

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

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CAF970002
v.	:	
	:	Hearing Officer - EBC
	:	
Respondents.	:	

**ORDER REGARDING MOTION OF RESPONDENTS AND ENFORCEMENT’S
MOTION TO STRIKE**

Respondents _____, through their counsel, have filed a motion requesting that the Hearing Officer issue an order relating to a variety of matters pertaining to discovery and the conduct of the hearing in this disciplinary proceeding. In support of their motion, Respondents submitted a declaration of their counsel, _____, with accompanying exhibits, a memorandum of law, and a document entitled “Supplemental Memorandum in Support of Respondents’ Motions” (Supplemental Memorandum). The Department of Enforcement has moved to strike Respondents’ motion on the grounds that it was not served with a copy of the Supplemental Memorandum; has opposed the motion on procedural and substantive grounds; has cross-moved, pursuant to Code of Procedure Rule 9136(e), to strike “scandalous or impertinent” matter from the Respondents’ moving papers; and has requested leave to file a brief exceeding the ten-page limit.

Procedures Applicable to Motion Practice

Before turning to the substance of these matters, the Hearing Officer observes that Respondents' motion is procedurally defective in two significant respects. First, Code of Procedure Rule 9146(c) requires that "[a]ll motions shall state the specific relief requested and the basis therefor"; Respondents' motion fails to satisfy these requirements. No statement of the relief requested or the matters at issue is included in the motion or the memorandum of law. In addition, although the proposed order sets forth in summary fashion the specific relief requested, with one exception (the request for "in person" testimony at the hearing), there appears to be minimal connection between the relief requested and the arguments made in the Respondents' memorandum of law. As a result, the Hearing Officer has been required to devote substantial time to perusing the correspondence attached as exhibits to counsel's declaration to ascertain the substance of Respondents' discovery requests.

Second, Respondents' motion fails to comply with Paragraph 4(a) of the Standing Pre-Hearing Order that was issued in this proceeding. Paragraph 4(a) requires a moving party, before filing a motion, to make a good faith effort to resolve the matters at issue with all Parties to whom the motion would be directed, and to include in its motion, a certification that the movant has satisfied this requirement. A review of Respondents' moving papers indicates that there was some dialogue between the Parties, but rather than continuing that dialogue, Respondents' counsel opted to file the motion that is now before the Hearing Officer. (See, e.g., _____ Dec., Ex. 6.)

As to Respondents' Supplemental Memorandum, the Hearing Officer observes that there is no provision in the Code of Procedure or in the Standing Pre-Hearing Order that allows for the filing of a supplemental memorandum; nor did Respondents' counsel seek leave to file this

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additional submission. Moreover, Respondents' Supplemental Memorandum is no more than a cover page, bearing a caption of this proceeding, to which additional correspondence between Respondents' counsel and counsel for the Department of Enforcement is attached. Obviously, in the context of motion practice, it is not unusual to provide correspondence to support statements or arguments made in a declaration or memorandum of law. However, the Code of Procedure does not contemplate that correspondence between the Parties shall serve as a substitute for traditional motion papers, and it does not allow for the filing of correspondence between the Parties. For the foregoing reasons, the Hearing Officer has declined to consider Respondents' Supplemental Memorandum in ruling on their motion.

In the future, the Hearing Officer will reject for filing any motion that fails to comply with the requirements of Rule 9146(c), or fails to comply with Paragraph 4(a) of the Standing Pre-Hearing Order. The Parties are also reminded that they are expected to comply with all provisions in the Code of Procedure pertaining to the form of papers.

Rulings

I. The Department of Enforcement's Request to Strike the Respondents' Motion and Request to File a Brief Exceeding the Ten-Page Limit

These requests can be resolved summarily. First, the Department of Enforcement's request to strike Respondents' motion is denied. Because the Hearing Officer has not considered Respondents' Supplemental Memorandum in ruling on their motion, the Department of Enforcement has not been prejudiced as a result of counsel's failure to serve it with a copy of the

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Supplemental Memorandum.¹ Second, given the number of discrete matters at issue in the Respondents' motion, the Department of Enforcement's motion for leave to file a brief exceeding the ten-page limit is granted.

II. Motion of Respondents _____

Seven of the eight items enumerated in the Respondents' proposed order involve discovery issues; the remaining item involves the use of "in person" testimony at the hearing. These issues will be discussed seriatim.

A. Discovery Issues

(1) The Scope of Discovery in NASD Disciplinary Proceedings

Rule 9251 requires that the Department of Enforcement make available to Respondents for inspection and copying all non-privileged and otherwise unprotected documents, prepared or obtained by Interested Association Staff, in connection with the investigation that led to the institution of the subject disciplinary proceeding. This includes, but is not limited to: (a) requests for information pursuant to Rule 8210; (b) written requests for information to persons not employed by the Association; (c) all documents provided in response to requests for information; (d) all transcripts and transcript exhibits; and (e) all other documents obtained from persons not employed by the Association. In addition to privileged material, Rule 9251(b) identifies various

¹ There is a dispute between the Parties on the issue of service of the Supplemental Memorandum. In support of its position that service was effected on the Department of Enforcement, the Respondents have submitted a declaration of _____, who is the secretary to _____ and responsible for effecting service of documents in this proceeding. In her declaration, _____ acknowledges that the Department of Enforcement was not included on the Service List she used to effect service by mail, see Declaration of _____, ¶ 3, but suggests that the Department of Enforcement was served with a copy of the document, via facsimile transmission. However, the record indicates that the facsimile number used to send the Supplemental Memorandum to counsel for the Department of Enforcement was incorrect. It appears that this was an inadvertent error. The Hearing Officer trusts that the Service List will be amended to ensure that the Department of Enforcement is served by mail with all documents filed in this proceeding, and that correct facsimile numbers will be used when Respondents' counsel also chooses to serve documents by facsimile transmission.

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categories of documents that are protected from disclosure, including attorney work product, examination or inspection reports, internal memoranda or writings prepared by Association staff that will not be offered in evidence, and material that would disclose an examination or investigatory technique, or the identity of a confidential source.

Notwithstanding the Department of Enforcement's right to withhold certain documents from disclosure, pursuant to Rule 9251(b)(2), it is required to produce all "material exculpatory evidence," so-called "Brady" material. In addition, Rule 9253 sets forth a procedure for respondents to obtain copies of statements of any person called or to be called as a witness by the Department of Enforcement that pertain to that witness's direct testimony. Rule 9253 is intended to permit respondents to obtain material required to be produced pursuant to the Jencks Act, 18 U.S.C. § 3500.

Respondents suggest that Section 15A of the Securities Exchange Act of 1934 (Exchange Act) requires broader discovery than that provided by the Code of Procedure. (See Respondents' Memorandum of Law, at p. 5; _____ Dec., ¶ 13.) Under Section 15A of the Exchange Act, a self-regulatory organization must provide a "fair procedure" for disciplining its members and persons associated with members, and afford respondents an "opportunity to defend" the charges. See Sections 15A(b)(8) and 15A(h)(1).² In approving the new Code of Procedure, on August 7, 1997, the Securities and Exchange Commission (SEC) evaluated the Code provisions "in light of the standards and objectives set forth in the Act," and concluded not only that the new Code provisions were "consistent with the Act," but that they would "enhance fairness in the disciplinary process." Exchange Act Release No. 38908, File No. SR-NASD 97-28, 1997 SEC LEXIS 1617, at * 92-93 (August 7, 1997). Further, as to the Code's discovery provisions, the

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SEC stated that were reasonably designed to “address the need for respondents to have broader documentary discovery rights” in disciplinary proceedings. *Id.* at *131. Accordingly, there is no basis to conclude that Section 15A of the Exchange Act entitles the Respondents to any discovery beyond that provided by the Code of Procedure.³

The Hearing Officer’s rulings on the Respondents’ specific requests are based on these general parameters that govern discovery under the Code of Procedure.

(2) Respondents’ Specific Discovery Requests

For ease of reference, rulings on Respondents’ requests are keyed to the paragraphs in their proposed order.

Paragraph 1: In Paragraph 1 of the proposed order, the movants request that the Department of Enforcement provide their counsel with all documents in the Department of Enforcement’s “custody, control or possession prepared or obtained by DOE staff in connection with the investigation that led to the institution of this proceeding, which relate to any person who has been identified in the Complaint in connection with these Respondents and/or who DOE

² 15 U.S.C. § 78o-3(b)(8) and 15 U.S.C. § 78o-3(h)(1), respectively.

³ In their memorandum of law, Respondents appear to argue – without the benefit of any relevant authority – that they are entitled to the requested discovery because the NASD is a “state actor,” and therefore required by the United States Constitution to provide the requested information. The courts, the SEC, and the National Business Conduct Committee consistently have rejected this argument. It is well-established that the NASD is a private corporation and not a governmental actor subject to Constitutional requirements. *See, e.g., Jones v. SEC*, 115 F.3d 1173, 1183 (4th Cir. 1997) (NASD disciplinary proceedings do not implicate the Double Jeopardy Clause because the NASD is a private corporation); *In re Herbert Garrett Frey*, Exchange Act Release No. 39007, n.17, 1997 SEC LEXIS 1796, at * 15 (Sept. 3, 1997) (rejecting respondent’s claim that the NASD is subject to the Fifth and Fourteenth Amendments and the Supremacy Clause of the United States Constitution); *District Business Conduct Committee No. 10 v. Stratton Oakmont, Inc.*, Complaint No. C10940044, 1996 NASD Discip. LEXIS 27, at *46-51 (NBCC April 16, 1996) (rejecting respondent’s arguments that it was entitled to a variety constitutional protections in an NASD disciplinary proceeding). *See also U.S. v. Solomon*, 509 F.2d 863, 867-869 (2d Cir. 1975) (rejecting the argument that the New York Stock Exchange for purposes of triggering the Fifth Amendment privilege against self-incrimination).

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intends to call as a witness at the hearing.” Respondents also request that the production “identify the witness as to whom the Documents relate.”

To the extent that this request requires the Department of Enforcement to produce documents that are subject to disclosure pursuant to Rule 9251, it is denied as moot. Pursuant to the Hearing Officer’s January 20, 1998 Order, all discoverable documents have been and are being made available to all Respondents for inspection and copying. Insofar as this request requires the Department of Enforcement to index, categorize, segregate, label, or otherwise identify the documents so that the movants can ascertain the witness or witnesses to whom each document relates, it is denied. There is no provision in the Code of Procedure that requires the Department of Enforcement to provide this information, and the Hearing Officer is not inclined, in the context of discovery, to require otherwise. In this regard, the Hearing Officer observes that there is no provision in the Federal Rules of Civil Procedure that requires the producing party to provide any index of its documents, much less an index such as that sought by Respondents.

Further, the Department of Enforcement and all other Parties will be required in advance of hearing to exchange and file exhibit lists that indicate the purpose for which each of their proposed exhibits is being offered. Through this and through the process of agreeing on stipulations and statements of undisputed and disputed facts, Respondents will know what evidence that relates to them and to each of the Department of Enforcement’s witnesses against them.

Paragraph 2: In Paragraph 2 of the proposed order, the movants request a list of any documents subject to disclosure pursuant to Rule 9251 that were, but are no longer, in the possession of the Department of Enforcement. The movants further request that such list include

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“the name(s) of DOE personnel with knowledge of the Document, its content, and a summary of the information contained therein and the witness from who [sic] it was obtained.”

Counsel for the Department of Enforcement, _____, has represented that there are no documents within the scope of this request, with the exception of one box of documents, which were originally part of an arbitration file and do not relate to any of the Respondents or issues in this proceeding. In any event, the Department of Enforcement has agreed to produce these documents. Further, based on his knowledge and the knowledge of his co-counsel and the examiners who worked on the underlying investigation, _____ has represented that no documents have been destroyed, or otherwise disposed. (_____ Dec., ¶ 7.) Accordingly, this portion of Respondents’ motion is denied as moot.

Paragraph 3: In paragraph 3 of the proposed order, the movants request that the Hearing Officer order the Department of Enforcement to produce a Withheld Document List, that specifies, with reference to Rule 9251(b), the category pursuant which each document has been withheld from disclosure. Pursuant to Rule 9251(c) a motion for production of Withheld Document List must be predicated “upon some reason to believe that a Document is being withheld in violation of the Code.” Based on the record presently before the Hearing Officer, it does not appear that the movants have made the requisite showing to warrant the production of a Withheld Document List. Although Respondents indicated in their moving papers that the Department of Enforcement improperly withheld (or destroyed) an entire file relating to one customer witness, account documentation relating to various customer witnesses (e.g., account statements and transaction confirmation slips), and correspondence between the customers and _____ (see _____ Dec., ¶¶ 6,18; Ex. 1), in fact, this material has been and will be made available to them. (See _____ Dec., Ex. 6; _____ Dec., ¶¶ 4-6; Ex. 1.)

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However, the Hearing Officer will defer ruling on this aspect of Respondents' motion to afford the Parties an opportunity for oral argument, and to allow the Parties to respond to any questions the Hearing Officer may have, including questions relating to the procedures used by the Department of Enforcement to identify and segregate discoverable from non-discoverable documents. The Parties should be prepared to address the subject of a Withheld Document List at the February 27 Pre-Hearing Conference.

Paragraph 4: In paragraph 4 of the proposed order, the movants request that the Department of Enforcement produce all documents responsive to _____ letters, dated December 10, 1997 and December 29, 1997, attached as Exhibits 1 and 3, respectively, to his declaration. Based on the Hearing Officer's independent review, it appears that counsel's December 10, 1997 letter requests specific documents relating to four potential customer witnesses and clarification as to whether the Department of Enforcement intends to call as witnesses two customers who were not identified in the Complaint. The December 29, 1997 letter is directed primarily to matters unrelated to the request for documents. The only portion of that letter relating to the production of documents states: "[w]e also do not have, and do now [sic] know if DOE will produce to us (a) copies of *all* correspondence with, (b) documents received from or sent witnesses, (c) *drafts* of the witness declaration (the files clearly indicate that there were no such documents), (d) notes of interviews or telephone conversations with the witnesses and (e) tapes of conversations." Counsel also requested clarification regarding the names of certain customers who were identified by initials in the Complaint, and production of one customer witness file.

First, no ruling can be made with respect to item (a) in the December 29, 1997 letter because the request, as phrased, is incomplete. Second, insofar as these letters request the

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production of documents, as opposed to other information, counsel for the Department of Enforcement has represented that all responsive documents, which are not being withheld pursuant to claims of privilege or on other grounds, have been and will be produced. (See _____ Dec., ¶¶ 4-5.) In addition, by letters dated January 6 and 12, 1998, _____ provided Respondents' counsel the clarification requested regarding the names of certain customers and the Department of Enforcement's anticipated witnesses. (See _____ Dec., Exs. 1-2.) Accordingly, this aspect of Respondents' motion is denied as moot.

Finally, to the extent there is a dispute between the Parties as to the nature of materials that are properly subject to protection from disclosure (e.g., draft affidavits that were not sent to potential customer witnesses and notes of interviews with customers that were prepared by Association employees) that matter is not properly before the Hearing Officer.⁴ If Respondents wish to raise this, they must file a separate motion accompanied by appropriate authority that specifically addresses the issue, rather than alluding to the issue and leaving it to the Hearing Officer to determine the parameters and nature of the dispute, and the Parties' respective positions. In addition, insofar as Respondents' claim that they are entitled to some of or portions of the documents on the grounds that they constitute or include Jencks Act material, the motion is premature and fails to comply with Code of Procedure Rule 9253.

Paragraph 5: In paragraph 5 of the proposed order, the movants request that the Hearing Officer direct the Department of Enforcement to produce directly, or through _____ Court Reporters ("Reporter"), information relating to its transcription of a tape recording made by _____ (the "_____ tape").

⁴ See _____ Dec., Exs. 3, 6.

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The Department of Enforcement has provided Respondents' counsel with two versions of the transcript, a version containing handwritten revisions and a "revised" version, as well as a copy of the tape. (See _____ Dec., Ex. 2; Complainant's Reply Memorandum, at p. 9.) Apparently, in some instances where the court reporter had originally indicated that a portion of the tape was "inaudible," handwritten revisions were added to complete the "inaudible" segments. Thus far, the Department of Enforcement has refused to provide any information regarding the reasons for the revisions, and has not identified the handwriting. (See _____ Dec., ¶ 11; Ex. 2; Complainant's Reply Memorandum, at p. 9.)

By letter, dated December 10, 1997, Respondents' counsel requested that Reporter provide him with information pertaining to the transcription of the _____ tape, including the reasons for the revisions and the identity of the person who made the revisions; and any correspondence between the Department of Enforcement and Reporter regarding the tape and the preparation of the transcript. (See _____ Dec., Ex. 2.) Although the record is not entirely clear, it appears that Reporter has refused to respond to _____ requests for information. (_____ Dec., Ex. 3.)

The Hearing Officer has no power or authority to order the Department of Enforcement to obtain documents or information from an entity that is not subject to the Association's jurisdiction. Further, the Code of Procedure does not provide for the use of interrogatories, which, in essence, _____ propounded in his December 10, 1997 letter to Reporter. Therefore, the Hearing Officer will not require the Department of Enforcement to respond directly to these inquiries. Accordingly, Respondents' requests, as they pertain directly to Reporter, and their requests for information from the Department of Enforcement are denied. While these matters are not properly the subject of discovery, the Hearing Officer observes that

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serious questions concerning the admissibility of the tape and the transcripts have been raised. Although matters pertaining to admissibility are premature, the Parties should be prepared to address these issues well in advance of hearing.

With respect to Respondents' request that the Department of Enforcement produce correspondence or other documents relating to the transcription of the _____ tape, the Hearing Officer will defer ruling on that portion of the request, and will afford the Parties an opportunity to be heard on the matter at the February 27 Pre-Hearing Conference.

Paragraph 6: In paragraph 6 of the proposed order, the movants request that the Hearing Officer direct the Department of Enforcement to solicit the production of certain documents from each anticipated customer witness. In particular, the movants request that the customer witnesses provide them with: (a) copies of his/her new account card and customer agreement with _____; (b) monthly account statements from _____ or any other broker-dealer during the period January 1, 1994 through December 31, 1996; (c) copies of checks or wire transfer instructions used to purchase securities at _____; (d) any correspondence that each witness sent to, or received from _____; and (e) any tape recordings and transcripts of tape recordings between any witness and any employee of _____.

The Hearing Officer has no power or authority to require the Department of Enforcement to request information from persons who are not subject to the Association's jurisdiction, such as customer witnesses. Accordingly, this portion of the Respondents' motion is denied.

Paragraph 7: In Paragraph 7 of the proposed order, the movants request that the Department of Enforcement be required to issue requests for information pursuant to Rule 8210

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to obtain all documents that were previously, but no longer, in its possession.⁵ For the reasons set forth above, Respondents' request is denied as moot. The Hearing Officer also notes that any requests seeking to require the Association to use its powers under Rule 8210, to compel the production of documents for use at the hearing, must be made pursuant to and comply with the requirements of Rule 9252.

B. The Use of In-Person Testimony at the Hearing

The movants request that all witnesses against them be required to appear and testify in person at the hearing. Respondents _____ and _____, through their respective counsel, have joined in this request. As stated in the Standing Pre-Hearing Order, no telephone testimony will be permitted absent leave of the Hearing Officer. Thus far, the Department of Enforcement has not filed any motions seeking leave to introduce witness testimony via telephone and a schedule for filing such motions has not yet been set. The use of telephone testimony will be addressed if and when such motions are made. Accordingly, this portion of Respondents' motion is denied as premature.

II. The Department of Enforcement's Motion to Strike "Scandalous or Impertinent" Matter

The Department of Enforcement is concerned about several statements made in _____ declaration, which, in essence, suggest that the Department of Enforcement sanitized certain files or destroyed documents (_____ Dec., ¶¶ 7-9, 18); refused to produce discoverable documents (_____ Dec., ¶¶ 7, 10, 17); and failed to respond to inquiries from Respondents' counsel regarding the status of the document production and related matters (_____ Dec., ¶¶ 7). Taken as whole, these statements accuse the Department of Enforcement

⁵ To the extent that this request encompasses other documents, the Hearing Officer is unable to discern, based on the Respondents' moving papers, what other documents are included.

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of acting in “bad faith” in satisfying its discovery obligations. The Department of Enforcement has moved, pursuant to Code of Procedure Rule 9136(e), to strike all or a portion of the declaration.

Rule 9136(e) provides, in relevant part, that “[a]ny scandalous or impertinent matter contained in any brief, pleading, or other filing . . . may be stricken on order of an Adjudicator.” “‘Scandalous matter’ has been defined as ‘that which improperly casts a derogatory light on someone, most typically on a party to the action.’” Carone v. Whalen, 121 F.R.D. 231, 233 (M.D. Pa. 1988) (quoting 5 Wright and Miller, Federal Practice and Procedure, Civil, § 1382, at 826 (footnote omitted)). For purposes of Rule 12(f) of the Federal Rules of Civil Procedure, a “scandalous pleading . . . must “reflect cruelly” upon a party’s moral character, “use repulsive language,” or “detract from the dignity of the court.” Skadegaard v. Farrell, 578 F. Supp. 1209, 1221 (D.N.J. 1984) (quoting 2A Moore’s Federal Practice, ¶ 12.21, at p. 2429 (1983) (footnote omitted)). See also Gilbert v. Eli Lilly & Co., 56 F.R.D. 116, 121, n.7 (D.P.R. 1972). “Impertinent matter” has been defined as statements that are “not responsive nor relevant to the issues involved” Id. at n.6.

Based on a review of the correspondence between counsel for the Parties, the Hearing Officer has concluded that _____ accusations of “bad faith,” including the insinuation of document destruction by the Department of Enforcement, are baseless. However, the Hearing Officer has drawn no conclusions adverse to the Department of Enforcement from the overtly litigious comments in _____ declaration. It is difficult to believe there will be any harm to the reputation of either the Department of Enforcement or any of its employees – especially since no employees are mentioned by name – as a result of the challenged statements. Accordingly, the Department of Enforcement’s motion to strike “impertinent or scandalous” matter is denied.

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In the future, the Hearing Officer expects that the Parties and their counsel will take appropriate steps to comply with the requirements of Code of Procedure Rule 9137(b) to ensure that there is a good faith basis for any statements made in a filing.

SO ORDERED.

Ellen B. Cohn
Hearing Officer

Dated: Washington, DC
February 25, 1998