

This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 16-05 (2012033393401).

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT

Respondent.

Disciplinary Proceeding
No. 2012033393401

Hearing Officer-RES

**ORDER SUSTAINING IN PART AND OVERRULING IN PART RESPONDENT'S
OBJECTIONS TO ENFORCEMENT'S HEARING EXHIBITS**

I. Introduction

The Department of Enforcement brings this matter against Respondent alleging five causes of action. The first two concern Respondent's alleged failure to disclose to his employer firm that he was a successor trustee and beneficiary of a living trust established by EC, one of his brokerage customers. According to the first cause of action, Respondent's alleged failure to disclose these facts violated NASD Rule 2110 and FINRA Rule 2010. According to the second cause of action, he violated FINRA Rules 3270 and 2010 by not disclosing to his employer firm his expectation of compensation from an outside business activity as a result of his position as successor trustee of EC's trust.

The other three causes of action concern Respondent's alleged conduct with respect to a different firm customer, KM. The third cause of action alleges that he violated NASD Rule 3110, NASD Rule 2110, and FINRA Rule 2010 by mismarking as unsolicited 36 out of 145 order tickets in KM's accounts, when the orders were actually solicited. The fourth cause of action alleges that he improperly exercised discretion in KM's accounts by executing 56 transactions without obtaining prior written authorization from KM and without having the accounts accepted as discretionary by his employer firm, in violation of NASD Rule 2510(b) and FINRA Rule 2010. The fifth cause of action alleges that Respondent violated NASD Rule 2210(d) and FINRA Rule 2010 by providing KM with consolidated reports misstating the value of KM's investments and exaggerating her investment return.

II. Discussion

Enforcement filed its proposed Exhibit List in this matter on December 23, 2015. On January 13, 2016, Respondent filed objections to certain of Enforcement's proposed hearing

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exhibits. On January 25, 2016, Enforcement filed its Response to Respondent's Objections. For the reasons stated below, the Objections are sustained in part and overruled in part.

CX-8: According to Enforcement's Exhibit List, CX-8 is Respondent's on-the-record testimony transcript. The stated purpose of this exhibit is to show admissions by the Respondent. Even though a party may introduce the opposing party's admissions as non-hearsay substantive evidence, for the party to proffer a 132-page transcript of such admissions is not an efficient way to present them to the triers-of-fact. The Scheduling Order provides that, when a party offers a transcript of prior testimony as a hearing exhibit, "[t]he exhibit should include only the portions of the transcript that the party intends to offer as evidence."¹

Accordingly, Enforcement is granted leave to file, on or before February 4, 2016, designations of Respondent's testimony transcript that it intends to move into evidence as party admissions. Pursuant to the doctrine of completeness, Respondent is granted leave to file, on or before February 8, 2016, cross-designations of his transcript. At the conclusion of the hearing, Enforcement will have leave to move into evidence any additional portions of Respondent's transcript that it read into the record for purposes of impeaching Respondent. Respondent will then have leave to move into evidence any portions of Respondent's transcript that his counsel read into the record pursuant to the doctrine of completeness. With these exceptions, Respondent's objection to the introduction of the entire testimony transcript is sustained.

CX-32: According to Enforcement's Exhibit List, CX-32 is KA's testimony transcript for the probate proceeding dated October 4, 2013. The stated purpose of this exhibit is to show conflict of interest regarding Respondent's roles. For the reasons stated in the Hearing Officer's Order dated February 1, 2016, granting in part and denying in part Respondent's motion to exclude KA, MC, and BS as witnesses ("Witness Order"), Respondent's objection to KA's deposition transcript will be sustained. The record fails to show how KA's probate testimony would make the existence of any consequential fact as to Respondent's alleged disclosure obligations to his employer firm more or less probable. Any probative value of KA's testimony is outweighed by the danger that it would be unduly prejudicial and confuse the issues. KA's testimony is relevant to the limited issues of the trust amendment making Respondent and his wife 100 percent beneficiaries of the trust's assets and whether Respondent knew that he or his wife was a beneficiary. However, the Scheduling Order provides that "[t]ranscripts of prior testimony . . . will be permitted upon a showing that the witness is unavailable."² KA appears on Enforcement's Witness List as a witness who is available to testify in person at the hearing. This makes her deposition transcript unnecessary. If she becomes unavailable at the hearing, Enforcement will be allowed to move for the introduction of designations of KA's transcript that

¹ Scheduling Order ¶ 5(D)(4).

² *Id.* Accord Fed. R. Evid. 804(b)(1) (hearsay exception for out-of-court testimony where the witness is unavailable). The formal rules of evidence do not apply in FINRA disciplinary proceedings. FINRA Rule 9145(a). However, the Federal Rules of Evidence are instructive for a FINRA Hearing Officer deciding an evidentiary motion. *Dep't of Mkt. Regulation v. Respondent*, OHO Order 15-11 (20090174025-02), 2015 FINRA Discip. LEXIS 41, at *2 (OHO Aug. 19, 2015).

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are relevant to the execution of the trust amendment making Respondent and his wife 100 percent beneficiaries of the trust and the surrounding circumstances, and whether Respondent knew that he or his wife was a beneficiary.³

CX-33: According to Enforcement's Exhibit List, CX-33 is a chronology attached as Exhibit 1 to KA's deposition. The stated purpose of this exhibit is to show KA's sequence/summary of events. The exhibit is an out-of-court statement being offered to prove the truth of the matters asserted and therefore is classic hearsay. Even though hearsay may be admitted in a FINRA proceeding when it is reliable, probative, unbiased, corroborated, or sworn,⁴ this exhibit is no more reliable than KA's live testimony, which is being excluded (with one exception) for the reasons stated in the February 1, 2016 Witness Order. Therefore, Respondent's objection to CX-33 is sustained.

CX-36: According to Enforcement's Exhibit List, CX-36 is BS's testimony transcript for the probate proceeding dated October 23, 2013. The stated purpose of this exhibit is to show conflict of interest regarding Respondent's roles. For the reasons stated in the February 1, 2016 Witness Order, Respondent's objection to BS's testimony transcript is sustained. The record fails to show how BS's probate testimony would make the existence of any consequential fact as to Respondent's alleged disclosure obligations to his employer firm more or less probable. Any probative value of BS's testimony is outweighed by the danger that it would be unduly prejudicial and confuse the issues.

CX-55, CX-56, CX-57: According to Enforcement's Exhibit List, CX-55, CX-56, and CX-57 are website printouts regarding First Trust Portfolio, India Growth Portfolio, and DryShips Inc., respectively. The stated purpose of each exhibit is to show information regarding an investment in customer KM's accounts. In fact, CX-57 appears to be the home page for the website of the DryShips company. Respondent objects to these exhibits on the ground that the initial offering dates for the securities described in them, or the dates of the exhibits themselves, post-date the latest trades in the same or similar securities purchased through KM's account. Enforcement contends in response that the securities described in CX-55, CX-56, and CX 57 are being offered as examples of the types of securities that were purchased through KM's account. Presumably, Enforcement intends to use these exhibits to argue that securities in First Trust Portfolio, India Growth Portfolio, and DryShips were so little known and complex that KM, an elementary school teacher, could not have initiated their purchase. Presumably, documents

³ KA's transcript indicates that she was questioned by an attorney representing Respondent's wife, CA, and that Respondent himself was present at the deposition.

⁴ *Dep't of Enforcement v. Meyers*, No. C3A040023, 2007 NASD Discip. LEXIS 4, at *32 n.12 (NAC Jan. 23, 2007) ("[f]ormal rules of evidence do not apply to NASD proceedings . . . and the SEC has emphasized that 'hearsay may be admitted into evidence and, in appropriate cases, may form the basis for findings of fact'") (quoting *John Montalbano*, Exchange Act Release No. 47227, 2003 SEC LEXIS 153, at *22 (Jan. 22, 2003)). *Accord Kevin Lee Otto*, 54 S.E.C. 847, 854 (2000); *Dillon Sec., Inc.*, 51 S.E.C. 142, 150 (1992); *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992).

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describing these securities with dates contemporaneous with the purchases in KM's accounts are no longer available.

A ruling will be reserved on Exhibits CX-55, CX-56, and CX-57 to see how the evidence develops at the hearing and assess the value and utility of the proffered exhibits. In particular, Enforcement might be able to establish the nature of the securities without having to resort to CX-55, CX-56, and CX-57. In the meantime, the parties are urged to discuss the possibility of a stipulation as to the nature of the securities in First Trust Portfolio, India Growth Portfolio, and DryShips purchased through KM's accounts.

CX-58, CX-59, CX-60: According to Enforcement's Exhibit List, CX-58, CX-59, and CX-60 are the declarations of TW, EW, and KM. The stated purpose of the TW declaration is to show prior sworn statements regarding the employer firm's procedures and Respondent's activities. The stated purpose of the EW declaration is to show prior sworn statements regarding the investigation of Respondent. The stated purpose of KM's declaration is to show prior sworn statements regarding the solicited nature of trades in her account.

The SEC has upheld the use of sworn declarations to support findings in a FINRA proceeding.⁵ However, the Scheduling Order provides that "[t]ranscripts of prior testimony . . . will be permitted upon a showing that the witness is unavailable."⁶ The same rule should apply to the TW, EW, and KM declarations. According to Enforcement's Witness List, each of these three witnesses is available for testimony at the hearing. Therefore, Respondent's objection to CX-58, CX-59, and CX-60 is sustained. If TW, EW, or KM becomes unavailable at the hearing, Enforcement will be allowed to introduce the witness's declaration into evidence.⁷

⁵ *Harry Gliksman*, 54 S.E.C. 471, 480-81 (1999) (SEC relied on the hearsay declaration of an allegedly "dissatisfied customer" where the declaration was written and under oath), *aff'd*, 24 F. App'x 704 (9th Cir. 2001).

⁶ Scheduling Order ¶ 5(D)(4).

⁷ Each of the declarations is made under the penalty of perjury and, presumably, represents what the declarant would say if he or she testified at the hearing. The Hearing Panel will make appropriate findings of reliability, probativeness, bias, and corroboration in deciding whether to rely on the declarations in its final decision following the hearing.

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III. Order

For the reasons stated, Respondent's objections to CX-8, CX-32, CX-58, CX-59, and CX-60 are **SUSTAINED IN PART AND OVERRULED IN PART** in accordance with the terms of this Order. Respondent's objections to CX-33 and CX-36 are **SUSTAINED**. Ruling is **RESERVED** with respect to CX-55, CX-56, and CX-57.

SO ORDERED.

Richard E. Simpson
Hearing Officer

Dated: February 2, 2016