deny the
20 petition and affirm.

21 **DISCUSSION**

22 I. Standard of Review

23 "In reviewing the SEC's opinion and order, we must
24 affirm '[t]he findings of the Commission as to the facts, if
25 supported by substantial evidence.'" Valicenti Advisory Servs.,

1 Inc. v. SEC, 198 F.3d 62, 64 (2d Cir. 1999) (quoting 15 U.S.C.
2 § 80b-13(a) (alteration in original)), cert. denied, 530 U.S.
3 1276 (2000); 15 U.S.C. § 78y(a)(4). The Administrative Procedure
4 Act, which applies to our review of Commission orders, see, e.g.,
5 Domestic Sec., Inc. v. SEC, 333 F.3d 239, 248 (D.C. Cir. 2003),
6 provides that a reviewing court shall "hold unlawful and set
7 aside agency action, findings, and conclusions found to be . . .
8 arbitrary, capricious, an abuse of discretion, or otherwise not
9 in accordance with law," 5 U.S.C. § 706(2). Moreover, "[a]n
10 administrator's decision whether to recuse herself under agency
11 rules designed to avoid apparent impropriety is reviewable for
12 abuse of discretion." Air Line Pilots Ass'n, Int'l v. U.S. Dep't
13 of Transp., 899 F.2d 1230, 1232 (D.C. Cir. 1990) (per curiam).

14 II. Alleged Conflicts of Interest

15 A. The Commission

16 MFS argues that because Commission Chairmen Pitt and
17 Donaldson labored under personal conflicts of interest with
18 respect to MFS's application for review, the Commission itself
19 was "hopelessly conflicted." Petitioner's Br. at 29. According
20 to MFS, the Commission as a whole was therefore required to
21 recuse itself from reviewing MFS's termination as an Exchange
22 member organization. MFS suggests that the Commission should
23 have delegated the proceedings to an independent arbitrator
24 instead.

25 We disagree. Irrespective of Pitt's and Donaldson's
26 personal interests, if any, in the outcome of MFS's case, their

1 personal recusals were sufficient to cure any impropriety or
2 appearance of impropriety with respect to the Commission
3 proceedings.

4 Under the due process clauses of the Fifth and
5 Fourteenth Amendments, parties and the public are entitled to
6 tribunals free of personal bias. In re Murchison, 349 U.S. 133,
7 136 (1955); see also Chew v. Dietrich, 143 F.3d 24, 28 n.4 (2d
8 Cir.) (observing that the due process clauses of the Fifth and
9 Fourteenth Amendments create equivalent requirements for most
10 purposes), cert. denied, 525 U.S. 948 (1998). This requirement is
11 applicable to administrative agencies such as the Commission in
12 much the same way as it is applicable to courts. See Gibson v.
13 Berryhill, 411 U.S. 564, 579 (1973). Although claims of bias
14 "must overcome a presumption of honesty and integrity in those
15 serving as adjudicators," Withrow v. Larkin, 421 U.S. 35, 47
16 (1975), persons ruling on disputes may not hear or determine
17 cases if they have an "interest" in the outcome, In re Murchison,
18 349 U.S. at 136.

19 But "[t]hat interest [in an outcome that requires
20 recusal] cannot be defined with precision. Circumstances and
21 relationships must be considered." Id. While an adjudicator's
22 "substantial pecuniary interest" in a proceeding obviously
23 requires recusal, Gibson, 411 U.S. at 579, other interests might
24 require recusal, too.

25 Fortunately, we need not address this often knotty
26 question here. Whether or not Chairman Pitt or Chairman

1 Donaldson suffered from a conflict of interest that required
2 their recusal, they did in fact recuse themselves. Due process
3 required no more. While MFS's application for review had the
4 potential for embarrassing the Exchange and, perhaps, generating
5 controversy had MFS established Donaldson's alleged approval of
6 "flipping" during his time as Exchange chairman, for example,
7 there is no basis upon which we can conclude that the Commission,
8 as an institution, was somehow thereby disqualified from
9 considering and ruling on the controversy.

10 In general, courts have been reluctant to impute a
11 conflict of interest on the part of an individual tribunal member
12 to the entire tribunal. See, e.g., Aetna Life Ins. Co. v.
13 Lavoie, 475 U.S. 813, 825-26 (1986); Antoniou v. SEC, 877 F.2d
14 721, 726 (8th Cir. 1989), cert. denied, 494 U.S. 1004 (1990);
15 Blinder, Robinson & Co. v. SEC, 837 F.2d 1099, 1106 & n.7 (D.C.
16 Cir.), cert. denied, 488 U.S. 869 (1988); Amos Treat & Co. v.
17 SEC, 306 F.2d 260, 267 (D.C. Cir. 1962); cf. United States v.
18 Oregon, 44 F.3d 758, 772 (9th Cir. 1994) (refusing to impute to a
19 state administrative tribunal the hostility of an Oregon
20 department and officials toward the position of an Indian tribe
21 in a water rights dispute in which the department and officials
22 would assist the adjudicator in developing an administrative
23 record), cert. denied, 516 U.S. 943 (1995).

24 In Aetna Life, the Supreme Court considered and
25 rejected an argument similar to that made by MFS. It refused to
26 impute the conflict of one state supreme court justice to the

1 entire court. The underlying controversy related to the tort of
2 bad-faith refusal to pay a valid first-party insurance claim.
3 575 U.S. at 816. During the pendency of the case, Justice Embry
4 of the Alabama Supreme Court filed two similar bad-faith refusal
5 to pay claims against insurance companies in Alabama state court.
6 One of the suits was a class action against Blue Cross-Blue
7 Shield of Alabama on behalf of Alabama state employees insured
8 under a group plan, a class which apparently included all of the
9 Alabama justices. Id. at 817. Finding that Justice Embry
10 therefore had a substantial interest in the outcome of the case
11 in question, the Supreme Court vacated the judgment and remanded
12 the action so that the Alabama Supreme Court could rehear the
13 case without his participation. Id. at 827-28. But the Court
14 rejected the argument that due process also required the other
15 justices of the Alabama Supreme Court to recuse themselves from
16 the case. Id. at 825-26. To rule otherwise, the Court feared,
17 "might require the disqualification of every judge in the State."
18 Id. at 825.

19 Similarly, in Blinder, Robinson, the United States
20 Court of Appeals for the District of Columbia Circuit rejected a
21 due process argument very much like that made by MFS here.
22 There, the Commission had been involved in litigation against
23 them in federal court and then had adjudicated an administrative
24 claim against the petitioners. Blinder, Robinson, 837 F.2d at
25 1104. The petitioners argued that the Commission's role as their
26 adversary in litigation prevented it from being an impartial

1 administrative adjudicator in the petitioners' administrative
2 action. Id. The court rejected the argument that due process
3 considerations prohibited the Commission from seeking
4 administrative sanctions against the petitioners, even though one
5 of the commissioners on the tribunal had participated in the
6 earlier litigation. Id. at 1106. "It would be a strange rule
7 indeed that . . . presumed that the bias spread contagion-like to
8 infect Commissioners who were not even [involved in the
9 litigation]." Id. Here, too, we think it absurd to suggest,
10 without more, that any bias on the part of the recused Commission
11 Chairmen somehow spread "contagion-like" to infect the Commission
12 as a whole.

13 Of course, the cases upon which we rely are not
14 identical to MFS's. In Blinder, Robinson and Amos Treat, for
15 instance, the conflict involved a Commissioner who had previously
16 acted in a prosecutorial role against a person who subsequently
17 came before the Commission in an adjudicatory proceeding. But if
18 the "contagion" did not spread to the entire Commission there, we
19 do not see on what basis we can conclude that it might have
20 spread to the Commission here.

21 The only case MFS cites in which due process required
22 an entire administrative body to recuse itself, Gibson v.
23 Berryhill, 411 U.S. at 564, is not helpful to MFS or to us.
24 There, the disqualification of the tribunal was based on the
25 personal pecuniary interest of every tribunal member in a
26 proceeding requiring them to pass on issues related to

1 competitors. Id. at 578-79. MFS, by contrast, alleges no
2 personal interest on the part of the other Commissioners. It
3 argues only that the potential for the case to embarrass Chairmen
4 Pitt and Donaldson, and the related threat of controversy
5 surrounding the proceedings, required the entire Commission to
6 withdraw from the case. We have never held that the mere
7 possibility that a proceeding might embarrass a colleague of
8 members of a tribunal, or even the tribunal as a whole,
9 constitutes a conflict of interest requiring recusal. Cf.
10 Blinder, Robinson, 837 F.2d at 1106 n.7 (rejecting the notion
11 that the Commission as a whole is biased where the agency's
12 "institutional prestige" is at stake).

13 In this case, moreover, the very structure of the
14 Commission alleviates MFS's professed concern. The Commission
15 consists of five Commissioners who are appointed "by the
16 President by and with the advice and consent of the Senate" for
17 five-year terms. 15 U.S.C. § 78d(a). Far from being a unitary
18 body, the Commission is thus intentionally designed to reflect
19 multiple viewpoints. See id. ("Not more than three of such
20 commissioners shall be members of the same political party, and
21 in making appointments members of different political parties
22 shall be appointed alternately as nearly as may be
23 practicable."). And although the Chairman of the Commission is
24 the most powerful of the five Commissioners owing to his or her
25 additional executive powers within the agency, the power to
26 remove Commissioners belongs to the President, and even that is

1 "commonly understood" to be limited to removal for "inefficiency,
2 neglect of duty or malfeasance in office." SEC v. Blinder,
3 Robinson & Co., 855 F.2d 677, 681 (10th Cir. 1988) (citation and
4 internal quotation marks omitted), cert. denied, 489 U.S. 1033
5 (1989). We think that the relative independence of the SEC's
6 Commissioners is yet another barrier to any "contagion-like"
7 spread from Chairman to Commissioners.

8 At the end of the day, then, on the record before us,
9 we are of the view that it is nonsense to assert, as MFS does,
10 that a recused Chairman's previous legal representation of the
11 Exchange or previous chairmanship of the Exchange in and of
12 itself so hopelessly pollutes the Commission that it thereby
13 becomes incapable of performing its oversight responsibilities
14 with respect to the Exchange. We cannot require, as a matter of
15 constitutional law, that administrative tribunals disqualify
16 themselves for the most theoretical and remote of reasons. To do
17 so might well impair their ability to fulfill their
18 congressionally imposed adjudicative functions. We therefore
19 conclude that the Commission did not abuse its discretion when it
20 decided to hear MFS's petition for review.

21 We cannot, of course, foreclose the possibility that
22 there may one day arise -- or indeed that there has once arisen
23 -- a case in which the conflict of interest of a person
24 associated with an agency taints or tainted the entire agency,

1 thereby disqualifying it from ruling in a particular matter.

2 This is not that case.²

3 B. The Exchange

4 MFS also argues that Exchange Chairman Richard Grasso's
5 alleged involvement in the promotion of "flipping" at the
6 Exchange prejudiced him, and thus the Exchange as an institution,
7 against MFS. According to MFS, not only was Grasso therefore
8 required to recuse himself, the entire Exchange (like the
9 Commission) was required to disqualify itself and refer the MFS
10 matter to an independent arbitrator.

11 In our opinion in D'Alessio v. SEC, No. 03-4883, ___
12 F.3d ___ (2d Cir. 2004), decided today, we discuss in some detail
13 the extent, if any, to which due process requirements apply to
14 proceedings before the Exchange, a private corporation exercising
15 congressionally delegated self-regulatory authority. Id. at ___,
16 slip. op. at []. We need not reach that issue in the present
17 case, however.

18 MFS did not, when it was before the Commission, raise
19 its argument that Chairman Grasso's involvement in the promotion
20 of "flipping" required the disqualification of the NYSE. MFS
21 petitions us for review of the Commission's order pursuant to 15

² The Commission also asserts that the it lacks the power to delegate its authority to review SRO actions to an independent arbitrator and therefore was required to hear MFS's application under the so-called "Rule of Necessity." See United States v. Will, 449 U.S. 200, 213-14 (1980); Cement Inst., 333 U.S. at 701; Tapia-Ortiz v. Winter, 185 F.3d 8, 10 (2d Cir. 1999). Because we conclude that the Commission was competent to hear MFS's petition, we need not and do not reach that issue.

1 U.S.C. § 78y(a)(1). When conducting section 78y review, we are
2 foreclosed from considering arguments not raised before the
3 Commission. 15 U.S.C. § 78y(c)(1) ("No objection to an order or
4 rule of the Commission, for which review is sought under this
5 section, may be considered by the court unless it was urged
6 before the Commission or there was reasonable ground for failure
7 to do so."); see also Gilligan, Will & Co. v. SEC, 267 F.2d 461,
8 468 (2d Cir. 1959) (applying section 78y to foreclose judicial
9 review of issue not raised before the Commission). Although MFS
10 did argue, when seeking to avoid the requirement that it exhaust
11 its Exchange remedies, see infra Part III, that the division was
12 biased against it, it offers no reason for its not having raised
13 the contention that the Exchange be disqualified from review
14 before the Commission. It therefore forfeited the objection. We
15 do not consider it here.

16 III. Exhaustion of Exchange Remedies

17 MFS argues that the Commission erred in dismissing
18 MFS's application for review for failure to exhaust the remedies
19 made available by the Exchange. Again, we disagree. The
20 Commission acted in accordance with both its practice in
21 reviewing SROs and general principles of administrative law when
22 it dismissed MFS's application for review on the ground that MFS
23 had chosen, on remand from the Exchange Board, not to avail
24 itself of the opportunity to present additional facts to and seek
25 redress from the Exchange.

1 In general, "a party may not seek federal judicial
2 review of an adverse administrative determination until the party
3 has first sought all possible relief within the agency itself."
4 Beharry v. Ashcroft, 329 F.3d 51, 56 (2d Cir. 2003) (citation and
5 internal quotation marks omitted). This requirement "serves
6 numerous purposes, including protecting the authority of
7 administrative agencies, limiting interference in agency affairs,
8 and promoting judicial efficiency by resolving potential issues
9 and developing the factual record." Id. Where such exhaustion
10 requirements are the creatures of statute, they are mandatory;
11 where they are judicially imposed, they usually are discretionary
12 and may therefore be subject to exceptions. Id. at 56-57.

13 The Commission has frequently applied an exhaustion
14 requirement in its review of disciplinary actions by SROs. See
15 Gary A. Fox, Exchange Act Release No. 46511, 78 S.E.C. Docket
16 1278, 2002 WL 31084725, at *2, 2002 SEC LEXIS 2381, at *4-*5
17 (Sept. 18, 2002); Datek Sec. Corp., Exchange Act Release No.
18 32306, 54 S.E.C. Docket 184, 1993 WL 175228, at *1-*2, 1993 SEC
19 LEXIS 1205, at *2-*3 (May 14, 1993); Royal Sec. Corp., 36 S.E.C.
20 275, 277 (1955). To be sure, the SEC's application of an
21 exhaustion requirement to such claims differs in several respects
22 from paradigmatic administrative exhaustion cases where a court
23 is presented with the assertion that the plaintiff failed to
24 pursue its claims fully before the relevant administrative
25 agency. In the three SEC cases cited above, as in this one, it
26 is an administrative agency, the Commission, that applies the

1 exhaustion requirement in its review of grievances initially
2 brought before the relevant SRO. We think that the requirement
3 of exhaustion is nonetheless valid in this context, too.

4 The Exchange is a self-regulatory organization to which
5 Congress has delegated authority to police its members for
6 violation of the Exchange's Commission-approved rules and the
7 securities laws. See Silver v. NYSE, 373 U.S. 341, 352-54
8 (1963); Barbara v. NYSE, 99 F.3d 49, 51 (2d Cir. 1996). The
9 SEC's requirement that aggrieved members of SROs ordinarily must
10 fully exhaust the remedies made available by those organizations
11 before seeking Commission review is a sensible way of preventing
12 circumvention of this congressional scheme. Were SRO members, or
13 former SRO members, free to bring their SRO-related grievances
14 before the SEC without first exhausting SRO remedies, the self-
15 regulatory function of SROs could be compromised. Moreover, like
16 other administrative exhaustion requirements, the SEC's promotes
17 the development of a record in a forum particularly suited to
18 create it, upon which the Commission and, subsequently, the
19 courts can more effectively conduct their review. It also
20 provides SROs with the opportunity to correct their own errors
21 prior to review by the Commission. The SEC's exhaustion
22 requirement thus promotes the efficient resolution of
23 disciplinary disputes between SROs and their members and is in
24 harmony with Congress's delegation of authority to SROs to
25 settle, in the first instance, disputes relating to their
26 operations.

1 Two of our sister circuits have for similar reasons
2 concluded that a person's failure to exhaust remedies made
3 available by an SRO -- in those cases, the National Association
4 of Securities Dealers -- bars judicial review of the SRO's
5 disciplinary action. See Merrill Lynch, Pierce, Fenner & Smith,
6 Inc. v. Nat'l Ass'n of Sec. Dealers, Inc., 616 F.2d 1363, 1370
7 (5th Cir. 1980); First Jersey Sec., Inc. v. Bergen, 605 F.2d 690,
8 696 (3d Cir. 1979) (citing 2 Louis Loss, Securities Regulation,
9 1363 n.73 (2d ed. 1961)), cert. denied, 444 U.S. 1074 (1980); see
10 also Bruan, Gordon & Co. v. Hellmers, 502 F. Supp. 897, 905
11 (S.D.N.Y. 1980). We said, in Barbara, "[G]iven the
12 'comprehensive review procedure' established by the Exchange Act,
13 Congress intended that the doctrine of exhaustion of
14 administrative remedies, in appropriate circumstances, apply to
15 challenges to the disciplinary proceedings of the national
16 securities exchanges." Barbara, 99 F.3d at 57 (citation
17 omitted). In Barbara, we ultimately declined to apply the
18 exhaustion doctrine to bar the plaintiff's claims for money
19 damages against the Exchange on the ground that money damages
20 were not available via Exchange and Commission proceedings. Id.
21 But our reasoning and our citation with approval of Merrill
22 Lynch, First Jersey, and Bruan, see id., indicates our approval
23 of the notion that general administrative exhaustion principles
24 apply to SROs.

25 The issue here is the wisdom of SEC administrative
26 review, rather than judicial review, in the absence of exhaustion

1 at the SRO level. We are of the view, though, that the failure
2 of a member of the Exchange to exhaust Exchange remedies
3 compromises the SEC's ability effectively to review the NYSE's
4 disciplinary action in much the same way as a failure to exhaust
5 an SRO's remedies compromises the ability of courts to perform
6 their review function.

7 MFS offers three objections to the SEC's application of
8 the exhaustion requirement in this case. First, MFS argues that
9 exhaustion should not be required where the action of the
10 Exchange was obviously wrong. But that misapprehends the
11 purposes and function of exhaustion requirements. Errors on the
12 part an administrative body, however obvious, do not excuse a
13 party from exhausting fully the remedies made available by that
14 body. Whatever error there may be, the administrative body must
15 be given an opportunity to correct it, and to build a record upon
16 which the reviewing administrative agency may engage in effective
17 review. See, e.g., Taylor v. Vt. Dep't of Educ., 313 F.3d 768,
18 790 (2d Cir. 2002) (explaining that exhaustion requirements
19 "afford[] full exploration of technical . . . issues, further[]
20 development of a complete factual record, and promote[] judicial
21 efficiency by giving . . . agencies the first opportunity to
22 correct shortcomings" (citation and internal quotation marks
23 omitted)); Shenandoah v. U.S. Dep't of Interior, 159 F.3d 708,
24 713 (2d Cir. 1998) ("The exhaustion doctrine prevent[s] premature
25 interference with agency processes, provides the agency an
26 opportunity to correct its own errors, [and] afford[s] the

1 parties and the courts the benefit of its experience and
2 expertise." (citation omitted; internal quotation marks omitted;
3 alterations in original)). Thus, although a cogent argument can
4 be made that the NYSE's initial action was indeed contrary to
5 NYSE Rule 475(a), the persuasiveness of the argument did not
6 excuse MFS from exhausting Exchange remedies.

7 Second, MFS suggests that exhausting the remedies made
8 available by the Exchange would have been futile because of the
9 Exchange's alleged bias against MFS. For similar reasons, this
10 argument is misguided because it does not take into account the
11 reasons why exhaustion of administrative remedies is required.

12 In Touche Ross & Co. v. SEC, 609 F.2d 570, 575 (2d Cir.
13 1979), we considered an argument that allegations that the
14 Commission was biased excused a party's failure to exhaust its
15 administrative remedies before the Commission. We declined so to
16 hold, reasoning that "[u]ntil the Commission has acted and actual
17 bias has been demonstrated, the orderly administrative procedures
18 of the agency should not be interrupted by judicial
19 intervention." Id. We think that the same result for the same
20 reasons obtains here. Requiring exhaustion before the allegedly
21 biased tribunal not only will give the tribunal the opportunity
22 to purge itself of bias, if any, but also will provide a
23 foundation for further review of the dispute either with respect
24 to the alleged bias or on its merits.

25 Third, MFS argues that the Commission was required to
26 permit MFS to proceed before the Commission despite MFS's failure

1 to exhaust because the Commission had previously done so in a
2 similar proceeding. JD American Workwear, Exchange Act Release
3 No. 43283, 73 S.E.C. Docket 559, 2000 WL 1397096, at *2 n.11,
4 2000 SEC LEXIS 1906, at *7 n.11 (Sept. 12, 2000). But while MFS
5 may be correct that the Commission was not required to dismiss
6 the MFS application for review because of failure to exhaust, we
7 do not think JD American Workwear means the Commission was
8 forbidden from doing so. JD American Workwear may properly be
9 read to establish that the SEC's requirement that a party exhaust
10 SRO remedies is discretionary. See id. ("We normally require an
11 applicant to exhaust the NASD's appellate procedure before
12 considering the application for review." (emphasis added)). We,
13 too, see no reason to doubt that administrative exhaustion
14 requirements not created by statute are discretionary. See
15 Beharry, 329 F.3d at 56-57. It does not follow from such
16 requirements that the agency is, absent exhaustion, without
17 jurisdiction.³ The exhaustion requirement applicable to review
18 of proceedings before SROs is akin to a judicially created
19 exhaustion requirement. It is therefore not mandatory. And the
20 fact that in another situation the Commission once decided not to
21 insist on observing the exhaustion requirement does not compel
22 the conclusion that it was required not to impose it here. We

³ Although we said in Barbara that we thought that "Congress intended" the exhaustion doctrine to apply to Commission review of SROs, 99 F.3d at 57, we did not conclude that the requirement was either statutorily imposed or mandatory.

1 find no abuse of the Commission's discretion in its decision to
2 require exhaustion here.

3 Finally, we note that MFS has brought an antitrust
4 action against the Exchange that has been stayed by the district
5 court pending resolution of this petition for review. MFS II,
6 277 F.3d at 617-18, 622. The issue is not before us, and we
7 therefore neither decide nor imply that MFS's ability to go
8 forward with that suit is barred by its failure to exhaust
9 remedies before the Exchange or the Commission. Cf. Barbara, 99
10 F.3d at 57 (permitting a state-law damages claim against the
11 Exchange to go forward, despite the plaintiff's failure to
12 exhaust Exchange remedies, noting that "the administrative review
13 provisions of the [Exchange Act] do not provide for money
14 damages, and this fact counsels strongly against requiring
15 exhaustion [in order for Barbara's damages claims to go
16 forward]").

17 **CONCLUSION**

18 For the foregoing reasons, the petition is denied and
19 the order of the SEC is affirmed.