

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 99-05 (CMS980108).

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CMS980108
v.	:	
	:	Hearing Officer - EBC
	:	
Respondent.	:	

**ORDER WITH RESPECT TO RESPONDENT'S MOTION
TO COMPEL PRODUCTION OF DOCUMENTS**

Respondent _____ moved for an order compelling the Department of Enforcement (Enforcement) to produce certain documents, and Enforcement opposed the motion. On April 6, 1999, the Hearing Officer held a Pre-Hearing Conference (Conference), by telephone, to obtain clarification regarding several matters raised by Respondent's motion.¹ Enforcement was represented by _____, and Respondent _____ was represented by _____.

The Hearing Officer concluded that Respondent was entitled to obtain certain discrete statistical information and, at the Conference, directed Enforcement to either produce responsive documents or provide the information through a statement of its counsel. Enforcement counsel chose the latter and, by letter dated April 7, 1999, supplied the information to Respondent's

¹ Pursuant to Code of Procedure Rule 9265(a), the Hearing Officer determined, in the exercise of her discretion, that given the limited scope of the matters to be discussed, it was not necessary to obtain the services of a court reporter to record and prepare a transcript of the Conference.

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counsel. In all other respects, the Hearing Officer denied Respondent's motion.

I. Background

Enforcement's Complaint alleges, among other things, that during the period from October 1 through December 12, 1997, _____ failed to execute 12 SelectNet orders to purchase or sell securities at its published quotations, and thereby violated SEC Rule 11Ac1-1(c) (the "SEC firm quote rule"), NASD Conduct Rule 3320 and The Nasdaq Stock Market Rule 4613(b) (the "NASD firm quote rules"), and NASD Conduct Rule 2110. Ten of the 12 instances of alleged "backing away" involve orders to sell the same security, identified in the Complaint as "VLNT," that were presented to the Firm within a span of approximately nine minutes.

Respondent moved to compel the production of two categories of documents: (1) statistical documents relating to "backing away," including any documents that may have been used by Enforcement to determine that the "backing away" instances alleged in the Complaint were above industry average; and (2) any documents relevant to determining whether transactions, such as those in VLNT, should be treated as one or multiple transactions.² In support of its motion, Respondent argued that the requested documents are relevant to both liability and sanctions, because they will show that the Firm did not engage in a "pattern" of "backing away," and that the 12 instances alleged in the Complaint were "at most isolated occurrences and well within industry averages."³ Respondent also submitted, with its motion, a

² Respondent's Motion to Compel Production of Documents, ¶ 1.

³ Id., ¶ 7.

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pre-Complaint letter, dated March 13, 1998, it received from the Vice President of the Department of Market Regulation of NASD Regulation, Inc., which states:

[d]uring the review period, the industry average for missed SelectNet liability orders was approximately **1.6%**. Your firm's average of missed SelectNet liability orders during the review period was approximately **12%**. This rate of unexecuted SelectNet orders without contemporaneous trades and quote movements may demonstrate a pattern of non-compliance with the firm-quote rule. Exhibit A, which is attached, sets forth a subset of the missed SelectNet orders, which appear to be in clear violation of Exchange Act Rule 11Ac1-1, NASD Conduct Rule 3320 and NASD Marketplace Rule 4613(b). (Emphasis original.)

Exhibit A to the March 13 letter identifies the same 12 SelectNet orders that are at issue in this proceeding, thus implying that the instances of "backing away" alleged in the Complaint represent less than 12% of the total number of SelectNet liability orders _____ received during the review period. At the Conference, Enforcement counsel confirmed that the 12 orders at issue are, in fact, a "subset" of the total number of the Firm's missed SelectNet liability orders during the review period.

In opposition to the motion, Enforcement claimed that the statistical documents Respondent requested were not prepared or obtained by Interested Association Staff in connection with the investigation that led to the institution of this proceeding, and that such documents contain other firms' proprietary information. Enforcement also argued that, pursuant Rule 9251(b)(1)(D), it is entitled to an order granting it leave to withhold these documents on relevancy grounds. Further, at the Conference, Enforcement claimed that it was entitled to withhold the documents because their disclosure would reveal investigative techniques and parameters generally used by the Department of Market Regulation in conducting "backing away" analyses. As to the second category of materials requested, i.e., documents relevant to determining whether the orders to sell VLNT should be treated as one or multiple orders,

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Enforcement represented that it has no responsive documents. Accordingly, the Hearing Officer denied this aspect of Respondent's motion as moot.

II. Discussion

Under Rule 9251(a), Enforcement is required to produce "Documents prepared or obtained by Interested Association Staff⁴ in connection with the investigation that led to the institution of proceedings."⁵ Despite Enforcement's claims, the March 13 letter indicates that at least certain statistical information was collected by Interested Association Staff in connection with the investigation that led to the institution of this proceeding. The Rule, on its face, does not limit discovery to documents that were prepared or obtained solely in connection with the underlying investigation. Accordingly, the Hearing Officer could not conclude that statistical information pertaining to _____ missed SelectNet liability orders is outside the scope of discovery provided by Rule 9251(a).

As to relevancy, the Hearing Officer agreed with Enforcement that the requested statistical documents are not germane to the question of liability in this proceeding. First, as Enforcement noted, the Complaint does not allege that _____ engaged in a pattern of firm quote rule violations and, further, its counsel represented that the "staff does not intend to prove a pattern or introduce evidence of a pattern during the hearing."⁶ Second, it is no defense to a violation of the SEC firm quote rule or the NASD firm quote rules that a respondent firm engaged in only isolated instances as opposed to a pattern of "backing away," or that the

⁴ Enforcement does not dispute that, for purposes of this proceeding, the Vice President of the Department of Market Regulation falls within the definition of "Interested Association Staff."

⁵ It follows that, at least typically, documents discoverable in an NASD disciplinary proceeding would be maintained in the underlying investigative file. This is not say, however, that the physical location of a document necessarily will be dispositive of Enforcement's disclosure obligations.

⁶ See Opposition to _____ Motion to Compel Production of Documents, p. 5.

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percentage of “missed” orders was within the industry average. The SEC firm quote rule provides, in relevant part, that “each responsible broker or dealer shall be obligated to execute any order to buy or sell a subject security, other than an odd-lot order, presented to it by another broker or dealer” (Emphasis added.)⁷

However, the Hearing Officer disagreed with Enforcement’s proposition that statistical information is irrelevant to sanctions. Although the NASD Sanction Guideline applicable to “backing away” violations does not list “pattern” as relevant factor,⁸ the “Principal Considerations in Determining Sanctions,” which apply to all types of disciplinary proceedings, expressly provide that adjudicators should consider “[w]hether the respondent engaged in numerous acts and/or a pattern of misconduct”⁹ The “Principal Considerations” also suggest that adjudicators should consider whether “the misconduct at issue was aberrant or not otherwise reflective of the firm’s historical compliance record.”¹⁰

The Hearing Officer, therefore, determined that Respondent was entitled to some statistical information, but that its nonspecific request for statistical documents relating to “backing away” was overbroad, and that Enforcement was permitted to withhold documents that would reveal its investigatory techniques or information pertaining to other firms. Accordingly, at the Conference, the Hearing Officer offered Enforcement the option of providing, either through documents or a statement of its counsel, information that would allow the Firm to

⁷ Similarly, NASD Conduct Rule 3320 provides that, “[n]o member shall make an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell.” (Emphasis added.)

⁸ NASD Sanction Guidelines 46 (1998 ed.).

⁹ Id., at 8.

¹⁰ Id., at 9.

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calculate, with respect to the 12 orders at issue, what percentage they represent of the total number of SelectNet liability orders it received during the review period. Enforcement chose to provide the information through a statement of its counsel and, by letter, dated April 7, 1999, supplied Respondent with statistics showing, among other things, the total number of SelectNet liability orders _____ received during the review period.

Enforcement is reminded that, in the event Respondent wishes to present at hearing any information in the April 7 letter, because that information is not in admissible form, Enforcement shall be required to stipulate to its accuracy.

SO ORDERED.

Ellen B. Cohn
Hearing Officer

Dated: Washington, DC
April 13, 1999