

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	
Complainant	
v.	Disciplinary Proceeding No. C3A040045
Respondent.	Hearing Officer – DMF

ORDER (1) GRANTING COMPLAINANT'S MOTION FOR LEAVE TO OFFER TELEPHONE TESTIMONY AND DENYING RESPONDENT'S MOTION TO POSTPONE THE HEARING; (2) GRANTING COMPLAINANT'S MOTION IN LIMINE; AND (3) DENYING RESPONDENT'S MOTION IN LIMINE

1. The Department of Enforcement filed a motion seeking leave to offer the testimony of two of Respondent's customers, DS and NS (husband and wife), by telephone. In its motion, Enforcement represents that the customers, who are not subject to NASD's jurisdiction, live in Massachusetts. Although they had previously told Enforcement they would travel to Phoenix for the hearing, they have now advised that they are unable to do so because of DS's health, but they remain willing to testify by telephone.

Respondent opposes the motion and requests that the hearing be delayed until the customers are able to testify in person, or alternatively until the customers' testimony can be videotaped, at Enforcement's expense, at a location near the customers' home. Respondent expresses concern, in particular, about his ability to utilize effectively a large number of documents that he plans to use in cross-examining the customers.

The use of telephone testimony in NASD disciplinary proceedings is well-established. NASD lacks subpoena authority, and allowing witnesses who are not subject

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to NASD authority to testify by telephone is a reasonable accommodation to ensure the presentation of relevant evidence. In this case, Enforcement previously filed an unopposed motion for leave to present the testimony of another customer witness by telephone, for similar reasons – i.e., the witness has health problems and may be unable to travel from her home to the hearing location – which was granted. The principal distinction with regard to the instant motion is that Enforcement filed it after the deadline for such motions set forth in the pre-hearing schedule. Enforcement has adequately explained, however, that the witnesses did not advise that they would be unable to travel to Phoenix until October 18, and Enforcement filed its motion the next day. Under these circumstances the Hearing Officer finds good cause for allowing Enforcement to file the motion out of time.

The mechanics of telephone testimony may be cumbersome, particularly when a witness is examined with regard to a large number of documents, but even if the hearing were postponed until December, as Respondent requests, there is no guarantee that the customers could or would appear for the hearing. And there is also no assurance that the customers could or would agree to videotaped testimony. Finally, Respondent's discussion of his planned cross-examination of the customers, including his lengthy list of the documents he plans to use, suggests that he may misapprehend the issues in this proceeding and the scope of relevant customer testimony. The issue before the Hearing Panel is whether Respondent fulfilled his obligation under Rule 2310 to have reasonable grounds for recommending that his recommendations to his customers were suitable, based on "the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs," and perhaps, as well, whether Respondent, in

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connection with his recommendations, fulfilled his obligation under the rule to “make reasonable efforts to obtain information” from his customers regarding their financial status, tax status, investment objectives, and other information. Both direct and cross-examination of the customer witnesses will be limited to questions relevant and material to these issues. Insofar as there may be disputes as to what information the customers provided, or what inquiries Respondent made, that is a proper subject of cross-examination, but this proceeding concerns Respondent's conduct, not the customers', and, pursuant to Rule 9263(a), the Hearing Officer will not permit either party to offer evidence, or pursue direct or cross-examination, that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial.

Enforcement's motion to offer telephone testimony is therefore granted, subject to the same requirements set forth in the order granting Enforcement's prior motion for leave to offer telephone testimony, and Respondent's motion to postpone the hearing is denied.

2. Enforcement also filed a motion in limine seeking pre-hearing rulings regarding two proposed summary exhibits. Enforcement states that the first exhibit contains excerpts from certain mutual fund prospectuses and variable annuity registration statements allegedly recommended by Respondent, apparently to show that they “were primarily equity funds, growth funds, or a combination of equity and growth.” Enforcement argues that this exhibit would make it unnecessary for Enforcement to introduce the full prospectuses and registration statements, which altogether run to “thousands of pages.” The second exhibit is purportedly “a summary of all new accounts opened by [Respondent] from July 1, 1999 to February 29, 2000 reflecting the name of

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the customer, the customer's date of birth, investment objective, income and net worth," which Enforcement would offer to "show that regardless of their respective financial situation and age, [Respondent's] customers, with very few exceptions, all had growth or aggressive growth checked as their investment objective." Enforcement argues that this exhibit would make it unnecessary for Enforcement to offer all of the customers' individual new account cards, "which in total comprise 520 pages." Enforcement seeks an advance ruling that it may offer these summary exhibits without also offering the underlying materials from which they were derived.

Respondent objects to both summary exhibits. With respect to both summaries, Respondent argues that Enforcement's motion indicates that the NASD staff secretary who prepared the summaries will not testify and be available for cross-examination; instead, Enforcement indicates that it will offer the summaries through a staff examiner who has reviewed and verified the information on the summaries. The question, however, is whether the summaries accurately reflect the underlying documents. If the witness has personally verified each entry by comparing it with the underlying document, the witness is competent to establish a foundation for the summaries, and by the same token, the witness may be effectively cross-examined regarding their accuracy and completeness.

Second, with regard to the prospectus summary, Respondent objects that even if Enforcement does not offer the complete prospectuses, Respondent will do so, "so that the customers who testify can be properly cross-examined." The fact that Respondent may wish to use the prospectuses for his own purposes, however, is not a valid objection to Enforcement's use of summaries. Enforcement represents that it has provided copies

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of all of the prospectuses to Respondent; it is up to him to designate those prospectuses or portions of prospectuses that he wishes to offer in evidence on his own behalf, subject to any objections that Enforcement may raise.

Next, Respondent argues that the prospectus summary would be inadmissible to the extent that the summarized prospectuses relate to investments by customers who will not testify at the hearing. As Respondent explains, this argument is premised on the Hearing Officer granting his separately filed motion in limine seeking to preclude any evidence regarding customers who, although identified in the Complaint, will not testify at the hearing. Since the Hearing Officer will deny that motion, for reasons set forth below, this argument against the summaries must fail. Respondent's objection to the new account summary on the ground that it includes information regarding customers who are not identified in the Complaint is essentially a relevance objection that goes beyond the scope of Enforcement's motion and the ruling herein; Respondent is not precluded from raising a relevance objection at the appropriate time.

Enforcement's motion is therefore granted, to the extent that Enforcement may offer the summaries without also offering the underlying documents, but without prejudice to Respondent's right to raise any other objections to the summaries.

3. Respondent has filed a motion in limine seeking an order precluding Enforcement "from introducing documents or testimony related to customers named in the Complaint who will not testify at the hearing and, as a result, will not be available for cross-examination" Enforcement opposes the motion.

Respondent argues that it would be unfair for Enforcement to offer, and the Hearing Panel to consider, evidence comprising communications from customers who

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will not be subject to cross-examination. Such evidence may take the form of affidavits or declarations, completed questionnaires, correspondence, etc. Respondent asserts that any reliance on such evidence would violate his right to "due process."¹

Although couched in more sweeping terms, this amounts to a hearsay objection. It is well established, however, that in NASD proceedings "hearsay statements may be admitted in evidence and, in an appropriate case, may form the basis for findings of fact." Charles D. Tom, 50 S.E.C. 1142, 1992 SEC LEXIS 2000 at *7 (Aug. 24, 1992). And as in Tom, those statements may include customer complaint letters, declarations or other evidence of customer statements. As the SEC explained in Tom: "In determining whether to rely on hearsay evidence, it is necessary to evaluate its probative value and reliability, and the fairness of its use. The factors to consider include the possible bias of the declarant, the type of hearsay at issue, whether the statements are signed and sworn to rather than anonymous, oral or unsworn, whether the statements are contradicted by direct testimony, whether the declarant was available to testify, and whether the hearsay is corroborated." Id. (footnotes omitted). The Panel will consider all these questions in determining the weight, if any, to be given to any hearsay customer evidence in this proceeding, but such statements will not be excluded.

¹ It is well established that NASD is a private entity, not a "state actor"; as a result, constitutional due process requirements do not apply to NASD proceedings. See, e.g., D.L. Cromwell Investments, Inc. v. NASD Regulation, Inc., 279 F.3d 155, 162 (2d Cir. 2002).

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Respondent's motion to preclude Enforcement from offering any testimony or documents relating to customers who do not testify at the hearing, therefore, is denied.

SO ORDERED.

David M. FitzGerald
Hearing Officer

Dated: October 31, 2005