

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C3A990071
v.	:	
	:	Hearing Officer—Andrew H. Perkins
Respondents.	:	
	:	

**ORDER GRANTING RESPONDENTS MOTION IN LIMINE REQUESTING
PRODUCTION OF DOCUMENTS**

On August 14, 2000, Respondents _____, _____, and _____ filed a motion requesting that the Department of Enforcement be ordered to produce copies of all post-complaint communications between the Department and _____ customers concerning _____ stock. The Department opposed the motion on the grounds that the documents do not fall within the categories of documents the Department is required to produce under Code of Procedure Rule 9251, and the moving Respondents had not made a sufficient showing to require their production as exculpatory material under the doctrine enunciated by the Supreme Court in Brady v. Maryland.¹ For the reasons set forth below, the Respondents' motion is granted.

¹ 373 U.S. 83 (1963) (“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.”).

Discussion

A. Principles Governing Discovery in NASD Disciplinary Proceedings.

In 1997 the NASD adopted the current Code of Procedure, which built on the recommendations of The NASD Select Committee on Structure and Governance² and expanded the discovery rights of respondents in NASD disciplinary proceedings. The Select Committee recommended that the Code of Procedure be amended to grant respondents documentary discovery rights to all non-privileged materials in the NASD's possession (including exculpatory evidence) directly relevant to the dispute, sufficiently far enough in advance of the hearing to permit the respondent to prepare its defense.³ The Select Committee based its recommendation on considerations of fairness and efficiency.⁴ But it also recognized that the NASD should not be burdened by prolonged "fishing expeditions."⁵ The Select Committee therefore recommended a balanced approach.

In response to and consistent with the Select Committee's recommendation, Rules 9251 through 9253 provide for the discovery of non-privileged documents by respondents in a disciplinary proceeding. In the Notice of Proposed Rule Change filed by the NASD for the current Code of Procedure,⁶ the NASD explained that Rules 9251 through 9253 were substantially the same as the SEC Rules of Practice and that they afforded respondents an automatic right to document discovery from the Department of Enforcement. For documents obtained by the NASD before a Complaint is

² *Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors*, September 15, 1995 (on file with the NASD) (hereinafter "Select Committee Report").

³ *Id.*, Part 3, Section II(B)(3), at R-24.

⁴ *Id.*, Part 2, Chapter 5, Section II(C)(4)(b), at V-11.

⁵ *Id.*, Part 3, Section II(B)(3), at R-24.

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).

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

filed, the Department's obligation under Rule 9251(a)(1) is not limited by relevance or materiality.

Unless otherwise provided by Rule 9251, or by order of the Hearing Officer, the Department must make available for inspection and copying all documents prepared or obtained by NASD staff "in connection with the investigation that led to the institution of proceedings." On the other hand under Rule 9251(a)(2), where the Department obtains additional documents post-complaint in response to a request under Rule 8210, it must automatically produce only those documents that are material and relevant to the disciplinary proceeding.

This dual standard was criticized by the only commentator to file comments regarding the Code of Procedure in response to the Notice of Proposed Rule Change.⁷ In defending the additional criteria for documents obtained after the Complaint is filed, the NASD explained that this was a "secondary production," which was "subject to a material relevance standard so that the Department of Enforcement must turn over only [d]ocuments that are relevant to the proceeding initiated and not other [d]ocuments that may relate to a person soon to be named as a [r]espondent as part of the same investigation file."⁸ In other words, post-complaint discovery of documents obtained in response to requests for information under Rule 8210 is narrower than pre-complaint so as not to compromise the Department's further investigation of others not named in the pending proceeding. This scheme assumes that in the usual case the Department will have completed its investigation and information gathering before it files a Complaint. Accordingly, in striking a balance between enhanced, automatic document disclosure and preserving the NASD's ability to effectively meet its regulatory obligations, Rule 9251 distinguishes between documents directly related to the charges against the named respondent, which

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.

⁸ Letter of July 11, 1997, from Alden S. Adkins to Katherine A. England, Assistant Director, Division of Market Regulation, Securities and Exchange Commission at 14.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

presumptively must be produced, and documents related to the investigation of others, which need not be produced automatically unless they contain material exculpatory evidence.

Rule 9251(b) further carves out other categories of documents that the Department may withhold except to the extent that they contain material exculpatory evidence. Generally, these are documents subject to customary claims of privilege and those that if revealed could impair the NASD's enforcement efforts. Specifically, Rule 9251(b)(1) shields the following documents from automatic disclosure: (1) documents that are privileged or constitute attorney work product; (2) examination or inspection reports; (3) internal memoranda and writings prepared by an NASD employee that shall not be offered into evidence; and (4) documents that would disclose an examination or investigatory technique or the identity of a confidential source. In its letter accompanying the Notice of Proposed Rule Change, the NASD justified withholding internal memoranda on the ground that many examinations are done by examiners and not lawyers, and therefore their documents and reports may not be subject to privilege.⁹ In other words, in the context of a proceeding brought by a self regulatory organization, withholding internal staff writings was viewed as being supported by the same policy considerations underlying the doctrines of attorney-client privilege and attorney work product.

In addition to automatic document disclosure under Rule 9251, the Rule also provides that the Hearing Officer may order the production of any other document not specifically enumerated in subparagraph (a)(1). The Hearing Officer's authority is limited only by Rule 9251(b)(1), as discussed above.

⁹ Id.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

B. Respondents' Motion.

Here, the Department opposes Respondents' request for the correspondence between Department staff and the customer witnesses who submitted affidavits and sworn questionnaires on three grounds.¹⁰ First, the Department argues that the Respondents are only entitled to the documents enumerated in Rule 9251(a)(1) and that it has made all of those documents available to the Respondents. Second, the Department argues that the collection of customer questionnaires and affidavits is a routine practice and that it would be a "dangerous precedent" to graft onto the Code of Procedure "by judicial fiat" the right to receive copies of the correspondence between the Department and its customer witnesses. Third, the Department argues that the Respondents' request is nothing more than a "fishing expedition," which is prohibited under Brady. In support of these arguments, the Department submitted an affidavit from counsel for the Department certifying that none of the correspondence subject to Respondents' motion was generated in connection with NASD Procedural Rule 8210 or contains material exculpatory evidence subject to production under Brady.

The Department's arguments, however, miss the mark in all respects. The issue here is not whether the documents should have been produced as part of the Department's automatic document disclosure under Rules 9251(a)(1) and (a)(2), but whether the documents should be produced at the discretion of the Hearing Officer under Rule 9251(a)(3) in the interest of fundamental fairness and as a precondition to the Department being permitted to offer the questionnaires and affidavits into evidence where the witnesses will not be available for cross-examination. Section 15A(b)(8) of the Securities Exchange Act of 1934 provides that the rules of the NASD must "provide a fair procedure for the disciplining of members and persons associated with members." The construction of Rule 9251

¹⁰ Dep't of Enforcement's Opp'n to Respondents' Mot. In Limine Requesting Produc. of Docs. at 1-2.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

advanced by the Department does not meet that standard. Under the Department's view of Rule 9251, whether the Respondents are entitled to the documents they request depends entirely upon the time the Department collected the questionnaires and affidavits. If the Department communicated with the customers before the Complaint is filed, the questionnaires, affidavits, and related correspondence would fall within Rule 9251(a)(1), and the Department would be obligated to make them available to the defense. However, if by fortuity or design, the Department does not correspond with the customer witnesses until after the Complaint is filed, the correspondence would be forever shielded from discovery. Such a construction would permit gamesmanship and deprive the Respondents of documents that are highly relevant to the admissibility of the questionnaires and affidavits.

Moreover, contrary to the Department's concern, an order directing that the subject documents be produced would not create new universal discovery rights. As discussed above, the automatic disclosure requirement under Rule 9251(a)(1) is just part of the discovery scheme set out in Rules 9251 through 9253. The fact that the subject correspondence does not fall within one of the enumerated categories does not axiomatically mean that the documents are shielded from production upon reasonable request where fundamental fairness or the efficient administration of the proceeding requires disclosure. Likewise, the fact that the subject documents do not contain Brady material does not end the inquiry.¹¹ The Hearing Officer's discretion under Rule 9251(a)(3), coupled with the Hearing Officer's general authority "to do all things necessary and appropriate to discharge his . . . duties" under Rule 9235, is broader than the judicially created restrictions on the application of the Brady doctrine.

Although the production of the type of documents requested here may not be appropriate in every instance, in this case the facts and circumstances favoring production are compelling. The

¹¹ The Hearing Officer accepts the Department's certification that the subject correspondence does not contain Brady material.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

Department has indicated its intent to offer more than 140 customer affidavits to supplement the live testimony of 10 of the _____ customers who purchased _____ stock in May 1996.¹²

Respondents point out that most of the affidavits are substantially identical although they describe individual conversations with different _____ registered representative, using the same descriptive language. In addition, the Respondents submitted a copy of a cover letter sent by a Department legal assistant to one customer that suggests that the enclosed form affidavit had been prepared without first speaking to the customer.¹³ Respondents argue that this letter calls into question the Department's methodology in obtaining the signed affidavits. And finally, at least some of the customers' affidavits diverge from their sworn responses in the questionnaires. Each of these factors raises potential questions regarding the reliability of the affidavits and questionnaires, and, thereby, elevates Respondents' request from a mere "fishing expedition."

The questionnaires and affidavits are hearsay evidence.¹⁴ And although Hearing Officers have great latitude in admitting hearsay evidence, which may form the sole basis for findings of fact, they should not be admitted if they are unreliable.¹⁵ The NASD has repeatedly stated that the following five factors must be employed to assess the reliability of hearsay statements: (1) whether the hearsay is corroborated; (2) whether the hearsay is contradicted by the direct testimony; (3) whether the affiant is possibly biased; (4) whether the missing affiant was available to testify; and (5) the type of hearsay at issue.¹⁶

¹² There were more than 360 _____ customers in total that purchased _____ stock over the applicable period.

¹³ Respondents' Mot. In Limine Requesting Produc. of Docs. by the Dep't of Enforcement, Ex. B.

¹⁴ See, e.g., In re Dist. Bus. Conduct Comm. for Dist. No. 2 v. Gallison, No. C02960001, 1999 NASD Discip. LEXIS 8, *11 (N.A.C. Feb. 5, 1999).

¹⁵ Id. at *13.

¹⁶ Id.

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 00-24 (C3A990071).

Where, as in this case, the respondents raise genuine questions concerning the reliability of the hearsay statements offered by the Department, the Hearing Officer must apply the foregoing factors to determine whether the hearsay statements are sufficiently reliable to be admitted into evidence. As the sponsoring party, the Department has the burden of satisfying this inquiry. If the Hearing Officer cannot determine that the hearsay statements are reliable, they must be excluded. There is no presumption in favor of the reliability of hearsay statements.

In this case, as discussed above, the Respondents have pointed to several factors challenging the reliability of the hearsay statements as a group, which mandate further inquiry. To assist in this inquiry, since the customers will not be available for questioning, the Respondents have requested copies of the correspondence between the Department and the customers, which they argue will provide further evidence of the Department's methodology in collecting the affidavits. In the Hearing Officer's judgment this is a warranted request. Indeed, under the specific facts and circumstances of this case, such further inquiry is required if the Department is going to request the Hearing Panel to accept the affidavits and questionnaires. Accordingly, the Hearing Officer orders the Department immediately to produce the requested correspondence to the Respondents.

SO ORDERED.

Andrew H. Perkins
Hearing Officer

Dated: Washington, DC
August 28, 2000