

This order has been published by the NASDR Office of the Hearing Officers and should be cited as OHO Order 98-17 (CAF970002).

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CAF970002
v.	:	
	:	Hearing Officer - EBC
	:	
Respondents.	:	

ORDER REGARDING SEVERANCE

This disciplinary proceeding involves charges that the Respondents violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, by engaging in a broad range of fraudulent sales practices or other misconduct while serving as principals, registered representatives, or associated persons of _____ The Department of Enforcement’s Complaint identifies thirteen types of fraudulent sales practices; sets forth allegations of misconduct involving the securities of twelve issuers; and identifies approximately 70 customers who were allegedly the victims of the Respondents’ fraudulent activities.¹ The Complaint also contains allegations stemming from and related to alleged supervisory deficiencies at the Firm. At present, the proceeding includes allegations against thirty-two Respondents, specifically 27 former registered

¹ The Complaint also charges some of the Respondents with violations of: NASD Conduct Rule 3110, by falsifying account documentation; NASD Conduct Rule 2310(a), by making unsuitable recommendations to customers; NASD Conduct Rule 2330(e), by falsely guaranteeing customers against loss; and NASD Procedural Rule 8210, by failing to respond or failing to respond truthfully to the NASD’s inquiries.

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representatives, four former supervisors, and one former research analyst of the now defunct Firm.

During the January 9, 1998 Initial Pre-Hearing Conference, the Parties were afforded the opportunity to discuss the possibility of severing the allegations in the Complaint, and establishing, for pre-hearing purposes or hearing, separate proceedings for each Respondent or certain groups of Respondents. The Parties also were invited to file, by January 23, 1998, written submissions addressing the issue of severance, and in particular, the appropriate juncture in the proceeding for possible severance. The Hearing Officer has received written submissions on behalf of six Parties: the Department of Enforcement and Respondents _____.

I. The Parties' Positions

The Department of Enforcement is opposed to severance at any stage in this proceeding. It argues that: neither the Hearing Officer nor the Chief Hearing Officer is empowered to sever a disciplinary proceeding or order separate hearings; the allegations against the registered representatives implicate common questions of law or fact, and it anticipates attempting to introduce substantially the same or similar evidence to prove the overlapping factual allegations; the time and resources of the Parties would be conserved by maintaining this action as a consolidated proceeding; and that no prejudice will inure to the Respondents from being required to defend the allegations against them in the context of a single disciplinary proceeding.

All Respondents or their counsel who orally or in writing expressed views on the issue of severance have asserted uniformly that severance should be ordered for purposes of hearing and that they would be unfairly prejudiced – on the merits and financially – if the Department of Enforcement were permitted to proceed with a single hearing against them. In support of their position, the Respondents have stated that the factual allegations against each individual

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registered representative are discrete, relating solely to his or her individual activities vis-à-vis his or her customers, and that proof of the alleged violations will depend solely on the merits of each customer's complaint. With respect to their claims of prejudice, the Respondents have expressed concerns that in the context of a single disciplinary hearing, the Department of Enforcement will attempt to attribute the misconduct of _____ to the individual Respondents or will attempt to attribute the misconduct of one Respondent to another. The Respondents also have indicated that a consolidated hearing would result in "major logistical obstacles" in scheduling the anticipated lengthy hearing, and cause inordinate expense, because they or their counsel would be required to be present through days of testimony involving other Respondents in order to interpose appropriate objections or otherwise protect their rights.

However, with the exception of Respondent _____, the Respondents suggest that the proceeding should remain consolidated for pre-hearing purposes. In this connection, the Respondents have expressed concerns that the severance of claims and the establishment of separate disciplinary proceedings at the pre-hearing stage, and a possible reassignment of individual cases to several Hearing Officers might result in inconsistent pre-hearing rulings on common issues, e.g., issues relating to discovery and the conduct of the hearing.

II. Legal Analysis and Discussion

The Code of Procedure invests a Hearing Officer with broad powers to determine all matters pertaining to case management during the pre-hearing and hearing phase of the disciplinary process. See generally Code of Procedure Rules 9235 and 9241; Exchange Act Release No. 38545, File No. SR-NASD-97-28, 62 Fed. Reg. 25226, 25250 (April 24, 1997) (the various provisions in the Code of Procedure "delegate to a Hearing Officer responsibility for case management from the institution of a proceeding to its conclusion.") The power to sever claims

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or Parties, either for pre-hearing purposes or hearing, derives from the general delegation of authority to the Hearing Officer to take any action “necessary and appropriate to discharge his or her duties” (Rule 9235) with a view toward enhancing the fairness and efficiency of the disciplinary process. The absence of a specific Code provision authorizing severance, therefore, is not preclusive.

Further, as the Department of Enforcement recognizes, the Chief Hearing Officer is authorized to consolidate disciplinary proceedings, either sua sponte or on a motion of a Party, to “further the efficiency of the disciplinary process” (Rule 9214.) Thus, the Code of Procedure contemplates that deference need not be accorded to the Department of Enforcement’s decisions on joinder of claims and parties; rather, in some proceedings, in connection with the proper discharge of adjudicatory responsibilities, it may be appropriate to alter the procedural posture of complaints authorized and issued by the Department of Enforcement. The power to sever claims and parties – the corollary to consolidation – is consistent with these general principles.

In support of its argument that neither the Hearing Officer presiding over an NASD disciplinary proceeding nor the Chief Hearing Officer is empowered to order severance or order separate hearings, the Department of Enforcement relies on dictum from an order issued in an SEC administrative proceeding, where the administrative law judge questioned his authority to grant respondent’s motion for severance. See In re First Jersey Securities, Inc., Admin. Proc. Release No. 221, 52 S.E.C. Docket 324, 1979 SEC LEXIS 2434 (September 12, 1979). The underlying reasons that gave rise to the administrative law judge’s concerns are inapplicable here. First, unlike Code of Procedure Rules 9214 and 9235, pursuant to the SEC Rule of Practice in effect at that time, the Commission had the sole power to consolidate proceedings, and it alone

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had the power to issue “orders concerning the conduct of such proceedings”² Second, there is a fundamental difference between the complaint authorization process in NASD disciplinary proceedings and the process in SEC administrative proceedings. In NASD disciplinary proceedings, the Department of Enforcement of NASD Regulation, Inc. (NASDR) authorizes and issues complaints. By contrast, in SEC administrative proceedings, the Commission, not SEC’s Division of Enforcement, authorizes and issues the Order Instituting Proceedings. Accordingly, the adjudicator’s power to alter the charging document in an SEC administrative proceeding indeed may be different from the adjudicator’s power to alter the charging document in an NASD disciplinary proceeding. In this connection, it is noteworthy that an NASDR Hearing Officer is empowered to grant motions to allow the Department of Enforcement to amend its complaint to include any new factual or legal matters. (See Rule 9212(b).) By comparison, an SEC administrative law judge is authorized only to allow amendments that set forth matters within the framework of the original Order Instituting Proceedings; motions to include matters that are outside the scope of the original Order Instituting Proceedings are considered to be within the sole province of the Commission. (See SEC Rule of Practice 200(d); 17 C.F.R. § 201.200(d) and Comment (d).)

Finally, although the SEC has had the opportunity to address the issue prior to the August 1997 amendments to the NASD’s Code of Procedure, it has never indicated that an adjudicator in

² It is noted that subsequent to the issuance of the order in the First Jersey case, the Commission, on June 9, 1995, amended its Rules of Practice to authorize the administrative law judge, as well as the Commission, to order consolidation and to issue orders to regulate the conduct of such proceedings. (SEC Rule of Practice 201, 17 C.F.R. § 201.201.)

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an NASD disciplinary proceeding lacks the power to sever claims and parties for pre-hearing purposes or to order separate hearings.³

In conclusion, in NASD disciplinary proceedings, when warranted by the particular facts and circumstances and to further the fairness and efficiency of the disciplinary process, a Hearing Officer, consistent with the broad powers granted by the Code of Procedure and in discharging his or her responsibilities for overall case management, properly may sever claims and parties for pre-hearing purposes, or order separate hearings. The Chief Hearing Officer, as a corollary to the power to order consolidation, likewise may do so.

Having reached this conclusion, it has been determined that the power to sever or to order separate hearings should not be exercised at this time. The Hearing Officer is persuaded that since it is likely many of the Respondents will raise the same pre-hearing issues pertaining to discovery and the conduct of the hearing, to promote efficiency in the disciplinary process and in the interest of judicial economy, this disciplinary proceeding should remain as originally instituted for all pre-hearing purposes.⁴ However, the Hearing Officer will not permit the Parties to delay the pre-hearing process simply because numerous respondents are involved; deadlines will be strictly enforced and the Parties will be expected to proceed with due alacrity in their pre-hearing preparation. The issue as to whether separate hearings shall be ordered for each individual Respondent or groups of Respondents will be re-visited at a later date.

³ See e.g., In re Carlton Wade Fleming, Exchange Act Release No. 36215, 60 S.E.C. Docket 523, 1995 SEC LEXIS 2326 (September 11,1995).

⁴ For practical reasons, a different conclusion may be appropriate as to those Respondents who have pending bankruptcy proceedings. The Department of Enforcement will be afforded the opportunity to specifically address the issue of severance or propose a case management plan as to such Respondents.

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III. Status of Various Respondents' Bankruptcy Proceedings

At present, there are four Respondents, namely _____, as to whom this proceeding has been and presently is stayed as a result of their pending bankruptcy filings.⁵ Based on the Department of Enforcement's Status Report, filed on January 29, 1998, it appears that determinations on the Department of Enforcement's motions to lift the automatic stay as to Respondents _____ will not be made for some time. As to Respondent _____, apparently the Department of Enforcement only recently learned of his bankruptcy filing, and has not yet filed a motion in the appropriate Bankruptcy Court to lift the automatic stay. The completion of discovery and other pre-hearing activities cannot be deferred until the Department of Enforcement obtains relief to proceed against these Respondents, or their debts are discharged. Accordingly, the Department of Enforcement shall serve and file, by February 12, 1998, a statement setting forth a proposed case management plan as to these Respondents, including a statement of its position on severance as to these Respondents.

SO ORDERED.

Ellen B. Cohn
Hearing Officer

Dated: Washington, DC
February 5, 1998

⁵ Based on the Department of Enforcement's Status Report, the Hearing Officer understands that pursuant to the Order of the Bankruptcy Court, the automatic stay was lifted as to Respondent _____ on December 30, 1997. Consequently, there appears to be no present impediment to the Department of Enforcement's ability to proceed against him.