

Background

On July 17, 2000, pursuant to Code of Procedure Rule 9251(a)(2), Enforcement filed a Notice Of Request For Information Pursuant To Rule 8210 (“Notice”).² The Notice states that on July 13, 2000, Enforcement issued requests for information to the Respondents to “provide information and appear for an on-the-record interview” on July 21, 2000 (the “Rule 8210 Requests”).

By separate letters filed July 19, 2000, counsel for the Respondents objected to the Rule 8210 Requests (“Objections”). Respondent _____ asked the Hearing Officer to enter an order quashing the Rule 8210 Requests, and Respondent ____ asked the Hearing Officer to enter a protective order preventing Enforcement from taking his testimony at this stage of the proceeding. As grounds for their Objections, the Respondents state that the Code of Procedure does not contemplate the taking of additional testimony from a respondent once a Complaint is filed. Each asserts that the use of Rule 8210 in this context is an abuse of discovery and should not be permitted. They further contend that Code of Procedure Rule 9251 is intended to facilitate Enforcement’s obtaining documents from persons or entities other than respondents to a complaint.

On July 20, 2000, an order was issued postponing the on-the-record interviews scheduled for July 21, 2000, setting a deadline for Enforcement to file a response to the Objections, and setting the case for argument on this issue on July 31, 2000.³

On July 24, 2000, Enforcement filed a response to Respondents’ Objections. Enforcement contends that it has the unfettered right to issue post-complaint requests for information “with respect to

² Pursuant to Code of Procedure Rule 9251(a)(2) Enforcement is required to notify the Hearing Officer and each other Party “if, after the issuance of a complaint, requests for information under Rule 8210 are issued under the same investigative file number under which the investigation leading to the institution of the disciplinary proceeding was conducted.”

³ This order was issued by the Deputy Chief Hearing Officer in the absence of the Hearing Officer assigned to this proceeding, pursuant to Code of Procedure Rule 9235(b).

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

any matter involved in a proceeding.”⁴ Enforcement also contends that nothing in the Code of Procedure restricts that right “so long as the Hearing Officer is generally notified and certain information determined from those requests is tendered to the defense.”⁵

On July 31, 2000, the Hearing Officer heard oral argument on the Respondents’ Objections. Counsel for the Respondents urged the Hearing Officer to restrict Enforcement’s attempt to conduct discovery at this time because the Code of Procedure does not permit Rule 8210 to be used in this manner and that to allow Enforcement to proceed would prejudice the Respondents by diverting their time and resources from preparing for the hearing. Enforcement responded by arguing that ferreting out the basis for Respondent ____’s Sixth Affirmative Defense before the hearing would aid the Hearing Panelists and expedite the hearing. With respect to the Respondents’ argument that they would be unfairly burdened by being forced to submit to questioning less than six weeks before the hearing, Enforcement represents that the on-the-record interviews would take no more than a half day.

Discussion

The Respondents' position that Rule 8210 cannot be used to obtain information from respondents in a pending disciplinary proceeding is without merit. Nothing in the language of Rule 8210 or the Code of Procedure limits the use of Rule 8210 requests to persons or entities other than respondents in a pending disciplinary hearing. The Rule provides that the Association shall have the right to require a member, a person associated with a member, or a person subject to the Association's jurisdiction to provide information "with respect to any matter involved in the investigation, complaint, examination or proceeding." (Emphasis added.) The language of the Rule does not differentiate between

⁴ Department of Enforcement’s Opp’n To Resp’t ____’s And _____’s Mot. To Quash The Department’s Rule 8210 Requests For Information Regarding ____’s Sixth Affirmative Defense (“Reliance On Counsel”) (hereinafter “Enforcement’s Opp’n”) at 5.

⁵ Id.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

respondents in a pending disciplinary proceeding and other parties or between pre-complaint and post-complaint requests for information. Rule 8210's scope is not limited to document requests, as the Respondents suggest. However, the specific application of the Rule to require that respondents appear and testify regarding their defenses to a pending Complaint is a novel issue. None of the Parties has pointed to a prior case permitting Enforcement to use Rule 8210 for this purpose, but the commentary surrounding the approval of the current rule clearly supports the conclusion that Rule 8210 may be used by Enforcement during course of a proceeding to gather additional information and documents.

Many of the same issues the Respondents raise were specifically addressed in 1997 when the National Association of Securities Dealers, Inc. ("NASD" or "Association") proposed the current Code of Procedure. In response to the NASD's notice of proposed rule change,⁶ the American Bar Association Ad Hoc Task Force on the NASD's Proposed Rules Relating to Investigations and Disciplinary Proceedings ("Ad Hoc Task Force") filed a comment letter with the Securities and Exchange Commission ("SEC").⁷ The Ad Hoc Task Force advocated that the NASD amend Rule 8210 to change the existing practice of allowing the NASD to obtain information and documents from a member or person associated with a member at any time. The letter pointed out that Rule 8210 "does not differentiate between NASD's right to obtain information and documents prior to a complaint being filed" and questioned "the propriety in making such demands once a proceeding is initiated."⁸ Further,

⁶ Notice of Filing of a Proposed Rule Change by the National Association of Securities Dealers, Inc. to Proposed Changes in the By-laws of the NASD, NASD Regulation, Inc., The Nasdaq Stock Market, Inc., the Plan of Allocation and Delegation of Functions by the NASD to Subsidiaries, Membership Application Procedures, Disciplinary Proceedings, Other Proceedings, and Other Conforming Changes (Release No. 34-38545; File No. SR-NASD-97-28), 62 Fed. Reg. 25226 (May 8, 1997).

⁷ Letter from George S. Frazza, Chair, Section of Business Law and Barry F. McNeil, Chair, Section of Litigation, American Bar Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 17, 1997 ("ABA Letter").

⁸ ABA Letter at 8.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

the ABA Letter recognized that the Rule “does not distinguish between respondents and non-parties.”⁹

The ABA Letter contended that “such broad and unfettered right to obtain information and documents and compel testimony once a proceeding is commenced without review by the Hearing Panel (or, at a minimum, a Hearing Officer) deprives respondents of their right to fundamental fairness and creates an advantage in favor of the staff of the Department of Enforcement.”¹⁰

In its response filed with the SEC, the NASD noted that changing the current practice would impede its investigatory and enforcement functions.¹¹ The Association stated that because of the obligations imposed on the Department of Enforcement under Code of Procedure Rule 9251(b) to turn over additional documents obtained pursuant to a Rule 8210 request to respondents, and because of Rule 9235,¹² which gives Hearing Officers broad authority regarding the conduct of disciplinary proceedings, and Rule 9146(k), which gives Hearing Officers authority to issue protective orders in the course of a disciplinary hearing, “it is [n]either necessary or appropriate to limit the investigatory and enforcement functions of the [NASD] during the pendency of a disciplinary proceeding in the manner suggested by the Ad Hoc Task Force.”¹³ While not specifically addressing the possible use of Rule 8210 to take the oral testimony of a respondent during the course of a disciplinary proceeding, the SEC

⁹ Id.

¹⁰ Id.

¹¹ Letter of July 11, 1997, from Alden S. Adkins to Katherine A. England, Assistant Director, Division of Market Regulation, Securities and Exchange Commission (“Response Letter”) at 6.

¹² Rule 9235(a) states in part: “The Hearing Officer shall . . . have authority to do all things necessary and appropriate to discharge his or her duties.”

¹³ Id.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

approved Rule 8210 as proposed by the Association, without the proposed amendments suggested by the ABA Ad Hoc Task Force.¹⁴

The foregoing makes clear that in drafting the revised Code of Procedure, the NASD did not intend to limit the use of Rule 8210 to pre-complaint investigations or to document requests. Rule 8210 is an essential tool to both NASD's investigative and enforcement functions. Thus, the Respondents' objections to Enforcement's use of Rule 8210 to obtain their oral testimony are denied.

Nevertheless, the broader concerns raised by the Respondents are legitimate. As the Association implicitly recognized in its Response Letter, once a disciplinary proceeding has commenced principles of fairness and efficiency in the conduct of the proceeding dictate that Enforcement's utilization of Rule 8210 be constrained. Contrary to Enforcement's position, its right to use Rule 8210 during the pendency of a proceeding is not unfettered. At its extreme, Enforcement's argument would permit it to interrupt the course of a hearing to conduct further discovery.¹⁵ Such a result would be inconsistent with the Hearing Officer's authority to manage the proceeding. Enforcement must exercise its right to issue post-complaint Rule 8210 requests in a manner consistent with the Hearing Officer's orders regarding scheduling and procedural matters.¹⁶

Furthermore, Hearing Officers are charged with the responsibility of assuring that disciplinary proceedings are conducted in a fundamentally fair manner. This can be assured only if Hearing Officers

¹⁴ Order Approving Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change, Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change, and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 3, 4, and 5 to Proposed Rule Change Regarding Membership Application Procedures, Disciplinary Proceedings, investigations and Sanctions Procedures, and Other Conforming Changes (Release No. 34-38908; File No. SR-NASD-97-28), 62 Fed. Reg. 43385 (Aug. 13, 1997).

¹⁵ Enforcement asserts that Rule 9251(a)(2) contemplates responses to Rule 8210 requests being made *during* the hearing, thereby suggesting little or no limit to discovery. Enforcement's Opp'n at 11.

¹⁶ OHO Order 98-23 (May 6, 1998), <http://www.nasdr.com/pdf-text/98_23oho.txt>.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

have the authority to protect respondents from unduly burdensome use of Rule 8210. On the other hand, in some instances the disciplinary process can benefit from the pre-hearing disclosure of the facts underlying a respondent's affirmative defenses. This is particularly true where the need for such additional discovery arises due to defenses first raised after the complaint is filed, such as is the case here. Ultimately, the Hearing Officer must balance Enforcement's need for the requested information and its value to resolving the issues in dispute in the proceeding on the one hand against the prejudice, if any, that will result to the respondents by allowing Enforcement to obtain testimony and documents from the respondents during the course of the proceeding.

In this case, the information Enforcement seeks is a proper subject of post-complaint discovery. And as Enforcement correctly points out, it could not have inquired about Respondent ____'s affirmative Sixth Affirmative Defense before he filed his Answer because the issue had not been raised earlier. But Enforcement's efforts to take the Respondents' oral testimony come very late in the proceeding. Respondent ____ filed his Answer on March 3, 2000, but Enforcement did not undertake discovery regarding his Sixth Affirmative Defense until June 16, 2000—more than three months later—when Enforcement issued a request to Respondent ____ that he provide evidence supporting the defense. Enforcement has not demonstrated sufficient justification for this delay. As a result, if the Respondents had showed that they would suffer undue prejudice from Enforcement taking their oral testimony at this stage of the proceeding an order prohibiting Enforcement from proceeding would have been appropriate. The Respondents, however, have failed to meet this burden.

The Respondents' claims of prejudice are generalized complaints. In essence they complain that they will be required to divert time and effort from their hearing preparation if Enforcement is allowed to proceed. However, such burden is inherent in all instances where Enforcement seeks additional

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

information from a respondent during the course of the proceeding, and it is insufficient to warrant entry of an order barring Enforcement's use of Rule 8210. To warrant such relief the Respondents must demonstrate undue prejudice that impairs their right to a fair hearing or such disruption to the hearing process that overrides Enforcement's need for the information.

In cases falling short of this standard some lesser relief may yet be appropriate. This is such a case. Given Enforcement's inordinate delay in seeking the information and Enforcement's stated need for the information—to file a motion to strike the affirmative defense—the Hearing Officer imposes the following limits:

- 1) Enforcement shall limit its inquiry to the facts surrounding Respondent ____'s Sixth Affirmative Defense.
- 2) Enforcement shall conclude its examination of the Respondents in one half day, the total amount of time it represented it would need to complete the examination of both Respondents.
- 3) Enforcement shall schedule their examinations to be completed not less than 14 days before the scheduled start of the hearing.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-21 (C3A990071).

The Hearing Officer further orders that Enforcement shall not make any other information requests under Rule 8210 in this proceeding without first obtaining leave to do so from the Hearing Officer.

SO ORDERED.

Andrew H. Perkins
Hearing Officer

Dated: Washington, DC
August 2, 2000