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NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant v. RESPONDENT FIRM, RESPONDENT 2, RESPONDENT 3, RESPONDENT 4, and RESPONDENT 5, Respondents.	Disciplinary Proceeding No. E102003025201 Hearing Officer – SW

ORDER RULING ON (1) OBJECTIONS TO WITNESSES, (2) MOTION TO SUBSTITUTE EXHIBIT, (3) MOTIONS IN LIMINE, AND (4) MOTIONS TO STRIKE THE RESPONDENTS' AFFIRMATIVE DEFENSES

I. THE PARTIES' OBJECTIONS TO WITNESSES OVERRULED

A. Respondent 4's Witnesses

On May 3, 2007, Respondent 4 filed his pre-hearing submission, which included a witness list of 11 individual witnesses.[1] On May 10, 2007, Respondent 4 supplemented his witness list to summarize the expected testimony of his witnesses.

On May 18, 2007, the Department of Enforcement ("Enforcement") filed an objection to three of the witnesses proposed by Respondent 4. Specifically, Enforcement

[1] Respondent 4 argued that his pre-hearing submission, received by the Office of Hearing Officers on May 3, 2007, was filed timely. Respondent 4 is directed to review NASD Procedural Rule 9135, which provides that papers that are required to be filed with an Adjudicator within a time limit specified by the Adjudicator or within a time limit set forth in the Rules shall be deemed timely **if received within the time limit**. (Emphasis added).

objected to TH, RH, and MK. Enforcement objected to TH and RH because they did not work at the Firm at any time, and therefore their testimony would be irrelevant to the conduct that occurred at the Firm. Enforcement objected to MK because the summary of his testimony was so vague as to be irrelevant and immaterial. On June 4, 2007, Respondent 4 filed a response to Enforcement' Objection, and at the pre-hearing conference held on June 6, 2007, Respondent 4 further supplemented his response.

TH and RH had interactions with the [Clearing Firm] and several of the hedge fund customers during the same time period as the conduct alleged in the Complaint, and they will testify that their interactions were similar to the interactions that Respondent 4 had with [the Clearing Firm] and the hedge fund customers, and is therefore relevant. MK will testify regarding the computer and time stamp systems used by Respondent 4. Accordingly, MK's testimony may be relevant to the determination of the accuracy of the time stamps presented on a number of the e-mails listed as Enforcement exhibits.

The Hearing Officer hereby overrules Enforcement's objections to the three witnesses, TH, RH, and MK. However, Enforcement may raise appropriate objections to specific questions at the Hearing.

B. Respondent 5's Witness

On May 22, 2007, Respondent 5 filed his pre-hearing submission, which included a witness list of six witnesses. On June 4, 2007, Enforcement filed an objection to one of the witnesses proposed by Respondent 5. Specifically, Enforcement objected to MK for the same reasons listed in its objection to Respondent 4's proposed witness list.

Finding MK's testimony to be relevant for the reason set forth above, the Hearing Officer overrules Enforcement's objection to MK as a witness in this proceeding.

C. Enforcement's Witness

On April 30, 2007, Enforcement filed its pre-hearing submission, which included a witness list of 15 witnesses. On May 22, 2007, Respondent 4 filed an objection to one of the witnesses proposed by Enforcement. Specifically, Respondent 4 objected to JB, arguing that [his] testimony would be irrelevant as it involved Respondent 4's activities at a prior firm and prior to his misconduct alleged in the Complaint.

On June 4, 2007, Enforcement filed a response to Respondent 4's objection. Enforcement argued that pursuant to a SEC subpoena, JB testified under oath that Respondent 4 showed him how to engage in several practices to conceal the identity of clients, in order to avoid mutual fund detection of his clients' trading, which Enforcement argues evidences Respondent 4's knowledge and intent to engage in deceptive actions to avoid mutual fund restrictions. The Hearing Officer hereby overrules Respondent 4's objection to JB.

II. ENFORCEMENT'S MOTION TO SUBSTITUTE EXHIBIT CX-488A GRANTED

On May 31, 2007, Enforcement filed a motion for leave to submit a substitute exhibit CX-488A for exhibit CX-448 in order to correct a production error in the preparation of CX-448.[2]

None of the Respondents objected to the motion. Accordingly, Enforcement's motion to substitute exhibit CX-488A is granted.

[2] Page 22 of the un-excerpted transcript of SR, rather than page 36 of the transcript was incorrectly included in exhibit CX-448.

III. MOTIONS IN LIMINE OVERRULED

A. Respondent 4's Objection to Transcript of JB Overruled

On April 30, 2007, Enforcement filed its pre-hearing submission, which included 528 exhibits and a corresponding exhibit list. On May 22, 2007, Respondent 4 filed an objection to Exhibit CX-450, excerpts of the sworn testimony of JB. Specifically, Respondent 4 argued that the excerpts of the transcript contained hearsay testimony and the testimony lacks a proper foundation. On June 4, 2007, Enforcement filed a response to Respondent 4's objection. Enforcement argued that it intends to seek JB's live testimony, but if for some reason he is unavailable to testify in person, Enforcement would seek to use excerpts of JB's SEC testimony.

Hearsay has repeatedly been held to be admissible in these disciplinary proceedings. Counsel is free to argue the weight to which the Hearing Panel should give such testimony. Respondent 4's objection is overruled. However, the Parties should note that documents are not in evidence until and unless they are offered and admitted at the Hearing. Pursuant to NASD Procedural Rule 9263, the Hearing Officer retains the authority to reject the proposed exhibits of any of the Parties at the Hearing.

B. Enforcement's Descriptive Exhibit List

Respondent 4 objected to various designations contained in Enforcement's Exhibit List as being unduly prejudicial in that the headings assumed facts yet to be proven. Specifically, Respondent 4 objected to grouping Exhibit CX-351 through Exhibit CX-365 under the heading "Indications of Interest," and use of the terms "Late Trading" and "Market Timing" in the descriptions of Exhibit CX-500 through Exhibit CX-528. The Hearing Officer does not find that Enforcement's exhibit list, which

attempts to separately identify the evidence that Enforcement believes supports each particular allegation, is unduly prejudicial.

Respondent 4's objection is overruled and the motion to strike any portion of the descriptions contained in Enforcement's exhibit list or the exhibits is denied.

IV. MOTIONS TO STRIKE AFFIRMATIVE DEFENSES DENIED

On February 28, 2007, Enforcement filed a motion to strike, or pursuant to Rule 9264 moved for summary disposition with respect to the six affirmative defenses raised by [the Firm and Respondents 2 and 3] in their answer.[3] On the same date, Enforcement filed a motion to strike, or in the alternative moved for summary disposition with respect to the eight affirmative defenses raised by Respondent 4.[4] On March 9, 2007, Enforcement filed a motion to strike or in the alternative moved for summary disposition with the respect to the affirmative defenses raised by Respondent 5.[5]

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[3] [The Firm and Respondents 2 and 3's] amended answer listed as affirmative defenses: (1) there is not sufficient factual or evidentiary basis to support the allegations of the Complaint; (2) damages, if any, were caused by parties other than Respondents; (3) damages, if any, were caused and brought about by intervening and superseding causes; (4) the Complaint fails to state a cause of action; (5) the conduct alleged in the Complaint did not violate applicable laws, rules or regulations; and (6) Respondents conducted themselves in a commercially reasonably manner, consistent with federal securities laws, and the rules and regulations of NASD.

[4] Respondent 4's answer listed as affirmative defenses: (1) Enforcement's failure to state a claim upon which relief could be granted; (2) Enforcement's failure to plead the allegations in a manner sufficient to put Respondent 4 on notice as to the claims against him; (3) the action is barred under the doctrine of laches; (4) the allegations are lacking merit under the doctrines of waiver, ratification, and estoppel; (5) there are no NASD, SEC, state or federal statutes that empower NASD to discipline associated members for "late trading" or "market timing"; (6) equitable principles dictate that this claim be dismissed, as the NASD action against Respondent 4 is arbitrary and capricious; (7) Respondent 4's actions in this matter where in concert with well established practices in the securities business; and (8) NASD Enforcement's motivation in prosecuting this case is not to protect the investing public but to cover up its own deficiencies as a regulatory body.

[5] Respondent 5's answer listed as affirmative defenses: (1) Enforcement has not presented sufficient factual or evidentiary basis upon which to support the allegations of the Complaint; (2) Respondent 5's conduct was in a commercially reasonable manner consistent with well established practices in the securities business and the rules and regulations of NASD; (3) Respondent 5 requests that the Complaint be dismissed as the alleged conduct of the Complaint did not violate applicable rules or regulations; (4) the Complaint should be dismissed as NASD action against Respondent 5 is arbitrary and capricious; (5) the cause of this action is due to the failure of NASD as a regulatory body empowered to educate and guide market participants.

In summary, Enforcement contends that each of the affirmative defenses should be stricken because they would waste resources through increased discovery, related motion practice, additional hearing preparation, and a lengthier and more complex hearing. On March 22, 2007, Respondent 4 filed a motion in opposition to Enforcement's motion to strike. On March 26, 2007, the Firm and Respondents 2 and 3 filed an opposition to Enforcement's motion to strike. On April 5, 2007, Respondent 5 filed an opposition to Enforcement's motion to strike. The motions to strike and oppositions overlap to such a degree that a single order addressing the matters at issue is appropriate.

In ruling on Enforcement's motion, the Hearing Officer looked to the standards that have been developed by the federal courts under the Federal Rules of Civil Procedure (Fed. R. Civ. P.). Fed. R. Civ. P. 12(f) provides that the court may strike any insufficient defense from any pleading. Courts generally disfavor Fed. R. Civ. P. 12(f) motions and do not grant them routinely.[6] The general policy is that pleadings should be treated liberally, and that parties should be given the opportunity to support their contentions at trial.[7]

Before a federal court will grant a motion to strike affirmative defenses, it must be convinced of the following: (1) there is no question of fact which might allow the defense to succeed; (2) there is no substantial question of law which might allow the

[6] See New York v. Almy Brothers, Inc., 971 F.Supp. 69, 72 (N.D.N.Y. 1997).

[7] See Bennett v. Spoor Behrins Campbell & Young, Inc. 124 F.R.D. 562, 563 (S.D.N.Y 1989).

defense to succeed; and (3) there is prejudice to the opposing party from inclusion of the defense.[8]

Failure to state a claim as an affirmative defense is a "routine practice which is rarely, if ever, stricken by the court as legally insufficient."[9] Issues of causation and proximate causation of harm may impact a determination regarding the appropriate sanctions. Although the assertion of an alleged lack of duty that merely negates an element of Enforcement's allegation is not appropriately considered an affirmative defense, the proper treatment is not to strike the averment, but rather to treat it as a specific denial.[10]

Accordingly, after reviewing the written motions and oppositions thereto, and listening to the arguments raised at the June 6, 2007 pre-hearing conference, the Hearing Officer was not persuaded that striking the affirmative defenses would significantly conserve either the time or expense of Enforcement or the Office of Hearing Officers. The Hearing Officer was also not persuaded that failure to strike the affirmative defenses would unduly prejudice Enforcement.

Accordingly, Enforcement's motions to strike the affirmative defenses of the Respondents are denied.

SO ORDERED.

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Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
June 11, 2007

[8] See Cattaraugus County Project Head Start, Inc. v. Executive Risk Indemnity, Inc., 2000 U.S. Dist. LEXIS 16981, at *6 (W.D.N.Y. Nov. 8, 2000).

[9] See Almy, 971 F.Supp. at 72.

[10] See Etienne v. Wal-Mart Store, Inc., 197 F.R.D. 217, 221 (Nov. 14, 2000).