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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. Respondents.	Disciplinary Proceeding No. CAF000013 Hearing Officer—Andrew H. Perkins

ORDER DENYING RESPONDENTS' MOTION FOR THE PRODUCTION OF DOCUMENTS FROM NASDAQ AND REQUIRING THE COMPLAINANT TO FILE A DECLARATION CERTIFYING THAT IT HAS COMPLIED WITH RULE 9251

By letter dated May 1, 2001, Respondents _____ and _____ (the "Respondents") have moved for an order directing NASDAQ, Inc. to produce certain information and documents relating to the time and manner _____ _____ reported the trades that underlie the charges in this case. The Department of Enforcement opposes the request on two grounds. First, the Department construes the letter as a request for information under Code of Procedure Rule 9252, which is untimely under the scheduling order entered in this case. Second, the Department argues that it is under no obligation to obtain the requested documents because they were not "prepared or obtained by Interested Association Staff in

connection with the investigation that led to institution of the proceedings." See Code of Procedure Rule 9251(a).

For the reasons discussed below, the Hearing Officer denies the Respondents' motion.

I. Background

The Complaint alleges that, on March 7, 1997, _____, acting through _____ and _____, charged fraudulently excessive markdowns in the purchase of 740,928 shares of Multimedia Games, Inc. common stock from 58 customers. Generally, the Complaint alleges that _____ and _____ knew that _____ was not a market maker in Multimedia common stock at that time and that the markdowns on these trades exceeded 5%. Despite this knowledge, the Department charges that _____ and _____ based the markdowns charged on these 58 transactions on the inside bid, rather than the firm's contemporaneous sales to other broker-dealers. (Complainant's Pre-Hearing Br. at 6.) Accordingly, the Department concludes that _____ violated Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2110, 2120, and 2440.[1]

The Respondents contend, and the Department concedes, that the time of execution for the 58 trades is of "some significance in this case." (Complainant's Pre-Hearing Br. at 7.) The Department contends that the trades were executed between 11:45 and 11:49 a.m., and the Respondents contend that the trades were executed at 9:40 a.m., but reported to NASDAQ later in the day as a bunched trade. (Id.) The Department concedes in its Pre-Hearing Brief that the "trades were reported to NASDAQ as a bunch trade at 11:43 a.m. with an 'as of' time of

9:40 a.m.," and that "[t]he trade was later canceled and reported again to NASDAQ at 4:09 p.m. as a bunch trade and with an 'as of' time of 9:40 a.m."(Id.) However, the Department further contends that two independent pieces of evidence support its conclusion that the trades were executed between 11:45 and 11:49 a.m. First, the trade tickets maintained by _____ are time stamped between 11:45 and 11:49 a.m. Second, the records show that during this period _____ resold approximately 58% of the stock it purchased from the 58 customers. (Id.)

Both sides point out that the timing of the subject trades is relevant to the calculation of the markdowns. According to the Respondents, if the earlier time is used, the markdown percentage is somewhat less than if the later time is used. (Complainant's Pre-Hearing Br. n.6 at 7.)

The Respondents argue that because the timing of the trades is "significant" to the outcome of the case, they are entitled to information and documents from NASDAQ relating to the reporting of the trades and NASDAQ's policies and procedures "relating to accepting and entering into the NASDAQ system orders out of sequence." (Mot. at 2.) Specifically, the Respondents request the Hearing Officer to issue an order to NASDAQ for the following:

a) the name(s) of the persons on duty between 9:00 a.m. and 12:00 a.m. on March 7, 1997;

b) the NASDAQ manuals, policies and procedures as existed in March 1997 relating to accepting and entering into the NASDAQ system orders out of sequence; and

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[1] The firm and _____ also are charged with failing to establish, maintain, and enforce adequate written supervisory procedures with respect to markdowns. These charges are not relevant to the present motion.

c) any notes or memoranda made to reflect the entry of the aforesaid orders by NASDAQ.

The Respondents argue that they are entitled to this material either because it is material exculpatory evidence that must be disclosed under Brady v. Maryland, 373 U.S. 83 (1963) or because it contains witness statements that must be disclosed in accordance with the Jencks Act, 18 U.S.C. § 3500. The Respondents expressly deny that they are requesting information pursuant to Rule 9252, and, thus, they argue that their request is not late.[2]

II. Discussion

The Respondents' request is ambiguous. It seeks relief that could only be granted under Code of Procedure Rule 9252, but it also invokes the Brady doctrine, which has been incorporated into the NASD Code of Procedure by Rule 9251(b)(2), and the Jencks Act, which has been incorporated into the NASD Code of Procedure by Rule 9253. Accordingly, the Hearing Officer will first analyze the request under Rules 9252 and 9253 (the Jencks Act) and then discuss the Department's obligations under Rule 9251(a)(1) and Rule 9251(b)(2) (Brady).

A. Rule 9252—Requests for Information

Code of Procedure Rule 9252 governs the manner in which respondents may seek the Association's assistance with the production of evidence at a disciplinary hearing. Under Code of Procedure Rule 9252(a), respondents must request that the Association, through the Hearing Officer, invoke Rule 8210 on their behalf. Such requests must contain specific information and make a specific showing, including whether the custodian of the requested documents is subject

to the Association's jurisdiction. The Rule also requires that the Hearing Officer consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome.

Although not denominated a request for information under Rule 9252, the Respondents' request is just that. The Respondents request the Hearing Officer to enter an order "directing NASDAQ, Inc. to produce to [the Respondents] certain documents that [they] need for the hearing." (Mot. at 1.) Such a request could only be granted pursuant to Rule 9252, as the Association lacks subpoena power to compel persons to testify or produce documents. The Association's power is limited in this regard to NASD Procedural Rule 8210. There is no other procedural mechanism that would allow the specific relief the Respondents request.

Since the Respondents' request must be considered under Rule 9252, it must be denied. While there are a number of deficiencies in the request, the two most important ones are that it was filed late and that it asks the Association to issue a Rule 8210 request for information to an entity or individuals that are not subject to its jurisdiction for the purposes of Rule 8210.

As to the first point, the Hearing Officer entered an Order requiring that all motions under Rule 9252 be filed by March 23, 2001. This deadline gave the Respondents ample time. This case has been pending since May 5, 2000, and the original deadline for such motions of October 20, 2000, was set with the agreement of all Parties. The Hearing Officer extended the filing deadline to March 23, 2001, after one of the Respondent's counsel requested that the hearing be continued to accommodate a conflict in his schedule. Nevertheless, the Respondents did not file their request until May 1, 2001.

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[2] The moving Respondents further state that they moved for production of Jencks and Brady

As to the second reason the motion is denied, the Hearing Officer finds that NASDAQ is not an entity over whom the Association has jurisdiction for the purposes of NASD Procedural Rule 8210. Accordingly, the Association lacks the authority to "direct" NASDAQ to produce the requested documents.

B. Rule 9253—Production of Witness Statements

Rule 9253 provides that a respondent may file a motion requesting that the Department make available for inspection and copying "any statement of any person called or to be called as a witness by the Department of Enforcement that pertains, or is expected to pertain, to his or her direct testimony and that would be required to be produced pursuant to the Jencks Act, 18 U.S.C. § 3500." The documents and information the Respondents request however do not fall within this Rule. Not only have the Respondents not asked for witness statements, but the Department does not intend to call anyone from NASDAQ to testify at the hearing. Accordingly, the Respondents' request also is denied under Rule 9253.

C. Rule 9251(b)(2) and the Brady Doctrine

The Respondents also argue that the Department should have produced the foregoing material because it is Brady material. The Department does not address this argument directly. Instead, the Department points out that it produced documents in accordance with Rule 9251, and the NASDAQ records were not among those documents because they were not "prepared or obtained by Interested Association Staff in connection with the investigation that led to the institution of the proceedings." (Reply at 2.) Counsel for the Department also states that he

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material at the outset of the case. However, the record of this proceeding contains no such motion.

informed defense counsel at their meeting on April 27, 2001, that the requested records were not "in its investigative files." (Id.) From these two statements, the Hearing Officer cannot ascertain whether the Department complied with Rule 9251 and Brady. It is conceivable that the Department failed to include documents held by NASDAQ on the grounds that they were not within the "investigative file," which would be a too narrow reading of its obligations under Rule 9251(a)(1).

D. The Department's Disclosure Obligations Under Rule 9251

The Department's disclosure obligation under Rule 9251(a)(1) is not limited to those documents in its immediate files. Code of Procedure Rule 9251(a)(1) requires the Department to make available to the defense for inspection and copying "Documents prepared or obtained by Interested Association Staff in connection with the investigation that led to the institution of the proceedings." For the purposes of a disciplinary proceeding such as this, Interested Association Staff are defined in Rule 9120(r)(1) as:

> (A) the Head of Enforcement;
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> (B) an employee of the Department of Enforcement who reports, directly or indirectly, to the Head of Enforcement;
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> (C) an Association employee who directly participated in the authorization of the complaint; [or]
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> (D) an Association employee who directly participated in an examination, investigation, prosecution, or litigation related to a specific disciplinary proceeding, and a district director or department head to whom such employee reports.

And the term Association is defined collectively as "the NASD, NASD Regulation, and Nasdaq." Rule 0120(b). Thus, Rule 9251(a)(1) covers any document that is obtained or generated during the course of an investigation or inquiry by any employee of the NASD,

NASD Regulation, or Nasdaq who directly participated in an examination, investigation, prosecution, or litigation related to this proceeding, the existence of which is known, or by the exercise of due diligence may become known, to counsel for the Department. The fact that the documents may have been generated, gathered or retained by Association employees outside of the Department is of no consequence. In other words, the Department is obligated to search for documents that may be in the possession of these other persons who also participated in some manner in this or a related proceeding, irrespective of whether they are maintained in the formal "investigative file."

From the foregoing universe of documents, the Department may withhold specific categories of documents. See Rule 9251(b)(1). These include documents falling within traditional definitions of privilege, such as documents subject to attorney-client privilege, as well as the following:

> (1) examination and inspection reports, internal memoranda, or other notes or writings prepared by an Association employee that shall not be offered in evidence;
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> (2) documents that would disclose (i) an examination, investigatory or enforcement technique or guideline of the Association, a federal, state, or foreign regulatory authority, or a self-regulatory organization; (ii) the identity of a source, including a federal, state, or foreign regulatory authority or a self-regulatory organization that furnished information or was furnished information on a confidential basis regarding an investigation, an examination, an enforcement proceeding, or any other type of civil or criminal enforcement action; or (iii) an examination, an investigation, an enforcement proceeding, or any other type of civil or criminal enforcement action under consideration by, or initiated by, the Association, a federal, state, or foreign regulatory authority, or a self-regulatory organization; and
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> (3) documents that the Hearing Officer permits the Department to withhold as not relevant to the subject matter of the proceeding, or for other good cause shown.

Rule 9251(b)(1). The NASD considered it essential that it be able to withhold the foregoing categories of documents to ensure that the NASD's enforcement efforts are not impaired while at the same time protecting respondents' discovery rights. See Order Approving Proposed Rule Change, Exchange Act Release No. 38,908, 1997 SEC LEXIS 1617, at *134 n.194 (Aug. 7, 1997).

The Department's right to withhold documents under Rule 9251(b)(1) is itself limited by Rule 9251(b)(2), which states: "Nothing in subparagraph (b)(1) authorizes the Department of Enforcement . . . to withhold a document, or a part thereof, that contains material exculpatory evidence." "This provision is intended to be consistent with the doctrine enunciated in Brady." Notice of Filing of Proposed Rule Change, Exchange Act Release No. 38,545, 1997 SEC LEXIS 959, at *14 n.99 (Apr. 24, 1997).

E. The Brady Doctrine

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

Brady emphasized the requirement that the prosecutor provide the defense with "evidence favorable to an accused." Brady, 373 U.S. at 87. "Favorable" evidence is that which relates to guilt or punishment and which tends to help the defense by either bolstering the defense's case or impeaching prosecution witnesses. See Giglio v. United States, 405 U.S. 150, 154-55 (1972). Accordingly, the government is obligated to disclose all evidence relating

to guilt or punishment that might reasonably be considered favorable to the defendant's case, which, if suppressed, would deprive the defendant of a fair trial. Bagley, 473 U.S. at 675. As a matter of fundamental fairness, this same standard applies to pre-hearing disclosure in NASD disciplinary proceedings relating to liability and sanctions.[3]

Although Brady generally should be applied to effect its purpose of assuring a fair hearing and a resulting decision which is "worthy of confidence," Smith v. Holtz, 210 F.3d 186, 196 (3d Cir. 2000), the extensive body of case law applying Brady in criminal trials has established certain limitations to its scope. First and foremost, Brady is not a discovery rule, Pennsylvania v. Ritchie, 480 U.S. 39, 59 (1987); it is a rule of fairness and minimum prosecutorial obligation. See United States v. Beasley, 576 F.2d 626 (5th Cir. 1978), cert. denied, 440 U.S. 947 (1979). Accordingly, the defense is not entitled to engage in a "fishing expedition" through the prosecutor's files in the hope of finding something helpful to their defense. See, e.g., In re Jett, 50 S.E.C. 830, 1996 SEC LEXIS 1683, at *1-2 (1996). Nor is the defense entitled to receive every scintilla of evidence that might be beneficial. See, e.g., Lieberman v. Washington, 128 F.3d 1085, 1092 (7th Cir. 1997). Second, there is "no constitutional requirement that the prosecution make a complete and detailed accounting to the defense of all police investigatory work on a case," Moore v. Illinois, 408 U.S. 786, 795 (1972), or to disclose merely cumulative evidence, United States v. Gonzales, 121 F.3d 928, 946 (5th Cir. 1997), cert. denied, 522 U.S. 1063 (1998). Ultimately, Brady seeks to protect

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[3] The same standard would not apply once a decision is entered. See Rule 9251(g). From a post-trial perspective, information is considered material "only if there is a reasonable probability that, had the evidence been disclosed to the defense, the result of the proceeding would have been different." Bagley, 473 U.S. at 682.

the quality and completeness of the evidence upon which a proceeding is determined. Therefore, Brady does not require the disclosure of information that would only assist the defense in creating its trial strategy. See, e.g., United States v. LeRoy, 687 F.2d 610, 619 (2d Cir.), cert. denied, 459 U.S. 1174 (1983). Finally, because Brady is concerned with the suppression of evidence unknown to the defense, Brady is not violated by failing to disclose information already known to the defense. See United States v. Morris, 80 F.3d 1151, 1170 (7th Cir.), cert. denied, 519 U.S. 868 (1996); see also LeRoy, 687 F.2d at 618.

The Respondents' motion does not identify any material exculpatory documents that have been suppressed by the Department. Accordingly, the Respondents' motion also is denied on this ground. On the other hand, since it is not clear whether the Department applied the proper standards when it completed its document review and disclosure in this case, the Hearing Officer will require the Department to file forthwith a declaration indicating the extent of its search and that it has applied the standards set forth in this Order. If the Department locates documents that should have been disclosed, it shall immediately deliver copies of those documents to the Respondents.

IT IS SO ORDERED.

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Andrew H. Perkins
Hearing Officer

May 21, 2001