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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. Respondents.	Disciplinary Proceeding No. CAF970011 Hearing Officer—AHP

ORDER DENYING MOTION FOR RECUSAL OF HEARING OFFICER

On January 20, 1998, all of the Respondents except _____ filed a Motion for Disqualification of _____, Esq. and Disqualification of the Hearing Panel.[1] The motion also asked that I recuse myself from participating further in this proceeding. The identical motion was filed again on January 21 by all of the Respondents. Accordingly, the motion will be treated as having been filed by all of the Respondents, and they will be referred to collectively in this Order as the Respondents.

For the reasons set forth below, the Respondents' motion that I recuse myself from participating in this proceeding is denied.[3]

[1] Although the motion is directed at the entire hearing panel, only the Hearing Officer was appointed at the time the Respondents filed the motion.

[3] The remainder of Respondents' motion to disqualify the other panel members, to remove certain references and documents from the record, and to disqualify _____, attorney for the Department of Enforcement, will be addressed in a separate order.

Respondents' Allegations

The Respondents rest their motion on the ground that the Department of Enforcement's "misconduct has tainted these proceedings and biased the Panel."[4] In support, the Respondents complain that _____, the Department of Enforcement's lead counsel, acted improperly by: (1) filing the Complaint on December 23; (2) filing the Department of Enforcement's opposition to the Respondents' motion for an extension of time to answer on January 8, without reference to the Department of Enforcement's intention to amend the Complaint; and (3) referring to settlement discussions and the Respondents' decision not to make a Wells submission before the Complaint was filed.[5] The Respondents argue that _____ took each of these actions to gain unfair advantage and unfairly prejudice the members of the hearing panel.[6] The Respondents do not explain how they were prejudiced by these actions.

Legal Standard

The general standard for disqualification or recusal that applies in NASD Regulation disciplinary proceedings is found in Rule 9160. Rule 9160 provides "[n]o person shall participate as an Adjudicator in a matter governed by the Code as to which he or she has a conflict of interest or bias, or circumstances otherwise exist where his or her fairness might reasonably be questioned." Likewise, Rule 9233(b) applies this standard to motions to disqualify a Hearing Officer. The standard provided in Rules 9160 and 9233 borrows heavily from the conflict of

[4] Motion for Disqualification of _____, Esq. and Disqualification of the Hearing Panel at 1.

[5] Id. at 4.

[6] Id.

interest standard applicable to federal judges found in Section 455(a) of Title 28 of the United States Code.[7]

Section 455(a) of the United States Code provides: "[a]ny justice, judge, or magistrate of the United States shall disqualify himself in any proceeding *in which his impartiality might reasonably be questioned*"(emphasis added).[8] NASD Regulation relies on judicial decisions interpreting the statutory standard applicable to federal judges when interpreting Rules 9160 and 9233(b).[9] More specifically, when proposing the recusal and disqualification provisions set forth in Rules 9160, 9233, 9234, and 9332, the NASD specifically noted:

> [Rule 9233(b) will] be interpreted in a manner that accords with the operation of a self-regulatory disciplinary system in which members of the industry are intended to serve as Adjudicators. The judicial interpretation of 28 U.S.C. 455(a) provides a basis for such an interpretation because the judicial interpretation relies upon additional objective factors used to determine a disputed claim of bias**.** *The Association intends to rely on such judicial interpretation of the clause "in which his impartiality might reasonably be questioned," in 28 U.S.C. 455(a), in interpreting the proposed clause, "if circumstances otherwise exist where ... [the Adjudicator's] fairness might reasonably be questioned."*[10]

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[7] See Exchange Act Release No. 38545, 64 S.E.C. Docket 862, 909 (April 24, 1997).

[8] Courts have interpreted the language of Section 455(a) to require parties to demonstrate a factual basis to support a claim of disqualification. United States v. Lovalgia, 954 F.2d 811, 815 (2d. Cir. 1992); United States v. Walker, 920 F.2d 513 (8th Cir. 1990); Parker v. Connors Steel Co., 855 F.2d 1510, 1524 (11th Cir.), reh'g denied, 864 F. 2d 795 (11th Cir.), cert. denied, 490 U.S. 1066 (1988); Pepsico v. McMillen, 764 F.2d 458 (7th Cir. 1985).

[9] See Exchange Act Release No. 38545, 64 S.E.C. Docket at 909. The NASD's proposed rule change, as amended, was approved by the Securities Exchange Commission on August 7, 1997. See Exchange Act Release No. 38908, 65 S.E.C. Docket 237 (August 7, 1997). The NASD also looks to Section 556(b) of the Administrative Procedure Act for guidance. 62 Fed. Reg. at 25,226, 25,255 (1997) (quoting 5 U.S.C. § 556(b)). Like Rule 9233(b), Section 556(b) requires a party to have a "good faith" belief when filing a motion to disqualify an adjudicator. 5 U.S.C. § 556(b).

[10] See Exchange Act Release No. 38545, 64 S.E.C. Docket at 909 (emphasis added).

Although the NASD uses the word "fairness" in Rules 9160 and 9233(b), rather than the word "impartiality" used in Section 455(a), the NASD emphasized in its rule filing with the SEC that *"[t]he notions of impartiality and fairness are inextricably linked in an analysis of whether an Adjudicator fairly judges a proceeding"* (emphasis added).[11]

Courts have interpreted Section 455(a) to require parties to establish a factual basis that demonstrates a judge's inability to act in a fair and impartial manner before ordering disqualification. In Pepsico v. McMillen, the Seventh Circuit interpreted Section 455(a) to require recusal whenever there exists "'*a reasonable basis*' for finding an 'appearance of partiality under the facts and circumstances' of the case" (emphasis added).[12] The Court found that the *test for partiality* is whether "… *an objective, disinterested observer fully informed of the facts* underlying the grounds on which recusal was sought would entertain a significant doubt that justice would be done in the case" (emphasis added).[13] Several other circuits have adopted similar interpretive language when construing this statutory standard.[14]

In addition, courts have held that there is a substantial burden on the moving party to show that a judge is not impartial.[15] "A judge should not recuse himself on unsupported,

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[11] Id.

[12] Pepsico, 764 F.2d at 460 (citing SCA Securities, Inc. v. Morgan, 557 F. 2d 110, 116 (7th Cir. 1977)).

[13] Id. at 460.

[14] See, e.g., Lovalgia, 954 F.2d at 815 ("Would a reasonable person, knowing all the facts, conclude that the trial judge's impartiality could reasonably be questioned?"); Walker, 920 F.2d at 517 (Would a "reasonable, uninvolved observer question the judge's impartiality … [and] [whether] an objective, disinterested observer fully informed of the facts underlying the ground on which recusal is sought would entertain significant doubt that justice would be done."); Parker, 855 F.2d at 1524 ("Whether an objective, disinterested, lay observer fully informed of the facts underlying the grounds on which recusal was sought would entertain a significant doubt about the judge's impartiality.").

[15] United States v. International Business Machines Corp., 475 F.Supp. 1372, 1379 (S.D.N.Y. 1979), aff'd, 618 F.2d 923 (2d Cir. 1980).

irrational, or highly tenuous speculation."[16] And a judge need not accept as fact mere conclusory speculation that lacks any factual support.[17] "Section 455(a) was not meant to require disqualification every time one party can make some argument, no matter how unreasonable, that the appearance of prejudice could result."[18] Otherwise, such challenges would be used improperly to select judges of a party's choosing rather than to disqualify biased judges.

These cases illustrate a consistent approach to interpreting Section 455(a) requiring parties to detail specific facts to support a motion for disqualification or recusal. [19] The provisions in Rules 9160 and 9233(b) for the disqualification or recusal of a Hearing Officer are substantially similar to the standard set forth in Section 455(a). They require that the moving party show that there is a "… reasonable, good faith belief that a conflict of interest or bias exists or circumstances otherwise exist where the Hearing Officer's fairness might reasonably be questioned."

Discussion

The Respondents do not explain how _____ conduct gives rise to a reasonable, good-faith belief that I am biased. Nonetheless, I have given them the benefit of the only possible argument that they can base on the allegations in the motion: that I will not be able to remain

[16] Hinman v. Rogers, 831 F.2d 937, 939 (10th Cir. 1987).

[17] United States v. Greenough, 782 F.2d 1556, 1558 (11th Cir. 1986).

[18] Lamborn v. Dittmer, 726 F.Supp. 510, 516 (S.D.N.Y. 1989).

[19] See, e.g., Rita H. Malm, 58 S.E.C. Docket 131, (Nov. 23, 1994), 1994 WL 665963, at *8 (conclusory allegation that a panelist's prior working relationship with respondent is insufficient to establish bias); Robert E. Gibbs, 54 S.E.C. Docket 504 (June 3, 1993), 1993 WL 190913, at *2 (fact that DBCC panelist testified against respondent's employer in an unrelated matter was insufficient to establish claim of bias); Arthur J. Lewis, 49 S.E.C. Docket 1487, 1489 (October 8, 1991), 1991 WL 294317, at *3 (respondent failed to produce evidence demonstrating that panel member had any improper bias or interest that would affect ability to render impartial decision).

impartial after learning that Respondents' counsel discussed the possibility of settlement with counsel for the Department of Enforcement and declined to submit a "Wells-type letter" before the Complaint was filed.[20] But this argument is not supported by law. Both the National Business Conduct Committee of the NASD and the SEC have held that introduction of evidence of settlement discussions does not render a panelist unable to reach a fair decision.[21] These rulings are consistent with the general rule under Section 455(a) that a requirement for recusal rarely can be based upon facts introduced or events occurring in the course of the current proceeding.[22]

The Respondents' reliance on Code of Procedure Rule 9216(a)(4) and Fed. R. Evid. 408 is frivolous. Code of Procedure Rule 9216(a)(4) provides that if a Letter of Acceptance, Waiver, and Consent (AWC) is rejected, the respondent will not be prejudiced by the AWC, and it may not be introduced into evidence "in connection with the determination of the issues set forth in any complaint or in any other proceeding." Contrary to Respondents' argument, Rule 9216(a)(4) does not prohibit all references to the existence of an AWC or the negotiations that led to its submission: the Rule merely limits the use of the AWC. Here, the Department of Enforcement referred to the earlier settlement discussions to rebut the Respondents' argument that they needed more time to review the Complaint before answering, not to prove the charges in the Complaint. Accordingly, Code of Procedure Rule 9216(a)(4) does not bar reference to the Parties' settlement talks.

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[20] _____ Decl. attached as Ex. 1 to Complainant's Resp. to Respondents' First Req. for Extension of Time to Answer ¶ 3.

[21] Keith L. DeSanto, 59 S.E.C. Docket 1429, 1995 S.E.C. LEXIS 1500, at *15-16 (June 19, 1995); District Business Conduct Committee for District 10 v. Rimson & Co., Complaint Nos. C10940071 and C10950014, 1996 NASD Discip. LEXIS 26, at *33 (NBCC January 29, 1996).

Furthermore, the Respondents overlook the significant distinction between the nature of reference to settlement discussions and an AWC. In this proceeding, the Department of Enforcement stated that Respondents' counsel represented all of the Respondents "[w]hen the possibility of settlement was discussed prior to the filing of this disciplinary proceeding …"[23] Not only did the Department of Enforcement not reveal substantive information about the Parties' settlement positions, but the Department of Enforcement did not say that settlement talks had been held—only that the "possibility of settlement" was discussed. Unlike an AWC, in which the submitting party must accept a finding of violation and consent to the imposition of sanctions, there is nothing in the Department of Enforcement's submission that possibly could be viewed as prejudicial. The Department of Enforcement referred to the fact that the Respondents' present counsel dealt with the issue of settlement before the Complaint was filed only to counter the Respondents' argument that they needed more time to review possible conflicts of interest among the Respondents before they filed their answers. Reference to the fact that the Respondents' present counsel represented all of the Respondents during the investigation is appropriate to support the argument that Respondents' counsel did not need as much time as they requested. Moreover, since the reference to the Parties settlement talks contains no admission or concession, there is nothing adverse to the Respondents that supports their claim of unfair prejudice.

Fed. R. Evid. 408 also does not lend support to Respondents' argument. Like Code of Procedure Rule 9216(a)(4), Fed. R. Evid. 408 is not a blanket prohibition against the introduction

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[22] Liteky v. United States, 510 U.S. 540, 555 (1994) (opinions of judge must "reveal such a high degree of favoritism or antagonism as to make fair judgment impossible").
[23] _____ Decl., supra, ¶ 3.

of evidence of settlement discussions. Courts have held consistently that evidence of settlement discussions and offers of settlement may be introduced into evidence for many purposes other than to prove "liability for or invalidity of a claim."[24] Indeed, Fed. R. Evid. 408 states that it does not require exclusion of evidence of settlement discussions when it is offered to negate a contention of undue delay. This exception is analogous to the present case in which the reference to settlement discussions was offered to negate the contention that delay was needed. Thus, by its terms, Fed. R. Evid. 408 would not require the exclusion of the Department of Enforcement's reference to the Parties' settlement discussions.

Equally without basis is the Respondents' argument that a finding of bias can be founded on the disclosure that the Respondents declined to make a Wells submission. The Respondents are under no obligation to make such a submission, and, knowing this, no reasonable person would conclude that a hearing officer would become biased upon learning of the Respondents' decision. Such a decision is properly viewed as a matter of strategy, not a litmus test of the relative merits of the parties' positions.

For the foregoing reasons, I find that the Respondents' motion fails to meet the requirements of Code of Procedure Rule 9160. None of the alleged facts, and no combination thereof, presented by the Respondents provide any basis for recusal under Code of Procedure Rule 9160. Specifically, the Respondents failed to demonstrate a "reasonable basis" for finding that I developed an improper bias due to the material in _____ declaration. Accordingly, the Respondents' motion that I recuse myself is denied.

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[24] Fed. R. Evid. 408. See also, 23 Charles A. Wright, Arthur R. Miller & Mary K. Kane, Federal Practice And Procedure Evid. R 408 (Interim. Ed. 1997).

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IT IS SO ORDERED.

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Andrew H. Perkins
Hearing Officer

Dated: Washington, DC
January 29, 1998