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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. STEPHEN BROWN (CRD No. 1799847), and JAMES GOETZ (CRD No. 2826111), Respondents.	Disciplinary Proceeding No. 2014042690502 Hearing Officer– DRS

ORDER GRANTING, IN PART, RESPONDENTS' MOTION REQUESTING ISSUANCE OF FINRA RULE 8210 REQUESTS

Respondents moved for an order under FINRA Rule 9252 directing the Department of Enforcement to issue FINRA Rule 8210 requests to five current or former employees of Merrill Lynch, Pierce, Fenner & Smith compelling them to testify at the hearing. The Department of Enforcement opposes the motion, primarily on the grounds that the requested testimony is irrelevant. As explained below, I grant the motion, in part, and will direct Enforcement to issue Rule 8210 requests to three of the five prospective witnesses requiring that they appear and testify at the hearing in this matter; I deny the motion with respect to the other two prospective witnesses.

A. Background

Enforcement charged Respondent Stephen Brown, formerly registered with Merrill Lynch, with violating FINRA Rules governing private securities transactions and outside business activities; with lying to Merrill Lynch about those activities in a compliance disclosure during the firm's internal investigation; and with directing an associated person to alter a document to evade Merrill Lynch's compliance oversight. Enforcement also charged Brown's partner, former Merrill Lynch registered representative James Goetz, with violating FINRA's private securities rule.

In answering the Complaint, Respondents deny the charges and assert a number of affirmative defenses: Merrill Lynch—including its compliance and management personnel—was aware of and approved their actions; Respondents relied on Merrill Lynch management and compliance personnel for guidance on reporting outside business investments and activities and private securities transactions; and they complied with all applicable laws, regulations and standards.

B. Discussion

1. Applicable Legal Standards

FINRA Rule 9252 establishes the procedures for a respondent to request that FINRA invoke its authority under Rule 8210 to compel production or testimony from member firms or associated persons. Under this Rule, the request must:

> describe with specificity . . . the testimony sought; state why the . . . testimony [is] material; describe the requesting Party's previous efforts to obtain the . . . testimony through other means; and state whether . . . each proposed witness is subject to [FINRA's] jurisdiction.[1]

Additionally, the Hearing Officer may grant the request only if:

> the information sought is relevant, material, and non-cumulative; the requesting Party has previously attempted in good faith to obtain the desired . . . testimony through other means but has been unsuccessful in such efforts; and each of the persons from whom the . . . testimony [is] sought is subject to [FINRA's] jurisdiction.[2]

Also, the Rule directs the Hearing Officer to "consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome, and whether the request should be denied, limited, or modified."[3] If, after considering "all the circumstances, the Hearing Officer determines that a request . . . is unreasonable, oppressive, excessive in scope, or unduly burdensome" then the Hearing Officer "shall deny the request, or grant it only upon such conditions as fairness requires."[4]

In evaluating the relevance and materiality of the proposed testimony, I am guided by the Federal Rules of Evidence, which, though not binding in this forum,[5] are frequently relied upon

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[1] Rule 9252(a).

[2] Rule 9252(b).

[3] Rule 9252(b).

[4] Rule 9252(c).

[5] *See* FINRA Rule 9145(a) stating that "[t]he formal rules of evidence" do not apply in FINRA disciplinary proceedings.

by FINRA Hearing Officers.[6] The Federal Rules of Evidence address relevance explicitly. Under the definition of relevance contained in Rule 401 of the Federal Rules of Evidence, "[e]vidence is relevant if (a) it has any tendency to make a fact more or less probable than it would be without the evidence; and (b) the fact is of consequence in determining the action."[7] While not referenced specifically, the concept of materiality is embodied in part (b) of the relevance test.[8] "Thus, although evidence may tend to make the existence of a fact more probable or less probable than it would be without the evidence, the evidence is not relevant unless the fact to be proved or disproved is material."[9]

2. Request for Testimony of Woodring, Lenz, and Means

The motion represents that Woodring is a financial advisor with Merrill Lynch, while Lenz and Means were previously associated with Merrill Lynch and are now financial advisors at Stifel Nicolaus, Inc. Respondents maintain that these three prospective witnesses invested in many of the same or similar investments that are the subject of the Complaint.

Respondents proffer that these witnesses are expected to testify about:

- "whether they obtained approval from Merrill Lynch for their involvement with these investments;"
- "the extent and substance of their conversations with a Merrill Lynch administrative manager about these investments;"
- "their compliance disclosures regarding these investments;" and
- "their knowledge of the other financial advisors at Merrill Lynch who were also involved in these investments."

Respondents assert that the collective testimony of these witnesses is relevant to "key defenses in this matter concerning":

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[6] *See, e.g.*, OHO Order 16-24 (2014043020901) (Aug. 30, 2016) at 2 (and cases cited therein), https://www.finra.org/sites/default/files/OHO_Order16-24_2014043020901.pdf.

[7] Fed. R. Evid. 401.

[8] *See United States v. Shomo*, 786 F.2d 981, 985 (10th Cir. 1986) ("Although the Federal Rules of Evidence do not define relevancy in terms of materiality, the concept of materiality is embodied in Rule 401 insofar as relevancy is defined as a relationship between certain evidence and a 'fact that is of consequence to the determination of the action.'"). *Accord: Little v. Reed-Prentice Div. of Package Machinery, Co.*, No. 87-2426-0, 1991 U.S. Dist. LEXIS 7698, at *13 (D. Kan. May 10, 1991). *See* also *United States v. Rodriguez-Soler*, 773 F.3d 289, 293 (1st Cir. 2014) ("Rule 401 says . . . that if the evidence has 'any tendency' to make a material fact more or less likely, it is relevant."), *cert. denied*, 2015 U.S. LEXIS 867 (U.S. Jan. 26, 2015); *United States v. Jones*, 768 F.3d 1096, 1103 (10th Cir. 2014) (same).

[9] *Shomo*, 786 F.2d at 985. *Little*, 1991 U.S. Dist. LEXIS 7698, at *13–14. Also, "[w]hether a fact is material is determined by the substantive law which governs the action." *United States v. Jones*, 768 F.3d at 1103 (10th Cir. 2014) (same).

- "the prevalence of these investments at Merrill Lynch;"
- "Merrill Lynch's knowledge of who was involved in these investments, both clients and other financial advisors;"
- "Merrill Lynch's failure to provide guidance to Respondents regarding their disclosures of these investments;" and
- "Merrill Lynch's approval of these investments with respect to other Merrill Lynch advisors."

More specifically, Respondents reason that if "Merrill Lynch approved the same conduct for other financial advisors," "then that approval becomes an express statement of policy from Merrill Lynch that contradicts, and potentially overrides, any other policies to the contrary." And if Merrill Lynch gave such approvals, then, Respondents continue, this is relevant "to Merrill Lynch's knowledge, failure to provide guidance to, and disparate treatment of, Respondents." Continuing, Respondents submit that these circumstances "provide a critical backdrop to communications that Respondents will testify they had with Merrill Lynch about remedying their compliance disclosures" and will aid the hearing panel's "consideration of whether Respondents acted with intent to deceive Merrill Lynch." Thus, Respondents conclude, the proposed testimony is relevant to both liability and sanctions, including whether there is mitigation.

Enforcement disagrees, arguing that the proposed testimony is irrelevant to both liability and sanctions. This argument rests on Enforcement's characterization of Respondents' position as: "if others are doing it, respondents cannot be held liable," a position which, it maintains, has been rejected under applicable precedent. Enforcement correctly states the law. Both the SEC and FINRA have long held that "it is no defense that others in the industry may have been operating in a similarly illegal or improper manner."[10] Respondents, therefore, cannot defend against charges of misconduct by proving that other Merrill Lynch employees engaged in similar conduct. Nor can Respondents exculpate themselves from liability by blaming Merrill Lynch for not providing them with proper guidance regarding their disclosures of the investments at issue, as such blame-shifting arguments have also been rejected.[11]

Even so, a portion of the proposed testimony is relevant and material for other purposes, based on the Complaint's allegations and provisions in the Sanction Guidelines ("Guidelines"). The Complaint alleges deceptive conduct by the Respondents. For example, the Complaint

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[10] *Patricia H. Smith*, 52 S.E.C. 346, at *6 n.8 (1995) (citing *Donald T. Sheldon*, 51 S.E.C. 59, 66 n.32 (1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995) and *C.A. Benson & Co., Inc.*, 42 S.E.C. 107, 111 (1964)). *See also Dep't of Enforcement v. Repine*, No. E0420030634-04, 2008 FINRA Discip. LEXIS 4, at *15–16 (OHO Feb. 21, 2008) (citing *Smith*, 52 S.E.C. at 348 (1995); *Dep't of Enforcement v. Winters*, No. E102004083704, 2009 FINRA Discip. LEXIS 5, at *15 (NAC July 30, 2009) (citing *Charles E. Kautz*, 52 S.E.C. 730, 733 (1996) (holding that it is no defense that others in the industry are also acting improperly)).

[11] *See, e.g., Dep't of Enforcement v. Trigillo*, No. C8A040082, 2005 NASD Discip. LEXIS 61, at *26 (OHO June 8, 2005) (rejecting respondent's attempt to blame "the firm for allegedly having lax supervision and a policy of tolerance towards [outside business activities], which he described as a 'free-for-all'," explaining that "a registered representative is responsible for his actions and cannot shift that responsibility to the firm or his supervisor.").

charges that Brown made false statements and failed to disclose material facts in his compliance disclosures in order to "circumvent" the firm's prohibitions against representatives "participating in private securities transactions involving investments in entities which customers had also invested and from engaging in outside business activities that involved customers in any capacity."[12] His "deception continued," according to the Complaint, "during a 2014 internal investigation into his disclosures," during which he allegedly "provided false responses to Merrill Lynch management and outside counsel regarding his private securities transactions and outside business activities."[13] Also, as to Goetz, the Complaint alleges that he "invested in at least five of the same private companies in which Brown had invested without making the required disclosures to or receiving authorization from Merrill Lynch."[14] And when Merrill Lynch questioned him about the nature of his Lorax investment, Goetz, according to the Complaint, allegedly made false statements about the purpose of investment.[15]

In light of these allegations that Respondents tried to deceive the firm about their private securities transactions and outside business activities, evidence that the firm already knew about similar transactions and activities by other representatives—and whether Respondents knew the firm was aware of them—is relevant and material. This evidence is relevant because it would tend to make it more probable that the firm was aware of similar transactions and activities of other registered representatives than it would be without that evidence. And the evidence is material because it relates to a fact of consequence in determining the action, namely, whether Respondents tried to deceive the firm.

Likewise, this evidence would also be relevant and material to sanctions (in the event the Hearing Panel makes a liability finding). For example, under the Sanction Guidelines, factors that "should be considered in conjunction with the imposition of sanctions with respect to all violations"[16] include "[w]hether the respondent's misconduct was the result of an intentional act, recklessness or negligence," [17] and "[w]hether a respondent attempted to conceal his . . . misconduct or to lull into inactivity, mislead, deceive or intimidate" his member firm employer.[18] Thus, I find that based on the foregoing, Respondents have shown that at least some of the proposed testimony of the three witnesses would be relevant and material.[19]

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[12] Complaint ("Compl.") ¶¶ 3–4.

[13] Compl. ¶ 5.

[14] Compl.¶ 15.

[15] Compl. ¶ 30.

[16] FINRA Sanction Guidelines at 6 (2016) ("Guidelines"), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.

[17] Guidelines at 7 (Principal Considerations in Determining Sanctions, No. 13).

[18] Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 10).

[19] Contrary to Enforcement's argument, this finding is not precluded by my August 22, 2016 order denying Respondents' motion requesting the issuance of Rule 8210 requests for documents and information regarding other brokers' investments (Aug. 22 Order). There, I acknowledged that the "requests may yield relevant and material documents," but that "their over-breath will likely require Merrill Lynch to search for and provide irrelevant and immaterial documents as well." I concluded that Respondents were engaged in a "fishing expedition for helpful

Also, for the purposes of this motion, I accept (1) Respondents' undisputed representations that these witnesses remain associated with FINRA member firms, and therefore, are subject to FINRA jurisdiction, and (2) their undisputed contentions that the testimony requests are not unreasonable, oppressive, excessive in scope, or unduly burdensome.

Further, I find that Respondents have shown that they previously attempted in good faith to obtain the desired testimony through other means but have been unsuccessful in such efforts. In a supplement to the motion,[20] Respondents represent that Merrill Lynch—Woodring's current employer— has refused to permit Woodring to appear at the hearing absent a FINRA Rule 8210 request. As to Lenz and Means, Respondents were not as definitive, stating that while they understand that these witnesses would be willing to appear voluntarily at the hearing, that willingness "may change" because, "upon information and belief," Lenz and Means' employer, Stifel, will require them to be served with a FINRA Rule 8210 request before letting them testify. Although this representation is a bit vague, I find that it is sufficient. Accordingly, I find that Respondents have met the requirements under FINRA Rule 9252 for FINRA to invoke Rule 8210 to compel the attendance of Woodring, Lenz, and Means at the hearing.[21]

3. Request for Testimony of Root and Glaser

In addition to Woodring, Lenz, and Means, Respondents also request that I direct Enforcement to compel the testimony, under FINRA Rule 8210, of Root and Glaser. The motion represents, and Enforcement does not dispute, that both proposed witnesses are employed by Merrill Lynch as financial advisers. Respondents wish to call Root to testify about:

- Merrill Lynch's relationship with a company called PAETEC Communications;
- "Merrill Lynch's knowledge of the involvement of former PAETEC executives in the angel investing community in Rochester, New York;" and
- "the clean technology companies which are the subject of the Complaint."

As for Glaser, Respondents proffer that he will testify regarding:

- "the investing community in Rochester, New York," and
- "that the local management at Merrill Lynch permitted its financial advisors to show and market the startup companies to other investors."

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documents," based on the "[t]he broad, sweeping nature of the document requests, coupled with Respondents' vague and speculative justifications for why they seek certain documents." Aug. 22 Order at 4. The present FINRA Rule 9252 request does not suffer from the same infirmities.

[20] Because the motion did not adequately address the issue of Respondents' attempts to obtain the testimony by other means, by order dated December 21, 2016, I afforded them an opportunity to supplement the motion on this issue. Respondents filed their supplement on December 27, 2016.

[21] While I find that at least a portion of the testimony offered by Woodring, Lenz, and Means is relevant and material, I make no finding, at this point, on the admissibility of any particular testimony from these witnesses, as such ruling is best made at a later time, upon a fuller record, and taking into account the actual context in which the testimony is offered.

According to the motion, the testimony of these witnesses will "establish Merrill Lynch's knowledge of the startup companies and the involvement of former PAETEC executives." The importance of this testimony, Respondents explain, is to show "that Respondents did not intend to deceive or conceal anything from Merrill Lynch, when the startups and who was behind them were known in the community and to Merrill Lynch."

Enforcement opposes Respondents' request on relevance grounds.[22] "[W]hat is relevant in this case," according to Enforcement, "is Respondents' knowledge that customers were investors in and/or principals of certain startup companies in which Respondents invested (contrary to firm policy and contrary to representations in compliance disclosures)." Further, Enforcement argues that it is irrelevant "[h]ow customers came to invest in those companies." Therefore, Enforcement views this evidence as having "no bearing on whether Respondents knew of the customer involvement but lied about it in compliance disclosures."

Enforcement, however, does not directly refute Respondents' contention that the anticipated testimony evidence will help show that they "did not intend to deceive or conceal anything from Merrill Lynch." Nevertheless, I find that Respondents have not established the relevance of the proposed testimony. As discussed above, whether Respondents intended to deceive Merrill Lynch about their private securities transactions and outside business activities is a fact of consequence in this case, i.e., it is a material fact. But the connection between the anticipated testimony and the material fact it seeks to establish is tenuous. Consequently, Respondents have not demonstrated that a material fact would be made more or less probable by the proposed evidence than it would be without it. I therefore find that Respondents have not shown that the proposed testimony of Root and Glaser is relevant.[23]

C. Order

Based on the foregoing, I hereby order as follows:

1. The motion as to Lee Woodring, Theodore J. Lenz, Andrew Means is **GRANTED**; Respondents shall, without delay, notify Enforcement about when they anticipate calling Woodring, Lenz, and Means to testify in this proceeding; then, in accordance with that information, Enforcement shall, without delay, issue requests under FINRA Rule 8210 compelling these witnesses' attendance and testimony at the hearing; and

[22] Enforcement also argues, as it did with respect to Woodring, Lenz, and Mean, that my earlier denial of Respondents' FINRA Rule 9252 request precludes my granting the instant motion as to Root and Glaser. This argument fails, however, for the reasons explained in n.19, above.

[23] Respondents assert that compelling the appearance and testimony of Root and Glaser is not unreasonable, oppressive, excessive in scope, or unduly burdensome. And Enforcement did not contest this assertion. But because I find that Respondents have not established a required element under FINRA Rule 9252, I need not reach these issues.

2. The motion as to Chandler Root and Richard Glaser is **DENIED.**

SO ORDERED.

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David R. Sonnenberg
Hearing Officer

Date: December 28, 2016