

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 98-32 (CAF980025).

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

: Disciplinary Proceeding

: No. CAF980025

: (Consolidating CAF980025 and CAF980027)

: Hearing Officer—AHP

**ORDER GRANTING PARTIAL SUMMARY DISPOSITION IN FAVOR OF THE
DEPARTMENT OF ENFORCEMENT AND CONTINUING THIS PROCEEDING
FOR HEARING ON SANCTIONS**

On June 22, 1998, the Department of Enforcement (“Enforcement”) filed a Complaint in this disciplinary proceeding, alleging that Respondents _____ and _____ violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210 by failing to provide testimony and documents requested by NASD Regulation, Inc. (“NASDR”). This matter is now before this Hearing Panel on a motion for summary disposition filed by Enforcement on August 31, 1998.

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For the reasons that follow, the Hearing Panel will grant Enforcement's motion as to liability and continue this proceeding to January 11, 1999, for a hearing on sanctions.

Background

In May 1996, NASDR commenced an investigation of _____ activities with respect to the initial public offerings for Sonics and Materials, Inc., Big City Bagels, and Netsmart Technologies, Inc.¹ In connection with that investigation, on April 15, 1998, Enforcement requested _____ and _____ to give an on-the-record interview and produce all documents in their possession relating to those companies. _____ and _____ had been associated with _____ from August 1994 until the firm closed in January 1998. _____ was _____ Director of Compliance,² and _____ was its Director of Trading.³

Since both _____ and _____ were represented by counsel, Enforcement directed the requests to their counsel.⁴ Both counsel agreed to accept service of the request on behalf of their respective client. NASDR requested that _____ appear on

¹ Complainant's Mot. for Summ. Disposition at 2.

² Respondent _____ Opp'n to Department of Enforcement's Mot. for Summ. Disposition ("_____ Opposition") at 1.

³ Respondent _____ Opp'n to Complainant's Mot. for Summ. Disposition ("_____ Opposition") at 2.

⁴ Id. at 3.

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May 29, 1998,⁵ and _____ on May 28, 1998.⁶ Both requests were sent under NASD Procedural Rule 8210.⁷

A. _____ *Failure to Testify*

_____ counsel received the request on Friday, April 17, 1998, and on Monday, April 20, 1998, he advised Enforcement that _____ agreed to be interviewed on-the-record with respect to the trading activities in the three securities under investigation.⁸ _____ counsel also advised Enforcement that _____ would like to have the interview conducted promptly. Due to scheduling conflicts, however, the interview could not be accelerated as much as _____ wanted although the interview was moved to May 27, 1998, to accommodate his counsel.⁹

On May 7, 1998, _____ and _____ were charged with several felonies in a complaint brought by the _____.¹⁰ _____ alleges that the criminal complaint was based, at least in part, upon his previous statements given to NASDR in connection with another investigation of _____. Fearing that further cooperation with NASDR could jeopardize his client, _____ counsel asked Enforcement on May 21, 1998, for an adjournment of the on-the-record interview until the criminal matter was resolved.¹¹ When Enforcement refused to adjourn the interview,

⁵ Declaration of Jonathan Golomb in Supp. of Mot. for Summ. Disposition (“Golomb Decl.”) ¶ 2.

⁶ Id. ¶ 7.

⁷ Golomb Decl. Exs 1, 4.

⁸ _____ Opposition at 3.

⁹ Id. at 3-4.

¹⁰ Id. at 4.

¹¹ Id. at 5.

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_____ counsel advised Enforcement that _____ would not testify “at that time.”¹² _____ did not appear to give testimony on May 27, 1998.¹³

By letter dated May 29, 1998, NASDR renewed its request for documents relating to Sonics and Materials, Inc., Big City Bagels, and Netsmart Technologies, Inc. On June 1, 1998, _____ counsel responded in writing that _____ had no documents in his possession responsive to NASDR’s document request.¹⁴ This letter confirmed counsel’s letter of April 20, 1998, in which he represented that _____ had no such documents in his possession.¹⁵

On June 22, 1998, Enforcement filed a Complaint against _____ charging him with violation of NASD Conduct Rule 2110 and NASD Procedural Rule 8210 for failing to appear and testify on May 27, 1998. That proceeding was consolidated with the present proceeding by Order dated August 13, 1998.

B. _____ *Failure to Testify and Provide Documents*

After _____ was charged criminally on May 7, 1998, his counsel twice requested (on May 18, 1998, and May 22, 1998) a four-week adjournment of the on-the-record interview scheduled for May 28, 1998.¹⁶ In his words, the adjournment was requested “so that the direction of the criminal matters can be clarified.”¹⁷ _____ counsel wrote that although _____ was “more than willing” to cooperate, he was

¹² Golomb Decl. Ex. 3.

¹³ _____ Opposition at 5.

¹⁴ Golomb Decl. fn. 2.

¹⁵ _____ Opposition at 3.

¹⁶ _____ Opposition at 2.

¹⁷ Id.

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concerned about memorializing _____ testimony at that particular time – before the direction of the criminal prosecution became clearer.¹⁸ _____ counsel also raised concern about protecting _____ right against self-incrimination because _____ counsel believed that NASDR “may be working closely with at least one prosecuting entity” and that entity may have an interest in “compelling non-immunized statements from _____ that the entity could not otherwise obtain through the criminal process.”¹⁹

On May 22, 1998, Enforcement denied _____ request for a four-week extension, so _____ counsel advised Enforcement that _____ would not appear on May 28, 1998, but he would appear at a later, unspecified date.²⁰ In fact, _____ did not appear on May 28, 1998, and Enforcement filed the Complaint in this proceeding against him on June 22, 1998, charging him with violation of NASD Conduct Rule 2110 and NASD Procedural Rule 8210.

Discussion

A. *Jurisdiction*

Although not currently registered with the Association, Respondents are subject to the NASD’s jurisdiction in this proceeding. Article V, Section 4(a) of the NASD’s By-Laws provides that the NASD retains jurisdiction over formerly registered persons who are no longer associated with any member firm for two years after the effective date of termination of registration. Moreover, Article V, Section 4 specifically permits the NASD to file a complaint against a formerly associated person during this period of retained

¹⁸ Golomb Ex. 6.

¹⁹ Id.

²⁰ _____ Opposition at 3.

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jurisdiction, based upon that person's failure to provide information, pursuant to NASD procedural Rule 8210, while subject to the NASD's jurisdiction.²¹ Because the Complaints in this proceeding were filed within two years of the date Respondents' registration terminated, the NASD has jurisdiction to bring this disciplinary proceeding.

B. Legal Standard for Summary Disposition

Rule 9264(d) of the NASD Code of Procedure permits a Hearing Panel to grant summary disposition when "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." This is the identical standard as that under Rule 56(c) of the Federal Rules of Civil Procedure ("Fed. R. Civ. P.") governing summary judgments.

It is well-established under Fed. R. Civ. P. 56 that the moving party bears the initial burden of showing "the absence of a genuine issue of material fact."²² The substantive law governing the case will identify those facts which are material and "only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment."²³

If the moving party meets that initial burden, the opposing party must "do more than simply show that there is some metaphysical doubt as to the material facts," but must come forward with specific facts "showing that there is a genuine issue for trial."²⁴

Absent such a showing, summary judgment is appropriate since a complete failure of

²¹ See NASD Notice to Members 92-19.

²² Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).

²³ Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).

²⁴ Matsushita Elec. Indus. Corp., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586-87 (1986).

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proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial.²⁵

In this case, Respondents concede that they failed to appear and testify on the date requested by NASDR. Thus, the only issue to be decided by the Hearing Panel is whether, as a matter of law, Respondents have raised a reasonable defense for their refusal to provide the requested information and to the charged rule violations. Respondents have raised two defenses. They assert that they did respond to the requests – albeit for the purposes of requesting an adjournment of the scheduled interviews and advising NASDR that they would not comply. Second, they claim that their refusal to be interviewed in no way impeded the prompt and efficient conduct of Enforcement's investigation. _____ and _____ argue that Enforcement's refusal to grant an adjournment of their scheduled interviews was designed to serve the interests of the criminal prosecutors, not the NASD.

C. *Failure to Testify and Provide Documents*

NASD Procedural Rule 8210(a)(1) authorizes the NASD to require an associated person "to provide information orally, in writing, or electronically . . . with respect to any matter involved in [an] investigation" The Rule provides a means for the NASD to carry out its regulatory mandate in the absence of subpoena power. As such, the Rule is a "key element in the NASD's effort to police its members."²⁶ A failure to respond "undermines the NASD's ability . . . to carry out its self-regulatory functions,"²⁷ and

²⁵ Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).

²⁶ In re Richard J. Rouse, 51 S.E.C. 581, 1993 SEC LEXIS 1831, at *7 (1993).

²⁷ In re John J. Fiero, Exchange Act Release No. 39544, 1998 SEC LEXIS 49, at *5 (Jan. 13, 1998).

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frustrates its ability “to conduct investigations and thereby protect the public interest.”²⁸

For this reason, registered persons may not impose conditions on compliance with requests for information issued under NASD Procedural Rule 8210.²⁹ “The Rules do not permit second guessing the NASD’s requests.”³⁰

Under NASD Procedural Rule 8210, _____ and _____ were required to testify irrespective of the pending criminal proceedings. The rule confers no right on registered persons to delay their testimony due to threatened or pending related litigation.³¹ The NASD relies on the cooperation of its members and associated persons to fulfill its statutory obligations. NASD Procedural Rule 8210 requires a full and timely response.³² _____ and _____ refusal to cooperate and testify when requested by NASDR was a violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110.³³

_____ and _____ also cannot justify their refusal to testify on the ground that they did not impede NASDR’s investigation. They may not substitute their judgment regarding the need for further information during an investigation for that of NASDR.³⁴

To permit otherwise would allow respondents to second guess NASDR in all

²⁸ In re Barry C. Wilson, Exchange Act Release No. 37867, 1996 SEC LEXIS 3012, at *14 (Oct. 25, 1996) (quoting Rouse, 51 S.E.C. at 588, 1993 SEC LEXIS 1831, at *16).

²⁹ In re Mark Allen Elliott, 51 S.E.C. 1148, 1150-51 (1994); Rouse, 51 S.E.C. 581, 586-87.

³⁰ In re Michael David Borth, 51 S.E.C. 178, 180-81 (1992).

³¹ See In re Darrell Jay Williams, 50 S.E.C. 1070, 1072 (1992) (rejecting attempt to postpone compliance until any possible related litigation was resolved).

³² See, e.g., In re Stratton Oakmont, Inc., Exchange Act Release No. 38390, SEC LEXIS 562, at *8 (March 12, 1997).

³³ See Markowski, 34 F.3d 99 (2d Cir. 1994).

³⁴ See Borth, 51 S.E.C. at 180-81 (belief that the NASD no longer needed the requested information provides no excuse for respondent’s failure to provide it).

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investigations, which would hobble NASDR's ability to meet its statutory obligations. NASDR must be free to conduct investigations unfettered by conditions that might be imposed by registered persons.³⁵

Likewise, _____ and _____ have presented no admissible evidence supporting their speculation that Enforcement was acting on behalf of the criminal prosecutors and their conjecture that Enforcement refused to grant them an adjournment in order to further the interest of the criminal prosecutors. Instead they rely solely on inference drawn from their unsupported assessment that Enforcement could have concluded its investigation without interviewing them. This is insufficient to defeat Enforcement's motion for summary disposition.³⁶ A party opposing summary disposition must bring forth admissible evidence to establish that there is a genuine issue for hearing.³⁷

The Hearing Panel concludes, based on the controlling precedent, that _____ and _____ have failed to raise any legally valid defense for their failure to provide information and documents requested by NASDR in connection with its investigation. As the law clearly shows, _____ and _____ were not entitled to impose their preferred schedule on NASDR,³⁸ second guess the need for the information,³⁹ or refuse to

³⁵ See In re Joseph Patrick Hannan, Exchange Act Release No. 40438, 68 S.E.C. Docket 24, 26 (Sept. 14, 1998).

³⁶ See, e.g., Fletcher v. ATEX, Inc., 68 F.3d 1451, 1456 (2d Cir. 1995).

³⁷ See, e.g., Wu v. City of New York, 934 F. Supp. 581, 587 (S.D.N.Y. 1996).

³⁸ Williams, 50 S.E.C. 1072.

³⁹ Borth, 51 S.E.C. at 180-81.

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supply the information out of concern about its use by the NASD.⁴⁰ Nor can they refuse to cooperate because they are subject to criminal prosecution. The “Association’s disciplinary and regulatory function coexists with other forums of redress, whether they be governmental or judicial, and the NASD’s process does not stop when another entity’s process begins.”⁴¹ Accordingly, the Hearing Panel has determined that _____ and _____ violated NASD Conduct Rule 8210 by failing to comply with the requests for information, and that their failure to cooperate did not comport with high standards of commercial honor and just and equitable principles of trade and, therefore, constitutes a violation of NASD Conduct Rule 2110.

On the other hand, the Hearing Panel is of the opinion that the Respondents should be provided an opportunity to further develop the record on the issue of sanctions. Accordingly, the Hearing Panel defers ruling on the issue of sanctions.

⁴⁰ See In re Boren & Co., Exchange Act Release No. 6367, SEC LEXIS 352, at *19-20 (Sept. 19, 1960) (where SEC rejected defense that respondent could withhold further information from NASD staff because they had shared information with his employer).

⁴¹ Market Surveillance Committee v. Wakefield Financial Corp., Complaint No. MS-936, 1992 NASD Discip. LEXIS 124, at *36 (NBCC May 7, 1992) (finding no unfair prejudice to the respondents as a result of the hearing panel’s refusal to stay the disciplinary proceeding pending the outcome of criminal proceedings). See also, In re Dan Adlai Druz, Exchange Act Release No. 36306, 60 S.E.C. Docket 911, 1995 SEC LEXIS 2572, at *34 (Sept. 29, 1995) (where the SEC rejected respondent’s claim that a New York Stock Exchange disciplinary action should have been stayed pending the completion of a criminal case.) Likewise, the courts have routinely acknowledged that the SEC and the Justice Department may each seek to enforce the federal securities laws, by pursuing “simultaneously or successively” separate civil and criminal actions arising out of the same set of operative facts. See, e.g., SEC v First Financial Group of Texas, Inc., 659 F.2d 660, 666-69 (5th Cir. 1981); SEC v. Grossman, 121 F.R.D. 207, 209-10 (S.D.N.Y. 1987); SEC v. Musella, Fed. Sec. L Rep. (CCH) ¶ 99,156 (S.D.N.Y. 1983).

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Conclusion

For the reasons stated above, Enforcement's motion for summary disposition is granted on the issue of liability, and this proceeding is continued to January 11, 1999, for a hearing on the issue of sanctions.

By Andrew H. Perkins, Hearing
Officer, for the Hearing Panel

Dated: December 21, 1998