

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

DEPARTMENT OF MARKET
REGULATION,

Complainant,

v.

RESPONDENT,

Respondent.

Disciplinary Proceeding
No. 20100215720-01

Hearing Officer—MC

**ORDER DENYING RESPONDENT'S MOTION FOR PERMISSION TO SEEK
ADDITIONAL PARTY DISCOVERY**

I. Introduction

Respondent is a broker-dealer operating an alternative trading system ("ATS"). An ATS provides facilities for bringing together purchasers and sellers of securities and performs the functions of a stock exchange.¹ With the ATS, Respondent matches buy and sell orders for broker-dealers subscribing to its services.² During the relevant period, between November 2009 and mid-March 2013, through its ATS Respondent effected approximately 80,000 trades, totaling approximately 13.5 million shares, daily.³ Respondent is required to report its transactions to the FINRA/NASDAQ Trade Reporting Facility.⁴

Some of Respondent's subscribers are FINRA members; others are not. In the relevant period, Respondent matched more than 14 million transactions, serving as an intermediary between non-FINRA member subscribers selling short and FINRA member subscribers purchasing.⁵

The transactions had two legs. The first leg was the short sale by the non-member to Respondent (the "non-member leg"). The Parties concur that Respondent did not need to report

¹ Complaint, Answer ¶¶ 3-4.

² Complaint, Answer ¶ 7.

³ Complaint ¶¶ 1, 4; Answer ¶ 4.

⁴ Complaint, Answer ¶¶ 5, 7.

⁵ Complaint, Answer ¶¶ 9, 23.

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this leg.⁶ The second leg was the sale by Respondent to the member broker-dealer (the “member leg”), which the parties agree Respondent was required to report.⁷ The chief issue in this case is whether Respondent should have reported the member leg with a short sale or short sale exempt indicator.

Respondent insists that to report the member leg with a short sale indicator would have been improper.⁸ Respondent claims that it reported the transactions correctly in reasonable reliance on FINRA rules and the guidance FINRA has provided on how to interpret those rules, specifically FINRA Regulatory Notice 09-08 and FINRA’s Trade Reporting Frequently Asked Question (“FAQ”) 308.2, which expressly cites Regulatory Notice 09-08.⁹

Market Regulation disagrees. The Complaint alleges that Market Regulation staff advised Respondent in June 2010 that it should report whether the seller was selling long or short. Market Regulation contends this advice was consistent with Regulatory Notice 09-08 and FAQ 308.2, and reinforced by Trade Reporting FAQ 407.8, which was promulgated in January 2012.¹⁰ The Complaint alleges that nonetheless Respondent continued to report the matches without the required short sale or short sale exempt indicator.

In its defense, Respondent argues that FAQ 407.8 was improperly adopted by FINRA in violation of provisions of the Securities Exchange Act of 1934 and “is not supported by any existing FINRA rule or interpretation.”¹¹

II. Respondent’s Motion and Market Regulation’s Opposition

Respondent’s motion requests an order requiring the Department of Market Regulation to provide it with “certain limited additional discovery that is essential to the Firm’s ability to present its defenses and that potentially could help facilitate an amicable resolution” of this proceeding, specifically “regarding the adoption of FAQ 407.8.”¹² Respondent specifically seeks four categories of documents:

- (i) “concerning the interpretation” of Trade Reporting FAQ No. 308.2, which provided guidance to member firms on reporting matches of FINRA member orders and non-FINRA member orders;

⁶ Respondent’s Motion for Permission to Seek Additional Party Discovery (Motion) 2; Market Regulation’s Opposition to Motion (Opposition) 7.

⁷ Motion 1-3.

⁸ *Id.* at 3-4.

⁹ *Id.* at 2-3.

¹⁰ Opposition 7.

¹¹ Answer ¶ 13; Motion 4.

¹² Motion 3-4.

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- (ii) identifying any FINRA member firm that relied, as Respondent did, on Trade Reporting FAQ 308.2 during the relevant period;
- (iii) relating to the promulgation of Trade Reporting FAQ 407.8 that refer to Respondent or any other FINRA member firm identified in (ii) above, or refer to a “need or desire ... to address the reporting of non-Member short sales;” and
- (iv) identifying “the authority supporting FAQ 407.8.”

Respondent claims that it needs these documents to support its defense that it reasonably relied on Trade Reporting FAQ 308.2 in interpreting the reporting rules, and that Trade Reporting FAQ 407.8 was issued as a result of Respondent’s and other firms’ request for further guidance on their reporting obligations.¹³

Market Regulation opposes the Motion. In its Opposition, Market Regulation states that it has produced all the discovery documents to which Respondent is entitled under FINRA Rule 9251, and that Respondent is not entitled to the documents it seeks because they are not material or exculpatory, and many are privileged.¹⁴

Market Regulation argues that the first category of documents Respondent seeks, documents “concerning the interpretation” of guidance provided in Trade Reporting FAQ 308.2, includes internal documents relating to the promulgation and interpretation of FAQs, which are privileged because they constitute attorney work product, and may be withheld pursuant to FINRA Rule 9251(b)(1)(A).¹⁵ Market Regulation asserts that the second and third categories of documents include matters involving FINRA’s investigations or examinations of other member firms, and are protected under FINRA Rule 9251(b)(1)(C). Furthermore, Market Regulation argues, all four requests seek to require disclosure of internal memoranda and notes that are exempt from production under FINRA Rule 9251(b)(1)(B).¹⁶

At Respondent’s request, the Hearing Officer held a pre-hearing conference to discuss the Motion. At the conference, Respondent claimed it does not seek privileged information, and emphasized that it needs the requested documents to identify FINRA member firms that have asked FINRA for guidance in interpreting FAQ 308.2 because this information supports Respondent’s defense.¹⁷

Market Regulation argued that Respondent is engaging in a “fishing expedition.” Market Regulation also contended that it has no idea how to identify other firms that may have sought

¹³ *Id.* at 4.

¹⁴ Opposition 1.

¹⁵ *Id.* at 4.

¹⁶ *Id.* at 5.

¹⁷ February 11, 2015 Pre-Hearing Conference Transcript (“Tr.”) 5, 12.

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guidance from FINRA about the Trade Reporting FAQs,¹⁸ and that in any event Respondent did not rely on other firms’ interpretation of the rules to reach its own determination of how to report the transactions at issue.¹⁹

III. Discussion

FINRA Rule 9251(a)(1) requires Market Regulation to provide Respondent with documents “prepared or obtained by Interested FINRA Staff in connection with the investigation that led to the institution of proceedings,” including requests for information issued pursuant to Rule 8210; written requests to non-FINRA personnel to provide information; the documents received in response to requests; transcripts and transcript exhibits; and all documents collected from non-FINRA personnel.

Respondent concedes that Market Regulation has complied with FINRA Rule 9251(a) because it has provided Respondent with the documents it prepared or obtained in connection with the investigation leading to the filing of the Complaint. But Respondent contends that production of Market Regulation’s investigative file is nonetheless “insufficient and prejudicial” because the dispute in this case concerns “the interpretation of the guidance” upon which it relied, “as well as the circumstances involving the promulgation” of Trade Reporting FAQ 407.8. Therefore, Respondent invokes Rule 9251(c) as authority for ordering production of these additional documents.²⁰

However, Rule 9251(c) concerns withheld documents. It authorizes a hearing officer to require Market Regulation to submit a withheld document list, or withheld documents, for the hearing officer to review and, if the hearing officer deems it proper, to make the list or withheld documents available to a respondent. But it states that a motion to compel production of withheld documents must be “based upon some reason to believe” they are “being withheld in violation of [FINRA’s] Code [of Procedure].” Respondent does not suggest the documents it seeks are being withheld in violation of the FINRA’s procedural rules. Thus, Rule 9251(c) does not apply.

Although Respondent has not invoked it, FINRA Rule 9251(a)(3) provides Market Regulation with discretion to produce, and a hearing officer with the authority to order the production of, “any other Document.” As Market Regulation points out, however, the discretion afforded by Rule 9251(a)(3) is not unbridled.²¹ It does not authorize a respondent to engage in a “fishing expedition” through records not otherwise subject to discovery.²²

¹⁸ Tr. 19-20.

¹⁹ Tr. 18.

²⁰ Motion 6.

²¹ Opposition 6.

²² *Manuel P. Asensio*, Exchange Act Release No. 62315, 2010 SEC LEXIS 2014, at *39 (June 17, 2010).

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Respondent argues that what it seeks is “[f]ar from a ‘fishing expedition.’”²³ However, the Motion asks that Market Regulation be required to produce unspecified internal FINRA documents relating to unspecified interactions between FINRA and other, unidentified member firms, and unidentified documents relating to the development of guidance on reporting obligations FINRA may have provided to other, unidentified firms. Respondent has not specifically identified the additional records in the four categories of documents it seeks, or sufficiently explained their relevance to the defense. Its requests are “broad and general” and do not establish a “reasonable and credible basis” for granting them.²⁴ Given their breadth, to grant the Motion would be tantamount to authorizing a fishing expedition not countenanced by Rule 9251.

Respondent's claim that the requested documents are essential to its defense is unpersuasive. Respondent has not shown that the additional discovery it seeks would yield relevant evidence to assist the Hearing Panel in determining whether Respondent failed to properly report the member leg of the transaction as charged.

Furthermore, Respondent has not substantiated its claim of prejudice if Market Regulation is not ordered to produce additional discovery. At the pre-hearing conference, Respondent's counsel conceded that Respondent is capable of contacting other firms that, like Respondent, sought guidance from FINRA on the reporting requirements at issue here. Respondent is therefore able to seek testimony from representatives of similarly situated firms, if relevant, at the hearing in this matter.²⁵

Despite this, Respondent insists that it needs the additional requested information in order to develop an “exhaustive” list of other firms that had the same disagreement over reporting requirements with FINRA.²⁶ This argument, too, is unpersuasive. It is unclear how other firms' interpretations of the trade reporting rules and guidance could be relevant to the charge that Respondent improperly reported over 14 million trades. Even if some such testimony were relevant, Respondent has not shown why it would need to compile an exhaustive list of all FINRA member firms who may have disagreed with Market Regulation's interpretation of the trade reporting rules.

²³ Motion 5.

²⁴ *Michael Sassano*, Exchange Act Release No. 58632, 2008 SEC LEXIS 2947, at *37, 39-401 (Sept. 24, 2008).

²⁵ Tr. 15-16.

²⁶ Tr. 16.

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IV. Conclusion

In sum, Market Regulation has complied with its discovery obligations by producing the documents required by FINRA Rule 9251. Respondent has not established that it is entitled to the additional documents it seeks, or that their production is necessary for Respondent to present its defenses. For these reasons, Respondent's Motion is denied.

SO ORDERED.

Matthew Campbell
Hearing Officer

Dated: March 19, 2015