

EXHIBIT B

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Page 1

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
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Shah v. National Ass'n of Securities Dealers
N.D.Ill.,1999.

Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois, Eastern
Division.

Ashvin SHAH, Plaintiff,

v.

THE NATIONAL ASSOCIATION OF
SECURITIES DEALERS, Defendant.

No. 98 C 5355.

April 9, 1999.

OPINION and ORDER

NORGLÉ, District J.

*1 Before the court is Defendant's Motion to Dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6). For the following reasons, Defendant's motion is granted.

I. BACKGROUND

For further background on this case, see the court's prior Opinion and Order: *Shah v. New England Life Insurance Co.*, 98 C 5355, 1998 WL 812542 (N.D.Ill. Nov. 18, 1998). See also *Shah v. Securities Exchange Commission*, 132 F.3d 36 (Table), 1997 WL 744590, at *1 (7th Cir. Nov. 26, 1997).

In August 1988, Plaintiff Ashvin Shah ("Shah") received a commission in the amount of \$755.46 from Northern Illinois Consultants ("NIC") for his work on securities transactions. Shah, however, was not yet licensed with the National Association of Securities Dealers ("the NASD") to receive commissions for securities transactions; his

registration application was still pending on the date of the transactions, and the NASD did not approve his application until approximately two weeks later. Shah claims that it was not until his receipt of a 1099 Form in January 1989 did he realize that he had received a commission for his transactional work.

Shah eventually reported the improper payment to the NASD and requested an investigation. As the court noted in its initial opinion, although Shah's complaint implies that he reported the payment immediately in January 1989, the NASD states that Shah did not report the payment until he filed a complaint in August 1991 against Jay Olshein, the owner of NIC and Shah's former supervisor at Phoenix Home Life Insurance Company ("Phoenix"); Shah worked for Phoenix until December 1990, when he "left" the company. (Compl. at ¶ 12.)

On June 29, 1992, the NASD's District Business Conduct Committee (the "DBCC")^{FN1} filed a complaint against Shah and Olshein, alleging that they had violated the by-laws of the NASD when Olshein paid Shah for commissions on security transactions though Shah was not qualified as a registered representative of the NASD at the time. (See *Compl.*, Ex. A.) On November 11, 1992, a subcommittee of the DBCC held a hearing on the allegations, and on March 29, 1993, the DBCC issued a decision finding Shah and Olshein guilty of violating Article III, Section 1 of the NASD's Rules of Fair Practice. (*Id.*, Ex. B.) Based on these findings, the DBCC assessed sanctions and costs against Shah and Olshein.

FN1. "The DBCC is the disciplinary body of the NASD and determines whether to prosecute a member or associate of the NASD." *Partnership Exchange Securities Co. v. National Association of Securities Dealers, Inc.*, -F.3d-, 1999 WL 93234, at *1 n. 3 (9th Cir. Feb. 25, 1999).

Not Reported in F.Supp.2d

Page 2

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

Shah appealed the DBCC's decision to the National Business Conduct Committee of the NASD (the "NBCC"). The NBCC upheld the DBCC's decision. (*Id.*, Ex. C.) On September 9, 1993, Shah appealed the NBCC's decision to the Securities and Exchange Commission ("SEC"). The SEC remanded the case back to the DBCC for another hearing "to consider additional allegations and matters raised by Shah in his appeal to the SEC." (Compl. at ¶ 11.) On remand, the DBCC reaffirmed its prior ruling. (*Id.*, Ex. E.) Shah then filed another appeal on February 2, 1995.

In the meantime, however, "an unknown individual from the NASD improperly contacted an unknown individual in an authority position with New England [Life Insurance Company]" (Compl. at ¶ 16.); at the time, Shah was under contract with New England to sell insurance. (*Id.*, Ex. D.) Specifically, Shah alleges that the unknown individual from the NASD "improperly informed" New England that he had been found guilty of violating securities rules. (Compl. at ¶ 16.) Following this alleged contact, New England informed Shah via a letter dated February 16, 1995, that the company was suspending him until his appeals were resolved. The letter states, in relevant part:

*2 New England Securities and The New England have been notified by the National Association of Securities Dealers, Inc of a Decision on Remand of its Complaint # C8A9201000 that found you violated Article III, Section 1 of the Rules of Fair Practice. The NASD imposed sanctions that you be censured, fined \$5,775, required to retake the Series 6 examination, and pay the costs of the proceedings.

The NASD has advised you that you have the right to appeal this decision to the National Business Conduct Committee. I understand that you have, in fact, begun this appeal process.

New England Securities and The New England have informed me that, because you have been found to be in violation of securities rules, you are no longer eligible to be covered under the Fidelity Bond. Because of this, I am required to suspend you as an Agent of The New England and a Registered Representative of New England Securities. This suspension will be effective immediately, and will

be in effect until the resolution of you [sic] appeal of this NASD Decision. At that time, The New England will make a decision on whether to reinstate your status as an Agent and Registered Representative.

During this suspension, you will not be allowed to represent The New England, or any of its agencies, affiliates, or its subsidiaries in any capacity, including marketing and/or policyholder services efforts.

...

(*Id.*, Ex. F.)^{FN2}

FN2. Although the letter states that Shah was a "registered representative" of New England Securities, it is unclear what the nature of Shah's relationship was with that entity. Shah does not refer to New England Securities anywhere in his complaint. Also, the exact relationship of New England Securities with New England Life Insurance Company is not clear from the record.

Shah disagreed with New England's reasons for terminating his eligibility, and contended that his alleged minor violation of the securities rules did not disqualify him from coverage by New England's Fidelity Bond. In a letter dated March 26, 1996, New England notified Shah that his contract with New England would be terminated in 30 days. (*Id.*, Ex. G.)

In July 1998, Shah filed a three-count complaint against New England and the NASD. In Count I, Shah alleges common law retaliatory discharge against New England; in Count II, Shah alleges that New England and the NASD conspired to wrongfully discharge him; and in Count III, Shah alleges tortious interference with employment expectancy against the NASD. In November 1998, the court granted New England's motion to dismiss Counts I and II because as an independent contractor Shah could not state a claim of retaliatory discharge. Therefore, Shah's claim in Count III that the NASD tortiously interfered with his employment expectancy is his only remaining

Not Reported in F.Supp.2d

Page 3

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

claim. The NASD moves to dismiss Count III pursuant to Federal Rule of Civil Procedure 12(b)(6)

Shah alleges that "NASD purposefully interfered with [him] and completely destroyed [his] expectancy of a continued business relationship with New England." (Compl. at ¶ 31.) In support of his claim, Shah alleges that "prior to any hearing on [his] appeal of the DBCC's decision on remand and prior to February 16, 1995, an unknown individual from the NASD improperly contacted an unknown individual in an authority position with New England." (*Id.* at ¶ 16.) According to Shah, that unknown NASD official "improperly informed [New England] that Shah had been found guilty of violating securities rules." (*Id.*)

*3 The NASD maintains that Shah's claim should be dismissed because: (1) the NASD is immune from suit for all acts undertaken with respect to Shah in the performance of its regulatory and disciplinary functions; (2) Shah does not have a private right of action against NASD under Sections 15A or 19 of the Exchange Act; and (3) because Shah was not an employee of New England, he cannot state a claim for tortious interference with employment expectancy.

II. DISCUSSION

A. Standard for a Motion to Dismiss

Federal Rule of Civil Procedure 12(b)(6) permits dismissal for "failure to state a claim upon which relief can be granted." Fed.R.Civ.P. 12(b)(6). When reviewing a motion to dismiss under Rule 12(b)(6), the court deems all well-pleaded factual allegations as true, and draws all reasonable inferences therefrom in favor of the plaintiff. *See Gutierrez v. Peters*, 111 F.3d 1364, 1368-69 (7th Cir.1997). Additionally, the documents attached to the complaint are considered "a part thereof for all purposes." Fed.R.Civ.P. 10(c). The court's task is to

determine "whether there is any possible interpretation of the complaint under which it can state a claim." *Martinez v. Hooper*, 148 F.3d 856, 858 (7th Cir.1998). At the same time, however, "[i]t is not proper to allow a plaintiff to plead himself out of court by alleging facts that establish defendants' entitlement to prevail." *Bennett v. Schmidt*, 153 F.3d 516, 518 (7th Cir.1998). Indeed, a "plaintiff can plead himself out of court by alleging facts which show that he has no claim, even though he was not required to allege those facts." *Soo Line R.R. Co. v. St. Louis S.W. Ry. Co.*, 125 F.3d 481, 483 (7th Cir.1997). The court is not "obliged to ignore any facts set forth in the complaint or its attached exhibits, see Fed.R.Civ.P. 10(c), that undermine the plaintiff's claim." *Hamilton v. O'Leary*, 976 F.2d 341, 343 (7th Cir.1992) (quoting *R.J.R. Services, Inc. v. Aetna Casualty & Surety Co.*, 895 F.2d 279, 281 (7th Cir.1989)). "[J]udicial efficiency demands that a party not be allowed to controvert what it has already unequivocally told a court by the most formal and considered means possible." *Soo Line R.R. Co.*, 125 F.3d at 483.

B. Shah's Tortious Interference Claim

As an initial matter, the court notes that Shah's claim of tortious interference with employment expectancy is substantially similar to a claim of "tortious interference with business expectancy" or "tortious interference with prospective economic advantage." *See Mustafa v. Ill. Dept. of Public Aid*, 96 C 5177, 1997 WL 194980, at *5 n. 1 (N.D.Ill. March 14, 1997). And where a contract is involved, a plaintiff may bring a similar tort known as "tortious interference with contract." *See, e.g., Williams v. Shell Oil*, 18 F.3d 396, 402 (7th Cir.1994). Outside of the existence/absence of a contract, however, the torts require essentially the same analysis. The plaintiff must show: (1) the existence of a contract or a reasonable expectation of a continued business relationship; (2) the defendant's knowledge of the contract or expectancy; (3) an intentional and unjustified interference by the defendant that induced or caused a breach of the contract or prevented the expectancy from ripening; and (4) damage resulting from the

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Not Reported in F.Supp.2d

Page 4

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

interference. See *Cook v. Winfrey*, 141 F.3d 322, 329 (7th Cir.1998); *Anderson v. Vanden Dorpel*, 667 N.E.2d 1296, 1299 (Ill.1996). It is also well-established that the “tortious interference allegedly committed by the defendant must be directed toward a third party-not the plaintiff.” *Silk v. City of Chicago*, 95 C 0143, 1997 WL 790598, at *19-20 (N.D.Ill.Dec. 17, 1997) (citing several cases). That said, federal notice pleading standards do not require Shah to plead these elements, because “[m]atching facts against legal elements comes later.” *Sanjuan v. American Bd. of Psychiatry and Neurology, Inc.*, 40 F.3d 247, 251 (7th Cir.1994). Thus, the court need not address the NASD’s third ground for dismissing Count III.

*4 The NASD’s remaining arguments do not allege any pleading defects in Shah’s complaint. As noted above, the NASD argues that it is simply not subject to suit for a claim of tortious interference under two theories: (1) the NASD is entitled to absolute immunity with respect to Shah in the performance of its regulatory and disciplinary functions; and (2) Shah does not have an express or implied right of action against the NASD under Sections 15A and 19 of the Exchange Act.

1. Immunity

Though this litigation is at its early stages, “courts must resolve immunity defenses before trial, and when possible before discovery.” *Schlessinger v. Salimes*, 100 F.3d 519, 523 (7th Cir.1996) (citing *Hunter v. Bryant*, 502 U.S. 224, 227 (1991) and *Harlow v. Fitzgerald*, 457 U.S. 800 (1982)). In deciding whether the NASD is entitled to immunity, the court relies on *Austin Municipal Securities, Inc. v. National Association of Securities Dealers, Inc.*, 757 F.2d 676, 679-80 (5th Cir.1985), an instructive case from the Fifth Circuit on the functions and regulatory role of the NASD.

In *Austin Municipal*, the DBCC, on behalf of the NASD, filed a twelve-count administrative complaint against Austin Municipal, a municipal bond brokerage firm registered with the NASD, for various securities law violations. After a hearing,

the DBCC dismissed six counts while finding Austin Municipal guilty on the remaining six counts. On appeal, the NASD Board of Governors upheld only one of those guilty counts.

Rather than filing another appeal to the SEC, Austin Municipal, along with several of its associates, sued the NASD, several officials of the NASD, the members of the DBCC that prosecuted and adjudicated the case, and the investment securities firms that employed each of the DBCC members (collectively, “the NASD defendants”). The claims against the NASD defendants included several constitutional violations, malicious prosecution, defamation, interference with business relations, and violations of the Sherman Act, 15 U.S.C. § 1. Most relevant here, Austin Municipal alleged:

During the investigation of [Austin Municipal’s] activities, the DBCC members violated the absolute confidentiality of the NASD disciplinary proceedings by leaking information to third persons. Some of these people conducted business with Austin [Municipal], and others were either current or potential associates of the firm. The DBCC members called the firm and its employees, “a bunch of crooks,” and said the firm might soon be out of business. These statements interfered with the firm’s business relation, and defamed the professional and personal reputation of its associates.

757 F.2d at 682.

The NASD defendants then moved for summary judgment, arguing that they were entitled to absolute immunity for actions connected to their official duties. The district court denied the motion, and an interlocutory appeal to the Fifth Circuit to decide the immunity issue followed.

*5 On appeal, the Fifth Circuit held that “the [NASD] and its disciplinary officers have absolute immunity from further prosecution for personal liability on claims arising within the scope of their official duties” *Id.* at 679. Before arriving at this conclusion, however, the court of appeals thoroughly analyzed whether the NASD and its officers are entitled to immunity. See *id.* 686-694. At

Not Reported in F.Supp.2d

Page 5

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

the outset, the Fifth Circuit provided an exhaustive overview of the NASD's disciplinary process:

The NASD is a nonprofit Delaware corporation registered with the Securities and Exchange Commission (SEC) as a national securities association, pursuant to the Maloney Act, 52 Stat. 1070 (1938), 15 U.S.C. SS 78o-3, et seq., amending the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. S 78a, et seq.

The Exchange Act provides a comprehensive system of federal regulation of the securities industry. As an integral part of that system, the Maloney Act established extensive guidelines for the formation and oversight of self-regulatory organizations, such as the NASD, and the registered stock exchanges, including the New York Stock Exchange (N.Y.SE) and the American Stock Exchange. Congress delegated power to these organizations to enforce, at their own initiative, "compliance by members of the industry with both the legal requirements laid down in the Exchange Act and the ethical standards going beyond those requirements." *Merrill Lynch, Pierce Fenner & Smith, Inc. v. National Association of Securities Dealers, Inc.*, 616 F.2d 1363, 1367 (5th Cir.1980) quoting S.Rep. No. 94-75, 1st Sess. 23 (1975), 1975 U.S.Code & Ad. News 179, 201.

To prevent the misuse of this Congressionally-mandated power, Congress granted the SEC broad supervisory responsibilities over these self-regulatory organizations. First, an organization may not become a registered securities association unless its by-laws and rules conform to the Exchange Act. 15 U.S.C. S 78o-3(b). The NASD met this requirement in *National Association of Securities Dealers, Inc.*, 5 S.E.C. 627 (1939).

The registered association is also subject to extensive oversight, supervision, and control by the SEC on an ongoing basis. 15 U.S.C. S 78s(a)(3)(B). With limited exceptions not relevant here, the SEC must approve all association rules, policies, practices, and interpretations prior to their implementation. 15 U.S.C. S 78s. These rules may not impose any burden on competition not necessary or appropriate to further the purposes of the Exchange Act. 15 U.S.C. S 78o-3(b)(9). In addition, the SEC may abrogate or add such rules as it deems necessary, if consistent with the requirements of the Exchange Act. 15 U.S.C. S 78s.

Every self-regulatory organization must comply with the provisions of the Exchange Act, its own rules, and the rules of the SEC and Municipal Securities Rulemaking Board (MSRB). 15 U.S.C. S 78s(g)(1). Furthermore, these organizations must force compliance with these rules by their members and persons associated with members. 15 U.S.C. S 78s(h).

*6 If an organization, member, or associate fails to comply with these requirements, the SEC has broad sanctioning power. The SEC can suspend or revoke the registration of the self-regulatory organization, or censure or restrict the activities, functions, and operations of the organization, a member, or an associate. *Merrill Lynch*, 616 F.2d at 1367. The SEC may remove from office or censure any officer or director of a self-regulatory organization if it finds she has willfully violated the rules or abused her position. 15 U.S.C. S 78s(b)(2). Finally, the SEC may bring an action to enjoin any activity by the organization that violates the Exchange Act or rules promulgated thereunder. 15 U.S.C. S 78u(d). See *Merrill Lynch*, 616 F.2d at 1367.

The Maloney Act specifies certain procedural safeguards for the self-regulatory organization's disciplinary process. The organization must "bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record." 15 U.S.C. S 78o3(h)(1). Any sanction imposed must be supported by a statement of the Act which constituted the violation, the specific provision or rule violated, the sanction imposed, and the reasons therefor. *Id.* The SEC closely scrutinizes the disciplinary process and must be satisfied the rules provide a fair procedure for disciplinary hearings. 15 U.S.C. SS 78o-3(b)(8), 78s(b)(1), (2).

757 F.2d 680-81.

Having provided an overview of the NASD's regulatory framework, the *Austin Municipal* court summarized the role of the NASD: "In short, 'the NASD plays an important role in a complex self-regulatory scheme carefully set down by Congress. The self-regulatory power of the NASD is broad, but so is the range of administrative remedies Congress has provided for those aggrieved

Not Reported in F.Supp.2d

Page 6

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

by NASD action.” *Austin Municipal*, 757 F.2d at 681 (quoting *Merrill Lynch*, 616 F.2d at 1368).

Turning to the issue of absolute immunity, the court referred to *Butz v. Economou*, 438 U.S. 478 (1978)), in which the Supreme Court granted absolute immunity to administrative officials in the Department of Agriculture who performed functions similar to those of judges and prosecutors. In *Butz*, the Court articulated the following test to determine whether absolute immunity applies:

- a) whether the official's functions share the characteristics of the judicial process;
- b) whether the official's activities are likely to result in recriminatory lawsuits by disappointed parties; and
- c) whether sufficient safeguards exist in the statutory framework to control unconstitutional conduct.

438 U.S. at 510-513.

The Fifth Circuit first found that the DBCC members satisfied the *Butz* test's criteria for absolute immunity “for their actions taken within the outer scope of their official duties.”*Id.* at 689. On the issue of whether the NASD and its staff were entitled to immunity, the court of appeals noted that “[t]he NASD exercises quasi-governmental authority pursuant to a statutory scheme enacted by the national sovereign.”*Id.* at 692. The court of appeals went on to liken the NASD's actions “to those of the SEC, which has sovereign immunity.”*Id.* Thus, while acknowledging that “the NASD possesses no sovereign power,” the Fifth Circuit concluded that “under the rationale of *Butz*, [the NASD] requires absolute immunity from civil liability for actions connected with the disciplining of its members.”*Id.*

*7 The Fifth Circuit reasoned that the “NASD was acting in an adjudicatory and prosecutorial capacity” and that “[t]he NASD is required by statute to enforce the securities laws.”*Id.* at 692. And because the DBCC members acted within their authority, the court of appeals found no reason to deny the NASD immunity. *See id.* Further, the court found that the NASD satisfied the other *Butz* criteria because the NASD is a likely target for

recriminatory suits and because there is sufficient oversight of the NASD's actions by Congress, the SEC, and the courts. *See id.* At the same time, however, the court noted that staff members of the NASD would “not have absolute immunity for their roles in the investigation of Austin and as administrators.”*Id.* at 693. In sum, the Fifth Circuit concluded that “the NASD is entitled to absolute immunity for its role in disciplining its members and associates.”*Id.*

This court finds the Fifth's Circuit's opinion in *Austin Municipal* well-reasoned and persuasive. Applying that reasoning and the *Butz* criteria to the facts at bar, the court concludes that the NASD is immune from Shah's tortious interference claim. Shah's allegation is simply that an unknown official from the NASD contacted New England and said that Shah had been found guilty of violating securities rules. As the NASD maintains, it “appropriately-and consistent with its regulatory and adjudicatory function-informed New England Securities that one of its registered representatives had been sanctioned by the DBCC.” (Reply at 3.) Indeed, Shah cannot dispute the truth of that statement at the time; though Shah filed an appeal, the DBCC had recently re-affirmed its prior decision finding Shah guilty of violating its rules. Shah's allegations merely demonstrate that the NASD was properly acting within its regulatory role by disseminating truthful information about his violations of the NASD's rules. No malicious intent can be reasonably inferred from Shah's admission that the NASD truthfully informed New England that he had violated the NASD's rules. *See Zandford v. National Association of Securities Dealers, Inc.*, 80 F.3d 559 (Table), 1996 WL 135716, at *1 (D.C.C. Feb. 14, 1996) (noting instances where the NASD may not be entitled to absolute immunity); *see also Partnership Exchange Securities Co. v. National Association of Securities Dealers, Inc.*, 96 C 2792, 1997 WL 448164 (N.D. Calif. July 3, 1997), *aff'd*,-- F.3d--, 1999 WL 93234, at *1 n. 3 (9th Cir. Feb. 25, 1999); *Sparta Surgical Corp v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209, 1213 (9th Cir.1998) (holding “that a self-regulatory organization is immune from liability based on the discharge of its duties under the [Securities] Exchange Act.”).

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Not Reported in F.Supp.2d

Page 7

Not Reported in F.Supp.2d, 1999 WL 240342 (N.D.Ill.)
(Cite as: Not Reported in F.Supp.2d)

In short, Shah has simply pleaded facts that show he has no claim. *Cf. Soo Line R.R. Co.*, 125 F.3d at 483 (A “plaintiff can plead himself out of court by alleging facts which show that he has no claim, even though he was not required to allege those facts.”). Accordingly, Shah's tortious interference claim is dismissed.

2. Private Right of Action

*8 As a postscript, the court notes that at least three courts have concluded that the NASD is not subject to a private right of action under Sections 15A or 19 of the Exchange Act. *See Sparta Surgical Corp v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209, 1213 (9th Cir.1998) (“[A] party has no private right of action against an exchange for violating its own rules or for actions taken to perform its self-regulatory duties under the [Securities Exchange] Act.”); *Desiderio v. National Association of Securities Dealers*, 2 F.Supp.2d 516, 521 (S.D.N.Y.1998); (“[T]he Exchange act provides no express private right of action against the NASD for common law claims or for claims arising from the NASD's statutory function as a securities regulator.”); *Niss v. National Association of Securities Dealers*, 989 F.Supp. 1302, 1307 (S.D.Calif.1997).

III. CONCLUSION

For the foregoing reasons, the NASD's Motion to Dismiss is granted.

IT IS SO ORDERED.

N.D.Ill.,1999.
Shah v. National Ass'n of Securities Dealers
Not Reported in F.Supp.2d, 1999 WL 240342
(N.D.Ill.)

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