FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. STEVEN E. LARSON (CRD No. 2422755), Respondent.	Disciplinary Proceeding No. 2014039174202 Hearing Officer–DRS

ORDER DENYING MOTION FOR DISMISSAL

I. Background

Late in the afternoon on April 7, 2017—the fifth day of the hearing—Enforcement disclosed that it just realized it had failed to produce certain documents in discovery.[1] In light of that revelation, and Enforcement's inability to represent that it knew the full extent of the non-production,[2] I directed Enforcement to review its discovery compliance in this case and report its findings in a declaration.[3] I also told the parties that the hearing would not finish until I was satisfied that Enforcement had fulfilled its discovery obligations.[4] I then adjourned the hearing.

A week later, after finishing its review, Enforcement announced at a status conference the extent of the non-production. It was massive. Enforcement admitted to not producing at least 30,000 emails[5] (plus attachments) that it obtained during the investigation. Putting the non-production into perspective, Enforcement estimated the volume of improperly non-produced documents at more than double the total documents it had produced.[6] Stated differently, well into the final phase of the hearing, Enforcement had only provided Larson with approximately half the documents he was entitled to receive.

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[1] Hearing Transcript ("Tr.") 1425–27, 1433.

[2] Tr. 1428–29.

[3] Tr. 1434–36, 1439–40. *See also* Status Conf. (Apr. 13, 2017) Tr. 51–52.

[4] Tr. 1430.

[5] Status Conf. (Apr. 13, 2017) Tr. 9–10.

[6] Status Conf. (Apr. 13, 2017) Tr. 16–17.

On April 18, 2017, Enforcement's counsel of record, Adam B. Walker, filed a declaration, under penalty of perjury, detailing Enforcement's discovery failure.[7] According to the declaration, a FINRA examiner obtained approximately 30,000 emails on a disc from Oakbridge Financial Services, Inc. ("OFS").[8] But, Walker explained, due to an "apparent miscommunication" between Enforcement and FINRA's Forensic Investigation and Litigation Support Group, the emails were never loaded to the computer program that Enforcement uses to review and produce documents in discovery.[9] As a result, the declaration goes on to say, Enforcement did not produce the OFS emails to Larson.[10] This was not all. Enforcement also identified an additional 160 documents and 17 emails (plus attachments) it "inadvertently omitted" from its previous discovery productions.[11]

By April 17, 2017, according to Walker's declaration, Enforcement produced to Larson all the omitted documents (including any email attachments).[12] And, to assist Larson "in identifying relevant documents and to lessen any prejudice resulting from the late production," Walker states that in addition to producing the full set of OFS emails, Enforcement "also produced two subsets of documents contained within" those emails: one set of emails "arguably" relating to Count 3, and all other documents found by searching the name "Beyer."[13] Continuing, Walker represents that "counsel for Enforcement have reviewed all the documents prepared or obtained by FINRA staff in connection with the investigations that led to the institution of this proceeding;" that "Enforcement has not withheld any material exculpatory evidence from Mr. Larson;"[14] and, finally, "Enforcement has complied fully with the requirements of Rule 9251."[15]

Afterward, at a status conference on April 28, 2017, Larson confirmed he had received "all relevant documents."[16] And, at a May 9, 2017 status conference, Larson announced he had finished reviewing the documents.[17]

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[7] Declaration of Adam B. Walker ("Decl.").

[8] Decl. ¶¶ 16, 18.

[9] Decl. ¶¶ 16, 20–21.

[10] Decl. ¶ 4.

[11] Decl. ¶¶ 25–26.

[12] Decl. ¶¶ 22, 25–26.

[13] Decl. ¶ 24.

[14] Decl. ¶ 27.

[15] Decl. ¶¶ 27–28. At the April 21, 2017 Status Conference, Enforcement stated that the OFS emails did not contain material exculpatory evidence. Tr. 6–7.

[16] Status Conference (Apr. 28, 2017) Tr. 5, 7.

[17] Status Conference (May 9, 2017) Tr. 8–9.

To mitigate any prejudice that Larson might have incurred because of Enforcement's untimely document production, I granted Larson another opportunity to file a motion for summary disposition (because he had not had a full document production by the time of the original deadline for filing summary disposition motions).[18] I also permitted him to file a supplemental witnesses list, a supplemental exhibit list, and supplemental exhibits so that when the hearing resumed, he could present evidence based on the additional documents that Enforcement produced to him.[19] And, on May 16, 2017, I issued a Second Amended Pre-Hearing Scheduling Order adopting a joint proposal submitted by the parties setting deadlines for these various events, as well as dates for the completion of the hearing, namely, August 14–18, 2017.

On May 19, 2017, Larson moved to dismiss the Complaint.[20] He seeks dismissal and other relief as a sanction based primarily on Enforcement's failure to timely produce documents he was entitled to receive in pre-hearing discovery. More specifically, the motion contends that:

1. Enforcement misrepresented "at the hearing that there were a few documents that they had found, one [of which] they were entering into evidence;"
2. Enforcement misrepresented that Mr. Scott DeArmey lacked a "relationship to the case and had him excluded from Mr. Larson's witness list" although Enforcement entered "into evidence an email where Mr. DeArmey was a recipient of the email showing that he did have knowledge" and therefore "should not have been excluded;"
3. Enforcement misrepresented that it complied with its discovery obligations when, in fact, it had failed to provide certain emails showing "that Mr. Tsiaklides received the hiring documents on 9/24/2013, signed and returned [them to the] home office;"
4. Enforcement failed to produce emails showing that Standley and Larson were the sole owners of OFS and then claimed that "Larson had misrepresented the ownership to FINRA;"
5. Enforcement failed to produce emails pertaining to Beyer showing that the firm had "fully vetted" him and mispresented the firm's "the hiring and review" of him. Larson asserts that had he "seen these documents his responses would have

[18] On May 19, 2017, Larson filed a motion for summary disposition that I will address by separate order.

[19] Status Conference (May 9, 2017) Tr. 19–23, 30, 39, 42. To date, he has not made these filings, which were due by June 12, 2017.

[20] Larson's motions for dismissal and summary disposition referenced certain emails that Enforcement had recently produced and Larson included them, and other emails, on a USB thumb drive he sent to the Office of Hearing Officers. For the reasons stated in my June 13, 2017 Order, I rejected the USB thumb drive for filing and ordered Larson to file, in paper format or as a .pdf attachment to an email, those emails he wants considered in connection with his two motions. On June 19, 2017, Larson filed exhibits in paper format. That filing, however, omitted a number of the emails referenced in the motion.

been more belligerent as the firm had done reasonable research prior to hiring Beyer and FINRA's allegations were unwarranted;" and

6. Enforcement misrepresented that "there was a lack of proper compliance review by" Larson, while possessing, but not producing, "emails that show that to be untrue." By improperly withholding these emails, Larson claims, he was "prevented . . . from making an affirmative defense."

Larson requests that in addition to dismissing this proceeding, I should enter an order:

1. Expunging his CRD "of any mention of the allegations or examination;"
2. Requiring Enforcement "to document changes it is making in its procedure to insure [sic] that it does not happen again in any current or future actions. A report should be provided to [the] Hearing Panel when completed;
3. Requiring Enforcement "to review any ongoing examinations to prevent any current or future misrepresentations 'in order to make a case.' A report should be provided to the Hearing Panel;"
4. Requiring Enforcement "to review current cases with the intent to become aware of all aspects of case [sic] with the understanding that most Broker Dealers are working hard to be compliant. . . . A report should be provided to the Hearing Panel;" and
5. Requiring "[a]n internal examination . . . be conducted to review the problem that have [sic] arisen in this case and the allegations Mr. Larson has made. Those responsible should be sanctioned based on his investigation just as any member firm or IR would be held responsible."

While conceding it should have produced the documents as part of its FINRA Rule 9251-mandated discovery, Enforcement argues that sanctions should not be imposed because its document production failure was inadvertent; it has now produced the omitted documents; Larson has not been prejudiced; and it did not make any misrepresentations.[21] For the reasons discussed below, I deny the motion.

II. Discussion

Under FINRA Rule 9280, a hearing officer or the hearing panel may impose sanctions against a party or an attorney for a party who violates a hearing officer's order or who engages in "other contemptuous conduct during a proceeding."[22] The rule authorizes the entry of "such orders as are just" regarding a party or an attorney for a party and gives examples of the various

[21] Department of Enforcement's Response to Steven Larson's Motion for Dismissal (June 12, 2017).

[22] FINRA Rule 9280(a).

types of orders that could be entered.[23] That rule also authorizes the hearing officer or hearing panel to "exclude an attorney for a Party . . . under Rule 9150." FINRA Rule 9150 permits an adjudicator to "exclude an attorney for a Party . . . from acting as counsel" in a "proceeding for contemptuous conduct under Rule 9280 or unethical or improper professional conduct in that proceeding."

In considering whether to impose sanctions in this case, I begin with FINRA Rule 9251. That rule requires Enforcement to make available to a respondent for inspection and copying all documents (subject to various exemptions) prepared or obtained by FINRA staff in connection with the investigation that led to the disciplinary proceeding.[24] It is essential that Enforcement exercise diligence in complying with this obligation, as rule-compliant document production by Enforcement is fundamental to a fair disciplinary proceeding. Also, under the Code of Procedure's regulatory scheme, a respondent typically relies substantially on Enforcement's good faith and diligence in producing documents; in most cases, a respondent will never know what documents Enforcement has withheld.[25]

Against this backdrop, Enforcement's failure to timely comply with its discovery obligations in this case is disconcerting in a number of respects. First, Enforcement not only failed to timely comply with FINRA Rule 9251, but also violated the Case Management and Scheduling Order. That order required Enforcement "to complete producing documents for inspection and copying under Rule 9251" by August 31, 2016. Second, the period of non-compliance was lengthy. Enforcement did not complete its document production until April 2017, eight months after the deadline for doing so had expired and after five days of hearing. Third, the volume of documents that Enforcement failed to produce is staggering. According to Enforcement, it failed to produce over 30,000 emails (plus attachments) comprising approximately half of the total documents Larson was entitled to receive in discovery. (By Larson's calculation, the omitted documents were even more numerous: 50,000 emails and seven

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[23] For example, the rule provides that the hearing officer or the hearing panel could issue:

> (A) an order providing that the matters on which the order is made or any other designated facts shall be taken to be established for the purposes of the disciplinary proceeding in accordance with the claim of the Party obtaining the order; (B) an order providing that the disobedient Party may not support or oppose designated claims or defenses, or may not introduce designated matters in evidence; (C) an order providing that pleadings or a specified part of the pleading shall be stricken, or an order providing that the proceeding shall be stayed until the Party subject to the order obeys it; (D) in lieu of any of the foregoing orders or in addition thereto, an order providing that contemptuous conduct includes the failure to obey any order; and (E) an order as provided in subparagraphs (A), (B), and (C) where a Party has failed to comply with an order to produce a person for examination, unless the Party failing to comply shows that such Party is unable to produce such person for examination.

[24] FINRA Rule 9251(a)(1) and (b).

[25] For example, a respondent cannot automatically obtain from Enforcement a list of withheld documents. To require Enforcement to produce a withheld documents list, the respondent must file a motion under Rule 9251(c) "based upon some reason to believe that a Document is being withheld in violation of the Code."

spread sheets totaling 80,000 pages).[26] Fourth, the non-production did not result from a single cause, but from a combination of miscommunications, misunderstandings, and other errors. Fifth, the discovery failure resulted in a four-month delay in the completion of the hearing, now scheduled to resume and finish in August. Finally, while it is unclear whether any of the additional documents contain material exculpatory evidence, some of these documents may at least be relevant to Larson's defense.[27]

On the other hand, certain factors weigh against dismissing the case. First, the record does not reflect that Enforcement engaged in willful misconduct, bad faith, or that it otherwise acted contemptuously.[28] Second, Enforcement admitted it made a mistake in not producing the omitted documents.[29] Third, Enforcement has made substantial remediation efforts. It has now completed its production of the omitted documents, providing them and the hearing transcript to Larson at no charge.[30] Enforcement also ran computer word searches on the documents to assist Larson's review and produced a subset of the OFS emails arguably relating to Count 3 of the Amended Complaint.[31] Fourth, any prejudice resulting from Enforcement's failure to timely produce the documents has been eliminated, or at least substantially mitigated, because I granted a four-month continuance of the hearing's resumption, which gives Larson ample time to use the newly produced documents in his defense. And, fifth, dismissing this proceeding—especially at this late stage[32]—would undermine the public policy favoring the disposition of cases on their merits.[33]

In conclusion, after considering the totality of the circumstances, I find that while Enforcement's failure to timely comply with its discovery obligations is troubling, dismissal of this case, or the imposition of lesser sanctions, is unwarranted. On balance, the interest of justice would be best

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[26] Motion for Dismissal, at 1. *See also* Status Conference (Apr. 28, 2017) Tr. 5 (Larson estimating that Enforcement's additional document production contained 48,000 emails).

[27] After finishing his review of the newly produced documents, Larson concluded that 225 emails and attachments totaling about approximately 350 pages were "material" to his defense. Status Conf. (May 9, 2017) Tr. 6–10. I make no finding at this point as to the relevance of any of the additional documents.

[28] *Cf. Exxon Valdez*, 102 F.3d 429, 432 (9th Cir.1996) (holding that under Fed. R. Civ. P. 37, "if a party fails to obey an order to provide discovery, the court may dismiss the action, ... Dismissal, however, is authorized only in 'extreme circumstances' and only where the violation is 'due to willfulness, bad faith, or fault of the party.'").

[29] *See, e.g.*, Status Conf. (Apr. 13, 2017) Tr. 33.

[30] Status Conf. (Apr. 21, 2017) Tr. 17–18, 26–27; Status Conf. (Apr. 28, 2017) Tr. 17.

[31] Status Conf. (Apr. 13, 2017) Tr. 35; Decl. ¶ 4.

[32] Enforcement rested its case-in-chief, and Larson, the only witness presently slated to testify for the defense, has finished his direct testimony.

[33] *Cf. Computer Task Group, Inc. v. Brotby*, 364 F.3d 1112, 1115 (9th Cir. 2004) (including "the public policy favoring disposition of cases on their merits" as a relevant factor when considering whether to impose the sanction of dismissal under Fed. R. Civ. P. 37).

served by resuming and finishing the hearing, as scheduled, in August. Accordingly, the motion is **DENIED.**

SO ORDERED.

David R. Sonnenberg
Hearing Officer

Dated: June 21, 2017

Copies to: Steven E. Larson (*via electronic and first-class mail*)
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