

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

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DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CMS970026
v.	:	
	:	Hearing Officer - JMF
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Respondents.	:	
	:	

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**ORDER GRANTING THE DEPARTMENT OF ENFORCEMENT’S MOTION  
FOR TELEPHONE TESTIMONY, DENYING RESPONDENTS’ MOTION FOR  
USE OF AN EXPERT WITNESS AND DENYING RESPONDENTS’ MOTION TO  
COMPEL PRODUCTION OF DOCUMENTS**

The Department of Enforcement (“Enforcement” or “Department”) filed a Motion for Leave to Offer Telephone Testimony of \_\_\_\_\_ on November 13, 1997. Respondents’ counsel indicated in a November 19, 1997 Pre-hearing Conference that Respondents’ opposed the Department’s Motion, although no written opposition was submitted.<sup>1</sup>

Respondents filed Motions for Use of an Expert Witness and a Motion to Compel Production of Documents on November 10, 1997 and November 13, 1997, respectively. The Department of Enforcement opposed Respondents’ Request for Use of an Expert Witness in a submission filed on November 17, 1997. The Department noted in a November 19, 1997 Pre-Hearing Conference that it did not oppose Respondents’ Motion to Compel Production of Documents from \_\_\_\_\_ a registered broker-

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<sup>1</sup> See Transcript of November 19, 1997 Pre-Hearing Conference at pp. 6-7.

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dealer and member of the National Association of Securities Dealers, Inc. (“NASD” or “Association”).<sup>2</sup>

The Hearing Officer took these motions under advisement at the November 19, 1997 Pre-hearing Conference, after the Parties indicated that they apparently had agreed to a settlement in this proceeding. The Hearing Officer, acting on behalf of the Hearing Panel pursuant to NASD Code of Procedure Rule 9270(a), stayed the December 9, 1997 Hearing in a November 26, 1997 Order after the Parties jointly requested a postponement of the Hearing in a telephone Pre-Hearing Conference on November 25, 1997.<sup>3</sup>

In a December 15, 1997 Pre-Hearing Conference, the Parties informed the Hearing Officer that Respondent \_\_\_\_\_ had withdrawn his settlement offer and that there no longer was an uncontested offer of settlement in this proceeding.<sup>4</sup> Consequently, the Hearing Officer in a December 15, 1997 Order rescheduled the Hearing in this proceeding for January 28, 1998.<sup>5</sup> Because this disciplinary proceeding is no longer stayed, the Hearing Officer must now rule on these pending motions.

**I. The Department’s Motion for Telephone Testimony**

The Department of Enforcement filed a Motion specifically requesting that \_\_\_\_\_, the sole proprietor and sole trader of \_\_\_\_\_, be permitted to testify telephonically at the Hearing in this proceeding from his offices in \_\_\_\_\_.<sup>6</sup>

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<sup>2</sup> See *Id.* at ¶7 and Pre-Hearing Conference Order dated December 10, 1997.

<sup>3</sup> Pre- Hearing Conference Order dated December 10, 1997 at ¶9.

<sup>4</sup> See Pre-Hearing Conference Order dated December 15, 1997 at ¶3.

<sup>5</sup> See *Id.* at ¶6. The January 28, 1998 Hearing was postponed, pursuant to a January 21, 1998 Order.

<sup>6</sup> The Department represents in its Motion that it will arrange for a competent notary to swear \_\_\_\_\_ from his location in \_\_\_\_\_, will ensure that \_\_\_\_\_ receives and has available at the time he testifies all exhibits relating to his testimony and that \_\_\_\_\_ will be available at a designated time; and, in the event

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The Department states that \_\_\_\_\_ testimony will relate principally to telephone conversations between \_\_\_\_\_ and Respondent \_\_\_\_\_ concerning the trading that is at issue in this proceeding. The Department further represents that it requested \_\_\_\_\_ to testify in person and offered to pay his expenses; however, \_\_\_\_\_ indicated that requiring his presence at the Hearing in Detroit, Michigan would cause him to temporarily close his business.

Counsel for Respondents has orally opposed the Department's Motion. At a November 19, 1997 Pre-Hearing Conference in this proceeding, counsel objected to the Department's Motion, essentially arguing that \_\_\_\_\_ credibility is an important issue and that the Hearing Panel could better assess his demeanor in person.<sup>7</sup> Counsel specifically indicated that Respondent \_\_\_\_\_ prior course of dealing with \_\_\_\_\_ was what motivated Respondent \_\_\_\_\_ to effect the trades that are the subject of this disciplinary proceeding in the manner he did. Respondents' counsel decided not to file any written opposition to the Department's Motion,<sup>8</sup> and has raised no other basis for objecting to the Department's request that \_\_\_\_\_ be permitted to testify telephonically.

### **DISCUSSION**

Section 15A(b)(8) of the Securities Exchange Act of 1934 (Exchange Act) requires the rules of a national securities association to "provide a fair procedure for the disciplining of members and persons associated with members."<sup>9</sup> Fairness in this context,

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of a change in schedule or if \_\_\_\_\_ needs to be recalled, the Department will be able to contact \_\_\_\_\_ expeditiously.

<sup>7</sup> Transcript of November 19, 1997 Pre-Hearing Conference at pp. 6-7.

<sup>8</sup> *Id.* at p. 7.

<sup>9</sup> 15 U.S.C. 78o-3(b)(8).

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however, does not mandate the procedural rights guaranteed to a defendant in a criminal proceeding.<sup>10</sup> On the contrary, in providing for self-regulation of securities dealers, Congress did not intend to create tribunals similar to the courts or the Securities and Exchange Commission (SEC).<sup>11</sup> Rather, Congress recognized the need for informality to enable effective self-regulation.<sup>12</sup>

The use of telephone testimony in lieu of a witness' personal appearance is one area of recognized, permissible informality that facilitates the Association's ability to carry out its self-regulatory duties.<sup>13</sup> Where the respondent is given an adequate opportunity to cross-examine the witness, the fact that the witness testifies by telephone rather than appearing in person does not violate the Exchange Act's fairness requirement. A respondent does not have a per se right to a face-to-face confrontation of a witness in NASD disciplinary proceedings.<sup>14</sup>

That telephone testimony meets the fairness requirement of Section 15A(b)(8) of the Exchange Act does not answer the question of whether telephone testimony should be

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<sup>10</sup> See, e.g., Robert E. Gibbs, 51 S.E.C. 482, 484 n.3 (1993), aff'd, 25 F.3d 1056 (10<sup>th</sup> Cir. 1994); Curtis I. Wilson, 49 S.E.C. 1020, 1024-25 (1989), aff'd, 902 F.2d 1580 (9<sup>th</sup> Cir. 1990); David A. Gingras, 50 S.E.C. 1286, 1293 n. 20 (1992).

<sup>11</sup> Sumner B. Cotzin, 45 S.E.C. 575, 579-580 (1974).

<sup>12</sup> Id.

<sup>13</sup> Id. See also Ronald W. Gibbs, Exchange Act Release No. 35998, 59 S.E.C. Docket 2079 (July 20, 1995), 1995 WL 442074, at \*5; Howard Alweil, Exchange Act Release No. 31278, 52 S.E.C. Docket 1734 (Oct. 1, 1992), 1992 WL 288827, at \*3 n.8.

<sup>14</sup> Howard Alweil, 1992 WL 288827, at \*3 n.8.

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permitted in a particular proceeding. Under the new NASD Code of Procedure,<sup>15</sup> telephone testimony generally will be allowed in disciplinary proceedings, but not as a matter of right. Instead, the determination of whether to allow telephone testimony will be based on the circumstances of each case.<sup>16</sup> Furthermore, the relative weight to be given to telephone testimony will depend upon the facts and circumstances of each case.

This proceeding does not involve an instance where the person whose telephone testimony is sought is beyond the NASD's jurisdiction. \_\_\_\_\_, as a registered principal and associated person of \_\_\_\_\_, is subject to the NASD's jurisdiction, and, pursuant to NASD Code of Procedure Rule 8210, could be compelled to attend the Hearing and testify in person. \_\_\_\_\_, however, has indicated that testifying in person poses a hardship, necessitating the closing of his firm for one or more days. The Department represents that \_\_\_\_\_ is a sole proprietorship and there simply are no other traders at the firm. Respondents do not controvert these representations.

Respondents' counsel has failed to identify any compelling reason why he would not be able to cross examine \_\_\_\_\_ telephonically in this proceeding. Simply claiming that a Hearing Panel would be better able to assess a witness' demeanor and ultimate credibility by observing him or her in person is not particularly helpful in determining whether telephone testimony should or should not be permitted in any particular

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<sup>15</sup> The new NASD Code of Procedure became effective on August 7, 1997. The current version of the Code of Procedure does not specifically address the use of telephone testimony.

<sup>16</sup> Letter from Alden S. Adkins, Esq., General Counsel of NASD Regulation, Inc., to Katherine A. England, Esq., Assistant Director, Division of Market Regulation, SEC, dated July 11, 1997 at p. 16. (NASD Regulation response to comments from the ABA Ad Hoc Committee regarding proposed changes (SR-NASD-97-28) to the NASD Code of Procedure).

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circumstance.<sup>17</sup> The Hearing Panel can assess credibility “by listening solely to a person’s voice.”<sup>18</sup> In addition, the Hearing Panel can assess a witness’ credibility by examining the consistency of the witness’ answers, evaluating how directly or indirectly the witness responds to cross examination, and comparing the witness’ testimony to other evidence in the proceeding.

Based on the facts presented in this disciplinary proceeding, the Hearing Officer has determined that \_\_\_\_\_ will be permitted to testify in this Hearing telephonically, provided certain conditions are met. The Department shall make arrangements so that a competent notary is available to swear the witness. In addition, the Department shall ensure that \_\_\_\_\_ receives, and has available at the time of testifying, all exhibits relating to his testimony, and that \_\_\_\_\_ will be available at a designated time. Finally, the Department must be able to contact \_\_\_\_\_ in the event of a change of schedule or if \_\_\_\_\_ needs to be recalled.<sup>19</sup> The Hearing Officer believes that these conditions ensure that Respondents will be able to fully cross examine \_\_\_\_\_ via telephone.

IT IS THEREFORE ORDERED, that \_\_\_\_\_ be permitted to testify telephonically in this proceeding, provided the Department complies with the conditions set forth above.

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<sup>17</sup> How an adjudicator evaluates the testimony of any particular witness depends on a variety of factors, some of which may relate to a witness’ demeanor. It may be appropriate in some cases for a hearing panel that cannot observe the demeanor of a witness testifying by telephone to give greater weight to in-person testimony.

<sup>18</sup> Joseph Alderman, Exchange Act Release No. 35997, 59 S.E.C. Docket 2075 (July 20, 1995), 1995 WL 442069, at \*1 n.6. See also Official Airline Guides, Inc. v. Churchfield Publications, Inc., 756 F. Supp. 1393, 1398 n.2 (D. Or. 1990), aff’d, 6 F. 3d 1385 (9<sup>th</sup> Cir. 1993).

<sup>19</sup> \_\_\_\_\_ also must have ready access to a facsimile machine in the event documents other than those provided him by the Department are discussed.

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## II. Respondents' Motion To Use an Expert Witness

In an October 9, 1997 Pre-Hearing Order, the Hearing Officer ordered that any motions requesting the use of expert witnesses be filed by November 7, 1997 and accompanied by, among other things, the identity of the proposed expert witness, the expert witness' qualifications, and a narrative summary of the opinion testimony to be offered by the expert witness.<sup>20</sup> Respondents' filed an Expert Witness Designation on November 7, 1997. The Department filed an Opposition to Respondents' Expert Witness Designation on November 17, 1997.<sup>21</sup> For the reasons discussed below, the Hearing Officer is denying Respondents' Motion to Designate an Expert Witness.

### DISCUSSION

The Respondents' filing identifies \_\_\_\_\_ as its expert designate, and provides attachments to its filing that establish \_\_\_\_\_ qualifications, a narrative statement of her opinion testimony and a listing of the documents and materials \_\_\_\_\_ relied upon in formulating her opinion. Respondents proffer \_\_\_\_\_ as an expert whose testimony is offered in relation to the allegations contained in Count Two of the Complaint. Count Two of the Complaint alleges that Respondent \_\_\_\_\_ violated Conduct Rules 2110 and 3010 by failing to establish, maintain and enforce adequate

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<sup>20</sup> In that October 9, 1997 Order, the Hearing Officer also noted the following:

The disciplinary hearing under the Code of Procedure is a businessman's forum. As such, panelists who hear the case, other than the Hearing Officer, are currently or formerly associated with member firms and have a degree of expertise about industry practice. Thus, in this forum, use of expert witnesses is not a right, but depends on the degree by which the offered opinion testimony would benefit the hearing panel in reaching a determination. Id. at 2-3.

<sup>21</sup> The Department raises a procedural objection to Respondents' Expert Witness Designation. It notes that Respondents filed an Expert Witness Designation but never formally filed a Motion and, therefore, failed to comply with the Hearing Officer's Pre-Hearing Order. The Respondents timely filed documents

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written supervisory procedures to ensure compliance with Conduct Rule 2110 to deter conduct and detect anti-competitive behavior by \_\_\_\_\_ traders. More specifically, Respondents note that \_\_\_\_\_ opinion is that \_\_\_\_\_ supervisory procedures and approach to addressing “anti-competitive” behavior of its registered representatives and associated persons, as of October 7, 1996, was consistent with industry practices.

(Respondents’ Expert Witness Designation, Exhibit 2).

The Department’s position is that Respondents have no right to offer expert testimony in NASD Regulation disciplinary proceedings, and that any decision to permit expert testimony rests within the sound discretion of the Hearing Officer. (Department’s Opposition to Respondents’ Expert Witness Designation at 3).

Respondents provide no compelling rationale as to how \_\_\_\_\_ testimony would provide assistance to the Hearing Panel in this proceeding. The fundamental question rests on whether the proposed expert testimony would help the Hearing Panel understand the evidence or a fact at issue in this proceeding.

In this particular case, Respondents propose submitting \_\_\_\_\_ views as to whether \_\_\_\_\_ supervisory procedures were consistent with industry practices to a hearing panel consisting of two persons currently associated with member firms and with substantial supervisory and trading experience. No new, complex or unusual securities products are involved in this proceeding. The Hearing Officer believes that the Hearing Panelists in this proceeding, based on their industry experience and knowledge, are capable of assessing Respondent \_\_\_\_\_ supervisory procedures as to the allegations

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with the Office of Hearing Officers that, in substance, complied with the Hearing Officer’s October 9, 1997 Pre-Hearing Order. The Department’s procedural objection is without merit.



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contained in Count Two of the Complaint. Moreover, \_\_\_\_\_ proposed testimony concludes that \_\_\_\_\_ supervisory procedures and approach to addressing anti-competitive behavior of its registered representatives and associated persons was consistent with industry practices. This type of judgment is precisely what NASD Regulation Hearing Panelists are expected to make in the context of a self-regulatory organization disciplinary proceeding. The Hearing Officer concludes that \_\_\_\_\_ proposed expert testimony would not significantly assist the Hearing Panel in its understanding of industry standards regarding reasonable supervisory practices. Consequently, Respondents' Motion for Use of an Expert Witness is denied.

### **III. Respondents' Motion to Compel Production of Documents**

Respondents have requested that \_\_\_\_\_, a registered broker-dealer and member of the NASD, be compelled to produce records showing all orders entered into the \_\_\_\_\_ on October 7, 8, and 9, 1996 for the following securities: Sun Microsystems, Inc. (SUNW), Read-Rite Corp. (RDRT), Komag, Inc. (KAMG), and American Power Conversion Corp. (APCC).<sup>22</sup> Respondents' request is made pursuant to NASD Code of Procedure Rule 9252.

The Department of Enforcement does not oppose Respondents' request that an 8210 request be issued to Instinet.<sup>23</sup>

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<sup>22</sup> \_\_\_\_\_ provides a real time trading service to clients, which include broker-dealers and institutional investors. \_\_\_\_\_ clients place orders with \_\_\_\_\_ that are displayed to all other \_\_\_\_\_ clients on an anonymous basis. \_\_\_\_\_ clients may execute trades via \_\_\_\_\_ at displayed prices and quantities.

<sup>23</sup> See Transcript of November 19, 1997 Pre-Hearing Conference at p. 7.

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

Rule 9252(a) permits respondents to request that the Association invoke Rule 8210 to compel production of documents or testimony at a hearing, provided such request is made in writing at least 21 days before the scheduled hearing and an appropriate showing is made.<sup>24</sup> In this instance, Respondents requested a voluntary production of the records from \_\_\_\_\_, but \_\_\_\_\_ would not provide copies of its records without some form of subpoena. (Respondents' Motion at p. 1). Respondents indicate further that \_\_\_\_\_ is subject to the Association's jurisdiction and allege that the requested documents are material to this proceeding.<sup>25</sup>

Rule 9252(b) specifically establishes the standards pursuant to which the Association shall grant requests for the production of documents or testimony. Three specific conditions must be satisfied. Such requests 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 and testimony through other means but has been unsuccessful in such efforts; and (3) each of the persons from whom the Documents and testimony are sought is subject to the Association's jurisdiction. (Rule 9252(b)). In addition, the Hearing Officer shall consider

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<sup>24</sup> The 9252(a) request shall: ... "describe with specificity the Documents, the category or type of Documents, or the testimony sought; state why the Documents, the category or type of Documents, or the testimony are material; describe the requesting Party's previous efforts to obtain the Documents, the category or type of Documents, or the testimony through other means; and state whether the custodian of each Document, or the custodian of the category or type of Documents, or each proposed witness is subject to the Association's jurisdiction." Rule 9252(a).

<sup>25</sup> Respondents indicate that they would not object to \_\_\_\_\_ redacting from its records information relating to the persons or entities placing the orders on the \_\_\_\_\_ System.

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whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome, and whether the request should be denied, limited, or modified. Id.

In the instant case, Respondents clearly have satisfied the second and third preconditions established in Rule 9252(b). More specifically, Respondents previously requested that \_\_\_\_\_ provide them with the requested information and \_\_\_\_\_ declined. In addition, \_\_\_\_\_, as a broker-dealer registered with the Securities and Exchange Commission and a member of the Association, is subject to the Association's jurisdiction. The remaining considerations focus on the documents' relevance and materiality to the issues presented in this disciplinary proceeding.

#### **DISCUSSION**

At a November 19, 1997 Pre-Hearing Conference, the Hearing Officer inquired how the orders \_\_\_\_\_ received in SUNW, RDRT, KAMG, and APCC on October 7, 8 and 9, 1996 have any relevance to the allegations that Respondent \_\_\_\_\_ engaged in improper harassment of another market maker \_\_\_\_\_ by executing numerous 100 share transactions of Oak Technology ("OAKT") on October 7, 1996.<sup>26</sup> Respondent \_\_\_\_\_ defense to the allegations in Count One is that he traded as he did with \_\_\_\_\_ in OAKT on October 7, 1996 because of prior dealings with \_\_\_\_\_. More specifically, Respondent \_\_\_\_\_ experience in the past was that \_\_\_\_\_ would back away or not honor his quotes. Id. Consequently, Respondent \_\_\_\_\_ believed that the best way for him to obtain the volume of shares in OAKT he wanted was to do so in smaller pieces. Id. at p. 8. To counter this defense, Respondents' counsel indicates that

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<sup>26</sup> Transcript of November 19, 1997 Pre-Hearing Conference at pp. 8-9.

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the Department is trying to show that Respondent \_\_\_\_\_, if he were attempting to obtain a better price, could have effected transactions in OAKT via Selectnet<sup>27</sup> or \_\_\_\_\_ at better prices but did not do so. The records from \_\_\_\_\_, according to Respondents' counsel, would demonstrate that, even if better prices were available on \_\_\_\_\_, \_\_\_\_\_ did not always utilize the \_\_\_\_\_ system for proprietary trading. Respondent \_\_\_\_\_ would utilize \_\_\_\_\_ only for the stocks he traded most actively.<sup>28</sup>

Respondent \_\_\_\_\_ admits in his Answer that he sold 2,000 shares of OAKT to \_\_\_\_\_ in 20 trades of 100 shares during the afternoon of October 7, 1996. (Respondents' Answer at p.3). Thus, there is no dispute as to whether the trades occurred. The Parties are free to present evidence that is relevant and material to the issues relating to whether Respondent \_\_\_\_\_ violated Conduct Rule 2110 as alleged in the Complaint by effecting the OAKT trades in the manner he did. The Hearing Officer, however, fails to see how the existence of better prices or equally good prices on Selectnet and \_\_\_\_\_ in other securities on October 7-9, 1996 that Respondent \_\_\_\_\_ did not take advantage of is probative to the issues in this proceeding. Quite simply, whether Respondent \_\_\_\_\_ did or did not trade in \_\_\_\_\_ or Selectnet in other securities is not material or relevant to the allegations of this proceeding.

Even if the Hearing Officer were to find that the documents Respondents seek from \_\_\_\_\_ were relevant and material, documents similar to what Respondents seek to

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<sup>27</sup> Selectnet is a screen-based trading system offered to members of the NASD to facilitate negotiation of transactions in securities through automated means, by-passing the need for telephone contact. Selectnet allows members to enter orders, direct orders to one or all market makers in a security, and negotiate the terms of the orders through counter-offers entered into the system.

<sup>28</sup> The requested documents would be used to compare Respondent \_\_\_\_\_ trading activity on the requested dates to orders posted on the \_\_\_\_\_ System.

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obtain from \_\_\_\_\_ relating to orders placed in Selectnet were provided to Respondents. (November 19, 1997 Pre-hearing Conference Tr. at pp. 13-14.) Rule 9252 (c) specifically requires the Hearing Officer, after considering all the facts and circumstances, to determine whether a request for information is unreasonable, oppressive, excessive in scope or unduly burdensome. If the Hearing Officer concludes the request is unreasonable, oppressive, excessive in scope or unduly burdensome, the request shall be denied, or granted only upon such conditions as fairness requires. Respondents' counsel, using the Selectnet data the Department of Enforcement already has provided, could seek to demonstrate that Respondent \_\_\_\_\_ did not necessarily effect transactions using Selectnet when Selectnet contained better quoted prices. The Hearing Officer believes that requesting any additional information from \_\_\_\_\_ in these circumstances would be cumulative and unjustifiable. The benefits from any additional information from \_\_\_\_\_ would be minimal.

WHEREFORE, Respondents' Motion to Compel Production of Documents from \_\_\_\_\_ is DENIED.

**SO ORDERED**

\_\_\_\_\_  
Joseph M. Furey  
Deputy Chief Hearing Officer

Dated: Washington, D.C.  
January 22, 1998