ABA Securities Litigation SRO Sub-Committee Hosts Panel Discussion on Trying FINRA Disciplinary Proceedings

On June 2, 2011, the ABA Securities Litigation SRO Subcommittee hosted a panel discussion on litigating disciplinary cases brought by FINRA. The panel included Andrew H. Perkins, Deputy Chief Hearing Officer of FINRA's Office of Hearing Officers ("OHO"), David R. Sonnenberg, Vice President & Head of Litigation of FINRA's Department of Enforcement, and Julian Friedman, of Stillman, Friedman & Schectman, P.C. The presentation was moderated by the SRO Subcommittees' Co-Chairs, Andrew Sidman of Bressler, Amery & Ross, Anne Flannery of Morgan Lewis, and David Boch of Bingham McCutchen. Paul Tyrrell of Bingham McCutchen helped organize the panel.

The panelists provided valuable insights and practice tips both for lawyers experienced in handling FINRA disciplinary proceedings and those new to the forum. Some of the highlights are summarized below.

THE ADVANTAGES OF SETTLING REGULATORY MATTERS PRE-COMPLAINT

The panel began with a discussion concerning the settlement process. A respondent who ultimately intends to settle FINRA charges, or is very likely to do so, may benefit from settling before Enforcement issues a complaint, through an "AWC" (Accept, Waiver and Consent). As Mr. Sonnenberg noted, the AWC process enables respondents to negotiate the language of the settlement agreement.

By contrast, a post-complaint settlement embodied in an "Offer of Settlement," usually tracks the allegations in the complaint. Because the complaint is a charging document, it often contains aggressive and descriptive language. As a result, if a respondent intends to settle, there may be a considerable advantage in reaching that settlement through the AWC process before a complaint is filed.

THE COMPLAINT AND ANSWER

Complaints filed by FINRA Enforcement are subject to the general pleading standard that they "specify in reasonable detail the nature of the charges and the rule, regulation or statutory provision violated." Although fraud need not be pled with "particularity" as in court, as a matter of practice, fraud allegations are often more detailed than other claims. Not surprisingly, Enforcement generally uses the complaint to tell its story and describe its case to the Hearing Officer.

As noted by Mr. Perkins, because the answer represents a respondent's first opportunity to communicate to the Hearing Officer, it likewise should tell the story from the respondent's perspective, and not merely admit or deny allegations. Mr. Perkins noted, however, that answers that are too long or argumentative, address extraneous issues or get bogged down in how unfairly the respondent is being treated, can be counter-productive.

THE APPOINTMENT OF HEARING OFFICERS AND PANELISTS

All disciplinary panels are composed of three members: a Hearing Officer, who is a FINRA employee, and two panel members who are industry professionals selected from FINRA District Committees and several other sources. There are six Hearing Officers in FINRA's OHO, which is headed by Chief Hearing Officer Linda D. Fienberg. The OHO is independent from FINRA's Enforcement, rulemaking and policy units.

Mr. Perkins provided some information concerning the six Hearing Officers, i.e., they have securities and/or litigation backgrounds, and include alumni from the SEC, DOJ, and FINRA Enforcement and Market Regulation. Cases are allocated to them with the goal of keeping their caseloads reasonably even. In assigning cases, OHO considers potential conflicts of interest and the appearance of impropriety and generally avoids assigning cases to Hearing Officers who have heard cases involving the same respondent.

Industry panelists are selected from the applicable venue and if particular expertise is needed for a case, the OHO attempts to select panelists with such experience. The Hearing Officer assigned to the matter initially selects panelists and recommends their names to Ms. Fienberg, who appoints them. Although the OHO does not keep a formal record of the industry panelists' awards, it does track how often they have served and the respondents in such cases.
Unlike in arbitrations, FINRA does not provide background information or award histories concerning panelists. As noted by Mr. Friedman, however, counsel have access to background information through BrokerCheck, internet searches and word of mouth. Not surprisingly, members of the Enforcement staff also share information concerning panelists they have encountered in previous cases.

**THE PRE-HEARING CONFERENCE**

Panelists provided a useful overview and guidance concerning the telephonic pre-hearing conference process. The initial conference, which takes place with the Hearing Officer before the panelists are even appointed, is an important opportunity to lay the groundwork for how the case will progress, and to try to ensure that it runs smoothly. During the conference, the Hearing Officer generally tries to get an initial feel for the fact issues and anticipated duration of the hearing. Among the items typically discussed are scheduling, location, estimated number of witnesses, the use of technology at the hearing, stipulations of fact, whether or not experts will be used, the likelihood of settlement and the parties' interest in mediation.

The applicable rule requires that the initial pre-hearing conference take place within 21 days of the date the final answer is due. As a practical matter, in some cases that period will not provide defense counsel with the time to gather sufficient information to adequately address all the required issues at the conference. A good practice pointer in such cases is to consider asking the OHO to postpone the pre-hearing conference to allow for additional preparation, or to ask for a supplemental conference.

Messrs. Perkins, Sonnenberg and Friedman agreed that it is a good idea for counsel to consider conferring before the pre-hearing conference to discuss and attempt to reach agreements on the items to be discussed in the call. Hearing Officers may be willing to modify standard portions of pre-hearing orders where counsel are proactive and propose a workable plan which will enable the case to run smoothly. Mr. Perkins cautioned, however, that non-cooperative and combative approaches to the pre-hearing conference are counter-productive.

**DISCOVERY**

The discussion concerning discovery focused on the unique features of FINRA practice, Enforcement's obligations and avenues for defense counsel to obtain additional information.

Discovery in disciplinary matters before FINRA is self-effectuating. The Staff is required to produce "all documents" obtained or prepared during the investigation, excluding privileged documents and internal memos that could reveal sensitive investigatory techniques. Enforcement then must consider whether any documents that otherwise may be withheld constitute Brady material, that is, documents that are "exculpatory" as that term is defined by federal case law. FINRA must produce Brady materials, "Brady trumps privilege."

Unlike parties in many courts and regulatory investigations, however, Enforcement generally does not have to provide a privilege log or list of withheld documents. If defense counsel wants such a list, he or she will have to file a motion and satisfy a stringent test, i.e., that there is a reasonable likelihood that there is a document that should have been produced but was not. Such motions are rarely granted. Thus, as a practical matter, respondents are largely dependent on the Staff's good faith in making complete productions.

As the panel discussed, obtaining discovery from third parties may be challenging in OHO proceedings. If the third party is a FINRA member, a respondent may move to have the Staff request documents and/or information through a "[Rule] 8210 request." Mr. Sonnenberg suggested that, before seeking such relief from the Hearing Officer, defense counsel consider contacting the Staff to discuss whether the Staff would agree to make an 8210 request without an order from the Hearing Officer.

A key advantage of seeking the Staff's assistance in obtaining discovery, rather than making a motion pursuant to Rule 9252 to have Enforcement issue an 8210 request is that Rule 9252 authorizes production "at the hearing." Applied literally, such production may leave insufficient time for meaningfully review before the hearing. By contrast, Enforcement may issue an 8210 request requiring production at any time during the proceeding.

The panelists noted that obtaining discovery from non-member third parties is difficult at best. Case law suggests that state subpoena power is unavailable in disciplinary proceedings. See, e.g., Gonchar v. NASD, 2006 WL 5255389 (N.Y. Sup. Ct. Feb. 7, 2006).
Another important procedural note is that, even after filing a complaint, the Staff may continue to “investigate” by issuing 8210 requests for documents or on-the-record testimony (“OTRs”). The OHO oversees this process to ensure fairness. When issuing a post-complaint 8210 request, the Staff must file a notice with the OHO with a copy to defense counsel. According to Mr. Sonnenberg, Rule 8210 requests after the complaint has been filed are used “surgically” as necessary. As a practical matter, because post-complaint 8210 requests may raise questions about the thoroughness of the pre-complaint investigation, such requests generally are limited to situations in which the Staff wants to collect additional information on affirmative defenses or other issues raised in the Answer. In the somewhat unusual instances in which a post-complaint OTR is scheduled, defense counsel may attend and cross-examine the witness.

DISPOSITIVE MOTIONS

Dispositive motions in OHO proceedings are called motions for summary disposition, and are similar to summary judgment motions in civil cases. The parties may move for summary disposition at the conclusion of discovery (i.e., before the hearing commences), as well as after Enforcement rests. These motions are infrequently granted, and should be used sparingly, such as in cases where a point of law may determine the outcome of the entire case, e.g., whether the investment at issue is a “security.” Even in the rare case in which summary disposition may be available as to liability, the panel needs to hear the facts to determine sanctions. Moreover, according to Mr. Perkins, the nature of the forum mitigates against the use of such motions, in that industry panelists often are non-lawyers who tend to be more likely to give parties their “day in court” than to grant a dispositive motion.

THE HEARING

FINRA hearings usually take place where the respondents are located or where the events giving rise to the complaint took place. Formal rules of evidence do not apply and hearsay may be admitted, within reasonable limits.

What works best at hearing? Mr. Perkins advised that counsel should focus on the merits with accurate and concise arguments, in a business-like and balanced fashion. On the flip-side, one of the big mistakes counsel can make is "over-lawyering." Aggressive presentations and hyperbole generally do not play well. Similarly, the “FINRA is out to get me” defense usually is not a panel-pleaser.

Another important take-away is to shape your presentation to appeal to both the Hearing Officer who is a lawyer, and the two industry panelists. Do not get too bogged down in legalistic arguments that will not resonate with the panelists. On the other hand, if there is a reasonable business explanation for the conduct at issue, consider emphasizing that point for the industry panelists. In addition, keep in mind that panels often take cases seriously even where there is no customer harm and that industry panelists can be particularly sensitive to and tough on cases involving poor business practices even without customer harm.

Because hearings are not bifurcated into liability and sanctions, defense counsel is in the difficult position of having to argue that the charges should be dismissed but if they are not, the sanction should be mild. In practice, Mr. Perkins said panelists do not view that double-barreled approach as undermining a respondent's defense to liability, because they understand that the defense counsel must argue sanctions, even while contesting liability. A best practice is to address liability in the closing and then clearly mark the shift in the focus of your argument and address sanctions.

Counsel obviously do not have much exposure to the deliberation process and Mr. Perkins provided some insights. After the hearing, the three panel members generally meet to reach a decision and sometimes they confer multiple times. They address liability first and then sanctions, with a view towards whether the respondent is a danger to the investing public.

SANCTIONS

As Mr. Perkins discussed, in determining sanctions, panels rely most heavily on FINRA's Sanctions Guidelines and, to a lesser extent, cases decided by FINRA's National Adjudicatory Council and the SEC. Although case law states that AWCs have little or no precedential value, because often there are relatively few adjudicated cases on point many lawyers take that guidance with a grain of salt and cite AWCs anyway. See, e.g., F.X.C. Investors Corp., Adm. Proceeding File No. 3-10625, Release No. 218, 2002 WL 31741561, at *8 (S.E.C. Dec. 9, 2002) (holding "settlements are of dubious value as precedent") and Terrance Yoshikawa, Adm. Proceeding File No. 3-12057, Release No. 34-53731, 2006 WL 1113518, at *7 n.36 (S.E.C. Apr. 26, 2006) (settled cases “have limited precedential value”). Mr. Perkins advised, however, that panels generally do not consider AWCs.
MEDIATION

A practice pointer to consider is the OHO’s voluntary mediation program. Parties can have either the Hearing Officer assigned to the case act as mediator, or another Hearing Officer assigned who is designated as a “Settlement Officer.” If a mediation is not successful, the Settlement Officer will not discuss the matter with the Hearing Officer. Mr. Sonnenberg suggested that mediation may be productive when the parties are willing to consider sanctions that are in the same “ballpark” and are both committed to the process.

FINAL CONSIDERATIONS

Counsel trying FINRA disciplinary hearings obviously should familiarize themselves with the applicable procedural rules and, just as important, the unwritten practices. Moreover, as the panelists emphasized, whatever differences defense counsel and Enforcement may have with respect to the underlying facts and issues, counsel should consider being proactive and communicating early and often to help streamline the process in general and the hearing in particular.

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