

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

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

**ORDER DENYING MOTIONS FOR PRODUCTION
OF DOCUMENTS PURSUANT TO RULE 9252**

Respondents _____, _____, _____, _____, and _____ have requested, pursuant to Rule 9252, that the Association invoke Rule 8210 to compel the production of documents. Three separate motions are pending, and the Department of Enforcement has opposed each. The Hearing Officer concludes, having considered the Parties' written submissions and having heard oral argument,¹ that Respondents have failed to make an adequate showing to justify the relief requested.

**Standards for Invoking Rule 8210 to Compel
Production of Documents Pursuant to Rule 9252**

Rule 9252(a) affords respondents the right to request that the Association invoke its Rule 8210 powers to compel the production of documents for hearing.² Pursuant to Rule 9252(b), a

¹ At the May 1, 1998 Pre-Hearing Conference, the Hearing Officer afforded the Parties the opportunity to present oral argument on these motions.

² A request under Rule 9252(a) must be in writing and "describe with specificity the Documents, [or] the category or type of Documents . . . sought; state why the Documents, [or] the category or type of Documents . . . are material; describe the requesting Party's previous efforts to obtain the Documents, [or]

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request shall be granted only upon a showing that: (1) the information sought is relevant, material, and non-cumulative; (2) the requesting Party has previously attempted in good faith to obtain the desired documents through other means but has been unsuccessful in such efforts; and (3) each of the persons from whom the documents are sought is subject to the Association's jurisdiction. In addition, the Rule requires the Hearing Officer to consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome, and whether the request should be denied, limited, or modified.

In support of their motions, Respondents _____, _____, and _____ argue principally that, in the context of a customer arbitration proceeding, they routinely would receive the documents they seek here. The scope of discovery in a customer arbitration proceeding is irrelevant in determining whether Respondents have made an adequate showing under Rule 9252.³ In addition, contrary to Respondents' assertion, this disciplinary proceeding is not analogous to a customer arbitration proceeding. In instituting and prosecuting a disciplinary proceeding, the Department of Enforcement does not act as a surrogate for aggrieved investors. Although the NASD, in its disciplinary proceedings, may obtain restitution for investor victims, the primary purpose of its disciplinary proceedings is to police its members and associated persons to ensure compliance with NASD rules and the federal securities laws. Accordingly, there may be defenses in a customer arbitration alleging fraudulent misconduct by a broker that

the category or type of Documents . . . through other means; and state whether the custodian of each Document, or the custodian of the category or type of Documents . . . is subject to the Association's jurisdiction." Rule 9252(a) also affords respondents the right to request that the Association invoke Rule 8210 to compel testimony at the hearing.

³ In the arbitration forum, an aggrieved customer voluntarily submits to the jurisdiction of the Association and, as a party to the proceeding, may be required to produce documents. By contrast, in an NASD disciplinary proceeding, aggrieved customers, including those who testify at hearing, are not subject to the Association's jurisdiction and cannot be compelled, through the invocation of Rule 8210 or otherwise, to produce documents.

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are not recognized in disciplinary proceedings alleging the same misconduct (e.g., lack of customer reliance) and, therefore, relevancy and materiality determinations will not be necessarily the same in both proceedings.

I. Respondent _____ Motion

_____ has requested the production of customer account documentation relating to all securities, commodities, or options accounts, maintained by his former _____ customers,⁴ at firms other than _____. Respondent's request does not identify any firms where these accounts were located; rather, it is directed to every NASD member that served as an introducing or clearing firm for such accounts.⁵ Respondent's request seeks the production of documents that were maintained, generated, or sent by these firms during a ten-year period, i.e., from January 1, 1986 to December 31, 1996, and identifies five categories of documents. Specifically, _____ seeks: (1) all complaints from the customers and any responses, and all other correspondence to or from the customers relating to their accounts; (2) customer agreements, accounts statements, and new account forms; (3) documents reflecting the customers' net worth and investment experience; (4) prospectuses and "red herrings" sent to the customers; and (5) notes of any conversations with the customers concerning their accounts.

⁴ Respondent's request identifies seven customers; each is identified, by initials, in the Complaint's allegations pertaining to him.

⁵ Enforcement suggests that Respondent, sub silentio, alternatively seeks to compel the NASD to obtain the requested documents directly from the customers. Because Respondent, in fact, has not made such a request, the Hearing Officer will not address it.

Discussion and Ruling

Although the member firms obviously are subject to the Association's jurisdiction, Respondent has failed to satisfy the other requirements of Rule 9252.

A. Relevance and Materiality

_____ is charged with: (1) making baseless and improper price predictions to one customer; (2) effecting unauthorized securities transactions in six customers' accounts; (3) failing to execute timely an unsolicited order to sell; (4) improperly promising one customer that he would recover that customer's losses through a subsequent securities transaction; and (5) making unsuitable recommendations and effecting unsuitable securities transactions in the account of one customer, and falsifying _____ account records relating to that customer's net worth and investment objectives.

Respondent asserts that the documents sought are relevant and material because they "will likely demonstrate that the allegations . . . against [him] are baseless" and that his _____ customers "were seasoned investors who were accustomed to trading in risky and speculative securities."⁶ Respondent also argues that the documents are necessary to effectively cross-examine and impeach the credibility of the customer witnesses who may testify against him.

The Hearing Officer recognizes, and Enforcement concedes, that evidence relating to a customer's sophistication or investment experience may be relevant and material in defending alleged suitability violations. However, this charge is only one of several; relates to only one of seven customers identified in the allegations pertaining to _____; and was not even mentioned in _____ motion papers.⁷ Respondent otherwise cannot demonstrate, and has not

⁶ Respondent _____ Motion to Compel Production of Documents, p. 3.

⁷ Enforcement also overlooked the fact that _____ is charged with suitability violations.

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demonstrated, that the evidence he seeks is substantively relevant to the charges against him. He has not proffered any theory as to how evidence of a customer's investment experience or degree of sophistication could be relevant to charges of unauthorized trading, refusing to timely execute an order to sell, or falsifying account documentation. And, as to the other charges, which involve false and misleading statements, it is well established that customers' sophistication or awareness of speculative risks does not justify making misstatements to them.⁸ Moreover, because reliance is not an element in proceedings brought by the NASD⁹ or the SEC,¹⁰ customer sophistication regarding securities and investment practices is irrelevant.¹¹

Respondent's other argument, that the documents sought will aid in impeaching adverse customer witnesses, is only marginally more appealing. _____ suggests that evidence showing a customer has a history of complaining about securities transactions (especially those where losses were incurred), or evidence showing a customer purchased, through other firms, the securities involved in this action may be helpful to discredit adverse testimony. (Transcript of May 1 Pre-Hearing Conference ("Tr."), pp. 55-59, 62.) However, Rule 9252 does not allow respondents to engage in a "fishing expedition," and _____ has not demonstrated that he has a

⁸ See e.g., In re James E. Cavallo, 49 S.E.C. 1099, 1102 (1989), review denied, 993 F.2d. 913 (Table) (D.C. Cir. 1993); In re Jay Houston Meadows, Exchange Act Release No. 37156, 1996 SEC LEXIS 1194, at * 20 (May 1, 1996) ("[w]e have . . . repeatedly rejected arguments that the antifraud provisions do not apply to customers who were experienced or sophisticated").

⁹ District Business Conduct Committee No. 8 v. Cruz, Complaint No. C8A930048, 1997 NASD Discip. LEXIS 62, at *50, n.31 (NBCC Oct. 31, 1997).

¹⁰ SEC v. Rana Research, Inc., 8 F. 3d 1358, 1363-64 (9th Cir. 1993); SEC v. North American Research & Dev. Corp., 424 F.2d 63, 84 (2d Cir. 1970) ("reliance is immaterial . . . because it is not an element of fraudulent misrepresentation under Rule 10b-5 in the context of an SEC proceeding against a broker").

¹¹ Cf. Weiss v. Blech, 1997 U.S. Dist. LEXIS 11701 (S.D.N.Y. Aug. 11, 1997) (because reliance is not an element of claims under Sections 11 and 12(2) of the Securities Act of 1933, the court denied defendants' motion to compel production of documents relating to plaintiffs' securities transactions that were not the subject of the lawsuit).

reasonable basis – or any basis – to believe that the documents sought contain any material evidence that might bear on the customer witnesses’s credibility.¹²

B. Respondent’s Effort to Obtain the Documents

In addition, _____ has failed to demonstrate that he made any good faith efforts to obtain the requested documents prior to filing his motion. Indeed, there is no evidence in the record that _____ made any reasonable efforts even to ascertain whether any of his _____ customers maintained accounts at other firms. Respondent claims he attempted to obtain the subject documents from Enforcement and the SIPC Trustee for _____. However, Respondent has not explained, under what circumstances, _____ SIPC Trustee conceivably would possess documentation relating to accounts at firms other than _____, or why he had reason to believe that Enforcement might be able to provide the documents.¹³ In the Hearing Officer’s view, these efforts do not satisfy the “good faith efforts” requirement in Rule 9252.¹⁴

C. Ruling

Respondent’s motion, if granted, would require every NASD member firm – approximately 5400 entities – to conduct a search of its records spanning a ten-year period, from January 1986 to January 1996.¹⁵ The Hearing Officer concludes that Respondent’s expansive request cannot be justified on the speculative hope of discovering evidence that is of limited

¹² The Hearing Officer also notes that under the Federal Rules of Evidence, which she may look to for guidance, specific instances of conduct introduced for the purpose of attacking a witness’s credibility may not be proved through extrinsic evidence. FRE 608(b).

¹³ Respondent has not suggested that Enforcement improperly withheld discoverable documents.

¹⁴ At oral argument, _____ counsel asserted that it would have been futile to seek the documents from either the customers or member firms. (Tr., pp. 65, 76.) However, there is no futility exception to the “good faith efforts” requirement in Rule 9252.

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substantive relevance and otherwise collateral. Further, Respondent has failed to demonstrate that he has made good faith efforts to obtain the documents prior to filing his motion. Under these circumstances, the Hearing Officer has no reason to consider limiting or modifying the scope of Respondent's request. Accordingly, the Hearing Officer denies Respondent _____ motion.

II. Motion of Respondents _____

The motion filed by Respondents _____ and _____ is substantially identical to, and adopts the same relevancy and materiality arguments made in, _____ motion.

However, these Respondents are not charged with suitability violations. Rather, they are charged with:

(1) making baseless and improper price predictions; (2) failing to execute customers' orders to sell, or aggressively discouraging customers from selling, certain securities; and (3) effecting unauthorized securities transactions. _____ also is charged with falsely promising to limit a customer's potential losses and improperly comparing the expected investment performance of one issuer to that of another. _____ also is charged with making false and misleading statements about the reason for a decrease in the price of a stock.¹⁵ For the reasons discussed above, the Hearing Officer concludes that the evidence Respondents seek is not substantively relevant or material to any of the charges against them. Nor have Respondents shown otherwise. At best, the evidence they hope to find is extrinsic and potentially relevant only to the extent that it might bear negatively on the customer witnesses' credibility.

¹⁵ The Hearing Officer notes that Respondent's request covers a time frame far beyond the SEC's record-keeping requirements. See, e.g., SEC Rules 17a-4(a), 17a-4(b), and 17a-4(c).

¹⁶ Respondents' motion papers incorrectly state the allegations against them.

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In addition, Respondents have failed to demonstrate that they have made good faith efforts to obtain the requested documents prior to filing their motion. In their motion papers, Respondents state that they have reason to believe that three of their _____ customers maintained, in the aggregate, accounts at twenty-six other firms. However, there is no indication that they made any efforts to obtain the requested documents from either these customers or the appropriate member firms. Rather, they claim to have made the same efforts to obtain the documents as did _____. As stated above, the Hearing Officer cannot find that requests for the subject documents, made to Enforcement and _____ SIPC Trustee, constitute “good faith efforts” under Rule 9252.

Therefore, and for the reasons discussed in the analysis of _____ motion, the Hearing Officer denies the motion of Respondents _____ and _____.

III. Motion of Respondents _____

Respondents seek an order directing Enforcement to “discover,” from “potential customer-witnesses,” the names of the firms, other than _____, where these customers maintained brokerage accounts. This request relates to other accounts that such customers maintained during the time they maintained their _____ accounts. Respondents independently have determined that, collectively, five of their former _____ customers maintained other brokerage accounts, and have identified seven firms where such accounts were maintained.

Respondents further request that the firms to be identified by Enforcement, as well as the seven firms they have identified, be compelled to produce documentation relating to the customers’ securities, commodities, and options accounts. Respondents’ request seeks the production of documents that were maintained, generated, or sent by these firms during a five

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year period, i.e., from January 1, 1994 through December 31, 1996. Their specific document requests otherwise are identical to those made by the other movants.

Discussion and Rulings

A. Respondents' Request for Discovery from "Potential Customer-Witnesses"

The Hearing Officer has no authority, under Rule 9252 or any other provision of the Code, to issue an order requiring Enforcement to invoke Rule 8210 to obtain documents or elicit testimony from persons who are not subject to the Association's jurisdiction, such as the "potential customer-witnesses." Even as to persons subject to the Association's jurisdiction, Rule 9252 authorizes the Association to compel only the production of documents or testimony at hearing; it does not provide for the use of interrogatories or any similar procedure. For these reasons, the Hearing Officer must deny this portion of Respondents' request and, therefore, their concomitant request for the production of documents from the firms to be identified by Enforcement is moot.

B. Respondents' Requests for Discovery from NASD Member Firms

Insofar as Respondents seek documents from the seven firms they have identified, they have satisfied the jurisdictional requirement in Rule 9252. However, they have failed to make an adequate showing under the other requirements in the Rule.

As to materiality and relevance, _____ and _____ have made essentially the same arguments as the other movants. In their motion papers, they assert: "in order to insure a fair hearing with all due process considerations, Respondents must be able to obtain all pertinent

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information regarding the sophistication and credibility of said customer-witnesses.”¹⁷ However, _____ and _____ are not charged with suitability violations as to any of the customers who maintained an account at one or more of the seven firms; nor are they charged with any other violations that might raise customer sophistication issues. Rather, as to these customers, _____ and _____ are charged with: (1) making baseless and improper price predictions; (2) effecting unauthorized securities transactions; and (3) failing to execute, or improperly delaying the execution of, orders to sell. _____ also is charged with improperly promising to make up losses through subsequent trading, and linking the opportunity to buy securities in an IPO to purchases of the same or different securities in the aftermarket.

Nor is the Hearing Officer persuaded that Respondents have made an adequate showing to entitle them to engage in a search for extrinsic evidence bearing on credibility. _____ and _____, like the other movants, have not demonstrated that they have a reasonable basis – or any basis – to believe that the documents sought contain any such evidence.

Moreover, Respondents have failed to demonstrate that they made good faith efforts to obtain the requested documents prior to filing their motion. Respondents state only that their counsel “was unable to contact” or “unsuccessful at attempts to contact” the customers. The Hearing Officer does not believe that these conclusory statements satisfy the showing required by Rule 9252. In addition, Respondents do not suggest that they made any attempts to obtain the documents from the relevant member firms.

¹⁷ Motion of Respondents _____ and _____ Seeking an Order to Compel the Production of Documents, pp. 2-3.

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Based on the foregoing, and on the discussion of _____ materiality and relevancy arguments, the Hearing Officer also denies this portion of the motion of Respondents _____ and _____.

SO ORDERED.

Ellen B. Cohn
Hearing Officer

Dated: Washington, DC
May 18, 1998