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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. CAF990018
v.	:	**HEARING PANEL ORDER**
	:	Hearing Officer - JN
Respondents.	:	

ORDER DENYING MOTION FOR SUMMARY DISPOSITION

Respondent _____ Motion for Summary Disposition seeks dismissal of the Complaint on factual and legal grounds. After considering the Motion and its supporting materials, the Department's Opposition, Respondent's Motion for leave to file a Reply, the Department's Opposition to that request, and Respondent's Reply (which the Hearing Officer allowed), the Hearing Panel concludes that the Motion should be denied.

A. Factual matters

In the Panel's view, the factual contentions, set out in _____ Memorandum supporting the motion, are inappropriate for resolution by summary disposition. These aspects of Respondent's Motion argue for rulings in his favor on such issues as beliefs, state of mind, and intent to deceive; the materiality of particular statements; the existence of good faith and a reasonable basis for believing that statements were true; reliance on Respondent _____ authority and determinations; the content of a particular conversation between _____ and _____; and the inferences which should or should not be drawn from _____ grandfather's receipt of certain stock. Such issues are often inappropriate for summary disposition. See

Wright, Miller and Kane, Federal Practice and Procedure (1998), Sections 2726, 2730, and 2732, fn. 22, and cases there cited.[1] As to these and other factual questions, the record is not so clear as to enable the Panel to find that there is no genuine issue with regard to any material fact. To resolve these matters, the Panel needs to assess documentary evidence in light of the questioning of witnesses and to see and hear the witnesses, including _____ himself. The Panel denies all aspects of the Motion which seek summary disposition based on his contentions as to the facts.

B. Legal issues

_____ sets out three discrete legal contentions: that NASD is barred from asserting aiding and abetting liability; that it cannot prosecute _____ for violating certain rules, allegedly applicable only to "members;" and that it lacks power to prosecute him for a violation of Section 17(b) of the Securities Act of 1933. The Panel believes that resolving these contentions now (rather than during the hearing or thereafter in post-hearing briefs) will expedite the proceeding.

1.) Aiding and abetting

_____ argues that NASD lacks power to prosecute on a theory of aiding and abetting because the Association (unlike the SEC) has no specific statutory authorization to do so (Memorandum in Support, pp. 13-16). Enforcement counters that the issue is irrelevant because the Complaint does not charge liability on an aiding and abetting theory (Opposition to Motion for Summary disposition, pp. 6-8). The Complaint's language, which does not use those terms, is consistent with the Department's statements that "[t]he Complaint charges _____

[1] As the SEC stated in authorizing motions for summary disposition: "Typically, enforcement and disciplinary proceedings that reach litigation involve genuine disagreement between the parties as to material facts. [A] hearing will … often be necessary to determine a respondent's statement of mind…. Based on past experience, the circumstances when summary disposition prior to hearing could be appropriately sought or granted will be comparatively rare." 60 Fed. Reg. 32738 (June 9, 1995), 1995 SEC LEXIS 1505, at *176, *180.

directly…" and that "he is charged with direct violations" (Opposition, pp. 7, 8). The Panel accepts those representations. Enforcement's case will stand or fall on evidence of direct violations, and not on any aiding and abetting theory. The Panel need not address the Motion's contention as to NASD's alleged powerlessness to prosecute for aiding and abetting, because that question is not presented by this Complaint.

Insofar as the Motion turns on _____ contentions that the facts fail to establish direct violations, it is denied. Here, again, the record does not enable the Panel to find no genuine issue of material fact. For example, the parties clash directly on the question of whether _____ told _____ that he wrote the research report in issue (Opposition, p. 7; _____ Reply, p. 5). To resolve this and other questions concerning _____ direct liability, if any, the Panel needs to see and hear the witnesses. The Panel accordingly denies the Motion to the extent that it seeks a determination by summary disposition that the evidence fails to show direct liability.

2.) Liability of Associated Person

_____ next argues that he cannot be held liable under Rules 2110, 2120, and 2210 because they pertain only to a "member" (Memorandum, pp. 16-19). The Panel disagrees.

The Association's General Provision 0115(a), entitled "Applicability," states: "[t]hese Rules shall apply to all members and persons associated with a member. Persons associated with a member shall have the same duties and obligations as a member under these Rules." Under this language, all of the duties and obligations of a member were equally applicable to _____. He, like a firm, was required to observe high standards of commercial honor and just and equitable principles of trade (Rule 2110), to refrain from inducing the purchase of a security by manipulative, deceptive, or fraudulent devices (Rule 2120), and to adhere to the requisite standards for communications with the public (Rule 2210). The Panel concludes that an

associated person may properly be disciplined under those Rules, consistently with their applicability to "members."

Noting that other NASD Rules specifically mention associated persons (Memorandum, 18), _____ argues that such references would be superfluous if members' duties and obligations already attached to associated persons under General Provision 0115(a). Invoking the canon that all words in a statute should be given meaning, he concludes that associated persons can be liable only when specifically mentioned in a Rule. That argument lacks merit.

First, it ignores General Provision 0115(a), which plainly states that associated persons "shall have the same duties and obligations as a member under these Rules." _____ result turns the "all words" principle on its head, leaving General Provision 0115(a) superfluous and without meaning. It renders the Association powerless under its current Rules to discipline registered representatives who engage in the very misconduct for which the Securities Exchange Act of 1934 required self-regulatory organization rules (Sec. 15A(b)(6)). An attempt to give meaning to all statutory words need not produce that outcome.[2] That is especially so under General Provision 0113, which provides that "[t]he rules shall be interpreted in such manner as will aid in effectuating the purposes and business of the Association, and so as to require that all practices in connection with the … securities business shall be just, reasonable and not unfairly discriminatory." _____ construction - stripping the Association of its power to prosecute individuals for grave misconduct - is just the opposite approach.

[2] "Statutes must be interpreted, if possible, to give each word some operative effect." Walters v. Metropolitan Educational Enterprise, Inc., 519 U.S. 202, 136 L. Ed. 2d 644, 652 (1997)(emphasis added). "But we may not, in order to give effect to those words, virtually destroy the meaning of the entire context; that is, give them a significance which would be clearly repugnant to the statute, looked as a whole, and destructive of its obvious intent." Van Dyke v. Cordova Copper Co., 234 U.S. 188, 191 (1914)(recognizing that certain words became superfluous).

Finally, the authorities do not support _____" construction. NASD and SEC cases unquestionably assume the applicability of General Provision 0115.[3] Moreover, one Court of Appeals (while deciding another question) quoted the General Provision and concluded that "there is no question that Alderman had a duty as an associated person of AIFC to act in accordance with NASD ethical standards towards AIFC customers." Alderman v. S.E.C., 104 F.3d 285, 287, fn. 2, 288 (9th Cir. 1997).

The Panel denies _____ request for summary disposition on this "member/ associated person" ground.

3.) Section 17(b) of the Securities Act of 1933[4]

This statute makes it unlawful

> for any person [using interstate commerce or the mails] to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, described such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

The Complaint's Second Cause (as to _____, _____, and _____) and Third Cause (as to _____) charge that failures to disclose consideration received from an issuer violated "Conduct Rules 2110, 2120, 2210 …, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Conduct Rule 2110 through violations of Section 17(b) of the Securities Act of 1933." By its terms, the Complaint thus invokes Section 17(b) only insofar as a violation of that

[3] See Opposition, pp. 8-9, citing cases which _____ recognizes as reflecting that assumption (Motion to File a Reply, p. 4).

[4] The Hearing Officer earlier deferred decision on this issue, in the context of Enforcement's Motion to Strike an affirmative defense which raised it. The parties' summary disposition papers incorporate by reference their prior submissions on the Section 17(b) question.

Section also constitutes a violation Rule 2110. There is, therefore, no need to resolve the question whether NASD has the power to prosecute a Section 17(b) violation directly.

_____ argues that NASD's disciplinary powers stem from Section 15A of the 1934 Act, which authorizes the Association to enforce compliance with various provisions, but not the 1933 Act. To treat violations of that Act as violations of Rule 2110, _____ urges that the Association must first issue a rule proscribing the particular conduct, citing General Bond & Share Co. v. SEC, 39 F.3d 1451 (10th Cir. 1994).

Section 15A's failure to mention the 1933 Act does not prevent the Association from treating violations of the latter as violations of Rule 2110's requirement for the observance of "high standards of commercial honor and just and equitable principles of trade." See e.g. In re Valley Forge Securities Co., Inc., 41 S.E.C. 486, 1963 SEC LEXIS 564, at *4-5 (April 12, 1963) (recognizing that "[t]he NASD has, and in our opinion, very properly so, uniformly considered violations of the Securities Acts and the rules and regulations issued thereunder as constituting conduct contrary to just and equitable principles of trade and thus contrary to [Rule 2110's predecessor]) "; In Re Eugene T. Ichinose, Jr., Exchange Act Rel. No. 17381, 1980 SEC LEXIS 105, at *9 (December 16, 1980) ("We have repeatedly approved the NASD's uniform practice of treating violations of the securities acts as violations of the Association's ethical standards").

_____ argues that such cases simply "assumed, without analysis, that the NASD has enforcement authority under the Securities Act." (Opposition to Department of Enforcement's Motion to Strike, p. 6). The Panel disagrees with this reading. These cases sustain the Association's power to treat a Securities Act as a violation of its own rules - precisely the situation at bar. They do not assume that NASD possesses some discrete authority to enforce the Act. A Hearing Panel is bound to apply applicable SEC and Association precedents. The cases'

explicit references to the propriety of charging "securities acts" violations as violations of NASD's "just and equitable principles" Rule are dispositive of the present challenge. Enforcement may properly allege a violation of Section 17(b) of the 1933 Act as a violation of NASD Rule 2110.

General Bond, supra, held that violation of a Notice to Members was not fairly implicit in NASD's "just and equitable principles" Rule, and thus could not be prosecuted under it - without promulgating the Notice through the rulemaking process. General Bond involved only a Notice, not an underlying statute (as in the instant case). The court accordingly limited its decision, noting that "the securities laws and SEC rules appropriately contain broad prohibitions against manipulative, deceptive or fraudulent practices," that "General Bond's activities … were not alleged to have violated any of these provisions," and that there was thus no need to determine whether violations of these anti-fraud statutes were fairly implicit in the Association's Rule (1994 U.S. App. LEXIS 30116, at *28). By its own terms, therefore, General Bond does not preclude treating violations of Section 17(b) of the 1933 Act - one of the anti-fraud provisions - as violations of Rule 2110.

The Panel finds that an alleged violation of Section 17(b) of the 1933 Act is "reasonably and fairly implied" in Rule 2110's requirement for "high standards of commercial honor and just and equitable principles of trade." Section 17(b) is a significant statute, reflecting a long-standing Congressional decision to remedy "articles in newspapers or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for."[5] This disclosure requirement embodies "the very essence of federal securities regulation." SEC v. Wall Street

[5] House Rept. No. 85, 73rd Cong., 1st Sess, p. 24, quoted in SEC v. Wall Street Publishing Institute, Inc., 851 F.2d 365, 376 (D. C. Cir. 1988), cert. denied, 489 U.S. 1066 (1989).

Publishing Institute, Inc., 851 F.2d 365, 374, fn. 9 (D. C. Cir. 1988), cert. denied, 489 U.S. 1066 (1989). It serves the "substantial interest of the investing public in knowing whether an apparently objective statement in the press concerning a security is motivated by promise of payment ..." United States v. Amick, 439 F.2d 351, 365 (7th Cir. 1971).

The prohibition in Section 17(b) does not set "a new standard of conduct" for NASD members, so as to necessitate rulemaking. General Bond, supra, at *1460. There is nothing "new" about the statute; it has been on the books since 1933. Nor can it be regarded as hidden or obscure. The investor interest underlying Section 17(b) is "obvious" (Amick, 439 F.2d at 365).

What is "obvious" to the courts should be even more readily apparent to the trained securities professional, who is properly chargeable with knowledge of NASD rules.[6] In notices issued well before the advertising in issue, the Association specifically alerted its members to this statutory requirement that consideration received for advertising a security must be disclosed. See NASD Notices to Members 75-16 (February 1975) and 96-83 (December 1996). In any event, a registered representative, operating in a regulatory system driven by disclosure principles, should realize that advertising a security for an undisclosed consideration clashes with the investor's "obvious" interest in disclosure. The duty to disclose cannot be viewed in isolation from NASD's requirement for ethical standards. See In re Paulson Investment Company, Inc., Exchange Act Rel No. 19603, 1983 SEC LEXIS 2190 (March 16, 1983) ("Kunesh omitted a material fact, and thereby violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Article III, Section 1 of the NASD's Rules … which requires the observance of 'high standards of commercial honor and just and equitable principles of trade'").

[6] See e.g. In re Jay Frederick Keeton, 50 S.E.C. 1128, 1130 (1992)

In the Panel's view, Section 17(b)'s requirement that representatives disclose consideration received in exchange for advertising a security is "reasonably and fairly implied" in Rule 2110's mandate for "high standards of commercial honor and just and equitable principles of trade."

HEARING PANEL.

_____
Jerome Nelson
Hearing Officer

Dated: Washington, DC
December 30, 1999