

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

The Department of Enforcement,

Complainant,

vs.

Respondent,

Respondent.

REMAND ORDER

Complaint No. C10000122

Dated: October 21, 2002

**Remand for further proceedings to provide basis for credibility findings
and to make findings on reliability of hearsay evidence.**

Appearances

For the Complainant Department of Enforcement: Enforcement Attorney or Counsel 1, of the Department of Enforcement of NASD.

For the Respondent: Respondent's Attorney or Counsel 2

Opinion

Respondent has appealed under Procedural Rule 9311 the finding of violation (one unauthorized transaction) and sanctions set forth in a 2001 Hearing Panel decision. The Department of Enforcement ("Enforcement") has cross-appealed under Procedural Rule 9311(d) the Hearing Panel's findings that Enforcement failed to prove by a preponderance of the evidence that Respondent effected four of the 10 unauthorized transactions alleged in the complaint.¹

¹ Enforcement originally cross-appealed the Hearing Panel's finding that Enforcement failed to prove by a preponderance of the evidence that Respondent effected nine of the unauthorized transactions alleged in the complaint. Prior to the appeal hearing in this matter, however, Enforcement amended its cross-appeal to include only the four transactions that Respondent claimed the customers had authorized. Neither Respondent nor Enforcement appealed the Hearing Panel's findings that Enforcement failed to prove by a preponderance of the evidence that Respondent had effected the remaining alleged five unauthorized transactions in

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After carefully reviewing the Hearing Panel's decision and the entire record, we remand this matter to the Office of Hearing Officers for further proceedings.

I. Facts and Procedural History

Enforcement filed a complaint in 2000, alleging that Respondent had effected 10 unauthorized transactions in the accounts of eight customers, in violation of NASD Conduct Rule 2110. The Hearing Panel found that Respondent, while associated as a general securities representative with Firm A, effected one unauthorized transaction in the joint account of RR and MR.² The Hearing Panel also found that Enforcement had failed to prove by a preponderance of the evidence that Respondent was responsible for the nine other unauthorized trades alleged in the complaint. The Hearing Panel imposed a 10-business-day suspension, a \$10,000 fine, and costs of \$6,436.00.

Respondent appealed the Hearing Panel's finding that he had effected one unauthorized purchase in the account of RR and MR, arguing that this finding was not supported by a preponderance of the credible evidence. Respondent also appealed the sanctions, claiming that they were excessive. Additionally, Respondent argues on appeal that his due process rights were violated because a Hearing Officer who had not participated in the proceedings below had written and signed the Hearing Panel decision without having observed the demeanor of Respondent and customer RR. Respondent asserts that the Hearing Panel's decision therefore should be vacated.

Enforcement cross-appealed the Hearing Panel's findings and conclusions that Enforcement had failed to prove by a preponderance of the evidence that Respondent was responsible for effecting four unauthorized purchases in the accounts of customers JJ, ER and JR, and MHS and DS. Enforcement argues that the Hearing Panel, in finding that Enforcement had not met its evidentiary burden, erroneously failed to consider the customer complaint letters and declarations in which the customers claimed that they had not authorized the transactions at issue. In addition, Enforcement argued that the NAC should increase the sanctions against Respondent significantly if, on appeal, it decided to reverse the findings and conclusions of the Hearing Panel that Enforcement had failed to prove by a preponderance of the evidence that Respondent had effected the four unauthorized transactions.

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the accounts of four customers. Respondent had argued that his supervisors had instructed him to fill out the order tickets for these trades.

² Enforcement commenced an investigation of Respondent's activities after receiving customer complaints alleging that he was responsible for the unauthorized transactions that occurred in their accounts while he was associated with Firm A.

II. The Hearing Panel Decision

The Hearing Panel reached distinctly different conclusions in its decision about Respondent's credibility based on whether or not the customers testified at the hearing below. With respect to the Hearing Panel's finding that Respondent effected an unauthorized transaction in the account of RR and MR, the Hearing Panel stated in its decision that it determined to credit the testimony of RR over that of Respondent after having "observed the demeanor of both RR and [Respondent]." The Hearing Panel did not credit Respondent's claim that RR had authorized the purchase at issue and had called Respondent, after having received the confirmation, merely to inquire about how much RR owed for the purchase. The Hearing Panel concluded that, "[a]s an experienced investor, RR was familiar with the process of paying for purchases based on the amounts stated in the confirmations he received" and that it was "more probable that, as RR testified, he called [Respondent] to complain that the transaction was unauthorized."

As to the transactions in the accounts of customers JJ, ER and JR, and MHS and DS, the Hearing Panel implicitly credited Respondent's testimony over the statements in the customers' documents, and found that Enforcement had not proven the allegations by a preponderance of the evidence. Although the customers chose not to participate in the hearing, they provided Enforcement with unsworn, signed declarations that were prepared by the Enforcement staff examiner who interviewed them, in which they represented that the trades at issue were unauthorized and that Respondent was their account representative. The record also includes timely complaint letters to Firm A from the customers in which they stated that they had not authorized the trades in question.

The Hearing Panel made the following specific findings with respect to the allegations of unauthorized trading in the accounts of JJ, ER and JR, and MHS and DS. As to the alleged unauthorized purchase and sale in customer JJ's account, the Hearing Panel concluded that because JJ did not testify, "his five-year old uncorroborated and untested written statements were the only evidence supporting Enforcement's allegations." The Hearing Panel then determined that because it had heard and observed Respondent, it was "critically important that it have an opportunity to observe JJ as a witness, and that [Respondent] and the Panel have an opportunity to question him."

Turning to the alleged unauthorized purchase in ER and JR's account, the Hearing Panel found that because Respondent testified that ER and JR had authorized the trade at issue and because the customers had not testified, the customers' written statements were insufficient to "prove by a preponderance of the credible evidence that [Respondent] [had] effected the trade in question without authorization." The Hearing Panel concluded that "in light of [Respondent's] in-person testimony denying that the trade was unauthorized and the absence of any evidence corroborating the customers' brief statements, it was essential for the Hearing Panel to have an opportunity to observe the customers and for the parties and the Panel to have an opportunity to question them."

Finally, as to the alleged unauthorized purchase in MHS and DS' account, the Hearing Panel found that, based on "[Respondent's] in-person testimony and the absence of any evidence

to corroborate the customers' statements," Enforcement had "failed to prove by a preponderance of the evidence that [Respondent] effected the trade without authorization."

III. Discussion

We are unable to apply an appellate standard of review to the Hearing Panel's findings that Respondent did not effect unauthorized transactions in the accounts of customers JJ, ER and JR, and MHS and DS. We remand this case to the Hearing Panel because the decision below: (1) failed to explain adequately and to provide support for the Panel's differing credibility determinations regarding Respondent's testimony; and (2) failed to take into account the hearsay evidence from customers that appears to contradict the Panel's implicit determination to credit Respondent's testimony. See Warren R. Schreiber, 53 S.E.C. 912 (1998) (finding that no deference could be given to the initial fact-finder's general credibility findings because the decision did not reflect whether the fact-finder, in making those findings, considered a substantial amount of record evidence that appeared to contradict them).

It is well established that hearsay may be admitted as evidence in administrative proceedings and, in appropriate circumstances, may constitute the sole basis for findings of fact. Otto v. SEC, 253 F.3d 960, 966 (7th Cir. 2001), cert. denied, 122 S. Ct. 548, 2001 U.S. LEXIS 10378 (2001). The factors used to assess the reliability of hearsay evidence include: possible bias of the declarant; whether direct testimony is contradictory; the type of hearsay at issue; whether the declarant was available to testify; and whether the hearsay is corroborated. Id. The Securities and Exchange Commission ("Commission") consistently has found hearsay evidence such as customer letters and declarations to be reliable and probative. See Charles D. Tom, 50 S.E.C. 1142 (1992).

In this case, although the customers' declarations and complaint letters are not sworn, we note that they are signed, and that they satisfy a number of the factors used to assess the probative value and reliability of hearsay evidence. See Otto, supra, at *6 (finding customer's unsworn written statements to be probative because they were written, signed, and confirmed and corroborated by respondent's own testimony and documents). The documents submitted by all three account holders -- JJ, ER and JR, and MHS and DS -- describe similar unauthorized transactions that were effected in the customers' accounts during the period in which Respondent was functioning as their account executive.³ In addition, the allegations of unauthorized trading described in the customers' documents were similar to the unauthorized trading that RR described in his telephone testimony,⁴ including the fact that all of the trades in question

³ See Allen Mansfield, 46 S.E.C. 356 (1976) (finding hearsay evidence reliable that consisted of complaint letters from several of respondent's customers that alleged respondent repeatedly engaged in unauthorized transactions).

⁴ We note that the Commission has repeatedly upheld reliance on telephone testimony. See, e.g., Daniel Joseph Alderman, 52 S.E.C. 366 (1995), aff'd, 104 F.3d 285 (9th Cir. 1997) (table format).

occurred in the same one-month period.⁵ Further, the customers' declarations are consistent with the complaint letters they sent to Firm A shortly after becoming aware of the unauthorized trades in their accounts.⁶ Also, there is no evidence that the customers knew each other or were biased against Respondent.

Additionally, as to a customer's unavailability at hearing, the Commission has stated that because "NASD lacks subpoena power, it [cannot] compel a customer's attendance." Harry Glikzman, Exchange Act Rel. No. 42255, 1999 SEC LEXIS 2685, *15 (Dec. 20, 1999), aff'd, 2001 U.S. App. LEXIS 25479 (9th Cir. Nov. 26, 2001). With respect to the fact that customers JJ, ER and JR, and MHS and DS did not testify, the NASD staff examiner who investigated this matter represented at the hearing that Enforcement staff had tried repeatedly to contact those customers to request that they make themselves available for the hearing, but they chose not to respond.

Because the Hearing Panel failed in its decision to assess expressly the reliability and probative value of the statements in the customer documents, its implicit determination to credit Respondent's testimonial denials of misconduct in the accounts of JJ, ER and JR, and MHS and DS appears not to follow the applicable case law. The Hearing Panel also did not adequately explain its apparently inconsistent determinations not to credit Respondent's testimony with respect to customer RR but to credit his substantially similar testimony with respect to customers JJ, ER and JR, and MHS and DS.

We therefore remand this matter to the Office of Hearing Officers for further proceedings to address the issues that we have identified here. On remand, the Hearing Panel should make complete findings and impose sanctions, if applicable, and explicitly discuss: (1) its general impression of Respondent's demeanor and candor; (2) any specific examples in which it found Respondent not to be credible and the relationship of those credibility findings to the credibility determinations that it makes regarding other aspects of Respondent's testimony; and (3) its findings with respect to the reliability of the hearsay evidence, including a complete analysis of the factors that are used to assess the reliability of such evidence. In ordering this remand, we express no view on either the Hearing Panel's ultimate credibility determinations or the outcome of this proceeding.

⁵ See Carlton Wade Fleming, Jr., 52 S.E.C 409, 412 (1995) (finding sworn affidavit reliable because it was corroborated by a contemporaneous letter and because the "affiant's recounted experience [was] similar to that of the three customers who testified").

⁶ Id.; see Charles D. Tom, supra, at 1145 (treating unsworn declaration as equivalent of sworn affidavit because it was made under the penalty of perjury, and finding such evidence reliable and probative because it was consistent with customer's complaint letter to the firm).

IV. Procedural Issues on Appeal

We first address Respondent's argument that this matter should be remanded on the basis that his due process rights were violated because of the participation of a replacement Hearing Officer in the proceedings below.

Although we reject Respondent's due process claim,⁷ we have determined that, in addition to the grounds for remand that we described above, this matter must be remanded consistent with our decision in Department of Enforcement v. U.S. Rica Financial, Inc., Complaint No. C01000003 (NAC Oct. 26, 2001). In U.S. Rica, we remanded the matter to the Office of Hearing Officers based on our finding that, under the Code of Procedure at the time, the replacement Hearing Officer had to participate in the decision. Here, the replacement Hearing Officer also did not participate in the decision except to edit the draft decision that the original Hearing Officer had prepared prior to leaving the Office of Hearing Officers by incorporating comments from the panelists.⁸ Accordingly, we order that this matter be remanded to the Office of Hearing Officers to permit the replacement Hearing Officer to discharge his duties on remand consistent with Procedural Rule 9231(e).⁹

We next address the procedural issues raised at the oral argument before the NAC Subcommittee. At the appeal hearing, Respondent's attorney provided the Enforcement attorney with a copy of Respondent's reply brief, and then requested that the Subcommittee admit the brief into the record. After hearing the parties' arguments, the Subcommittee determined not to admit Respondent's untimely reply brief into the record. Procedural Rule 9347(b) requires briefs to be filed on the dates established in the briefing order. We find that Respondent's counsel did not articulate a sufficient reason for not having filed the brief by the deadline, thus we affirm the Subcommittee's decision not to admit the brief into the record.

⁷ The federal and state cases on which Respondent relies to argue that his due process rights were violated are inapplicable. Federal constitutional standards apply only to "state actors," and numerous courts have held that NASD is not a state actor. See D.L. Cromwell Inv., Inc. v. NASD Regulation, Inc., 279 F.3d 155 (2d Cir. 2002), pet. for cert. filed, 71 U.S.L.W. (U.S. Aug. 6, 2002) (No. 02-202); Desiderio v. NASD, 191 F.3d 198, 206 (2d Cir. 1999), cert. denied, 531 U.S. 1069 (2001); United States v. Shvarts, 90 F. Supp. 2d 219, 222 (E.D.N.Y. 2000). In addition, Respondent has failed to show that the State Judiciary Law applicable to trial judges that he cites in his brief governs proceedings other than those held in that State's state courts.

⁸ We note that the Hearing Panel in this case issued its decision shortly before we issued our decision in U.S. Rica. The Hearing Panel below therefore did not have the opportunity to follow our decision in U.S. Rica.

⁹ We recommend that the Chief Hearing Officer reappoint the replacement Hearing Officer pursuant to new Procedural Rule 9231(e), to ensure that the replacement Hearing Officer has all the available authority under the new rule.

Respondent's attorney also made motions to adjourn the appeal hearing and to have the attorney-adviser to the Subcommittee removed from the case. Respondent's attorney claimed that he had been unsuccessful in his attempt to obtain a copy of the record from the Office of General Counsel and he argued that therefore he should not have to proceed with his oral argument because he did not have adequate knowledge of the facts of the case. Respondent's attorney further argued that the attorney-adviser to the Subcommittee should be removed from the case because she would be unable to give the Subcommittee unbiased advice because Respondent's attorney had corresponded with her about his difficulty in obtaining a copy of the record from Respondent's former attorney and his claimed difficulty in obtaining a copy of the record from the Office of General Counsel. Despite these claims, Respondent's attorney decided to proceed with his oral argument. The Subcommittee advised the parties on the record that it would rule on the merits of the motion at a later date.

After a thorough review of the record, the Subcommittee issued its ruling denying the motions. The Subcommittee noted that in a letter addressed to the attorney-adviser in this matter and sent more than four months before the oral argument, Respondent's attorney stated that he had "obtained telephone numbers from [the Senior Legal Assistant with the Office of General Counsel] . . . to arrange for the copying of the files from the NASD . . . to enable [him] to finalize [his] appellate papers." Thus, Respondent's attorney had ample opportunity to obtain a copy of the record in this matter. Based on our review of the record, we find no support for Respondent's attorney's procedural arguments and therefore affirm the Subcommittee's decision to deny his motions.

V. Conclusion

We order that this proceeding be remanded to the Office of Hearing Officers for further proceedings in accordance with this opinion and we further order that the sanctions imposed by the Hearing Panel against the Respondent in this proceeding be vacated.¹⁰

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

¹⁰ We also have considered and reject without discussion all other arguments advanced by Respondent and Enforcement.