ADMINISTRATIVE PROCEEDING
FILE NO. 3-12738

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 28, 2008

In the Matter of	
NEXT FINANCIAL GROUP, INC.	ORDER DISCUSSING DIVISION OF ENFORCEMENT'S PROPOSED PRIVACY POLICY EXHIBITS

At issue is the status of certain exhibits collecting the written privacy policies of non-party brokerage firms. Respondent NEXT Financial Group, Inc. (NEXT), has moved to exclude one late-filed exhibit submitted by the Division of Enforcement (Division). Based on my preliminary review of the transcript (Tr. ___), another privacy policy exhibit was discussed at length, but not offered into evidence by the Division. I never accepted or rejected that exhibit, and the Division never formally withdrew it. Nonetheless, the court reporting company recently filed that exhibit with the Secretary of the Securities and Exchange Commission (Commission). Given the ambiguous state of the record and the potential significance of these exhibits, we will resolve this issue before commencing the posthearing briefing schedule.

Background

In relevant part, the Order Instituting Proceedings (OIP) alleges that NEXT, a registered broker-dealer, willfully aided and abetted and caused other broker-dealers' violations of Regulation S-P, 17 C.F.R. § 248. According to the OIP, NEXT did so by encouraging, and in many cases facilitating, newly employed registered representatives (recruits) to disclose their customers' nonpublic personal information to NEXT without proper notice to the customers and a reasonable opportunity for the customers to opt out of such disclosure (OIP ¶¶ II.B.18-19).

At the first prehearing conference, the Division explained that it would present evidence that the privacy policies of the recruits' current brokerage firms did not reveal that a registered representative might disclose a customer's nonpublic personal information to an unaffiliated brokerage firm, such as NEXT, when the registered representative departed to join NEXT. The Division estimated that it would offer a sampling of five to ten such privacy policies. The Division represented that, if it could not reach a stipulation with NEXT, it anticipated calling live witnesses from such non-party brokerage firms to authenticate the firms' privacy policies (Prehearing Conference of Sept. 26, 2007, at 7). The Division stated that it would not request the presiding Administrative Law Judge (ALJ) to issue subpoenas so that it could obtain documents from non-parties (Prehearing Conference of Sept. 26, 2007, at 8-9).

The Division submitted its list of proposed witnesses on October 12, 2007. Proposed Division witness # 16 was Commission employee Matthew Jenkins (Jenkins), a summary witness who would testify about, among other things, "whether the privacy policy of the firm the

recruit left disclosed that a representative would be permitted to transfer customer information to a non-affiliated broker-dealer when a recruit left the current firm." Proposed Division witness # 17 was identified generically as "representatives of NEXT recruits' prior firms for the purpose of authenticating privacy policies."

On or about October 19, 2007, the Division provided NEXT with a copy of its proposed hearing exhibits. On November 19, 2007, the parties filed the first of three sets of stipulated facts. Proposed stipulation # 17 and Exhibit H collect the privacy policies of non-party broker-dealers from which NEXT recruited registered representatives between January 2004 and December 2005. On November 29, 2007, the Division and NEXT jointly stipulated to the "authenticity and admissibility" of numerous exhibits, including Division Exhibit 60 (DX 60), a 282-page compilation of privacy policies from approximately fifty-three brokerage firms that previously employed NEXT recruits.[1] NEXT reserved the right to object at the hearing to the relevance of proposed DX 60.

During the first day of the hearing, I reminded the Division that it needed to offer each of its proposed exhibits separately (Tr. 209-11). I explained that, once the Division offered an exhibit, I would determine if NEXT objected, and then issue a ruling, admitting or rejecting the proposed exhibit. Division counsel agreed to proceed in that fashion (Tr. 211).

Jenkins testified on the second and fourth days of the hearing. NEXT asked Jenkins when and how he and another Commission employee obtained the privacy policies in proposed DX 60 from the fifty-three non-party brokerage firms (Tr. 435-37, 846-60). The record demonstrates: first, that Jenkins and his colleague requested and collected these privacy policies from fifty-three brokerage firms in mid-October 2007, well after the Commission had issued the OIP; second, that Jenkins and his colleague never informed the non-party brokerage firms whether production on their part was voluntary or mandatory (Tr. 852); and, third, that in dealing with eleven of the fifty-three brokerage firms, Jenkins and his colleague invoked the Commission's powers under Section 17 of the Securities Exchange Act of 1934 (Exchange Act) and Rules 17a-3 and 17a-4 thereunder, either directly or through SEC Form 1661 (DX 79).

The Division conceded that, if NEXT wished to obtain documents from non-parties, it could not have invoked comparable powers under Section 17 of the Exchange Act (Tr. 863). Rather, NEXT would have had to request the presiding ALJ to issue subpoenas (Tr. 863).

I expressed concern that the Division had invoked powers outside the scope of discovery provided in the Commission's Rules of Practice to generate evidence for use in a pending adjudicatory proceeding, when the respondent had no corresponding powers available to it (Tr. 863-64). In essence, the Division's approach would reduce the Rules of Practice to a nullity on its side; the Rules would bind only NEXT.

I determined that the Division had acted inappropriately—a determination the Division has never asked me to reconsider—and the inquiry then turned to the question of what to do

[1] Proposed DX 60 is identical to Exhibit H of the First Set of Stipulations of Fact. In two months (from September 26 to November 29, 2007), the Division's "representative sample" of five to ten privacy policies grew to fifty-three privacy policies.

about it (Tr. 864). During the hearing, I was not aware of any Commission or judicial precedent addressing the issue of how to handle improperly obtained evidence. The parties did not cite any relevant case law on whether there is, or should be, a sanction for evading the limits on discovery under the Rules of Practice. Accordingly, I relied on the Initial Decision of an ALJ at another agency, dealing with a comparable question. See Mitchell R. Newman, 1990 CFTC LEXIS 323, *2-8 (July 17, 1990) (ALJ Arthur Shipe) (rejecting proposed exhibits and excluding them from consideration), on appeal, 1992 CFTC LEXIS 325, *7 n.2 (Aug. 6, 1992) (agency notes that the issue had not been raised on appeal and declines to address the issue on its own motion).[2]

After discussing various options with the parties, I granted the Division two weeks after the hearing to determine if it could cure the impropriety by duplicating the privacy policies in DX 60 from public sources (Tr. 869-72, 944). The parties explained that it was difficult to get historic information from the Internet (Tr. 440, 867).

On December 19, 2007, two weeks after the close of the hearing, a paralegal for the Division submitted for filing with the Office of the Secretary a document identified as "late filed Division Exhibit 60."[3] The tendered document is 397 pages in length. It contains multiple privacy policies from approximately twenty brokerage firms.[4] The December 19 cover letter did not move for admission of the late-filed exhibit. Nor did it formally withdraw the original DX 60.

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[2] I have subsequently identified several relevant Commission and judicial opinions. Cf. James F. Glaza, 83 SEC Docket 3101, 3107-08 & n.7 (Sept. 30, 2004) (holding that the Commission will not set aside stipulations of fact without compelling reasons; and ruling that an ALJ is under no obligation to second-guess tactical decisions made by counsel for a party in reaching such stipulations); Richard O. Bertoli, 47 S.E.C. 148, 153 n.23 (1979) (dictum) (citing United States v. Janis, 428 U.S. 433, 447 (1976)). In Bertoli, the respondent moved to suppress evidence allegedly acquired as the result of an illegal search and seizure engaged in by the Commission's staff. In dictum, the Commission noted that "the Supreme Court declined to exclude illegally seized evidence in a civil tax case and stated that it had never applied the exclusionary rule in a civil proceeding." See also Pa. Bd. Of Probation & Parole v. Scott, 524 U.S. 357, 364 (1998) (holding that no exclusionary rule applies in parole revocation proceedings); INS v. Lopez-Mendoza, 468 U.S. 1032, 1050 (1984) (holding that no exclusionary rule applies in civil deportation proceedings).

[3] At an early stage of the proceeding, I reminded the Division that Rule 153(a) of the Commission's Rules of Practice requires every filing to be signed by at least one counsel of record (Prehearing Conference of Sept. 26, 2007, at 4-5). The December 19, 2007, cover letter is not signed by at least one counsel of record. It invokes Rule 220(e) of the Commission's Rules of Practice, which is not germane to the present dispute.

[4] The late-filed exhibit does not include privacy policies from any different brokerage firms (i.e., each of the firms identified in the late-filed exhibit was also identified in the original exhibit). However, the late-filed exhibit includes additional iterations of some firms' privacy policies. The Division was also afforded an opportunity to make clear the source of privacy policies in exhibits other than DX 60 (Tr. 870-72, 945-46). Although the December 19, 2007, cover letter did not address the point, it appears that the late-filed exhibit contains this information.

On January 7, 2008, NEXT moved to exclude portions of the Division's late-filed exhibit, as well as portions of other Division exhibits containing privacy policies (Motion to Exclude). On January 11, 2008, the Division opposed NEXT's Motion to Exclude (Opposition). It also moved to admit its late-filed exhibit (Opposition at 6).

Discussion

Terminology. There are too many "Division Exhibit 60s" floating around the official docket. The parties' references to "original DX 60" and "revised DX 60" do not eliminate the potential for confusion when the Commission eventually reviews the record.

IT IS ORDERED THAT, for the remainder of this proceeding, the parties shall refer to the 282-page document discussed at the hearing as "Division Exhibit 60" or "DX 60."

IT IS FURTHER ORDERED THAT, for the remainder of this proceeding, the parties shall refer to the 397-page document filed with the Office of the Secretary on December 19, 2007, as "Division Exhibit 60A" or "DX 60A."[5]

Division Exhibit 60A. NEXT moves to exclude DX 60A for several reasons. For example, NEXT argues that the Division has failed to demonstrate that the privacy policies collected in DX 60A were in effect when the registered representatives left their prior brokerage firms to join NEXT. This, of course, is the relevance argument that NEXT reserved the right to make in the November 29, 2007, stipulation. The parties are welcome to develop this issue in their posthearing briefs, but NEXT cannot legitimately repackage the argument now as presenting a question of "authenticity." NEXT also challenges the Division's reliance on the Internet Archive's "Wayback Machine," an information retrieval system that allows the public to visit archived versions of stored websites.[6] NEXT cites judicial decisions requiring affidavits or other evidence of authenticity before documents from the "Wayback Machine" are considered authentic under Federal Rule of Evidence 901. NEXT has already stipulated to the authenticity of the privacy policies in DX 60. Exhibit H to the First Set of Stipulations of Fact is already part of the record. A comparison of those privacy policies with the corresponding privacy policies in DX 60A could demonstrate or disprove the authenticity of the privacy policies offered in DX 60A. Cf. Fed. R. Evid. 901(b)(3). The parties may address that issue in their respective briefs, as well. In addition, NEXT argues that some of the language of the archived privacy policies in DX 60A differs from the language of the privacy policies collected in DX 60. Again, this issue may be developed in the posthearing briefs. It would be most helpful if the parties can focus on substantive differences between the relevant language of the privacy policies compiled in DX 60 and the corresponding privacy policies collected in DX 60A. It will not be helpful if the parties

[5] This is the approach we took with Respondent's Exhibit 17 (unsigned version of a letter from NEXT to Jenkins) and Respondent's Exhibit 17A (signed version of the same letter) (Tr. 381-82, 701-02).

[6] I reject the Division's suggestion that DX 60A should be immune from attack by NEXT because the Division purportedly performed "as directed by the Court" and "meticulously followed the Court's instructions" (Opposition at 2-3).

dwell on insignificant language differences, punctuation discrepancies, or non-germane portions of the privacy policies.

While certain of NEXT's arguments may have merit, they go to the weight that should properly be accorded to DX 60A, rather than to its admissibility. NEXT's Motion to Exclude is denied and DX 60A is accepted into the record.

Division Exhibit 60. My preliminary review of the record shows that the Division never offered proposed DX 60 into evidence.[7] While I expressed concern about how the Division's agents gathered parts of the exhibit (Tr. 441, 851), I never explicitly rejected it. The Division never withdrew proposed DX 60, either. For its part, NEXT has offered only a cursory explanation as to why it should not be bound by Exhibit H to the First Set of Stipulations of Fact and its November 29, 2007, stipulation about the authenticity and admissibility of DX 60.

When the court reporting company recently filed the hearing exhibits with the Office of the Secretary, DX 60 was included in the package. At present, DX 60 remains in a state of uncertainty: neither offered in whole or in part, nor admitted, nor withdrawn, nor rejected.

By February 1, 2008, the Division must make explicit its position with respect to DX 60. The Division shall either move to admit DX 60, in whole or in part, for a limited purpose (i.e., authenticating the entries in DX 60A) or for all purposes, or it shall withdraw DX 60. If the Division moves to admit DX 60, in whole or in part, NEXT may file an opposition on or before February 8, 2008. The parties shall address Scott, Lopez-Mendoza, Janis, Newman, Glaza, and Bertoli, as well as any other relevant case law, in their submissions.[8]

The schedule adopted at the close of the hearing required the Division to file its proposed findings of fact, proposed conclusions of law, and brief by February 1, 2008. However, the status of DX 60 should be resolved first. Under the circumstances, the due date for the Division's posthearing pleadings will be enlarged until February 15, 2008. A comparable enlargement of time will be granted to NEXT to file its posthearing pleadings, and to the Division to file its optional reply.

SO ORDERED.

James T. Kelly
Administrative Law Judge

[7] If the parties' review of the record shows otherwise, they should cite the appropriate transcript page.

[8] NEXT contends that the Division violated the Privacy Act of 1974, 5 U.S.C. § 552a, in collecting the materials for DX 60 (Tr. 852-53, 858-59; Motion to Exclude at 2). However, that statute applies to the government's collection of information from natural persons, not business entities. If NEXT intends to pursue this argument, it must identify with particularity the statutory provision the Division allegedly violated.