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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C11970032
v.	:	
	:	Hearing Officer - SW
Respondent.	:	

ORDER GRANTING MOTION TO STRIKE AFFIRMATIVE DEFENSES

The Department of Enforcement ("Enforcement") filed a Motion to Strike Respondent's eleven affirmative defenses on March 9, 1998. Respondent did not file a response to Enforcement's motion.

A motion to strike a defense should be granted where it is clear that the affirmative defense is irrelevant and frivolous, and its removal from the case would avoid wasting unnecessary time and money litigating an invalid defense. An affirmative defense is irrelevant if (1) the defense would not constitute a valid defense under any facts that could be proved, or (2) the defense would not constitute a valid defense to the allegation, even if the underlying facts of the defense were proven, so that evidence in support of the defense becomes irrelevant. Based on the above standard, the Hearing Officer grants Enforcement's motion to strike Respondent's eleven affirmative defenses.

First Affirmative Defense: Causes of Action are Not Legally Cognizable

Respondent's first affirmative defense is that Enforcement has failed to state a legally cognizable cause of action. Respondent argues that, even if accepting as true all of the Complaint's allegations, there is no provision of the NASD Conduct Rules that would prohibit the conduct alleged in the complaint. This is simply not true.

If Enforcement can prove that Respondent made recommendations to customer ____ without having reasonable grounds for believing the recommendations were suitable for ___ based on his other security holdings and his financial situation and needs, Respondent would have violated Conduct Rule 2110 and be subject to the NASD Sanction Guidelines for unsuitable recommendations.[1] Similarly, if Enforcement can prove that Respondent failed to amend his Form U-4 and falsely indicated that he was not the subject of an NASD investigation, Respondent would have violated Conduct Rule 2110 and be subject to the NASD Sanction Guideline for the filing of a false or misleading Form U-4.[2] Because these actions, if proved, would be violative of Conduct Rule 2110, the Hearing Officer strikes Respondent's first affirmative defense.

Second Affirmative Defense: Lack of Personal Jurisdiction

Respondent claims that NASDR lacks personal jurisdiction over him. Respondent, however, fails to set forth any facts addressing why NASDR lacks personal jurisdiction over a general securities representative. Under Article XII of the NASD By-laws, NASDR has

[1] NASD Sanction Guidelines, 83 (1998).

[2] NASD Sanction Guidelines, 65 (1998).

jurisdiction to bring disciplinary proceedings against member firms and their associated persons. At the time the Complaint in this proceeding was filed on January 7, 1999, Respondent was registered as a general securities representative with _____, a member firm. NASDR clearly retains jurisdiction with respect to Respondent. The Hearing Officer, therefore, strikes the defense of lack of personal jurisdiction.

Third Affirmative Defense: Laches

Respondent alleges that he was notified in 1997 that the case was closed. Respondent appears to misunderstand the concept of laches. The doctrine of laches is an equitable defense to be applied when one party is guilty of unreasonable and inexcusable delay that has resulted in prejudice to the other party.[3] Where these elements are present, the damage to the party asserting the defense must be caused by his detrimental reliance on his adversary's conduct. Respondent has provided no evidence and has not asserted that he has relied to his detriment on NASDR's conduct.

Respondent's alleged misconduct occurred from October 31, 1995 to on or about August 26, 1996. On July 25, 1997, NASDR sent Respondent a letter advising Respondent that Enforcement was considering taking formal disciplinary action against him. Enforcement brought this action in January 1999. Taking three years to investigate a claim does not display the requisite lack of diligence to support a laches defense.[4] Further, Respondent has provided no evidence that he is materially prejudiced by the delay. Accordingly, The Hearing Officer strikes the laches defense.

[3] In re Larry Ira Klein, Securities Exchange Act Release No. 37835, 1996 SEC LEXIS 2922 at *20 (Oct. 17, 1996).

[4] Id.

Fourth Affirmative Defense: NASDR Lacks Legal Capacity to File Complaint

Respondent fails to state specifically why Enforcement lacks the legal capacity to file the Complaint. Effective August 7, 1997, the NASDR Enforcement staff, rather than the district business conduct committees, initiate complaints. Rule 9211(a) specifically provides that "If the Department of Enforcement believes any NASD member or associated person is violating or has violated any rule, regulation, or statutory provision, . . . , the Department of Enforcement may authorize a complaint." The Hearing Officer strikes the lack of legal capacity defense.

Fifth Affirmative Defense: Statute of Limitations

Respondent's fifth affirmative defense is that Enforcement is time-barred from bringing an action because of a statute of limitations. Respondent fails to specify what statute of limitations. However, giving Respondent the benefit of the doubt, Respondent's argument must be based on 28 U.S.C. §2462 ("§2462"), a federal five-year statute of limitations applicable to judicial and administrative governmental proceedings brought for the enforcement of any civil fine, penalty, or forfeiture. The Securities and Exchange Commission ("SEC") has unequivocally held that the five year limitation period of §2462 does not apply to disciplinary proceedings initiated by self-regulatory organizations, such as the NASD. The SEC, among other things, observed that applying a statute of limitations to a self-regulatory organization would impair the organization's statutory obligation and duty to protect the public and discipline its members.[5] In any event, the Hearing Officer notes that the Complaint in this proceeding was filed within five years of the alleged misconduct.

[5] See In re Henry James Faragalli, Jr., Securities Exchange Act Release No. 37991, 1996 SEC LEXIS 3263, at *36 (Nov. 26, 1996).

The Hearing Officer strikes Respondent's statute of limitations defense.

Sixth Affirmative Defense: Paid the Claim

Respondent states as his sixth affirmative defense that, before the Complaint was filed, his employer discharged ____ claim by paying $45,000. The fact that Respondent's employer settled with customer ___ for $45,000 does not preclude a disciplinary action by NASDR. NASDR's purpose is not only to protect particular investors, but also to strengthen market integrity. As part of its regulatory mission, NASDR must discipline the misconduct of member firms and their associated persons in order to promote the public interest.

Accordingly, evidence regarding prior payment to an injured customer is not relevant as to liability. To the extent Respondent can demonstrate that he attempted to remedy the misconduct that may be relevant to determining what sanctions are appropriate if the Hearing Panel determines that Respondent committed the violation charged in the Complaint.

Seventh Affirmative Defense: Statute of Frauds

Respondent is under the misapprehension that Enforcement must receive a signed and written complaint from the affected customers prior to initiating a disciplinary action. There is no such requirement. The NASD's power to enforce its rules is independent of a customer's decision not to complain.[6] Accordingly, even if Respondent were successful in proving that there was no written complaint, Respondent would be held liable for the unsuitable recommendations if Enforcement were successful in proving the underlying claim regarding unsuitable recommendations.

[6] See In re Bernard D. Gorniak, Securities Exchange Act Release No. 35996 at 3 n. 5, 1995 SEC LEXIS 1820 (July 20, 1995).

Eighth Affirmative Defense: Res Judicata

Respondent fails to state what other tribunal adjudicated the claims that are the subject of this proceeding, but rather reports that the matter was closed by the NASD in 1997. The doctrine of res judicata provides that a judgment on the merits in a prior suit bars a second suit involving the same parties based on the same cause of action. The possible adjudicators are federal or state; civil or criminal; and court or quasijudical agency.[7] Closing or completing an investigation is not an adjudication of a matter, and, therefore, cannot be the predicate for a defense of res judicata.

Ninth Affirmative Defense: Estoppel En Pais

Respondent states that Enforcement is estopped from bringing this proceeding. Four elements must be present to establish an estoppel defense: (1) The party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury.[8]

Respondent asserts that the Senior Regional Attorney's inaction in 1997 precluded NASDR from bringing a complaint in 1999. Respondent does not assert that he has changed his position in reliance on NASDR's actions. Respondent does not respond to Enforcement's assertion that a letter was sent to Respondent on July 25, 1997 advising Respondent that Enforcement was considering formal action, nor does Respondent respond to Enforcement's assertion that on at least two occasions in the fall of 1997, the staff conducted in person

[7] Differences in the standard of proof must also be taken into account in determining whether res judicata applies.

[8] Hecht v. Harris, Upham & Co., 430 F.2d 1202, 1208, 1970 U.S. App. LEXIS 8840 (June 8, 1970).

interviews of Respondent.

Respondent was put on notice that the issues regarding unsuitable recommendations had not been resolved when he received the July 25 letter from the NASDR staff. The doctrine of estoppel does not erase the duty of due care on the part of Respondent to ascertain Enforcement's intentions if he were receiving conflicting oral and written information. Respondent has not set forth the minimum requirements for arguing an estoppel defense. The Hearing Officer, therefore, strikes the estoppel defense.

Tenth Affirmative Defense: Qui Tam Relator

The False Claims Act[9] provides in part that any person conspiring to defraud the Government by getting a false or fraudulent claim allowed or paid is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000, plus 3 times the amount of damages which the Government sustained. The qui tam provisions of the Act permit private individuals who know about fraud against the federal government to file a qui tam lawsuit in federal district court against the party committing the fraud on behalf of the federal government. The person who files the law suit (often referred to as the "relator") is generally entitled to receive between 15% and 30% of any money the government recovers.

The Act prohibits an employer from taking any action against an employee because he or she has filed a law suit under the qui tam provisions of the Act.[10]

Respondent fails to state what actions define him as a qui tam relator. Regardless, if he has filed a qui tam lawsuit, the affirmative defense is not applicable to NASDR disciplinary

[9] 31 U.S.C. §3729 (1998).

[10] 31 U.S.C. §3730 (h) (1998).

proceedings. NASDR is not a governmental entity,[11] and, accordingly, the False Claims Act has no applicability to its proceedings. The Hearing Officer strikes the qui tam relator defense.

Eleventh Affirmative Defense: Customer did not File a Complaint

As discussed in the statute of frauds defense section above, there is no requirement that a written complaint be received by NASDR prior to instituting an investigation or filing a disciplinary complaint. The Hearing Officer strikes the failure of customer to file a complaint defense.

Conclusion

Enforcement's Motion to Strike Respondent's eleven affirmative defenses is granted. No evidence regarding these issues may be submitted at the Hearing except to the extent that such evidence relates to mitigation. All evidence bearing on liability and sanctions, including any evidence of mitigation, must be presented at the Hearing because the Hearing is a unitary proceeding. The Hearing Officer will address specific evidentiary issues as they arise.

SO ORDERED.

_____
Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
April 27, 1999

[11] District Business Conduct Committee for District No. 10 v. Stratton Oakmont, Inc., 1996 NASD Discip. LEXIS 52, *24 (NBCC 1996).