

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Disciplinary Proceeding
No. 2005001919501

Hearing Officer—Andrew H. Perkins

**ORDER DENYING RESPONDENT'S MOTION TO COMPEL
PRODUCTION OF EXCULPATORY AND OTHER MATERIAL DOCUMENTS**

The Respondent moved pursuant to NASD Procedural Rules 9251(a)(3) and 9251(b)(2) for entry of an order compelling the Department of Enforcement ("Enforcement") to search for and produce documents relating to the adoption, application, and enforcement of NASD Conduct Rule 2711, NASD's Research Analyst Rule. Respondent contends that the requested documents may possibly contain exculpatory evidence. Respondent also moved for entry of an order requiring Enforcement to compile a privilege log so that she can test whether Enforcement has properly asserted its right to withhold privileged and confidential material under Procedural Rule 9251(b).

Enforcement opposed Respondent's motion on the grounds that the requested documents fall outside the scope of Procedural Rule 9251 because they were not "prepared or obtained by [NASD] staff in connection with the investigation that led to the institution of proceedings." In addition, Enforcement contended Procedural Rule 9251(b)(2) does not obligate Enforcement to conduct an entity-wide search for evidence that might help the defense. Enforcement opposed production of a privilege log on the

grounds that Respondent failed to show that she has a reason to believe that Enforcement had improperly withheld any documents.

For the reasons discussed below, Respondent's motion is denied.

A. Background

Enforcement has charged Respondent with violations of several NASD Conduct Rules in connection with the issuance of three research reports on [CDS] while she was employed as a sell-side research analyst for [the Firm]. The Complaint alleges that Respondent violated Conduct Rules 2711(h)(1)(C), 2210(d)(1)(A), and 2110 by failing to disclose her discussions regarding possible employment with CDS in the first two reports, and her acceptance of employment with CDS in the third report. The Complaint further alleges that each of the research reports she authored was favorable to CDS.

Most of the material facts are undisputed. According to the Complaint and the papers filed by the parties in support of and in opposition to the present motion, in January 2005, an executive search firm contacted Respondent about an Investor Relations position at CDS. On or about January 31, 2005, Respondent met with representatives of the search firm. Enforcement alleges that the purpose of the meeting was to prepare for upcoming interviews with CDS management. On February 4, 2005, the Firm issued the first of the three reports at issue in this proceeding. In it, Respondent reiterated her "buy" rating, which she had issued in her previous report dated January 13, 2005. In addition, she increased her target price for CDS stock. Respondent did not disclose that she had participated in discussions about her possible employment at CDS.

On February 11 and 16, 2005, Respondent interviewed with senior members of CDS management. The Complaint alleges that on February 28, 2005, Respondent advised the search firm that she was interested in the job, but there were details that she wanted to address before she made a final decision. Thereafter, on March 2, 2005, the Firm

published another favorable research report on CDS, which Respondent authored.¹ Respondent did not disclose that she was in discussions and considering employment with CDS.

Respondent received an offer from CDS in late March 2005, which she accepted on April 8, 2005. On the same day, Respondent told her supervisor that she was accepting the CDS offer. The Firm did not suspend her coverage of CDS. On April 28, 2005, the Firm released the third favorable research report on CDS. The third report did not disclose that Respondent had accepted the position with CDS.

B. The Document Requests

Respondent states that the Conduct Rules Enforcement relies on do not specifically address the conduct, or the materiality of the conduct, at issue. Respondent theorizes that this omission might be the result of an “informed decision not to regulate disclosure pertaining to employment discussions with covered companies.”² Accordingly, Respondent contends that she is entitled to inspect and copy a wide-range of documents relating to the “deliberative process” that led to the promulgation and adoption of Conduct Rule 2711.³ Respondent argues that these documents, as well as others relating to the application of Conduct Rule 2711, are essential to her defense because, to her knowledge, Enforcement has never “challenged this wide spread industry conduct as violative of the conflict of interest rules pertaining to analysts.”⁴

Respondent identified three categories of documents that she contends may possibly contain exculpatory or other “highly probative” information.⁵ The three

¹ Respondent appeared on the reports as the senior analyst, and YH appeared on each as the junior analyst.

² Respondent Mot. at 5.

³ *Id.* at 3.

⁴ *Id.*

⁵ *Id.* at 1, 5-8.

categories are (1) documents relating to industry practices in the handling of disclosures of employment discussions, (2) documents relating to NASD examinations of other analysts that allegedly accepted employment with companies they covered while employed by a member firm, and (3) documents relating to the deliberative process underlying the promulgation of Conduct Rule 2711. Respondent argues that documents within these three categories are critical to her ability to discover evidence pertaining to the following topics:

- (1) regulatory consideration of the materiality of pre-acceptance employment discussions with covered companies;
- (2) industry standards with respect to analyst disclosure of employment discussions with covered companies;
- (3) industry standards with respect to analyst and member firm disclosure of an analyst's decision to accept future employment with a covered company;
- (4) exculpatory evidence pertaining to what constitutes a "financial interest" in a covered company;
- (5) the rationale behind the use of the words "actual conflict of interest" in the drafting of Rule 2711; and
- (6) the applicability of Rule 2711 to analyst disclosure in Research Reports as opposed to Member Firm disclosure.⁶

1. Category 1—Industry Standard Practice

First, Respondent seeks discovery of documents relating to seven publicly reported instances where analysts accepted employment with companies they covered, but no known enforcement action ensued. None of the reported cases relate either to the Firm or CDS.

In this category, Respondent seeks production of the following documents:

1. All documents that constitute, evidence, relate or refer to the investigatory and deliberative files pertaining to the [] matter it claims to have "looked into."

⁶ *Id.* at 3-4.

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2. All documents that evidence, relate or refer to NASD consideration of requiring analysts to disclose employment discussions or acceptance of employment with covered companies.

3. All documents that evidence, relate or refer to the NASD's definition of "compensation" under Rule 2711, including classifying "future" or contingent benefits as compensation.

4. All documents that evidence, relate or refer to what constitutes an "actual" conflict of interest requiring disclosure under Rule 2711.

5. All documents that constitute, evidence, relate or refer to NASD inquiries and/or investigations, questionnaires or "sweeps" relating to analysts moving to covered companies.⁷

2. Category 2—NASD Examination Files

Second, Respondent seeks discovery of documents relating to NASD examinations of the six member firms with which the analysts identified in Category 1 were associated when they reportedly accepted an offer of employment with a company they covered. In this category, Respondent seeks production of the following documents:

1. NASD examination guidelines pertaining to Rule 2711.

2. NASD interpretations pertaining to Rule 2711, including interpretations of conflict of interests, materiality, and compensation.

3. Those portions of the examination files, Exit Summaries and responses to Exit Summaries pertaining in any way to [the publicly disclosed analysts who accepted positions in companies they covered while employed by NASD member firms].⁸

3. Category 3—Files Related to the Consideration and Promulgation of Rule 2711

Finally, Respondent seeks production of all non-privileged material in two files, SR-NASD-2002-21 and SR-NASD-2004-141. Respondent speculates that these files

⁷ *Id.* at 6.

⁸ *Id.* at 7.

contain exculpatory evidence, including documents analyzing “industry practices as they relate to regulating analyst conducts, including conflicts of interest.”⁹

C. Discussion

Procedural Rule 9251 defines the scope of discovery in NASD disciplinary proceedings by creating three categories of documents.

First, Rule 9251(a) sets the outside limit of discovery in NASD disciplinary proceedings, which is substantially less than the scope of discovery permitted in federal court under the Federal Rules of Civil Procedure. NASD Procedural Rule 9251(a) obligates Enforcement to allow respondents to inspect and copy non-privileged “Documents prepared or obtained by Interested Association Staff in connection with the investigation that led to the institution of proceedings.”¹⁰ Under this definition, Enforcement must produce documents prepared or obtained by any NASD employee who directly participated in the case at issue or any related examination, investigation, prosecution, or litigation regardless of whether the documents are contained in Enforcement’s case file. Thus, Enforcement counsel has the duty to search for and review documents that may be in the possession of other NASD employees who participated in some manner in the case at issue or in a related proceeding, irrespective of whether the documents are maintained in the formal investigatory file.¹¹

Second, Rule 9251(b)(1) permits Enforcement to withhold from production any of the documents falling within the first category of documents that are privileged. Privileged documents include those subject to attorney-client privilege, as well as

⁹ *Id.* at 8.

¹⁰ The term “Interested Association Staff” is defined in Rule 9120(r)(1). Generally, the definition covers any Enforcement employee and any other NASD employee who directly participated in a related examination, investigation, prosecution, or litigation.

¹¹ As discussed below, Enforcement must include a search for any documents that contain material exculpatory evidence.

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confidential internal reports, memoranda, notes, and other writings related to an investigation or examination, and documents that would reveal an enforcement technique or guideline.¹² NASD permits such documents to be withheld to ensure that NASD's enforcement efforts are not impaired.¹³ In addition, under Rule 9251(b)(1)(D), the Hearing Officer may grant leave to Enforcement to withhold a document or category of documents as not relevant to the subject matter of the proceeding, or for other good cause.

Third, under Rule 9251(b)(2), Enforcement must produce any document it withheld pursuant to Rule 9251(b)(1) if it contains "material exculpatory evidence."¹⁴ NASD applies Procedural Rule 9251(b)(2) consonant with the principles enunciated by the Supreme Court in *Brady v. Maryland*, 373 U.S. 83 (1963). In *Brady*, the Supreme Court held "that the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution."¹⁵ The Supreme Court later held that the duty encompasses impeachment evidence as well as exculpatory evidence. In the pre-hearing phase of an NASD disciplinary proceeding, "material evidence" is evidence relating to liability or sanctions that might be considered favorable to the respondent's case, which, if suppressed, would deprive the respondent of a fair hearing.¹⁶

¹² See Rule 9251(b)(1).

¹³ See Order Approving Proposed Rule Change, Exchange Act Release No. 38,908, 1997 SEC LEXIS 1617, at *134 n.194 (Aug. 7, 1997).

¹⁴ See Rule 9251(b)(2).

¹⁵ 373 U.S. at 87. The Supreme Court later held that the duty encompasses impeachment evidence as well as exculpatory evidence. See *United States v. Bagley*, 473 U.S. 667, 676 (1985).

¹⁶ OHO Redacted Order 01-13, CAF000045, at 11 (May 17, 2001), available at http://www.nasd.com/RegulatoryEnforcement/Adjudication/OfficeofHearingOfficersDecisionsandProceedings/OHODisciplinaryOrders/2001Orders/NASDW_007867 (citing *United States v. Bagley*, 473 U.S. 667, 675 (1985)).

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Contrary to Respondent's arguments, Procedural Rule 9251(b)(2) and the *Brady* doctrine it incorporates do not expand the scope of documents that must be produced beyond the limits set in Rule 9251(a). Rather, Rule 9251(b)(2) limits the scope of documents Enforcement may withhold from production under a claim of privilege pursuant to Rule 9251(b)(1).

Here, Respondent has not shown that any of the categories of documents she requests falls within the reach of Procedural Rule 9251(a). None of the documents she seeks was obtained or prepared by NASD employees in connection with this or a related proceeding. Accordingly, Enforcement has no duty to produce those documents.

Moreover, Respondent has not shown that the requested documents contain admissible material exculpatory evidence. Respondent argues that she has been treated differently from the six other analysts who reportedly also accepted employment with companies they covered. Respondent repeatedly makes the point that NASD did not take enforcement action against any of the other analysts. However, a registered representative cannot excuse her misconduct by showing that others engaged in similar misconduct. Further, Respondent has not claimed that she is the target of improper selective prosecution.¹⁷

In addition, Respondent cannot rely on the file notes and other documents she speculates are in NASD's files relating to the rule-making proceedings that led to the adoption and amendment of Conduct Rule 2711. Such documents are not part of the Rule's legislative history and are inadmissible.

¹⁷ To establish selective enforcement, a respondent must show "that she was singled out for enforcement while others who were similarly situated were not and that her prosecution was motivated by arbitrary or unjust considerations, such as race, religion, or the desire to prevent a constitutionally-protected right." *District Bus. Conduct Comm. v. Roach*, No. C02960031, 1998 NASD Discip. LEXIS 11, at *19 n.13 (N.B.C.C. Jan. 20, 1998) (citing *George H. Rather*, Exchange Act Release No. 36,688, 1996 SEC LEXIS 85, at *6 (Jan. 5, 1996)). Respondent has not made such a claim.

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Accordingly, the Hearing Officer denies Respondent's Motion to Compel Enforcement to Produce Exculpatory Documents and Other Material Documents.

IT IS SO ORDERED.

Andrew H. Perkins
Hearing Officer

Dated: July 13, 2007