United States District Court
Southern District of New York

Chambers of
Shirley Wohl Kram
United States District Judge

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

STANDARD INVESTMENT CHARTERED, INC.,	x	
Plaintiff,	x	07 Civ. 2014 (SWK)
-against-	x	
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., et al.,	x	OPINION AND ORDER
Defendants.	x	

SHIRLEY WOHL KRAM, U.S.D.J.

Defendants National Association of Securities Dealers, Inc. ("NASD") and NYSE Group, Inc. ("NYSE"), on behalf of themselves and several individual defendants, appeal an order of the Magistrate Judge granting in part the plaintiff's motion for expedited discovery and denying the defendants' request for a stay of all discovery during the pendency of the defendants' anticipated motion to dismiss. As the Magistrate Judge's Order was neither clearly erroneous nor contrary to law, the Court affirms that order.

I. BACKGROUND

Defendants NYSE, through a subsidiary, and NASD are both self-regulatory organizations ("SROs") registered with the Securities and Exchange Commission ("SEC"). "As an SRO, the NASD is, like other SROs such as [defendant NYSE], authorized by Congress to 'promulgate and enforce rules governing the conduct

of its members,'" and is subject to oversight by the SEC. DL Capital Group, LLC v. NASDAQ Stock Mkt., Inc., 409 F.3d 93, 95 (2d Cir. 2005) (citing Barbara v. New York Stock Exch., Inc., 99 F.3d 49, 51 (2d Cir. 1996)).

On November 28, 2006, NASD and NYSE announced "a plan to consolidate their member regulation operations into a combined organization that will be the sole U.S. private-sector provider of member firm regulation for securities firms doing business with the public." (Compl. ¶ 13.) As the consolidation of these entities requires NASD to amend its by-laws, the defendants "promulgate[d] the proxy statement in support [thereof on] December 14, 2006," and "scheduled a vote [of NASD members] on January 19, 2007" (Compl. ¶ 14), at which time the by-law amendments were approved (Defs.' Br. 2, Apr. 10, 2007).

On March 8, 2007, the plaintiff, an NASD member, initiated the instant lawsuit as a class action, alleging that the consolidation of NASD and NYSE will disenfranchise certain NASD members and that the proxy statement seeking approval of the consolidation was misleading. The plaintiff seeks an injunction barring the NASD and NYSE's regulatory consolidation, the issuance of a revised proxy statement, and damages. On March 12, 2007, the plaintiff filed a motion for expedited discovery, including requests for both document production and depositions. The request for expedited discovery was referred to Magistrate

Judge Debra Freeman. The Magistrate Judge accepted submissions from the parties and engaged in telephone conferences with them before granting the plaintiff's request for expedited document discovery, to be produced by April 11, 2007, and staying all further discovery pending her further order.

Following extensive deliberations concerning expedited schedules for the plaintiff's anticipated motion for a preliminary injunction and the defendants' anticipated motion to dismiss, the defendants represented to the Court that the regulatory consolidation between NASD and NYSE would not close before June 1, 2007, and the parties were ordered to propose revised motion schedules on the basis of that date. (Endorsed Order, Apr. 4, 2007.) The defendants then sought reconsideration of the Magistrate Judge's expedited discovery order on April 6, 2007. Following the denial of that request on April 9, 2007, the defendants filed this appeal.

II. STANDARD OF REVIEW

Federal Rule of Civil Procedure 72(a) governs the district court's referral of "pretrial matter[s] not dispositive of a claim or defense of a party" to a magistrate judge. See Catskill Development, L.L.C. v. Park Place Entertainment Corp., 206 F.R.D. 78, 86 (S.D.N.Y. 2002) (reviewing magistrate judge's discovery orders under standard set forth in Federal Rule of Civil Procedure 72(a)) (citing Sheikhan v. Lenox Hill Hosp., 98

Civ. 6468, 1999 WL 386714, at *1 (S.D.N.Y. June 11, 1999)); Mathias v. Jacobs, 167 F. Supp. 2d 606, 622-23 (S.D.N.Y. 2001) (same). When faced with objections to non-dispositive orders, "[t]he district judge to whom the case is assigned shall consider such objections and shall modify or set aside any portion of the magistrate judge's order found to be clearly erroneous or contrary to law." Fed. R. Civ. P. 72(a). "An order is 'clearly erroneous' when the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed," while an "order is 'contrary to law' when it fails to apply or misapplies relevant statutes, case law or rules of procedure." Collens v. City of New York, 222 F.R.D. 249, 251 (S.D.N.Y. 2004) (citation and internal quotation marks omitted). Finally, with respect to discretionary decisions, courts in this district have concluded that "magistrate judges are afforded broad discretion and reversal is only appropriate if there is an abuse of discretion." Mathias, 167 F. Supp. 2d at 622-23 (citation and internal quotation marks omitted).

III. DISCUSSION

The instant dispute concerns the interplay between the plaintiff's desire for expedited discovery in order to bolster its anticipated motion for a preliminarily injunction and the defendants' claim that they are not subject to discovery because

they enjoy absolute immunity and because the Court lacks jurisdiction over this action due to the plaintiff's failure to exhaust its remedies as required by the Securities Exchange Act of 1934 (the "Exchange Act"). In her Order, the Magistrate Judge made two interrelated rulings responsive to these concerns: (1) a partial grant of the plaintiff's request for expedited discovery; and (2) a denial of the defendants' request for a stay of *all* discovery pending the motion to dismiss. The defendants raise four distinct objections to the Magistrate Judge's balancing of the competing interests at issue. Each is denied for the reasons that follow.

A. Asserted Immunity Defenses Must Be Balanced With Exigent Circumstances

The defendants' first objection relates to the Magistrate Judge's denial of their requested stay of all discovery during the pendency of their anticipated motion to dismiss.[1] They contend that the Magistrate Judge erred by basing her discovery grant, in part, on a finding that it "is not clear whether Defendants' forthcoming motion to dismiss [on immunity grounds] will be successful." (Order 1, Mar. 27, 2007.) Rather, the

[1] The defendants filed a motion to dismiss the complaint shortly after it was filed. Although they intend to submit an updated motion to dismiss the newly-filed amended complaint, they assure the Court that they will continue to argue that "the defendants are absolutely immune from suits related to their conduct of their regulatory functions," and that the plaintiff's allegations challenge nothing more than that. (Defs.' Br. 4.)

defendants argue that the proper standard for staying discovery prior to deciding immunity issues is whether the immunity defense "is at least arguable." (Defs.' Br. 5.)

The Supreme Court has indicated that immunity defenses are meant to provide protected parties "a right, not merely to avoid 'standing trial,' but also to avoid the burdens of 'such pretrial matters as discovery . . . .'" Behrens v. Pelletier, 516 U.S. 299, 308 (1996) (emphasis omitted) (quoting Mitchell v. Forsyth, 472 U.S. 511, 526 (1985)). Of course, a defendant's mere assertion of immunity can not be sufficient to stay all discovery in exigent circumstances. None of the defendants' proffered authority supports such a broad proposition, nor does logic demand it.

The defendants cite three authorities for the proposition that the proper test to apply in these circumstances "is whether the immunity defense 'is at least arguable.'" (Defs.' Br. 5.) The first of these is a recent, unpublished mandate of the Second Circuit staying trial and pre-trial proceedings to allow the appellate court to consider whether the appellants' "arguable . . . assertions of immunity . . . have merit." In re World Trade Center Disaster Site Litig., 06-5324-cv (2d Cir. Mar. 9, 2007). Apart from the fact that this administrative disposition is devoid of analysis or precedential effect beyond the law of the case, there is no indication that the mandate

considered exigent circumstances similar to those present here. Thus, the defendants' primary authority carries little weight. Nor do the defendants' other proffered authorities balance the damage to defendants imposed by premature discovery with the ill effects a plaintiff may suffer when denied expedited discovery. Rather, these authorities merely stand for the proposition that, absent a countervailing need for expedited discovery, a stay may be granted where an anticipated motion to dismiss "appears not to be unfounded in the law." Niv v. Hilton Hotels Corp., No. 06 Civ. 7839(PKL), 2007 WL 510113, at *1 (S.D.N.Y. Feb. 15, 2007); accord Anti-Monopoly, Inc. v. Hasbro, Inc., No. 94 Civ. 2120 (LMM)(AJP), 1996 WL 101277, at *4 (S.D.N.Y. Mar. 7, 1996).

In fact, granting a discovery stay pending disposition of a merely "arguable" motion to dismiss when there is a demonstrated need for exigent relief completely undermines the purpose of temporary remedies, whether dispositive, as in the case of a preliminary injunction, or not, as in the case of discovery. Thus, that the Magistrate Judge declined to stay all discovery because, *inter alia*, it was "not clear" whether the forthcoming motion to dismiss would be successful, is not contrary to law, nor does the Court find it to be clearly erroneous in light of the "entire evidence" on the record. Collens, 222 F.R.D. at 251.

B. Consideration of Arguments Based on the Exhaustion of Administrative Remedies

The defendants also object to the Magistrate Judge's "conclusion that expedited discovery could go forward even though the plaintiff had not exhausted its administrative remedies." (Defs.' Br. 6.) They argue that the "comprehensive scheme of administrative and judicial review established by the Exchange Act" provides the "*exclusive* method of challenging the validity of NASD rulemaking," and that the challenged conduct here was attendant to such rulemaking. (Defs.' Br. 6.) The defendants contend that allowing even the limited discovery ordered by the Magistrate Judge permits plaintiffs to opt out of the statutorily mandated process.

Again, however, the defendants fail to consider the discovery order in the context of a request for *expedited* discovery required by the fast-approaching consolidation at issue here. The plaintiff has requested expedited discovery in aid of its motion for a preliminary injunction. If discovery is stayed until the defendants' motion to dismiss on exhaustion grounds has been resolved, the plaintiff may be effectively denied access to the remedy of injunctive relief, even though it may prevail on the motion to dismiss. Indeed, at least one other court in this district has allowed an "evidentiary hearing" and argument on a preliminary injunction contemporaneous with its

consideration of a motion to dismiss for failure to exhaust administrative remedies. See American Benefits Group, Inc. v. Nat'l Ass'n of Sec. Dealers, No. 99 CIV 4733 JGK, 1999 WL 605246, at *1 (S.D.N.Y. Aug. 10, 2006). For these and the reasons stated supra in Part III.A, the Court finds that the Magistrate Judge's decision to deny a stay of all discovery during the pendency of the motion to dismiss based on exhaustion grounds is neither contrary to law nor clearly erroneous.

C. The Magistrate Judge's Finding that the Plaintiff Would Be Prejudiced in the Absence of Expedited Discovery

The defendants' first two objections focus largely on the prejudice that they will face if they are not granted a stay of all discovery prior to a ruling on the motion to dismiss. Their third objection challenges the Magistrate Judge's finding that the plaintiff "would be unfairly prejudiced if a complete stay of discovery is granted." (Order 1, Mar. 27, 2007.) The defendants provide three separate rationales for this objection: "[1] the plaintiff will not be prejudiced by sequencing the motions to dismiss before discovery; [2] the plaintiff's remedies under the Exchange Act are more than adequate to protect its interests; and [3] the plaintiff's supposed time crisis is of its own making." (Defs.' Br. 8.) Each of these rationales relies to some degree on the fact that the defendants, on April 2, 2007, a week after the Magistrate

Judge's discovery Order, formally represented to the Court that the regulatory consolidation would close, at the earliest, on June 1, 2007.[2]

First, the defendants argue that the Magistrate Judge set her original motion schedule, which established a document discovery date of April 11, 2007, with the understanding that a preliminary injunction would be forthcoming in late April. They contend that the recently-stipulated adjournment for briefing of the anticipated preliminary injunction, based on the June 1, 2007, closing date, is a new fact that the Magistrate Judge failed to examine when she declined to reconsider the discovery schedule. However, it is not clear from the record that the Magistrate Judge expected the anticipated motion for a preliminary injunction to be heard in late April as opposed to some later date. Thus, the Court is unwilling to conclude that the Magistrate Judge abused her discretion in determining that the June 1, 2007, closing date did not constitute a material fact necessitating reconsideration of her initial determination.

[2] However, it bears mention that the defendants had every opportunity to either indicate the earliest possible date by which the regulatory consolidation would close or stipulate to a date before which they would not effect closure of the consolidation in order to allow consideration of the motion to dismiss. Defendants were served with the complaint in early March, and had extensive discussions with the Magistrate Judge in mid- to late-March, yet the Court's review of the record does not reveal a written confirmation of a closing date until the letter of April 2, 2007.

Further, any decision that the April 11, 2007, discovery date was appropriate even in light of a June 1, 2007, closing date is not clearly erroneous on the evidence before the Court.

The defendants' second rationale for challenging the Magistrate Judge's finding concerning unfair prejudice to the plaintiff also fails. If the defendants' actions attendant to the proposed by-law amendments are indeed the type of actions covered by the administrative remedies supplied by the Exchange Act, then the plaintiff will not be prejudiced by being precluded from discovery prior to disposition of the motion to dismiss. However, the Magistrate Judge found that it was unclear whether the Exchange Act's administrative remedies cover the proposed by-law amendments. In fact, the necessity for exhaustion of remedies is precisely what will be decided when the Court resolves the defendants' motion to dismiss. In light of the uncertainty surrounding the defendants' exhaustion argument, and given the exigent circumstances here, the Court cannot say that the Magistrate Judge's finding that the plaintiff would be unfairly prejudiced by a stay of all discovery prior to the disposition of the motion to dismiss was clearly erroneous.

Defendants also argue that any prejudice to the plaintiff was self-inflicted by its failure to file or amend its complaint at an earlier date. The first of these purported "self-inflicted

wounds" was clearly known to the Magistrate Judge at the time she filed her initial Order on March 27, 2007. The second was brought to her attention by April 6, 2007, at the latest (Endorsed Order, Apr. 6, 2007), well before she denied reconsideration of her Order. Clearly the Magistrate Judge concluded that these alleged "self-inflicted wounds" did not undermine her finding of "unfair prejudice" to the plaintiff. As the Court finds that this was not clear error, it declines to disturb the Magistrate Judge's ruling on this ground.

D. The Legal Standard Underlying the Magistrate Judge's Grant of Expedited Discovery

Finally, the defendants argue that, "even if they are accepted as true, the Magistrate Judge's findings do not support allowing expedited discovery" because she failed to make explicit findings regarding the elements first set out in Notaro v. Koch, 95 F.R.D. 403, 405 (S.D.N.Y. 1982).[3] This final objection is also an insufficient ground for setting aside the Magistrate Judge's order.

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[3] In Notaro, Judge Edelstein proposed that courts require plaintiffs seeking expedited discovery to demonstrate:

> (1) irreparable injury, (2) some probability of success on the merits, (3) some connection between the expedited discovery and the avoidance of the irreparable injury, and (4) some evidence that the injury that will result without expedited discovery looms greater than the injury that the defendant will suffer if the expedited relief is granted.

95 F.R.D. at 405.

As an initial matter, the Notaro test, while well-suited to the circumstances of that case and often used in this District, is not controlling authority. See Ayyash v. Bank Al-Madina, 233 F.R.D. 325, 326-27 (S.D.N.Y. 2005) (rejecting the Notaro test in favor of "a more flexible 'good cause' test"). Indeed, in Ayyash, Judge Lynch opined "that the intention of the [Federal Rules of Civil Procedure is] to confide the matter [of expedited discovery] to the Court's discretion, rather than to impose a specific and rather stringent test." Id. at 326.[4] Further, Notaro deals with specific circumstances, notably a request for expedited depositions in a politically volatile situation, that are not present here. In sum, the Magistrate Judge's Order partially granting expedited discovery was neither contrary to controlling law, nor was it an abuse of her discretion in adjudicating this discovery dispute.

IV. CONCLUSION

For the reasons stated above, the Court declines to set aside the Magistrate Judge's Order partially granting expedited discovery and rejecting the defendants' motion to stay all discovery pending a decision on the anticipated motion to

[4] Judge Lynch also recognized that "employing a preliminary-injunction type analysis to determine entitlement to expedited discovery makes little sense, especially when applied to a request to expedite discovery in order to prepare for a preliminary injunction hearing." Ayyash, 233 F.R.D. at 326-27 (citation omitted). These are precisely the circumstances at issue in this litigation.

dismiss. In light of the disposition of the defendants' appeal, the request to temporarily stay the Magistrate Judge's Order pending consideration of these objections is denied as moot.

SO ORDERED.

SHIRLEY WOHL KRAM
UNITED STATES DISTRICT JUDGE

Dated: New York, New York
April 11, 2007