

**NATIONAL ASSOCIATION OF SECURITIES DEALERS**

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<b>Department of Market Regulation,</b>	)	
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	)	
<b>Complainant</b>	)	
	)	<b>Disciplinary Proceeding</b>
<b>v.</b>	)	<b>No. 20042000056-01</b>
	)	
<b>Lek Securities Corporation</b>	)	
<b>(CRD # 33135)</b>	)	<b>Hearing Officer Alan W. Heifetz</b>
<b>140 Broadway</b>	)	
<b>29<sup>th</sup> Floor</b>	)	
<b>New York, NY 10005,</b>	)	
	)	
	)	
<b>Respondent.</b>	)	
_____	)	

**RESPONDENT’S MOTION FOR SUMMARY DISPOSITION**

Pursuant to NASD Code of Procedure Rule 9264(e), Lek Securities Corporation (“Lek”), hereby moves for Summary Disposition. Lek requests that relief be granted in the form of an Order dismissing all of Complainant’s claims.

The basis for this Motion is set forth in detail in the concurrently filed Memorandum of Law in Support of Respondent’s Motion for Summary Disposition

**REQUEST FOR ORAL ARGUMENT**

Respondent respectfully requests that it be allowed to present oral argument in support of this Motion.

Respectfully submitted,



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September 1, 2006

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**MEMORANDUM OF LAW IN SUPPORT OF RESPONDENT'S  
MOTION FOR SUMMARY DISPOSITION**

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**MEMORANDUM IN SUPPORT OF RESPONDENT'S**  
**MOTION FOR SUMMARY DISPOSITION**

Respondent, Lek Securities Corporation (“Lek”), seeks Summary Disposition against claims made by Complainant, Department of Market Regulation, for alleged violations of National Association of Securities Dealers (“NASD”) Marketplace Rule 6955(a) and Conduct Rules 2110 and 3010. Complainant alleges that Lek did not submit Reportable Order Events (“ROEs”) to the NASD’s Order Audit Trail System (“OATS”) in a timely fashion or implement and enforce supervisory procedures concerning the submission of data to OATS. Lek, however, cannot be sanctioned for failing to comply with OATS-related rules because the NASD did not promulgate the OATS rules in accordance with the Paperwork Reduction Act, Pub. L. No. 104-13, 109 Stat. 163 (codified at 44 U.S.C. §§ 3501-3520 (2006)) (“PRA”). Accordingly, Lek is entitled to judgment as a matter of law, and Complainant’s claims must be dismissed.

## STATEMENT OF UNDISPUTED FACTS

Lek began OATS reporting on October 8, 2002. NASD 20, 54.<sup>1</sup> Prior to its initial OATS submission, Lek undertook extensive and detailed testing to ensure proper reporting to OATS. NASD 20, 54, 222-23. Lek's OATS testing provided every indication that Lek would be in full compliance with the NASD's Rules governing OATS reporting. NASD 20. In fact, after subjecting itself to four consecutive days of testing, the NASD informed Lek that "conditions [had] been met for the firm to proceed [with] production" and that it had "met conditions for OATS test[s]." NASD 222-23.

Lek's attempts to ensure proper OATS reporting did not cease after its initial testing of OATS submissions. Lek continued to be proactive with respect to OATS reporting requirements. For example, on numerous occasions, Lek contacted the NASD and spoke with various programming and network personnel in an attempt to resolve issues and questions concerning OATS reporting. NASD 21, 54, 206-09, 217-18, 224-31, 233-37, 332-335, 342-45, 346-47.

Despite Lek's extraordinary efforts to submit information to OATS timely and completely, Complainant alleges that, from October 1, 2002 through December 31, 2002, Lek submitted 174,971 ROEs after the 4:00 A.M. E.T. OATS reporting deadline.<sup>2</sup> Complaint ¶ 4. These submissions were apparently marked "late" by OATS. *Id.* Complainant also alleges that, during the October 1, 2002 through December 31, 2002 time period, Lek submitted to OATS 3,066 ROEs that were not in the electronic form prescribed by the NASD and that Lek did not

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<sup>1</sup> Citations to documents produced by Complainant will be identified as "NASD #," which indicates Bates numbers on the documents.

<sup>2</sup> Nothing in this submission may be construed as an admission to any of Complainant's allegations.

implement and enforce written supervisory procedures concerning OATS data submissions and reporting. *Id.* ¶¶ 5, 11.

In addition to submitting ROEs to the NASD on its own behalf, Lek served as the reporting agent for two other reporting members. *Id.* ¶7. Complainant alleges that, during the January 1, 2003 through March 31, 2003 time period, Lek did not report 61,854 ROEs on behalf of the two other reporting members prior to the 4:00 A.M. E.T. OATS reporting deadline. *Id.* ¶ 8.

### **LEGAL STANDARD FOR SUMMARY DISPOSITION**

NASD Code of Procedure Rule 9264(e) 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.” NASD Code of Procedure Rule 9264(e) (2006). Rule 9264 is modeled on Federal Rule of Civil Procedure 56. *See* NASD Notice to Members 00-56 (Aug. 2000). Therefore, the NASD looks to federal law for guidance in cases involving summary disposition. *Dep’t of Enforcement v. Quattrone*, No. CAF030008, 2004 NASD Discip. LEXIS 17 (N.A.C. Nov. 22, 2004) (citing *Dep’t of Enforcement v. U.S. Rica Fin., Inc.*, No. C01000003, 2003 NASD Discip. LEXIS 24, at \*12 & n.3 (N.A.C. Sept. 9, 2003)). Applying the federal standard, the moving party need merely show that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). “Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment.” *Dep’t of Enforcement v. Coniglione*, No. C10000140, 2001 NASD Discip. LEXIS 29, at \*6 (N.A.C. May 14, 2001).

## ARGUMENT

The reporting and recordkeeping requirements imposed by the OATS rules, including NASD Conduct Rule 3110 and NASD Marketplace Rules 6954 and 6955, are subject to the clearance and approval process of the PRA. *See* Affidavit of Jim Tozzi (“Tozzi Aff.”). The PRA requires the approval of the Office of Management and Budget (“OMB”) for all information collection activities conducted by *or at the direction* of a federal government agency. S. Rep. No. 104-8, at 22 (1995) (emphasis added). As the PRA requires:

An agency shall not conduct *or sponsor* the collection of information unless in advance of the adoption or revision of the collection of information . . . the [OMB] Director has approved the proposed collection of information . . . and . . . the agency has obtained from the [OMB] Director a control number to be displayed upon the collection of information.

44 U.S.C. § 3507(a) (emphasis added).

As explained below, and as confirmed by Jim Tozzi, a preeminent expert on the PRA who has been intimately involved with the PRA since its inception, OATS is undoubtedly a federally-sponsored collection of information. As such, the OATS rules are subject to the PRA. Yet, it is beyond dispute that the OATS rules were not promulgated in accordance with the PRA’s requirements. As a result, as a matter of law, Lek cannot be sanctioned for violating the OATS rules and dismissal of Complainant’s claims is required.

### **All Claims Against Lek Must Be Dismissed Because OATS Was Not Promulgated In Accordance With The PRA**

The OATS rules are subject to the clearance and approval process of the PRA because: (i) the United States Securities and Exchange Commission (“SEC”) ordered the NASD to create OATS and therefore OATS is “federally-sponsored”; (ii) the PRA expressly applies to federally-sponsored collections of information, such as OATS, even if done through a non-government agency, such as the NASD; and (iii) the PRA expressly prohibits the imposition of a penalty

where the collection of information was not approved in accordance with the PRA's clearance and approval requirements. The OATS rules were not promulgated in accordance with the PRA's requirements. Therefore, Lek cannot be sanctioned for any alleged violations of the OATS rules. As a result, as a matter of law, Complainant's claims must be dismissed.

**A. Because The SEC Mandated The Creation Of OATS, OATS Is “Federally-Sponsored” For Purposes Of The PRA**

OATS is federally-sponsored for purposes of the PRA. Tozzi Aff. ¶¶ 9-25. The PRA requires an OMB clearance and approval process for all “Federally-sponsored collections of information.” S. Rep. No. 104-8, at 36; 44 U.S.C. § 3507. Such federally-sponsored collections of information include paperwork burdens “imposed on one party by another party *at the direction of a Federal agency.*” S. Rep. No. 104-8, at 22 (emphasis added). The PRA specifically recognizes the SEC as an agency within the scope of the statute.<sup>3</sup> There can be no dispute that the SEC directed the NASD to impose the OATS reporting and recordkeeping requirements on NASD member firms. *See* Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Creation of an Audit Trail System, 62 Fed. Reg. 47,096 (proposed Aug. 28, 1997) (“OATS Proposing Release”); Order Approving Proposed Rule Change Relating to the Creation of an Order Audit Trail System, 63 Fed. Reg. 12,559 (adopted Mar. 6, 1998) (“OATS Adopting Release”); *In re Nat’l Ass’n of Secs. Dealers, Inc.*, Exchange Act Release No. 37,538 (Aug. 8, 1996) (“Order”). Therefore, the OATS rules, including NASD Conduct Rule 3110 and NASD Marketplace Rules 6954 and 6955, are “Federally-sponsored” for purposes of the PRA.

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<sup>3</sup> Under the PRA, “agency” is defined to include “independent regulatory agency” and “independent regulatory agency” is defined to include the SEC. 44 U.S.C. § 3502 (1) & (5).

On August 8, 1996, the SEC issued an order finding that the NASD failed to “enforce its rules and the federal securities laws.” *See* Order. Pursuant to that Order, the SEC directed the NASD to:

[D]esign and implement . . . an audit trail sufficient to enable the NASD to reconstruct markets promptly, effectively surveil them and enforce its rules; which audit trail shall, subject to the Commission’s approval, at a minimum . . . provide an accurate time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker-dealer and the customer or counterparty and further documenting the life of the order through the process of execution . . . of that order.

*Id.*

Responding to the SEC’s directive, the NASD created OATS and its corresponding rules. *See* OATS Proposing Release (“[T]he implementation of the Order Audit System would *directly fulfill one of the undertakings contained in the order issued by the SEC* relating to the effectuation of the Associations’ regulatory responsibilities.”) (emphasis added); OATS Adopting Release (“[T]he proposed OATS is *directly responsive to a mandate issued by the Commission.*”) (emphasis added); *see also* Letter from Edward S. Knight, Executive Vice President and General Counsel, The Nasdaq Stock Market, Inc. (“Nasdaq”), to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Dec. 13, 2005) (<http://www.sec.gov/rules/other/10-131/esknight3192.pdf>), at 4 (“The Commission’s Order dated August 8, 1996 . . . *mandated the creation of OATS* by the NASD[.]”) (emphasis added). As noted in the opening paragraph of the OATS Reporting Technical Specifications in effect during the October 1, 2002 through March 31, 2003 time period, OATS was “developed by the [NASD] in response to the August 1996 settlement with the [SEC].” *See* July 15, 2002 OATS Reporting Technical Specifications, at 1-1 (NASD 985); October 12, 2002 OATS Reporting Technical

Specifications, at 1-1 (NASD 1250); December 16, 2002 OATS Reporting Technical Specifications, at 1-1 (NASD 1528).

Based on the foregoing, it cannot be disputed that the NASD created OATS and its related rules at the direction of the SEC – the NASD and the SEC have admitted that fact. Tozzi Aff. at ¶¶ 9-25.

In fact, Congress amended the PRA to expressly cover situations like OATS, where one party imposes recordkeeping requirements on another party at the direction of a federal agency. Specifically, in response to the Supreme Court’s decision in *Dole v. United Steelworkers of America*, 494 U.S. 26 (1990), which held that the PRA did not apply if a government agency directed a non-government agency to impose disclosure requirements on third parties, Congress amended the PRA in 1995 to clarify that “the Act applies to all Government-sponsored collections of information (including disclosure requirements), [thereby] eliminating any confusion over the coverage of third-party paperwork burdens (those imposed by one private party on another private party due to a Federal regulatory mandate). . . .” S. Rep. No. 104-8, at 1.

The present matter is exactly the type of situation contemplated to be covered by the 1995 amendments to the PRA. The 1995 amendments to the PRA made clear that the PRA is undoubtedly applicable to OATS because OATS is a collection of information “imposed by one private party on another private party due to a Federal regulatory mandate,” *id.*, i.e., the SEC’s Order. The fact that the SEC’s directive was in the form of a Commission order instead of a formal rule does not matter for purposes of the PRA. 44 U.S.C. § 3502(3) (PRA defines “collection of information” as “the obtaining, causing to be obtained, soliciting, or requiring the

disclosure to third parties or the public, of facts or opinions by or for an agency, *regardless of form or format[.]*” (emphasis added).

Moreover, failing to conclude that OATS is subject to the PRA would create a loophole allowing agencies to both circumvent the requirements of the PRA and impose burdensome collections of information on private parties without the mandatory statutory review.<sup>4</sup> Simply by restructuring the form of a collection of information, an agency would be able to avoid the PRA and ignore Congress’ express intent that all collections of information be covered by the PRA.

Following the Supreme Court’s decision in *Dole*, Congress expressed its fear that federal agency collections of information could be structured to evade the requirements of the PRA, and noted the fear of small businesses, like *Lek*, that the PRA would not protect them from onerous federally-directed recordkeeping and reporting requirements. S. Rep. No. 104-8, at 12. Congress noted that:

Those segments of the public most burdened by Federal paperwork requirements, especially the small business community, became alarmed [after the Supreme Court’s decision in *Dole*] that the protections afforded the public by the 1980 Act [the PRA] could be circumvented by simply recasting the proposed paperwork burden as a third-party paperwork requirement, i.e., one imposed by a private party on another private party, even if directed to do so by a Federal agency regulation. In the view of the advocates of the Paperwork Reduction Act, the Supreme Court had created a potentially enormous loophole that could be readily exploited by an agency simply by recasting the form of a proposed paperwork burden.

*Id.*

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<sup>4</sup> There are only extremely limited circumstances where the PRA does not apply to federally-sponsored collections of information. The PRA does not apply to the collection of information “*during* the conduct of a Federal criminal investigation or prosecution, or during the disposition of a particular criminal matter” or “during the conduct of (i) a civil action to which the United States or any official or agency thereof is a party; or (ii) an administrative action or investigation involving an agency against specific individuals or entities.” 44 U.S.C. § 3518(c) (emphasis added). None of the PRA exemptions applies to the present case. The full list of exemptions to the PRA is described at 44 U.S.C. § 3518.

Congress affirmatively expressed its desire to close this loophole and ensure that all federally-directed collections of information be covered by the PRA by stating that it was “united in its continuing belief in the need for, and the requirements of, the paperwork clearing process, as well as the need for it to remain comprehensive and without loopholes.” *Id.* at 21.<sup>5</sup> Holding that OATS rules, which the NASD admits were promulgated at the SEC’s direction, are not subject to the PRA directly contradicts the reasons for the 1995 amendments to the PRA. Tozzi Aff. ¶¶ 9-25. Such a result would be without a legal basis and cannot be permitted.

**B. Collections of Information Involving Third Parties, Like OATS, Are Covered By The PRA**

The OATS rules constitute a “collection of information” for the purposes of the PRA. *Id.* ¶¶ 26-31. As noted above, Congress amended the PRA in 1995 to expressly include third-party collections of information, like OATS, where a federal agency requires one private party to impose information collection requirements on other private parties. *Id.* ¶¶ 26-27.

The PRA prohibits any federally-sponsored collection of information unless the OMB approves the collection. 44 U.S.C. § 3501. The PRA defines “collection of information” as:

[T]he obtaining, causing to be obtained, soliciting, or requiring the *disclosure to third parties* or the public, of facts or opinions *by or for an agency*, regardless of form or format, calling for . . . answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons,

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<sup>5</sup> Similarly, Senator Lawton Chiles, the sponsor of the original version of the PRA, filed an amicus brief with the Supreme Court in *Dole* noting that “the law was intended to be comprehensive in its coverage of federally sponsored ‘collections of information.’” Brief of Lawton Chiles as Amicus Curiae in Support of the Petition for Certiorari, *Dole v. United Steelworkers of America*, 494 U.S. 26 (1990). As Senator Chiles noted in his amicus brief, the “fundamental premise of the Paperwork Reduction Act [is] that every person is entitled to be assured that their government has checked the need for information before it asks them to provide or maintain information.” *Id.* It is because of this fundamental premise that Congress overturned the Supreme Court’s decision in *Dole* and expressly included third-party paperwork burdens. Congress’ intent was that the PRA remain “comprehensive and without loopholes.” S. Rep. No. 104-8, at 21. Allowing OATS to evade the requirements of the PRA ignores the fundamental premise of the PRA and creates a loophole directly undermining the intent of Congress.

other than agencies, instrumentalities, or employees of the United States . . . .

*Id.* § 3502(3) (emphasis added).

The PRA’s definition of “collection of information” clearly encompasses the reporting and recordkeeping requirements imposed by OATS. *Tozzi Aff.* ¶¶ 28-31. It cannot be disputed that OATS imposes “identical reporting [and] recordkeeping requirements” on ten or more NASD member firms.<sup>6</sup> *Id.* at ¶¶ 28-29. In fact, OATS imposes two separate requirements on NASD member firms that are each considered a “collection of information.”

First, NASD Conduct Rule 3110(h) mandates that, to comply with OATS, member firms must “record and maintain . . . (A) an identification of each registered person who receives the order directly from a customer; (B) an identification of each registered person who executes the order; and (C) . . . an identification of the department that originated the order.” NASD Conduct Rule 3110 (2006). In addition, NASD Marketplace Rule 6954 requires firms to record specified information relating to orders in equity securities which are traded in the Nasdaq.<sup>7</sup> NASD Marketplace Rule 6954 (2006). Member firms must record and report whether a Reporting Agent is used to fulfill reporting obligations, the medium used to transmit the order, the terms of the order, whether the order is transmitted to another department aside from the trading department, as well as a plethora of other information. *Id.* This information must be recorded when orders are originated, received, transmitted, modified, canceled, or executed. *Id.*

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<sup>6</sup> The PRA defines a person as “an individual, partnership, association, corporation, business trust, or legal representative, an organized group of individuals, a State, territorial, tribal, or local government or branch thereof, or a political subdivision of a State, territory, tribal, or local government or a branch of a political subdivision.” 44 U.S.C. § 3502(10).

<sup>7</sup> The legislative history regarding the adoption of the PRA states specifically that “recordkeeping requirements . . . are explicitly included as means of soliciting facts or opinions by an agency. Information maintained, as opposed to directly provided by Federal agencies, is therefore subject to the clearance requirements for collections of information . . . .” S. Rep. No. 96-930, at 38 (1980).

Second, in addition to imposing recordkeeping requirements, OATS requires NASD member firms to report “all applicable order information required to be recorded under Rule 6954.” NASD Marketplace Rule 6955. The required information must be transmitted to the NASD each time an order is “originated, received, transmitted to another department within the member or to another member, modified, canceled, or executed.” *Id.* The reports must be transmitted on the day that the event occurs, or the first day the information regarding the specified event becomes available. *Id.*

The SEC directed the NASD to create OATS because the SEC:

[E]ncountered significant difficulties reconstructing activity in the Nasdaq market. Broker-dealer order tickets, among the most fundamental of records, were too often unavailable or inconvenient to retrieve. Timestamping was often unreliable for the purposes of determining compliance with applicable rules, such as the firm quote rule and limit order protection rules.

*See* Adopting Release. As such, OATS reporting is done, at least in part, to assist the SEC with its regulatory responsibilities. The SEC can, and does, access reported OATS information. *See, e.g.,* U.S. Securities and Exchange Commission, *Office of Economic Analysis: Report on the Comparison of Order Executions Across Equity Market Structures*, Jan. 8, 2001, Appendix C (<http://www.sec.gov/pdf/ordrxmkt.pdf>).

In light of the extensive information that must be recorded and reported to the NASD, the OATS rules undoubtedly are “collections of information” as defined by the PRA. As such, the NASD and SEC were required to comply with all of the PRA’s requirements, including the PRA’s clearance and approval process. *Tozzi Aff.* ¶ 6. The NASD and SEC, however, did not do so. *Id.* ¶ 32.

### **C. OATS Was Not Promulgated In Accordance With The PRA**

Despite the fact that OATS is a federally-sponsored collection of information subject to the PRA, promulgation of the OATS rules did not comply with the PRA's clearance and approval requirements. *Id.*

To satisfy the PRA's statutorily-mandated clearance and approval process, there must be: (1) an internal review of any information collection by the federal agency seeking the collection of information, (2) solicitation and evaluation of public comments, (3) submission of the proposed collection of information to the OMB, and (4) publication of a notice in the Federal Register. 44 U.S.C. § 3507(a)(1). Publication in the Federal Register must include: (a) a notice stating that the collection of information has been submitted to OMB for approval, (b) a title for the collection of information, (c) an explanation of the need for the information, (d) an explanation of the proposed use of the information, (e) a description of the likely respondents, (f) a description of the frequency of response required, (g) an estimate of the burden, and (h) a notice that public comments may be submitted to the agency and OMB. *Id.* § 3507(a)(1)(D). In addition, the OMB must approve the information collection, and the information collection must display an OMB assigned control number on the collection of information. *Id.* § 3507(a)(2)-(3).

While OATS was promulgated by the NASD in accordance with Section 19(b)(1) of the Exchange Act, that procedure does not meet the PRA requirements. For example, the OATS proposal was not submitted to OMB and the notice in the Federal Register did not include an estimate of the burden or state that comments could be submitted to OMB. *See* OATS Proposing and Adopting Releases. Nor did the OMB issue a control number. Tozzi Aff. ¶ 32.

**D. Lek Cannot Be Sanctioned For Any Alleged Violations Of The OATS Rules**

The PRA includes a “public protection” provision which ensures that members of the public do not have to comply with an unapproved collection of information. 44 U.S.C. § 3512.

Specifically, the section provides that:

[N]o person shall be subject to any penalty for failing to comply with a collection of information . . . if the collection of information does not display a valid control number assigned by the Director [of the Office of Management and Budget] . . .

*Id.* To ensure that all collections of information are subject to this provision, the “public protection” provision was amended in 1995 “to unequivocally cover all collections of information.” S. Rep. No. 104-8, at 55.

Because the OATS rules were not promulgated in accordance with the requirements of the PRA, Lek is protected by the “public protection” provision and cannot be sanctioned for failing to comply with the OATS rules. *Tozzi Aff.* ¶¶ 33-37. As Congress noted, the public protection “section’s intended protection can be asserted effectively in empowering members of the public to defend themselves against unapproved collections of information.” S. Rep. No. 104-8, at 55. Accordingly, as a matter of law, the claims against Lek must be dismissed.<sup>8</sup>

Moreover, in light of the PRA’s unambiguous applicability to the OATS rules, as well as the public protection provision, Lek is under no obligation to continue submitting information in response to the OATS rules.

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<sup>8</sup> The alleged violations of Marketplace Rule 6955 are the predicate for the alleged violations of Conduct Rules 2110 and 3010. Therefore, the dismissal of the Rule 6955 claims necessitates the dismissal of the Rule 2110 and 3010 claims.

## CONCLUSION

Lek recognizes that the Hearing Panel may be reluctant to issue an opinion acknowledging that the PRA applies to the OATS rules. Lek appreciates that the Hearing Panel may have concerns about the repercussions that such a holding could have on the OATS program. Those concerns, however, cannot prevent the Hearing Panel from applying the law. As we have explained in detail, the law is clear and unambiguous. The PRA applies to the OATS rules, and the OATS rules were not promulgated in accordance with the PRA's requirements. As a matter of law, Lek cannot be sanctioned for not complying with the OATS rules.

For the foregoing reasons, Lek respectfully requests that the Hearing Panel grant Lek's Motion for Summary Disposition and dismiss all of Complainant's claims.

**REQUEST FOR ORAL ARGUMENT**

Since the granting of this Motion for Summary Disposition would obviate the need for a hearing, Lek respectfully requests an oral argument on the Motion. Lek believes that oral argument would aid the Hearing Panel's consideration of its Motion for Summary Disposition.

Respectfully submitted,



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Counsel for Respondent Lek Securities Corporation

September 1, 2006

DC02:593622

AFFIDAVIT OF JIM J. TOZZI

As an expert in the federal implementation of the Paperwork Reduction Act (44 U.S.C. chapter 35), and having reviewed pertinent documents relating to the "Order Audit Trail System" (OATS), established by the National Association of Securities Dealers (NASD) as required by the U.S. Securities and Exchange Commission (SEC), I hereby present my analysis and declare my conclusions as follows:

*Experience and Professional Qualifications.*

1. As explained below, I was the career Office of Management and Budget (OMB) official responsible for Executive Office liaison with the Congress on the drafting and development of the Paperwork Reduction Act of 1980 (P.L. 96-511) (PRA). Upon its enactment, I became responsible for ensuring that OMB and the Federal agencies carried out their responsibilities established by the PRA. This included ensuring that Federal agencies submitted all information collections subject to the PRA to OMB for review and approval or disapproval.
2. From 1979 through 1980, I served as an Assistant Director in OMB responsible for developing a national regulatory policy and reviewing all U.S. governmental information collections affecting U.S. firms. OMB is located in the Executive Office of the President; OMB career staff are civil servants working directly with and for the White House.
3. From 1981 through 1983, I continued these responsibilities, serving as Deputy Administrator in the Office of Information and Regulatory Affairs, an OMB component established by the PRA.
4. After leaving OMB in 1983, I became a Member, Board of Advisors, of the Center for Regulatory Effectiveness (CRE). CRE is a regulatory watchdog organization that (1) ensures the public has access to data and information used to develop federal regulations, (2) ensures that information federal agencies disseminate to the public is of the highest quality, and (3) evaluates agency compliance with "Good Government Statutes," including, e.g., the PRA and the Data Quality Act, and Executive Order 12866 (Regulatory Review). I serve as the leader of this organization.
5. In the quarter of a century since the enactment of the PRA, I have been actively involved in subsequent Congressional and Administration modifications thereto, including the 1995 amendments to the PRA. In addition, in my professional capacity at CRE, I have been actively involved in monitoring and assessing agency compliance with the PRA.

*Applicability of PRA to OATS.*

*Summary and Key Elements of the PRA.*

6. The PRA states that "(a) [a]n agency shall not conduct or **sponsor** the collection of

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information unless in advance of the adoption or revision of the collection of information – ... (2) the [OMB] Director has approved the proposed collection of information ... ; and (3) the agency has obtained from the [OMB] Director a control number to be displayed upon the collection of information.” (44 USCA 3507, emphasis added).

7. For the OATS recordkeeping and information disclosure system established by the NASD to be subject to OMB review and approval under the PRA, the SEC needs to have “**sponsored**” what constitutes a “**collection of information.**” If OATS is a collection of information, NASD members can only be sanctioned for failing to comply with OATS if OATS displays a valid “**control number**” obtained from OMB. These points will be discussed in detail in the remainder of this Affidavit.

*Summary of Conclusions.*

8. OATS is a collection of information that is subject to OMB review and approval under the PRA. The failure of OATS to display a valid PRA control number, issued by OMB, means that no NASD member can be sanctioned for failing to comply with OATS.

*OATS is federally sponsored.*

9. The use of the word “sponsor” in the PRA emphasizes that a Federal agency is subject to the PRA, even if the Federal agency does not itself collect the information. The OMB regulation states this explicitly: “(d) *Conduct or Sponsor.* A Federal agency is considered to ‘conduct or sponsor’ a collection of information if the agency ... requires a person to provide information to another person, or ... causes another ... to ... require the disclosure to third parties or the public of information by or for the agency.” (5 CFR 1320.3(d)).
10. If the SEC “caused another” (i.e., NASD) to require individual NASD members to “disclose” information to other “parties or the public” (including the disclosures of information to the NASD) to serve, at least in part, the regulatory responsibilities of the SEC, then the SEC has “sponsored” OATS.
11. Earlier this year, on January 20, 2006, OMB further explained its definition of “sponsor” in “QUESTIONS AND ANSWERS WHEN DESIGNING SURVEYS FOR INFORMATION COLLECTIONS:”

“5. What does it mean for an agency to conduct or sponsor an information collection?

“An agency conducts or sponsors an information collection if the agency collects the information using its own staff and resources, or causes another agency or entity to collect the information, or enters into a contract or cooperative agreement with another person or contractor to obtain the information. [Cites 5 CFR 1320.3(d)] If the agency requests the collection directly or indirectly through another entity or contractor or

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- exercises control over those collecting the information, the agency is conducting or sponsoring the collection ... ." (p. 4)
12. The SEC is an "agency" subject to the PRA. "(1) [T]he term 'agency' means ... any independent regulatory agency ... ." "(5) [T]he term 'independent regulatory agency' means ... the Securities and Exchange Commission, ... ." (44 USCA 3502).
  13. On August 8, 1996, the SEC issued an "Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934 (Exchange Act), Making Findings and Imposing Remedial Sanctions" against the NASD. (Release No. 37538; Administrative Proceeding File No. 3-9056) (SEC Order). This SEC Order required NASD "to design and implement within the next twenty-four months ... an audit trail sufficient to enable the NASD to reconstruct markets promptly, effectively surveil them and enforce its rules; which audit trail shall, subject to the Commission's approval, at a minimum, (a) provide an accurate time-sequenced record of orders and transactions, ... and (b) provide for Nasdaq marketwide synchronization of clocks utilized in connection with the audit trail." (Paragraph IV.B.7. of the SEC Order).
  14. The SEC subsequently explained that this 1996 Order arose in response to an SEC finding that: "In the course of the investigation [of the NASD], the Commission staff encountered significant difficulties reconstructing activity in the Nasdaq market. Broker-dealer order tickets, among the most fundamental of records, were too often unavailable or inconvenient to retrieve. Timestamping was often unreliable for the purposes of determining compliance with applicable rules, such as the firm quote rule and limit order protection rules." (SEC March 6, 1998 Order, File No. SR-NASD-97-56, p. 2).
  15. On September 5, 1997, the SEC published for public comment a "Notice of Filing of Proposed Rule Change by National Association of Securities Dealers Relating to the Creation of ... an Audit Trail System Owned and operated by [NASD]." (62 Fed. Reg. 47096, daily ed.). As explained in this notice, "NASD Regulation is proposing new Rules 6900 through 6970 of the Conduct Rules of the NASD, relating to an audit trail system owned and operated by the NASD that is designed to capture order information reported by members for integration with the Nasdaq Stock Market, Inc. ("Nasdaq") quote information and trade information reported to the Automated Confirmation Transaction Service ("ACT") in order to provide the Association with an accurate time sequenced record of orders and transactions." (62 Fed. Reg. 47096, daily ed.). The public was to submit comments to the SEC.
  16. In its OATS proposal, NASD acknowledged that "the implementation of the Order Audit System would directly fulfill one of the undertakings contained in the order issued by the SEC relating to the effectuation of the Association's regulatory responsibilities." (62 Fed. Reg. 47098 (September 5, 1997), daily ed., emphasis added).
  17. NASD has subsequently reaffirmed that the SEC's 1996 Order "mandated the creation of

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OATS by the NASD ... ." (December 13, 2005 letter from the Nasdaq General Counsel, Edward S. Knight, to the SEC Secretary, concerning Exchange Act Release No. 52559; File Number 10-131, p. 4).

18. On March 6, 1998, the SEC adopted the OATS rules and issued an Order entitled, "NASD Rulemaking: Various Orders Relating to the Creation of an Order Audit Trail System." (Release No. 34-39729; File No. SR-NASD-97-56). The SEC explained that "OATS is intended to fulfill one of the undertakings contained in the ordered issued by the SEC relating to a settlement of an enforcement action against the NASD for failure to adequately enforce its rules" and that the creation of the OATS rules is "directly responsive to the mandate issued by the Commission." (pp. 1-2, 11).
19. The SEC discussion in the 1998 Order points out the interlinked nature of the regulatory oversight conducted by both the SEC and NASD: "[t]he Commission recognizes that there may be, particularly with respect to manual orders, information items not required to be recorded and reported by the proposal that could prove helpful to the NASD or the Commission in carrying out their regulatory responsibilities." (pp. 16-17).
20. The SEC has "sponsored" the OATS reporting system, within the meaning of the PRA.
21. First, pursuant to the 1996 Order, the SEC "caused" or "required" NASD to establish OATS. Paragraph IV.B.7. of that Order explicitly required NASD to impose this "audit trail" system on its members. When proposing and adopting the OATS rules, both the SEC and NASD acknowledged that the OATS rules were promulgated pursuant to the SEC's mandate.
22. Second, the 1996 Order makes clear that this disclosure of information is carried out, at least in part, "for" the SEC. i.e. to serve the regulatory responsibilities of the SEC. That the SEC relies upon its access to OATS to carry out its oversight and regulatory responsibilities is explicitly demonstrated in an SEC January 8, 2001, "Report on the Comparison of Order Executions Across Equity Market Structures." In Appendix C, the SEC explains specifically how it relied upon OATS reporting information to support the analysis it provided in that report.
23. The 2006 OMB publication makes it completely clear that information collections by a Self-Regulatory Organization (SRO), like NASD, at the direction of a federal agency, like the SEC, must be submitted to OMB for PRA review and approval. Thus, in terms of the latest OMB guidance on "sponsorship," SEC is sponsoring OATS.
24. Moreover, it is clear from the legislative history supporting the 1995 amendments to the PRA that Congress intended to include within the scope of the PRA an agency's reliance on SROs to collect information from the SRO's members.

"Increasingly, Federal agencies are using third party disclosure requirements to meet

program needs, instead of directly collecting, processing, and disseminating information itself. Third party disclosures include Federal requirements for labeling, self-certification, public recordkeeping, conveying information between third parties (such as pension data a Federal agency requires employers give their employees); and directly conveying information to State or local governments.

“Third party disclosure is increasing partly because agencies, with their own limited resources to collect and analyze information, have discovered that their program objectives may be met by requiring private parties to provide information directly to the intended beneficiary (e.g., an employee of the employer) or enforcer (e.g., the State or local government charged with regulatory enforcement), eliminating the Federal middle-man. In order to decrease the direct cost of Government services, agencies may also adopt third party disclosure in the form of self-certification and recordkeeping by private entities to replace extensive information collections.” (House Report No. 104-37 (February 15, 1995), p. 12)

25. The PRA exemption for a collection of information conducted during “an administrative action” is quite narrow. That information applies only to a collection of information carried out by an agency “during the conduct” of its “administrative action.” This exemption does not apply to OATS.

*OATS is a Collection of Information.*

26. The PRA definition of “collection of information” determines the scope of the PRA. “(3) the term ‘collection of information’ – (A) means ... causing to be obtained, ... or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency ... calling for ... (i) answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons ... .” (44 USCA 3502). As the 1995 Senate Report stated: “[S]everal phrases are added (i.e., ‘causing to be obtained,’ ‘requiring the disclosure to third parties or the public,’ and ‘or for’ an agency) to clarify that all Federally-sponsored collections of information, not just those directly provided to a Federal agency, are contemplated within the meaning of the term. ... **Whether a ‘collection of information’ is conducted for or simply sponsored by the Federal government, rather than whether the government is the primary or immediate user of the information collected by a respondent, is the primary factor which determines whether a collection of information is covered by the meaning of the term.**” (Senate Report 104-8, February 1995, p. 36, emphasis added. Identical language is found in House Report 104-37, February 15, 1995, p. 36.).
27. Similarly, the PRA defines the term “recordkeeping requirement” extremely broadly to mean “... a requirement imposed by or for an agency on persons to maintain specified records, including a requirement to – (A) retain such records; (B) notify third parties, the Federal Government, or the public of the existence of such records; (C) disclose such records to third parties, the Federal Government, or the public; or (D) report to third

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parties, the Federal Government, or the public regarding such records.” (44 USCA 3502(13); emphasis added.)

28. Both the NASD and the individual NASD members are PRA “person[s].” “(10) [T]he term ‘person’ means an individual, partnership, association, corporation, ... [or] an organized group of individuals, ... .” (44 USCA 3502).
29. While, under the PRA, a “collection of information” is to be “posed to ... or imposed on, ten or more persons ... ,” (44 USCA 3502(3)), the OMB regulation points out that this concept is to be read in practical terms: “(c)(4) ... (i) Any recordkeeping, reporting, or disclosure requirement contained in a rule of general applicability is deemed to involve ten or more persons. (ii) Any collection of information addressed to all or a substantial majority of an industry is presumed to involve ten or more persons.”
30. Information collected pursuant to OATS is disclosed to third parties, including the NASD and SEC. The PRA explicitly defines “recordkeeping” to include disclosing retained records to third parties, such as NASD and the SEC. This OATS generated recordkeeping and information disclosure constitutes a “disclosure to third parties or the public” by NASD members.
31. Thus, OATS is a collection of information covered by the PRA. Pursuant to NASD rules 3110, and 6950-6957, NASD members must report extensive information to the NASD and maintain extensive records. The SEC may also access OATS information.

*OMB did not Issue a Control Number for OATS.*

32. There is no record that SEC has ever submitted the NASD OATS rules to OMB for OMB review and approval under the PRA.

*The PRA’s Public Protection Provision Prevents NASD Members from being Penalized for not Complying with the OATS Rules.*

33. To ensure that Federal agencies comply fully with the PRA, the statute includes a very broad “public protection” provision. “(a) Notwithstanding any other provision of law, no person shall be subject to any penalty for failing to comply with a collection of information that is subject to this subchapter if – (1) the collection of information does not display a valid control number assigned by the [OMB] Director in accordance with this subchapter; or (ii) the agency fails to inform the person who is to respond to the collection of information that such person is not required to respond to the collection of information unless it displays a valid control number.” (44 USCA 3512)
34. The 1995 House Report stressed the broad applicability of PRA “public protection”: “[t]he [public protection] section is amended, ... to unequivocally cover all collections of information, i.e., maintaining, providing, or disclosing information to or for an agency or

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person, or to a third party or the public on the instructions or behalf of a Federal agency.” (House Report 104-37 (February 15, 1995), pp. 53-54).

35. Both Senate and House Reports indicate explicit Committee consideration and support for the “public protection” provision set forth in the PRA in 1995. “Court decisions have affirmed that the section’s intended protection can be asserted effectively in empowering members of the public to defend themselves against unapproved collections of information. The Committee supports this provision and the purposes for which it was originally enacted, and continues, to serve.” (Senate Report 103-392 (September 30, 1994), p. 71. House Report 104-37 (February 15, 1995), p. 54, is similar.)
36. Reinforcing the broad scope of this “public protection” provision in 1995, Congress added to the PRA a broad and open-ended definition of “penalty:” “(14) the term ‘penalty’ includes the imposition by an agency or court of a fine or other punishment; a judgment for monetary damages or equitable relief; or the revocation, suspension, reduction, or denial of a license, privilege, right, grant, or benefit.” (44 USCA 3502).

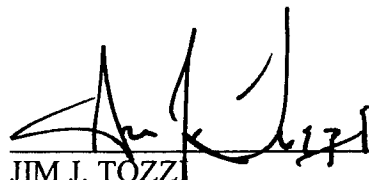
*The failure of OATS to display a valid PRA control number, issued by OMB, means that no NASD member can be penalized for failing to comply with any collection of information required by OATS, either by the SEC or by NASD.*

37. The failure of OATS to display a valid PRA control number means that, under the PRA, no NASD member can be penalized for failing to comply with any OATS reporting and recordkeeping requirement.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

IN WITNESS WHEREOF, JIM J. TOZZI, has hereunto set his hand and seal on this, the

1 day of September 20006.

 (SEAL)

JIM J. TOZZI  
Member, Board of Advisors  
Center for Regulatory Effectiveness  
11 Dupont Circle, NW  
Suite 700  
Washington, DC 20036

On this 1<sup>st</sup> day of September, 20006, before me, the subscriber, a Notary Public in the District of Columbia, personally appeared the within named JIM J. TOZZI, and in due form of

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law acknowledged the within or foregoing instrument of writing to be his act and deed and that he executed the same for the purposes therein contained.

IN WITNESS WHEREOF, I have hereunto set my hand and notarial seal.


Virginia C. Ghulam (SEAL)

MY COMMISSION EXPIRES  
NOVEMBER 30, 2008

**CERTIFICATE OF SERVICE**

I hereby certify that, on this 1st day of September 2006, a true and correct copy of the foregoing Respondent's Motion for Summary Disposition and Memorandum of Law in Support of Respondent's Motion for Summary Disposition has been furnished to the counsel identified below via Federal Express:

Gerard M. Babendreier, Esq.  
Senior Attorney  
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Department of Market Regulation  
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Michael A. Umayam