

This Order has been published by NASD's Office of Hearing Officers and should be cited as OHO Order 02-09 (C01010009).

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C01010009
v.	:	
	:	HEARING PANEL ORDER
	:	
	:	
	:	Hearing Officer - SW
Respondent.	:	
	:	

**ORDER DEFERRING DECISION
ON COMPLAINANT'S MOTION FOR SUMMARY DISPOSITION**

The Department of Enforcement filed a Complaint alleging that Respondent participated in the sales of nine-month, non-recourse, promissory notes, secured by retail automobile installment loan contracts, issued by First Lenders Indemnity Corporation, without providing prior written notification to his employer, Pruco Securities Corp. ("Pruco"), in violation of Rules 3040 and 2110. Respondent's Answer admits that Respondent participated in the promissory note transactions, but argues that the promissory notes were not securities and that he provided oral notification of the transactions to Pruco.

Enforcement moved for summary disposition, pursuant to Rule 9264, requesting that the Hearing Panel find that promissory notes were securities, that Respondent participated in the sale of securities, and that Respondent's failure to provide written

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notice of the transactions violated Rule 3040 and 2110.¹ Respondent opposed Enforcement's Motion.

Code of Procedure Rule 9264(d) provides that the Hearing Panel "may grant [a] 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 moving party (in this case, Enforcement) bears the initial burden of showing "the absence of a genuine issue of material fact." Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). Pursuant to Code of Procedure Rule 9264(d), the Hearing Panel may grant or deny a motion for summary disposition or defer decision on the motion.

Under the particular facts of this case, the Hearing Panel has decided to defer a decision on Enforcement's Motion because of Enforcement's failure to set forth in its motion an analysis concerning whether the promissory notes are securities, and Respondent's failure to provide information concerning whether the notes may be properly classified as commercial paper.

In footnote 15 on page 4 of the Enforcement Memorandum, Enforcement states that the disclosure document makes clear that the promissory notes were securities, albeit securities for which there was a claimed exemption from registration. The Hearing Panel does not agree that the disclosure document is clear, especially since the disclosure document describes the notes as commercial paper.

The proper transactional analysis for determining whether the notes are a security is the family resemblance test articulated by the Supreme Court in Reves v. Ernst &

¹ In support of its Motion for Summary Disposition ("the Motion"), Enforcement filed a Memorandum of in Support of Summary Disposition on the Merits ("Enforcement Memorandum") and the Declaration of _____ to which were attached 22 exhibits.

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Young, 494 U.S. 56 (1990). Under the Reves family resemblance test, every promissory note is presumed to be a security, as defined in Section 3(a)(10) of the Exchange Act. However, the presumption that a note is a security can be rebutted if the note bears a strong family resemblance to an item on the judicially crafted list of exceptions.

The list of exceptions includes (i) notes delivered in consumer financings, (ii) notes secured by mortgages on homes, (iii) short-term notes secured by liens on small businesses or some of the small businesses' assets, (iv) notes evidencing 'character' loans from banks, (v) short-term notes secured by an assignment of accounts receivable, (vi) notes which simply formalize an open-account debt incurred in the ordinary course of business, and (vii) notes evidencing loans by commercial banks for current operations.²

The motivation of the sellers and purchasers, the plan of distribution, the reasonable expectation of the public, and the adequacy of a regulatory scheme are the four factors that are used to determine whether a family resemblance exists between a particular promissory note and the above list of exceptions. Enforcement's memorandum failed to discuss explicitly why the promissory notes in this case do not meet the family resemblance test, particularly why the notes failed to resemble short-term notes secured by an assignment of accounts receivable.

In Reves, the Supreme Court explicitly left open the question of whether the presumption that every note is a security applies to short-term notes, i.e., notes with terms of less than nine months. However, a number of circuits have narrowed the Section 3(10) Exchange Act exclusion from "any note . . . which has a maturity at the time of issuance of

² Reves, 494 U.S. at 60.

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not exceeding nine months” to notes which qualify as “(1) prime quality negotiable commercial paper, and (2) of a type not ordinarily purchased by the general public.”³

Respondent, on the other hand, has the burden of persuasion that the notes meet the commercial paper exemption. Respondent failed to explicitly address this issue in his opposition motion.

Therefore, it is ORDERED that Enforcement's Motion is DEFERRED.⁴ The Hearing will proceed as scheduled on June 14, 2002 in San Francisco, California for the purpose of receiving evidence and hearing arguments relating to liability and sanctions, including any aggravating and mitigating factors.

At the Hearing, Enforcement should be prepared to demonstrate, if true, why the promissory notes in this case fail to meet the family resemblance test of the Reves court, and Respondent should be prepared to demonstrate, if true, why the notes meet the commercial paper exemption.

SO ORDERED

HEARING PANEL

By: _____
Sharon Witherspoon
Hearing Officer

Dated: Washington, D.C.
May 14, 2002

³ Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075, 1079 (7th Cr. 1972), cert. denied, 409 U.S. 1009 (1972).

⁴ The Hearing Panel noted that the State of California Department of Corporations has ruled that the promissory notes are securities.