

trading and fraudulent markups are inappropriate for temporary cease and desist proceedings.

In response, the NASD noted that the proposal does not permit it to seek a temporary cease and desist order for any securities law violation because Rule 10b-5 under the Act requires a showing of fraud. In addition, the NASD believes the proposed rule only addresses the forms of misconduct most likely to result in rapid dissipation of investor funds, such as unauthorized trading and charging fraudulent, excessive markups.

4. Due Process

While NASAA believes the proposed rule change contains sufficient safeguards to ensure adequate due process,³¹ Orrick contends that the timetable for a hearing on a temporary cease and desist order fails to give the respondent an adequate amount of time to prepare for the hearing.³² In response to Orrick's concerns, the NASD extended the minimum amount of time between service of notice of a hearing and the hearing date from four to seven days.³³

5. Standard for Issuance of a Temporary Cease and Desist Order

Two commenters believe that the "preponderance of evidence" standard, alone, is an inadequate basis for granting the extraordinary relief of a temporary cease and desist order.³⁴ These commenters contend that there should be a finding that investors will be irreparably harmed or that their chances of subsequent recovery will be damaged by the standard disciplinary process. One commenter further believes that, in cases that do not involve potential investor losses, there should be a finding that there is a substantial likelihood that respondents will engage in future violations. Another commenter contends that the standard for issuance of a temporary cease and desist order invites arbitrary imposition of orders based on subjective interpretation of the standard.³⁵

NASD responds that the "likelihood of success" standard is an inappropriate standard in the context of the other required showings, and that an irreparable harm standard would frustrate its attempt to stop ongoing fraudulent activity. Under such a standard, as long as a member could show that it is solvent and, at the time the disciplinary action is proceeding,

could pay any potential arbitration or mediation awards, NASD would be unable to stop the ongoing fraudulent activity until the completion of the regular disciplinary proceeding. The NASD notes that the member's financial condition often significantly changes after the conclusion of the disciplinary proceeding. Finally, NASD believes that once it has been shown that the violative conduct or the continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors, the potential harm to the respondent if an order is issued is overshadowed by the harm that is likely to occur if the order is not issued.

6. Review of Temporary Cease and Desist Order

Two commenters noted that, unlike a temporary cease and desist order issued by the Commission, entry of a temporary cease and desist order issued by the NASD cannot be immediately appealed to a U.S. District Court. These commentators raised a concern about the ability of a respondent to appeal decisions issuing temporary cease and desist orders to the SEC because it was unclear whether temporary cease and desist orders are final disciplinary decisions of NASD.³⁶

NASD responded that it believes a temporary cease and desist order should be considered a final disciplinary sanction of NASD under Section 19(d) of the Act and, therefore, should be appealable to the SEC as soon as the order is issued. A temporary cease and desist order is issued after notice and an opportunity for a hearing and upon a finding by a preponderance of the evidence that a violation of a statutory provision or rule has occurred. The temporary cease and desist order is an "other fitting sanction" under Section 15A(b)(7) of the Act because the order directs a respondent to cease violating a rule, to cease specified violative conduct, and, as appropriate, to cease and desist dissipating or converting assets. In addition, NASD notes that a temporary cease and desist order is immediately effective and enforceable and, moreover, a respondent that violates the terms of a temporary cease and desist order can have its membership or registration suspended or canceled.³⁷

³⁶ See SIA Letter, p. 4, and Orrick Letter, p. 4.

³⁷ NASD believes that its view that temporary cease and desist orders are subject to Commission review under Section 19(d) of the Act is further supported by the Commission's Order Accepting Jurisdiction issued *In the Matter of the Application of Martin Lee Eng*, Release No. 42962 (June 20, 2000). NASD states that the Commission found that

7. Permanent Cease and Desist Authority

One commenter strongly opposed the provision that allows the NASD to impose a permanent cease and desist order on the grounds that the industry and other interested parties had not been provided adequate notice of the provision.³⁸ This commenter further stated that the NASD has not articulated either a purpose or need for permanent cease and desist powers, a compelling justification for the authority, the circumstances in which a permanent cease and desist order would be sought, or the evidentiary standard for issuance.

The NASD responded that it did not highlight the issue of permanent cease and desist authority because it believes it already has the authority to issue them as an "other fitting sanction" under NASD Rule 8310. In response to the commenter's concerns, however, the NASD added language that it does not anticipate seeking permanent cease and desist orders on a routine basis, and listed the factors the NASD will consider in determining whether a permanent cease and desist order is appropriate.³⁹

8. Collateral Consequences

The Commission solicited comments on what impact, if any, the issuance of a temporary cease and desist order will have on other laws (other than the federal securities laws). Two commenters responded that the proposal did not contain any consideration of the potential collateral consequences of a temporary cease and desist order.⁴⁰ These commenters contend that the NASD should evaluate the potential collateral consequences of the issuance of a temporary cease and desist order and report the results before Commission approval of the proposed rule change.

NASD responded that it believes the use of temporary cease and desist authority will have limited collateral effects. The NASD reviewed the state securities laws and did not find any state statute that would mandate the denial, suspension, or revocation of a broker-dealer's registration based on the

it had jurisdiction to review NASD's imposition of a letter of caution in a disciplinary action because the letter of caution constituted a "sanction" under Section 19(d). The NASD contends that the Commission based its finding of jurisdiction on the fact that the letter of caution resulted from a finding in a formal NASD disciplinary proceeding that the respondent violated an NASD rule and that the letter of caution had been reported to the Central Registration Depository ("CRD").

³⁸ See ABA Sections Letter, pgs. 17-19.

³⁹ See Amendment Nos. 3 and 5.

⁴⁰ See ABA Sections Letter, pgs. 14-15, and SIA Letter, pgs. 4-5.

³¹ See NASAA Letter, p. 2.

³² See Orrick Letter, p. 4.

³³ See Amendment No. 4.

³⁴ See ABA Sections Letter, p. 9, and Orrick Letter, p. 4.

³⁵ See SIA Letter, p. 4.