

**FINANCIAL REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT FIRM,

and

RESPONDENT 2,

Respondents.

Disciplinary Proceeding
No. E112005002003

Hearing Officer—Andrew H. Perkins

**ORDER DENYING RESPONDENTS’ MOTION TO COMPEL
IDENTIFICATION AND PRODUCTION OF WITHHELD DOCUMENTS**

The Respondents [“Respondent Firm” or the “Firm”, and “Respondent 2”] moved for entry of an order compelling the Department of Enforcement (“Enforcement”) to produce for inspection and copying all documents Enforcement withheld from discovery pursuant to Procedural Rule 9251(b)(1) that may contain “material exculpatory evidence,” as that term is defined by Procedural Rule 9251(b)(2) and the principles enunciated by the Supreme Court in *Brady v. Maryland*, 373 U.S. 83 (1963), commonly referred to as the Brady Doctrine. In the alternative, the Respondents moved for entry of an order compelling Enforcement to produce a list of withheld documents so that the Hearing Officer could conduct an in camera review of the listed documents to determine if any had been withheld improperly.

Enforcement opposed the Respondents’ motion. Enforcement argued that the Respondents’ motion failed to show a sufficient basis for their speculation that any of the

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withheld documents contain material exculpatory evidence.¹ Thus, Enforcement argued that the Respondents failed to meet their burden under Procedural Rule 9251(c). In addition, Enforcement stated that it did not intend to use any of the withheld documents at the hearing and that it did not possess any witness statements discoverable under Procedural Rule 9253.

For the reasons discussed below, the Hearing Officer denies the Respondents' motion and orders Enforcement to file an affidavit or sworn declaration certifying the following: (1) Counsel for Enforcement conducted a search for all documents encompassed by Procedural Rule 9251(a), including those that may not be kept as part of Enforcement's "investigatory file"; (2) Enforcement produced all documents encompassed by Procedural Rule 9251(a) that are not subject to protection from disclosure pursuant to Procedural Rule 9251(b)(1); and (3) Counsel for Enforcement reviewed all documents withheld pursuant to Procedural Rule 9251(b)(1) in accordance with the standards set forth in this Order, and none contain material exculpatory evidence.

Discussion

A. Background

Enforcement charged the Respondents with violations of several NASD Conduct Rules in connection with a routine FINRA examination of the Firm in March 2005. First, the Complaint alleges that the Respondent Firm, acting through Respondent 2, its Managing Director and Chief Compliance Officer, violated NASD Conduct Rule 2110 by providing FINRA staff with what they purported were the Firm's Anti-Money Laundering (AML) Compliance Procedures for 2003 and 2004, when the firm did not have such procedures in place during that time. Second, the Complaint alleges that the Firm, acting through Respondent 2, violated NASD Conduct Rules 3010 and 2110 by

¹ Opp'n to Respondent's Mot. to Compel Produc. of Docs. at 7.

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(1) failing to establish, maintain, and enforce an adequate supervisory system; (2) failing to adopt written supervisory procedures designed to ensure that the Firm’s registered representatives obtained sufficient suitability information from each customer before recommending a security; and (3) failing to preserve written reports of the Firm’s annual internal inspections for the years 2003 through 2005. Third, the Complaint alleges that the Respondents failed to develop and implement a written AML program, in violation of NASD Conduct Rules 3011 and 2110, between April 2002 and October 2005. The Respondents dispute all of these allegations.

B. The Respondents’ Motion to Produce Withheld Documents

The Respondents focus on the first cause of action, charging the Respondents with providing false information to FINRA in connection with its March 2005 examination of the Firm’s books and records. The Respondents contend that the unique nature of the facts and circumstances surrounding this charge require Enforcement either to produce all of the staff’s notes regarding the examination and interview with Respondent 2 or to provide the documents to the Hearing Officer for his review. The Respondents distinguish this case from other enforcement actions on the grounds that the allegations surrounding Respondent 2’s misrepresentations to the FINRA examiner “do not involve external matters, but instead are limited solely to internal policy matters resulting from the audit, and the interactions between the Firm and [the FINRA examiner] during the audit.”² The Respondents therefore argue that they should have access to the examiner’s notes because the notes “very likely contain information that could be exculpatory.”³ Otherwise, Respondent 2 will not have the opportunity to determine for himself “whether the documents provide evidence in support of his defense—that no false or misleading statements were made.”⁴ The Respondents argue

² Mot. to Compel at 2.

³ *Id.* at 3.

⁴ *Id.*

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that Enforcement should not be allowed to determine unilaterally whether the examiner’s notes should be produced under Procedural Rule 9251(b)(2) and *Brady*.

C. Procedural Rule 9251(b)(2) and the Brady Doctrine

Contrary to the Respondents’ arguments, Procedural Rule 9251(b)(2) and the Brady Doctrine do not expand the scope of documents that must be produced beyond the limits set in Procedural Rule 9251(a). Rather, Rule 9251(b)(2) limits the scope of documents encompassed by Procedural Rule 9251(a) that Enforcement may withhold from production if the documents contain material exculpatory evidence.

Procedural Rule 9251(a) sets the outside limit of discovery in NASD disciplinary proceedings, which is substantially less than the scope of discovery permitted in federal court under the Federal Rules of Civil Procedure. NASD Procedural Rule 9251(a) obligates Enforcement to allow respondents to inspect and copy non-privileged “Documents prepared or obtained by Interested Association Staff in connection with the investigation that led to the institution of proceedings.”⁵ Under this definition, Enforcement generally must produce documents prepared or obtained by any FINRA employee who directly participated in the case at issue or any related examination, investigation, prosecution, or litigation regardless of whether the documents are contained in Enforcement’s case file. Thus, Enforcement counsel has the duty to search for and review documents that may be in the possession of other FINRA employees who participated in some manner in the case at issue or in a related proceeding, irrespective of whether the documents are maintained in the formal investigatory file.

Notwithstanding the obligation under Procedural Rule 9251(a), Enforcement may withhold any document protected by Procedural Rule 9251(b)(1). They include documents subject to attorney-client privilege, as well as internal reports, memoranda, notes, and other writings related to an investigation or examination, and documents that

⁵ The term “Interested Association Staff” is defined in Procedural Rule 9120(r)(1).

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would reveal an enforcement technique or guideline.⁶ FINRA permits such documents to be withheld to ensure that FINRA’s enforcement efforts are not impaired.⁷ In addition, under Rule 9251(b)(1)(D), the Hearing Officer may grant leave to Enforcement to withhold a document or category of documents as not relevant to the subject matter of the proceeding, or for other good cause.

Enforcement’s ability to withhold otherwise discoverable documents is limited however by Procedural Rule 9251(b)(2), which requires Enforcement to produce any document it withheld pursuant to Rule 9251(b)(1) if it contains “material exculpatory evidence.”⁸ NASD applies Procedural Rule 9251(b)(2) consonant with the principles enunciated by the Supreme Court in *Brady*.

In *Brady*, the Supreme Court held “that the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution.”⁹ The Supreme Court later held that the duty encompasses impeachment evidence as well as exculpatory evidence. In the pre-hearing phase of an NASD disciplinary proceeding, “material evidence” is evidence relating to liability or sanctions that might be considered favorable to the respondent’s case, which, if suppressed, would deprive the respondent of a fair hearing.¹⁰ However, mere speculation that FINRA documents might contain material exculpatory information is not sufficient to warrant

⁶ See Procedural Rule 9251(b)(1).

⁷ See Order Approving Proposed Rule Change, Exchange Act Release No. 38,908, 1997 SEC LEXIS 1617, at *134 n.194 (Aug. 7, 1997).

⁸ See Procedural Rule 9251(b)(2).

⁹ 373 U.S. at 87. The Supreme Court later held that the duty encompasses impeachment evidence as well as exculpatory evidence. See *United States v. Bagley*, 473 U.S. 667, 676 (1985).

¹⁰ OHO Redacted Order 01-13, CAF000045, at 11 (May 17, 2001), available at http://www.nasd.com/RegulatoryEnforcement/Adjudication/OfficeofHearingOfficersDecisionsandProceedings/OHODisciplinaryOrders/2001Orders/NASDW_007867 (citing *United States v. Bagley*, 473 U.S. 667, 675 (1985)).

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their production or an in camera review by the Hearing Officer.¹¹ Instead, a respondent must make a “plausible showing” that the requested documents contain information that is both favorable and material to its defense.¹² In addition, the Brady Doctrine is not violated by failing to disclose information already known to the defense.¹³

Here, the Respondents have failed to make a plausible showing that Enforcement is withholding material exculpatory evidence sufficient to overcome the presumption that Enforcement has complied with its disclosure obligations under Procedural Rule 9251(b)(2) and the Brady Doctrine.¹⁴ In addition, the Brady Doctrine does not appear to cover the examiner’s notes because under the Respondents’ theory the notes simply reflect Respondent 2’s interview statements, information already in the possession of the defense. Respondent 2 will be able to testify regarding his interview statements at the hearing. Accordingly, the Respondents’ motion for production of the documents Enforcement withheld pursuant to Procedural Rule 9251(b)(1) is denied.

Nonetheless, while Respondents have failed to make a plausible showing that any materially exculpatory information has been withheld improperly, Enforcement’s representations regarding its compliance with the Brady Doctrine and Procedural Rule 9251(b)(2) are insufficient when read in conjunction with the arguments in its opposition to the Respondents’ motion. The Hearing Officer cannot determine if Enforcement has made an exhaustive search for material exculpatory evidence, consistent with the principles expressed in this Order. Accordingly, the Hearing Officer orders Enforcement

¹¹ See *In re Jett*, 50 S.E.C. 830, 1996 SEC LEXIS 1683, at *1-2 (1996) (vacating an SEC order for the Division of Enforcement to produce memoranda for in camera review, finding that defendant’s proposal amounted to a “fishing expedition” through confidential documents, in the hope of finding something useful to his case).

¹² *Id.* at 2.

¹³ *United States v. Morris*, 80 F.3d 1151, 1170 (7th Cir. 1996).

¹⁴ The Respondents also have failed to make a sufficient showing that Enforcement has withheld improperly witness statements that must be produced pursuant to Procedural Rule 9253.

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to file an affidavit or a sworn declaration certifying that counsel for Enforcement: (1) conducted a search for all documents encompassed by Procedural Rule 9251(a), including those that may not be kept as part of Enforcement's "investigatory file"; (2) produced all documents encompassed by Procedural Rule 9251(a) that are not subject to protection from disclosure pursuant to Procedural Rule 9251(b)(1); and (3) reviewed all documents withheld pursuant to Procedural Rule 9251(b)(1) in accordance with the standards set forth in this Order, and none contain material exculpatory evidence.¹⁵ Enforcement shall file the certification on or before August 31, 2007.

IT IS SO ORDERED.

Andrew H. Perkins
Hearing Officer

Dated: August 16, 2007

¹⁵ *Cf. Anaheim*, Administrative Proceeding File No. 3-9739, 1999 SEC Lexis 1662 (July 30, 1999) (citing *Jett*, 52 SEC at 831) (holding that such an affidavit "should be the primary tool for resolving Brady disputes over privileged materials and in camera examination by an Administrative Law Judge should be a secondary tool").