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FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. Respondent.	Disciplinary Proceeding No. E3A20030495-01 Hearing Officer – LBB

ORDER DENYING RESPONDENT'S MOTION TO DISMISS THE COMPLAINT

Respondent has moved to dismiss the Complaint, arguing that the amount of time that elapsed between the alleged violations and the filing of the Complaint was excessive and prejudicial, requiring a dismissal pursuant to the doctrine of *laches*; that he did not violate NASD Conduct Rules 2110 and 3010 by failing to supervise PB[1] and failing to establish adequate supervisory procedures as alleged in the Complaint; and that the filing of the Complaint constitutes "malicious prosecution" because it was allegedly brought in retaliation for Respondent's refusal to settle on the terms proposed by the Department of Enforcement ("Enforcement"). Enforcement has opposed the motion, arguing that the motion is procedurally defective and substantively without merit.

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

[1] The Complaint named PB as a Respondent in this proceeding, but on June 2, 2008, the Office of Hearing Officers received an order accepting his offer of settlement. Therefore, he is no longer a party to this proceeding.

I. The Complaint

The Complaint alleges that from August 15, 2002, through September 30, 2003, PB facilitated improper market timing and late trading of mutual funds by certain customers of [Respondent's firm (the "Firm")]. According to the Complaint, Respondent knew or should have known of PB's improper market timing and late trading, but failed to supervise PB's trading activities and failed to establish adequate supervisory procedures.

II. Enforcement's Procedural Arguments

Enforcement argues that the motion should be denied for failure to comply with the requirements of Rule 9264(d). Respondent's motion, although called a "Motion to Dismiss," relies on factual allegations that are not asserted in the Complaint. These factual allegations should have been supported by admissible evidence, but Respondent has submitted no evidence in support of his motion. *See* NASD Procedural Rule 9264(d). Furthermore, Respondent has failed to submit a statement of undisputed facts as required by Rule 9264(d), which would be especially important in considering a motion that is based on factual allegations. As discussed below, the absence of evidence to support Respondent's factual assertions requires that the motion be denied.

Enforcement also argues that the motion was filed too early, before the completion of discovery. While the actual selection and copying of documents might not have been completed, Enforcement represented at the initial prehearing conference of May 20 that all documents had been made available for inspection and copying, to the extent required by NASD Procedural Rule 9251. Based on this representation, the motion does not appear to be filed prior to the time permitted by Rule 9264.

III. Respondent Has Not Established a *Laches* Defense

The charges against Respondent arise out of PB's alleged market timing and late trading of mutual funds from August 15, 2002, through September 30, 2003. The Complaint was filed more than five years after the violations allegedly began, and the most recent violations charged took place more than four years before the Complaint was filed. Because Respondent has not shown that the amount of time between the violations and the filing of the Complaint will result in prejudice to his ability to defend the case, the motion is denied.

Respondent's only statement concerning prejudice consists of generic, unsupported allegations:

> Owing to the time frame that has passed, the memories of the witnesses with first hand knowledge of the allegations will almost certainly be compromised. Moreover, any and all documents that may be used as evidence in [Respondent's] defense may have been destroyed or misplaced. Also, [Respondent] does not work in the securities industry anymore and his lack of access to [the Firm's] files may create undue prejudice.

Respondent's Joint Motion to Dismiss and Answer to the Complaint at 3. Because Respondent has offered no evidence to support any of these factual allegations, they cannot be considered, other than as an argument that the lapse of time was so egregious that it is inherently unfair to require him to defend without evidence of prejudice.

In support of his unfairness argument, Respondent relies exclusively on *Jeffrey Ainley Hayden*, 2000 SEC LEXIS 946 (2000), in which the SEC concluded that the proceeding was unfair because the complaint was filed fourteen years after the first alleged violation and more than six years after the last. The time between both the first and last alleged violations by Respondent are less than those alleged in *Hayden*, and thus even a mechanical application of *Hayden* does not support Respondent's motion. Furthermore, several subsequent decisions have explained that the availability of a defense based on the alleged unfairness of the time between

the offenses charged and the filing of a complaint requires a showing of prejudice, and Respondent has failed to establish that the lapse of time will result in prejudice.

More recent cases have made clear that "there are no bright-line rules or mechanical tests concerning the impact of a delay on a disciplinary proceedings fairness." *Dep't of Enforcement v. Kaweske*, No. C07040042, 2007 NASD Discip. LEXIS 5, at *39 (N.A.C. Feb. 12, 2007), citing *Dep't of Enforcement v. Morgan Stanley DW, Inc.*, No. CAF000045, 2002 NASD Discip. LEXIS 11, at *24 (N.A.C. July 29, 2002) and *Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *15 (Feb. 13, 2004). To establish the defense, Respondent must demonstrate that the delay has caused actual prejudice. *Kaweske* at *39, citing *Dep't of Enforcement v. Apgar*, No. C9B020046, 2004 NASD Discip. LEXIS 9, at *25 (N.A.C. May 18, 2004); *see also James Gerard O'Callaghan*, Exchange Act Rel. No. 57840, slip op. at 14 (May 20, 2008) (available on the SEC web site).

Even if Respondent's allegations of prejudice had been submitted in the form of admissible evidence,[2] such conclusory allegations of prejudice have been routinely rejected as a basis for a *laches* defense. *See, e.g., EEOC v. Lockheed Martin Global Telecommunications, Inc.*, 514 F. Supp. 2d 797, 805 (D. Md. 2007); *Adidas America, Inc. v. Payless Shoesource, Inc.*, 2008 U.S. Dist. LEXIS 14063, at *101 (D. Or. Feb. 22, 2008); *U. S. v. Rodriguez-Agguire*, 264 F.3d 1195, 1208 (10th Cir. 2001); 27A Am Jur 2d Equity §185. It is not enough to allege prejudice. In order to establish prejudice, "[a] defendant must identify key witnesses or evidence whose 'absence has resulted in [Respondent's] inability to present a full and fair defense on the merits.'" *Adidas America* at *101 (citation omitted). A party claiming prejudice must produce evidence that a witness's memory "would have been fresh one, two, or three years ago, but is not

[2] It is highly doubtful that such conclusory statements would have been admissible even if they were offered by a witness under oath, rather than as arguments of counsel.

fresh today." *EEOC v. Lockheed* at 805. Respondent has identified no witnesses or other evidence that will not be available at the hearing, nor any witnesses whose memories would have been fresh if the Complaint had been filed earlier.

Even if Respondent had shown that documents have been lost, an allegation that documents have been lost, without evidence of their significance in the case and the circumstances, is insufficient to support the defense. *Adidas America* at *17. A party claiming prejudice must prove that any lost evidence would ultimately support its position. *EEOC v. Lockheed* at 803. Respondent has not even asserted that any evidence that may have become unavailable would have been significant or supported his defense.

The only evidence in the record on the issue of prejudice was offered by Enforcement, and supports the absence of prejudice. Key witnesses have testified in on-the-record interviews. The fact of the investigation was disclosed to Respondent soon after the events that are the subject of the Complaint, and a broad Rule 8210 document request was served on Respondent's firm, presumably preserving most, and perhaps all, relevant documents. Indeed, Respondent has twice requested extensions of time to answer the Complaint because he needed more time to review the large investigatory file. *See* Motions of March 6, 2008, and April 23, 2008. The record casts substantial doubt on an argument that the passage of time will result in a loss of important testimonial evidence or that important documents have been lost.

Furthermore, as president of his firm until October 2007, Respondent was in a position to preserve relevant evidence, and was, in fact, required to do so. "When one party gives another party notice or knowledge that he may or will pursue a claim against it, the latter party should preserve whatever evidence it has relevant to the claim." 27A Am Jur 2d Equity §184. If

significant evidence has been lost, Respondent at least shares the blame, and cannot claim that he has been prejudiced as a result.

Because Respondent has failed to show that his ability to mount an effective defense has been prejudiced by the alleged delay in filing the Complaint, Respondent's motion to dismiss based on the defense of *laches* is denied.[3]

IV. Respondent Has Not Established That He Cannot Be Liable for Supervisory Failures

Respondent has alleged that the Complaint should be dismissed because he did not violate NASD Rules, and that, if there was a violation, PB was the only proper respondent. Respondent alleges that PB had the direct responsibility for supervising the New York office, and that, as a result, Respondent cannot be charged with failure to supervise PB. Respondent's motion does not specifically address the adequacy of firm procedures. Respondent has not supported his motion with any evidence.

Rule 3010(a)(5) requires each firm to have a supervisory system that provides for "[t]he assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities." The requirement is not satisfied by a system that provides for a representative – even a principal – to supervise himself. *Hans N. Beerbaum*, Exchange Act Rel. No. 55731, 2007 SEC LEXIS 971, at *7 n.8 (May 9, 2007); Notice to Members 99-45 (June 1999). "Whether a particular supervisory system or set of written procedures is in fact 'reasonably designed to achieve compliance' depends on the facts and circumstances of each case." *Dep't of Enforcement v. Pellegrino*, No. C3B050012,

[3] Respondent has similarly offered no evidence that the amount of time that it took to investigate the case and file the Complaint was unreasonable, instead relying solely on *Hayden* to argue for a *per se* finding of unreasonableness, even though the time periods were shorter than those in *Hayden*. Enforcement has offered evidence of the activities that led to the timing of the filing of the Complaint, including settlement negotiations. Because Respondent has failed to show prejudice, there is no need to consider the evidence that Enforcement submitted, or to address the issue of the reasonableness of the amount of time between the alleged violations and the filing of the Complaint.

2008 FINRA Discip. LEXIS 10, at *38 (N.A.C. Jan. 4, 2008) (citations omitted). Respondent has not shown that, under the facts and circumstances of this case, he is entitled to summary disposition with respect to the cause of action alleging failure to establish an adequate supervisory system.

Respondent has also not shown that he is entitled to summary disposition with respect to the cause of action alleging that he failed to supervise adequately. The president of a firm is responsible for supervision of a firm's trading activities unless he has delegated that responsibility and has no reason to know that person is not properly performing the delegated duties. *Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS 1558, at *43 n.45 (July 6, 2005); *see also Harry Gliksman*, Exchange Act Rel. No. 42255, 1999 SEC LEXIS 2685, at *24 (Dec. 20, 1999). Furthermore, firm officials can be held liable for supervisory failures where the officials have the "'responsibility, ability, or authority to affect the … conduct' of Firm personnel." *Robert E. Strong*, Exchange Act Rel. No. 57426, 2008 SEC LEXIS 467, at *18-19 (Mar. 4, 2008) (citation omitted). Respondent has not shown that his supervision of PB was adequate under the facts and circumstances of this case.

While Respondent may be able to establish that the firm's procedures were adequate, and that he diligently supervised PB, those are factual matters that must be established by admissible evidence, and depend upon the facts and circumstances of the case. Respondent has offered no admissible evidence in support of his motion. The motion is denied with respect to the arguments that Respondent did not violate NASD Rules and is not the proper party.

V. Respondent's "Malicious Prosecution" Defense Is Not Recognized in FINRA Proceedings

Relying on both federal court and administrative precedent, the National Adjudicatory Council recently held that a respondent "may not maintain, as a matter of law, any defense that

rests upon an assertion of FINRA misconduct to reduce or eliminate his own misconduct." *Dep't of Enforcement v. Epstein*, No. C9B040098, slip op. at 33-34, (N.A.C. Dec. 20, 2007), *appeal docketed*, No. 3-12933 (S.E.C. Jan. 31, 2008). Allegations of staff animosity toward a particular respondent have been rejected as a basis for the defense of FINRA cases. *See Dist. Bus. Conduct Comm. v. Roach*, No. C02960031, 1998 NASD Discip. LEXIS 11, at *19 n.13 (N.B.C.C. Jan. 20, 1998). The Seventh Circuit has affirmed the SEC's rejection of arguments that FINRA staff's motivations in filing an enforcement action were grounds for judgment in favor of a respondent:

> We need not ponder petitioner's theories about a conspiracy among "rogue" staff members, however, because courts will not inquire into a prosecutor's ill motive unless there is a showing of selective enforcement … or an attempt to discriminate by arbitrary classification.… NASD disciplinary proceedings are treated as an exercise of prosecutorial discretion.… Thus the motives of NASD staff members are irrelevant.

Schellenbach v. SEC, 989 F.2d 907, 912 (7th Cir. 1993) (citations omitted). *See also SEC v. Weil*, 1980 U.S. Dist. LEXIS 12144, at * 2-4 (Feb. 7, 1980) (holding that allegations of prosecutorial bad faith cannot be asserted against a government agency acting in the public interest).

Respondent's allegations of "malicious prosecution" by the Enforcement staff, even if they were supported by evidence, do not provide a basis for the dismissal of the Complaint, and the motion to dismiss on that basis is denied.

VI. Conclusion

Respondent's motion relies on factual allegations that are not supported by admissible evidence, and is denied on that basis. Respondent's motion is also denied because his allegations of prejudice would be insufficient to support a *laches* defense even if supported by admissible

evidence; his assertion that he cannot be held liable for supervisory failures is unsupported by evidence and fails as a matter of law; and his "malicious prosecution" defense does not exist in a FINRA disciplinary proceeding.

SO ORDERED.

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Lawrence B. Bernard
Hearing Officer

Dated: June 12, 2008
Washington, DC