

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET
REGULATION,

Complainant,

v.

Respondent 1,

Respondent 2,

and

Respondent 3,

Respondents.

Disciplinary Proceeding
No. 2005000127502

Hearing Officer—Andrew H. Perkins

**ORDER DENYING COMPLAINANT'S
MOTION FOR PARTIAL SUMMARY DISPOSITION**

On August 17, 2006, the Department of Market Regulation (the "Department") filed a motion for summary disposition of on Causes Four and Five of the Complaint, which alleged that the Respondents recommended the purchase of two thinly traded, thinly capitalized securities ("microcap securities") quoted in the OTC market without a reasonable basis for their recommendations. Causes Four and Five of the Complaint allege that the Respondents thereby violated NASD Conduct Rules 2315 and 2110. The Department contends that there are no genuine issues in dispute as to these charges because the Respondents admitted under oath in their on-the-record interviews that they did not conduct a due diligence review of the companies' current financial statements and material business information before recommending that customers purchase the microcap securities, as required by Conduct Rule 2315. The Department attached relevant excerpts from the transcripts of the Respondents' on-the-record interviews in

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support of the Motion. The Department did not file a statement of undisputed facts or an affidavit or declaration supporting the Motion.

The Respondents filed their opposition to the Motion on October 13, 2006.¹ The Respondents contend that the Department's Motion should be denied because the Department failed to comply with Procedural Rule 9264 governing motions for summary disposition and because there are disputed genuine, material issues of fact. The Respondents also failed to file a statement of undisputed facts.

For the reasons discussed below, the Hearing Officer denies the Department's Motion.

DISCUSSION

I. PROCEDURAL DEFICIENCIES

Rule 9264(e) of NASD's Code of Procedure sets forth the standard for ruling on summary disposition motions:

The Hearing Panel or, if applicable, the Extended Hearing Panel, may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law.

The critical inquiry is whether a genuine issue of material fact exists. A genuine issue of material fact exists when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party."² The record and all reasonable inferences drawn from the record are viewed in the light most favorable to the nonmovant.³ There is no genuine issue for trial unless there is sufficient evidence favoring the nonmoving party to support

¹ The Respondents' opposition was due on September 15, 2006. On October 9, 2006, the Respondents requested an extension of time to file their opposition. Without objection, the Hearing Officer granted the Respondents' request.

² *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986).

³ See, e.g., *Foley v. City of Lafayette, Ind.*, 359 F.3d 925, 928 (7th Cir. 2004).

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a decision for that party.⁴ Furthermore, a material fact is “one ‘that might affect the outcome of the suit under the governing law.’”⁵

On a motion for summary disposition, the moving party bears the initial burden of showing that there are no genuine issues of material fact for trial.⁶ This burden may be met by showing the panel that a lack of evidence exists to support the nonmoving party’s case.⁷ Upon discharging that burden, the nonmoving party must demonstrate that the trier of fact could reasonably find in the nonmoving party’s favor with respect to each issue on which that party has the burden of proof at trial.⁸

Like Fed. R. Civ. P. 56, Rule 9264 of the NASD Code of Procedure provides a framework to prevent summary disposition practice from becoming “a game of cat-and-mouse, giving rise to the ‘specter of [triers of fact] being unfairly sandbagged by unadvertised factual issues’”⁹ NASD Procedural Rule 9264(d) requires that all motions for summary disposition be accompanied by: (1) a statement of undisputed facts; (2) a supporting memorandum of points and authorities; and (3) affidavits or declarations that set forth such facts as would be admissible at the hearing and show affirmatively that the affiant is competent to testify to the matters stated therein.

In addition, the Hearing Officer issued an Order Establishing Pre-Hearing Procedures on June 15, 2006 (“Procedural Order) that directed the parties to comply with

⁴ See, e.g., *Anderson*, 477 U.S. at 248; *Hershey v. Donaldson, Lufkin & Jenrette Securities Corp.*, 317 F.3d 16, 19 (1st Cir. 2003).

⁵ *United States v. One Parcel of Real Prop.*, 960 F.2d 200, 204 (1st Cir. 1992) (quoting *Anderson*, 477 U.S. at 248).

⁶ *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986).

⁷ See, e.g., *Rochester Ford Sales, Inc. v. Ford Motor Co.*, 287 F.3d 32, 38 (1st Cir. 2002).

⁸ *Id.*

⁹ *Ruiz Rivera v. Riley*, 209 F.3d 24, 28 (1st Cir. 2000) (quoting *Stepanischen v. Merchants Despatch Transp. Corp.*, 722 F.2d 922, 931 (1st Cir. 1983)).

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Rule 9264. The Procedural Order further directed that a moving party's statement of undisputed facts shall be in numbered paragraphs and directed a responding party to specifically respond to each numbered paragraph of the movant's statement of undisputed facts.

The Department's summary disposition motion materially fails to comply with NASD Procedural Rule 9264 and the Hearing Officer's Procedural Order. The Department failed to file either an affidavit or a statement of undisputed facts. Such failures constitute grounds for denial of the Department's summary disposition motion.

II. CONDUCT RULE 2315

Although the Hearing Officer is not required to do so, he has also reviewed the record to see if the materials the Department submitted suggest that summary disposition is appropriate. If the Hearing Officer were to ignore the procedural shortcomings in the Department's submission, nevertheless the record materials the Department provided fail to indicate that the Respondents violated NASD Conduct Rule 2315 (the "Recommendation Rule").

NASD Conduct Rule 2315(a), entitled Review Requirements, provides in relevant part:

No member or person associated with a member shall recommend that a customer purchase or sell short any equity security that is published or quoted in a quotation medium and that ... is not listed on Nasdaq or on a national securities exchange ... unless the member has reviewed the current financial statements of the issuer, current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation.

The Recommendation Rule further imposes specific obligations on members before any of its brokers may sell a microcap security. Conduct Rule 2315(c), entitled Compliance Requirements, states that the member shall designate a registered person to

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conduct the due diligence review required by the Recommendation Rule and then document the information reviewed.

Under the scheme of the Recommendation Rule, it is the member, not its individual associated persons, that is obligated to undertake the due diligence review required by the rule.

In this case, however, the Department has alleged in Cause Four and Five of the Complaint that the Respondents failed to undertake their own review of the issuers' financial statements and material business information. The Department does not allege whether their firm complied with the Recommendation Rule, and the Department did not question the Respondents about their firm's compliance with the Recommendation Rule during its investigation. Accordingly, the alleged admissions the Department relies upon in the Respondents' on-the-record interviews cannot support entry of summary disposition against the Respondents. Even if the Panel were to accept the Department's contention that the relied-upon statements in the on-the-record interview amounted to admissions that they had not conducted the review required by the Recommendation Rule, those admissions would not be dispositive of the charges against the Respondents. The issue that must be resolved at the hearing is whether the Respondents reasonably relied upon information that the firm had conducted the required reviews.¹⁰

¹⁰ The Hearing Officer does not reach the issue of whether the Complaint sufficiently alleges a violation of the Recommendation Rule.

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Accordingly, the Hearing Officer denies the Department's summary disposition motion.

IT IS SO ORDERED.

Andrew H. Perkins
Hearing Officer

October 20, 2006