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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. WEDBUSH SECURITIES, INC. (CRD No. 877), Respondent.	Disciplinary Proceeding No. 2012033105901 Hearing Officer–DW

ORDER GRANTING DEPARTMENT OF ENFORCEMENT'S MOTION TO STRIKE AFFIRMATIVE DEFENSE

A. Background

On May 27, 2016, the Department of Enforcement filed a three-cause Complaint against Respondent Wedbush Securities, Inc. ("Wedbush"). The Complaint alleges that Wedbush (1) failed to comply with segregation requirements for various securities, in violation of Section 15(c) of the Exchange Act of 1934, Exchange Act Rule 15c3-3(b)(1), and FINRA Rule 2010; (2) improperly funded by over $200 million its customer reserve account to account for amounts owed to customers, in violation of Section 15(c) of the Exchange Act, Exchange Act Rule 15c3-3(e), and FINRA Rule 2010; and (3) failed to supervise its registered representatives' compliance with segregation requirements and maintenance of customer reserves, in violation of NASD Rules 3010(a) and 3010(b) and FINRA Rule 2010.

Wedbush answered the Complaint on July 5, 2016, responding to the Complaint's allegations and asserting five affirmative defenses. On August 19, 2016, Enforcement moved to strike Wedbush's third affirmative defense that "FINRA is estopped from seeking fines and sanctions higher than those previously agreed to by FINRA as set forth in the Acceptance Waiver and Consent sent to Wedbush on August 17, 2015."

Enforcement argues that the defense should be stricken as legally insufficient. Enforcement maintains that FINRA never agreed to the Acceptance Waiver and Consent, or proposed settlement document, and it is therefore inadmissible as evidence. It maintains that settlement negotiations are not properly considered in the determination of either liability or sanctions, and therefore they are irrelevant. Wedbush opposes the motion, arguing that the purported settlement is potentially relevant and material in that it provides a basis for estopping

Enforcement from seeking sanctions greater than reflected in the proposed agreement, and that it demonstrates the firm's willingness to accept responsibility for its alleged misconduct.

B. Discussion

FINRA's Code of Procedure Rule 9136(e) permits a Hearing Officer to strike "[a]ny scandalous or impertinent matter contained in any brief, pleading, or other filing." While the rule does not speak directly to motions to strike defenses, the National Adjudicatory Council ("NAC") has recognized that "[t]he practice in disciplinary proceedings is to strike those affirmative defenses that do not constitute a valid defense to avoid wasting time litigating irrelevant facts."[1] In ruling on motions to strike, Hearing Officers have looked for guidance from the cases decided under Rule 12(f) of the Federal Rules of Civil Procedure, which governs motions to strike.[2]

Those cases set forth certain principles that are instructive here. As a general matter, motions to strike are not favored.[3] Accordingly, the burden on the moving party is "formidable."[4] "Nevertheless, 'a defense that might confuse the issues in the case and would not, under the facts alleged, constitute a valid defense to the action can and should be deleted.'"[5] Also, "[s]triking an affirmative defense is warranted if it cannot, as a matter of law, succeed under any circumstance."[6] In seeking to strike a defense as insufficient, the movant must show (1) that there is no question of fact, or substantial question of law, that might allow the defense to succeed; and (2) that it would be prejudiced by the inclusion of the defense.[7]

Here, Enforcement has met its burden and demonstrated that the affirmative defense should be stricken. It is undisputed that the purported settlement was never approved by FINRA's Office of Disciplinary Affairs ("ODA") or the NAC. Though Wedbush contends that the proposed agreement "was 'agreed to' by Enforcement staff acting as an agent for FINRA with apparent authority to bind FINRA,"[8] FINRA's Rules of Procedure make clear that a

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[1] *Dep't of Enforcement v. Bullock*, No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at *56 (NAC May 6, 2011) (quoting *Dep't of Enforcement v. Epstein*, No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *88 (NAC Dec. 20, 2007), *aff'd*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009).

[2] *See* OHO Order 07-21 (E102003025201) at 6–7. The Hearing Officer notes, however, that unlike FINRA Rule 9136(e), Fed. R. Civ. P. 12(f) specifically authorizes striking "an insufficient defense."

[3] *Emp'rs Ins. Co. of Wausau v. Crouse-Cmty. Ctr., Inc.*, 489 F. Supp. 2d 176, 179 (N.D.N.Y. 2007).

[4] *Pogue v. Diabetes Treatment Ctrs. of Am.*, 474 F. Supp. 2d 75, 79 (D.D.C. 2007).

[5] *Waste Mgmt. Holdings v. Gilmore*, 252 F.3d 316, 347 (4th Cir. Va. 2001) (quoting 5A A. Charles Alan Wright *et al.*, *Federal Practice & Procedure* § 1381, 665 (2d ed. 1990)).

[6] *United States v. Renda*, 709 F. 3d. 472, 479 (5th Cir. 2013).

[7] *Coach, Inc. v. Kmart Corps.*, 756 F. Supp. 2d 421, 425 (S.D.N.Y. 2010); *UMG Recordings, Inc. v. Lindor*, 531 F. Supp. 2d 453, 458 (E.D.N.Y. 2007).

[8] Respondent's Opp. at 3.

settlement is "deemed final" only if accepted by ODA or the NAC.[9] An agreement not ultimately approved "may not be introduced into evidence in connection with the determination of the issues set forth in any complaint or in any other proceeding."[10] There is no question of fact, or substantial question of law, that might permit proof of unconsummated settlement terms excluded from evidence by FINRA rules.

Wedbush acknowledges that settlement evidence is generally inadmissible, but argues that the general prohibition should not apply to "evidence that is offered for a purpose other than establishing liability."[11] It maintains that because terms of the settlement were "agreed to" by Enforcement staff on behalf of FINRA, the agreement will prove an estoppel against FINRA precluding it from imposing any sanction against Wedbush that might exceed that provided in the agreement.[12] But again, there was no "agreement." The argument that an Enforcement attorney may agree to settle a case on FINRA's behalf acting under actual or apparent authority is "wrong."[13] And FINRA's rules foreclose admission of a failed agreement for *any* purpose.[14] Evidence of the unapproved settlement agreement is therefore not proper proof of estoppel, Wedbush's acceptance of responsibility,[15] or anything else.

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[9] FINRA Rule 9216(a)(4).

[10] *Id*.

[11] Respondent's Opp. at 3 citing Fed. R. Evid. 408.

[12] Respondent's Opp. at 3.

[13] *See* OHO Order 14-07 (2011030781201) at 3, n.6 (noting that "[t]he authority to approve settlements rests with FINRA's independent ODA. *See* Regulatory Notice 09-17."). And *compare Fed. Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 384 (1947) ("Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority. The scope of this authority may be explicitly defined by Congress or be limited by delegated legislation, properly exercised through the rule-making power. And this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority.").

[14] *Compare* Fed. R. Evid. 408 (excluding settlement evidence to prove the validity or amount of a claim or for impeachment, but permitting the evidence for other purposes) *with* FINRA Rule 9216(a)(4) (excluding rejected settlement agreements for all purposes).

[15] Wedbush acknowledges that settlement evidence is not admissible to "establish[] liability." Respondent's Opp. at 3. It does not explain how settlement evidence might demonstrate its acceptance of responsibility unless used for the improper purpose of establishing its liability, nor does it explain how a post-investigation settlement agreement might demonstrate its acceptance of responsibility "prior to detection and intervention by . . . a regulator." *See* FINRA Sanction Guidelines at 6 (2015), http://www.finra.org/Industry/Sanction-Guidelines (Principal Considerations in Determining Sanctions, No. 2) (directing adjudicators to consider whether the respondent "accepted responsibility for and *acknowledged the misconduct* to . . . a regulator *prior to detection and intervention by . . . a regulator*.") (emphasis added).

Accordingly, Enforcement's motion to strike the third affirmative defense is **GRANTED**. Wedbush is directed to file an amended Answer that excludes the stricken defense and any reference to purported settlement or settlement negotiations by September 23, 2016.

SO ORDERED.

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David Williams
Hearing Officer

Dated: September 13, 2016