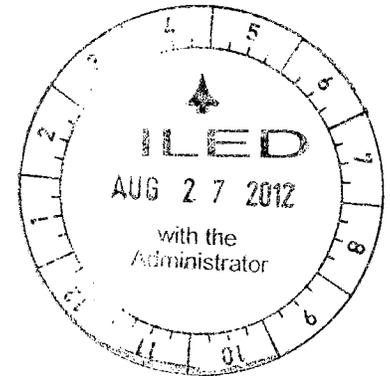


STATE OF OKLAHOMA  
DEPARTMENT OF SECURITIES  
FIRST NATIONAL CENTER  
120 NORTH ROBINSON, SUITE 860  
OKLAHOMA CITY, OKLAHOMA 73102



In the Matter of:

Geary Securities, Inc. *fka* Capital West Securities, Inc.;  
Keith D. Geary; Norman Frager; and CEMP, LLC,

Respondents.

File No. 09-141

**DEPARTMENT'S RESPONSE TO  
MOTION OF RESPONDENT NORMAN FRAGER FOR RULING ON MOTION TO  
DISMISS AND SUPPLEMENT TO MOTION TO DISMISS**

The motion of Respondent Norman Frager ("Frager") to dismiss this proceeding brought by the Oklahoma Department of Securities ("Department") is frivolous and simply another ploy to delay the hearing on the merits.<sup>1</sup> Frager filed his motion to dismiss on February 27, 2012 ("Motion to Dismiss"), without providing any legal basis to support the motion. The Department incorporates herein by reference its March 5, 2012, response to Frager's Motion to Dismiss.

Now, in his motion for a ruling on the Motion to Dismiss and supplement to the Motion to Dismiss filed on August 16, 2012 ("Supplement"), Frager argues that this enforcement action against him should be dismissed for three reasons: 1) Frager

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<sup>1</sup> After the Hearing Officer ordered, on June 1, 2012, the parties to "promptly confer about an appropriate date for the hearing to be in August, 2012," the Department proposed dates in August, and then September, that were rejected by Frager. On July 27, 2012, and on several occasions since then, the Department asked for an agreement to reset the hearing to commence the week of October 1-5, 2012. Frager has yet to agree to reset the hearing to commence that week or propose any other dates in October or any subsequent month thereafter.

committed no violation of the Rule 15c3-1 (the “Net Capital Rule”), promulgated by the SEC under the Securities Exchange Act of 1934 (the “1934 Act”), in May 2009; 2) 660:11-5-17 of the Rules of the Oklahoma Securities Commission and the Department of Securities (“Rules”) is an unconstitutional delegation of legislative authority; and 3) the Department lacks jurisdiction to interpret Rule 15c3-1. Frager’s Motion to Dismiss ignores prior rulings by the Hearing Officer and is still without merit.<sup>2</sup>

**I. The “Background” section of Frager’s Supplement contains inaccurate information and material omissions.**

In his Supplement, Frager states that Geary Securities “was an Oklahoma Corporation registered as a broker-dealer with the SEC and a member of the NASD and subsequently FINRA[.]” Supplement, ¶ 5. Frager omits that Geary Securities was also registered under the Oklahoma Uniform Securities Act of 2004 (“Act”), Okla. Stat. tit. 71, §§ 1-101 through 1-701 (2011), at all times material hereto.

In addition, Frager misrepresents the Department’s allegations by phrasing them in a manner that suggests that Geary Securities acted as an intermediary rather than in a principal capacity. See Supplement, ¶ 9. To be clear, the Department maintains, and the evidence shows, that Geary Securities acted in a principal capacity when it effected purchases of the relevant securities in its proprietary account and later sold the relevant securities to two of its customers.

Frager’s misrepresentation of the Department’s allegations is consistent with his mischaracterization of the nature of the transaction in other parts of the Supplement. For example, on page 12 of the Supplement, Frager argues that through this

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<sup>2</sup> In an Order issued on January 31, 2012, and filed on February 1, 2012, the Hearing Officer denied Respondent Frager’s motion to stay this proceeding pending a resolution of the purportedly pending FINRA action involving the same issues.

proceeding the Department is imposing its own limitations on a broker-dealer's ability to conduct cancel and re-bill transactions and riskless principal transactions. Geary Securities' purchases of the CMOs at issue from Frontier State Bank on May 28, 2009, were **never** canceled and re-billed and were executed with Geary Securities acting in a principal capacity and **not** as riskless principal transactions. See Ex. A (Roth Dep.) at 52:23-53:4; 87:1-25; Ex. 5. Geary Securities' sale of the CMOs at issue to two customers, originally entered with trade dates of June 1<sup>st</sup> and 3<sup>rd</sup>, 2009, were cancelled and re-billed with the same settlement date and a new trade date of May 28, 2009, **but not until November 12, 2009** – almost six months after the original transactions and five months after the filing of the firm's FOCUS report for the month of May 2009. See Ex. A at 56:19-71:2; 87:1-88:7, Ex. 9. The sales of the CMOs by Geary Securities to its two customers were not executed as riskless principal transactions. See Ex. A at 56:19-71:2; 87:1-88:7, Ex. 9.

**II. Frager's Motion to Dismiss on the purported basis that Frager committed no violation of the Net Capital Rule in connection with the May 2009 transactions is a Motion for Summary Decision that should be denied.**

Motions to dismiss are generally viewed with disfavor. *Gens v. Casady School*, 177 P.3d 565, 568 (Okla. 2008) (citing *May, M.D. v. Mid-Century Ins. Co.*, 2006 OK 100, ¶ 10, 151 P.3d 132; *Lockhart v. Loosen*, 1997 OK 103, ¶ 4, 943 P.2d 1074; and *Washington v. State ex rel. Dept. of Corrections*, 1996 OK 139, ¶ 7, 915 P.2d 359). "The function of a motion to dismiss is to test the law of the claims, not the facts supporting them." *Id.* at 569 (citing *State ex rel. Wright v. Oklahoma Corp. Comm'n*, 2007 OK 73, ¶ 52, 170 P.3d 1024; and *Estate of Hicks ex rel. Summers v. Urban East, Inc.*, 2004 OK 36, ¶ 5, 92 P.3d 88). Under the Oklahoma Pleading Code, a motion to

dismiss for failure to state a claim is treated as a motion for summary judgment when a party tenders evidentiary materials outside the pleading with the motion. *State ex rel. Macy v. One (1) Pioneer CD-ROM Changer*, 891 P.2d 600, 603 (Okla. Civ. App. 1994).

Fragar's Motion to Dismiss the Department's claims related to the May 2009 net capital violation on the purported basis that the claims "lack any support" equates to either a motion to dismiss for failure to state a claim or a motion for summary decision. Fragar's Motion to Dismiss on this basis should be treated as a motion for summary decision because Fragar is asking the Hearing Officer to consider evidentiary materials outside the *Enforcement Division Recommendation*. See Supplement, Exs. A-I.

The issuance of a summary decision is only authorized where there is no genuine issue as to any material fact and the moving party is entitled to prevail as a matter of law. Okla. Admin. Code § 660:2-9-3(d). There can be no trial of fact, and the Hearing Officer cannot weigh the evidence, on a motion for summary decision. See *Flanders v. Crane Co.*, 693 P.2d 602, 605 (Okla. 1984) (citing *Stuckey v. Young Exploration Co.*, 586 P.2d 726, 730 (Okla. 1978)).

Fragar is asking the Hearing Officer to weigh the evidence. In his Supplement, Fragar attempts to prove that Geary Securities properly accounted for the May 2009 transactions at issue through the Affidavit of Samuel Luque, Jr. See Supplement at 4-8. Fragar tries to establish that Mr. Luque is more credible than David Paulukaitis, the Department's expert witness. See Supplement at 4-5. Mr. Paulukaitis has testified that, if Keith Geary's testimony to the Department was accurate, Fragar did not properly account for the securities at issue on behalf of Geary Securities. See Paulukaitis Aff. ¶ 22 (Oct. 1, 2011). As demonstrated by Mr. Paulukaitis' testimony and the other

evidence presented by the Department in connection with its *Motion for Summary Decision Against Respondent Norman Frager* (filed November 1, 2011), *Reply to Respondent Frager's Response to Motion for Summary Decision* (filed December 7, 2011), and *Reply to Supplemental Response of Norman Frager to Department's Motion for Summary Decision against Norman Frager* (filed March 5, 2012), that are incorporated herein by reference, there is a genuine issue as to a material fact relating to the violations stemming from the May 2009 transactions at issue.<sup>3</sup>

In summary, Frager's Motion to Dismiss on the basis that Frager did not violate the Rules with respect to the May 2009 transactions should be treated as a motion for summary decision and denied because there is a genuine issue as to a material fact.

**III. Frager's Motion to Dismiss should be denied because Oklahoma Rule 660:11-5-17 is not an unconstitutional delegation of legislative authority.**

In Sections B and C of his Supplement, Frager once again attempts to argue that the Department is without authority to pursue the pending matter. Once again, Frager is wrong.

Pursuant to the Administrative Procedures Act ("APA"), Okla. Stat. tit. 75, §§ 250-323 (2011), the Oklahoma Legislature may grant a state agency the authority to make rules. Section 250.2(B) of the APA provides, in part:

In creating agencies and designating their functions and purposes, the Legislature may delegate rulemaking authority to these agencies to facilitate administration of legislative policy. The delegation of rulemaking authority is intended to eliminate the necessity of establishing every administrative aspect of general public policy by legislation.

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<sup>3</sup> This genuine issue did not exist until Frager submitted the Affidavit of Samuel Luque, Jr. The Department contends that there is still no genuine issue as to any material fact relating to the February 2010 net capital violations.

Accordingly, the Oklahoma Legislature delegated certain rulemaking authority to the Administrator of the Department in Section 1-410(A) of the Act. The statute reads, in pertinent part: “a rule adopted . . . under this act may establish minimum financial requirements for broker-dealers registered . . . under this act[.]” The Oklahoma Legislature also mandated that the Administrator “achieve uniformity among the states and coordination with federal laws” when adopting, amending, and repealing rules[.] Okla. Stat. tit. 71, § 1-605(B) (2011).

Rule 660:11-5-17 establishes the minimum financial requirements for broker-dealers registered under the Act. The rule states:

(a) General requirement. All broker-dealers registered under the Securities Act shall at all times have and maintain net capital of no less than the highest minimum requirement applicable to each broker-dealer as established by the SEC in 17 CFR 240.15c3-1.

(b) Calculation of “net capital.” As used in this subchapter, net capital shall mean the net worth of a broker-dealer calculated according to the formula established by the SEC.

The Administrator’s promulgation of 660:11-5-17 of the Rules was clearly authorized by the Oklahoma Legislature in Section 1-410(A) of the Act. Further, the rule not only achieves coordination with federal laws, as mandated by Section 1-605, but, as will be discussed below, conforms to Section 15(i) of the 1934 Act (no state agency rule may establish requirements for broker-dealers that differ from, or are in addition to, the requirements established under the 1934 Act).

The delegation of legislative authority was addressed by the Oklahoma Supreme Court in *Musgrove Mill, LLC v. Capitol-Medical Center Improvement & Zoning Comm’n*, 2009 OK 19, 210 P.3d 835. The court in reviewing regulations promulgated by the state

agency in question held that “[g]iven the Legislative oversight and approval of agency law-making provided for in the Administrative Procedures Act, this Court must conclude that agency law-making undertaken in compliance with Article I of the Administrative Procedures Act is not an unconstitutional delegation of Legislative power.” *Id.* at ¶11. Rule 660:11-5-17 was promulgated in compliance with Article I of the APA. See Ex. B (21 Okla.Reg. 1921 (June 15, 2004)). Accordingly, Rule 660:11-5-17 is not an unconstitutional delegation of legislative authority.

Fragar’s reliance on *City of Okla. City v. State ex rel. Okla. Dept. of Labor*, 918 P.2d 26 (Okla. 1996), is misplaced. In the statute at issue in *City of Okla. City*, the Oklahoma Legislature left the determination of the prevailing wage to the United States Department of Labor. The court found the statute to be an unconstitutional delegation of legislative authority explaining that there was no opportunity for Oklahoma’s public entities to challenge the determination. The court also explained that the state statute did not set forth the necessary guidelines or standards for determining the prevailing wage. Here, the Oklahoma Legislature delegated the rulemaking authority to the Administrator of the Department - **not** to the SEC or any other federal agency. Contrary to the situation in *City of Okla. City*, interested persons were given the opportunity to express their comments, concerns and objections as to 660:11-5-17 as part of the rulemaking process. See Ex. B (21 Okla.Reg. 1921 (June 15, 2004)). Finally, the language of Section 1-410 of the Act sets forth the standards to be used in establishing the minimum financial requirements for broker-dealers registered under the Act, that is, the financial requirements established by the SEC under the 1934 Act.

The permissibility of 660:11-5-17 is further supported by Section 251(D) of the APA that provides in pertinent part as follows: “[A]n agency may use the published standards established by . . . federal agencies by incorporating the standards or rules in its rules or regulations by reference . . . without reproducing the standards in full.” See *also* Okla. Admin. Code § 655:10-5-15. Frager’s additional attempt to nullify 660:11-5-17 by injecting the purported effect of future amendments by the SEC to the Net Capital Rule is without merit. First, the SEC has not amended the Net Capital Rule since 1993, long before 660:11-5-17 of the Rules was promulgated by the Administrator. Secondly, Oklahoma’s rules on rulemaking prohibit the incorporation by reference of future amendments:

(4) Future amendments. Agencies may not incorporate by reference standards *as they may be amended in the future*. If the standard is updated, the agency may update the rule to reflect the updated standards only by promulgating another rule, or an amendment to the existing rule, which incorporates the new material. (Emphasis added.)

Okla. Admin. Code § 655:10-5-15. Rule 660:11-5-17 is not an unconstitutional delegation of legislative authority. Therefore, Frager’s request for dismissal of this action is meritless.

**IV. Frager’s Motion to Dismiss should be denied because the Department is not barred from pursuing this matter pending action by FINRA.**

The Administrator’s jurisdiction in connection with any matter is dictated by the provisions of the Act. Sections 1-411, 1-603 and 1-604 authorize the Administrator to proceed against any person who has violated or failed to comply with a rule adopted under the Act. The pendency, or the possibility, of a FINRA proceeding is not material to the jurisdictional determination.

In this regard, Frager is confused at best. He falsely claims that Section 15(i) of the 1934 Act preempts states “from making findings contrary to those of FINRA”.<sup>4</sup> Supplement at 12. A careful reading of Section 15(i) shows that states are preempted from establishing **requirements** that differ from those under the 1934 Act. Section 15(i)(1) provides in pertinent part as follows:

No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital . . . **requirements** for brokers, dealers . . . that differ from, or are in addition to, the **requirements** in those areas **established under this title**. The Commission shall consult periodically the securities commissioners (or any agency or office performing like functions) of the States concerning the adequacy of such requirements as established under this title. (Emphasis added.)

There are no references, directly or indirectly, to *findings* by FINRA within the statute. Thus, the Department is not preempted from enforcing 660:11-5-17 of the Rules.

In discussing the issue of preemption, an article published in *Business Lawyer* states:

NSMIA prohibits any state law from establishing requirements in the specified areas which differ from, or are in addition to, the requirements of federal law. **This formulation was presumably intended to encourage states to enact provisions identical to federal ones, and then share enforcement responsibility.** State-enforcement resources add critical front-line troops to those of the SEC and SROs. Blue-sky authorities are particularly able to respond to investor complaints against smaller regional brokerage firms operating primarily in one or a few states. (Emphasis added.)

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<sup>4</sup> In making this argument, Frager mischaracterizes the testimony of David Paulukaitis by stating that he admitted that “[I]t is precisely because of this risk that there are no cases where a state brings a net capital claim based on its own interpretations of 15c3-1 rather than based on a calculation and determination of the same by FINRA who defers to the SEC on such interpretations.” In truth, Mr. Paulukaitis testified that **he has not encountered, in his practice at Mainstay**, “any states bringing **fairly sophisticated** net capital computation cases individually and not based on a calculation by FINRA” (emphasis added). See Supplement, Ex. C, 44:3-11.

\* \* \*

In NSMIA, Congress merely precluded states from establishing nonconforming requirements. . . . **When nonconforming state laws exist**, they are unenforceable. With no permission to enforce federal requirements, state blue-sky officials have their hands tied. They have no authority to proceed against a problem broker-dealer firm for violating financial responsibility, reporting, or recordkeeping requirements. Blue-sky authorities may not, for example, issue a state cease-and-desist order prohibiting the broker-dealer from continuing to violate **federal requirements not mirrored in state law**. The state must await a decision by the SEC or one of the SROs to devote resources to the case. (Emphasis added.)

Howard M. Friedman, *The Impact of NSMIA on State Regulation of Broker-Dealers and Investment Advisers*, 53 Bus.Law. 511, 522-23 (1998).

The regulation upon which the Department's action is based simply incorporates by reference the SEC capital requirements for a broker-dealer; therefore, the Department is not imposing its own requirements or limitations. In making its allegations against Frager, the Department has applied the requirements established under the 1934 Act and, with respect to the February 2010 violations, the SEC approved interpretations thereof. No interpretation of the Net Capital Rule is necessary to determine that Geary Securities' net capital was below the \$250,000 requirement set forth in Rule 15c3-1 on May 28, 2009, through June 1, 2009.

As authorized under Oklahoma and federal securities laws, the Department is acting in an appropriate manner. Moreover, there is no reason to doubt that the Hearing Officer will not exercise his duties in a like manner.

**V. The Department has not acted frivolously.**

Frager's final argument in his Supplement is that he deserves an award for his attorneys' fees because the Department has purportedly acted in a frivolous manner. Frager's argument is based on untruths.

While the Department's expert stated that Geary Securities "effectively borrowed from Pershing the funds necessary to" pay for the securities, the Department has not asserted that there was actually a loan between Pershing and Geary Securities. See Paulukaitis Aff. ¶ 13 (Oct. 1, 2011). Rather, the evidence shows that the ultimate result of the settlement of the May 28, 2009 transactions was an obligation by Geary Securities to pay Pershing for the costs of the transactions.

Second, as previously determined by the Hearing Officer, the telephone recordings between the Department and Pershing on October 12, 2009, June 25, 2010, and July 6, 2010, are of little or no "evidentiary value". See Ex. C at 50.

Third, three of the four assertions by Frager regarding Pershing are also lacking in evidentiary support and completely ignore Pershing's subsequent written explanation of July 22, 2010. Pershing did **not** state the May 28<sup>th</sup> transactions were "consistent with a transfer by Geary Securities to McKean's accounts with Geary Securities acting solely as intermediary." Pershing did **not** state that "the account into which the CMOs were placed prior to settlement was an account used to hold securities pending settlement and transfer to a customer's specific account." Instead, Pershing generally stated that the account "**could be . . . an allocation account . . . where [a firm] will take a transaction and allocate it to a customer account**" (emphasis added). Ex. D, 6:3-16. Pershing also stated that the account could be a proprietary trading account or an error account. Ex. D, 6:3-16. In addition, Pershing did **not** state that "there was no money ever **credited** to Geary Securities' account for the CMOs" (emphasis added). Pershing's final word on the matter directly refutes this assertion. Ex. E ("Frontier Bank [s]ells 13,040,000 to Geary Securities MBS/CMO Account vs. \$8,453,516.81 with trade

date of 5/28/09 and same day settlement” and “Geary Securities sells 13,040,000 to Joseph D. McKean Jr. vs. \$8,409,716.20 on 6/1/2009”.)

The Department has a valid net capital claim with regard to the May 2009 transactions. The Department’s claims relating to February 2010 are also valid. The Department has acted totally within the parameters established by Oklahoma and federal securities laws. Frager’s demand for attorneys’ fees is not made in good faith and is frivolous.

### **CONCLUSION**

Frager’s Motion to Dismiss on the purported basis that Frager committed no violation of the Net Capital Rule in May 2009 should be treated as a motion for summary decision and denied because there is a genuine issue as to a material fact. Frager’s Motion to Dismiss on the other grounds presented in his Supplement should also be denied because 660:11-5-17 is not the result of an unconstitutional delegation of legislative authority and the Department is not barred from pursuing this matter pending an action by FINRA. Finally, Frager’s request to be rewarded attorneys’ fees should be denied because the Department’s action is not frivolous. For the foregoing reasons, the Department requests that Frager’s Motion to Dismiss, including the motion for summary decision and request for attorneys’ fees contained therein, be denied.

Respectfully,



Melanie Hall

Terra Shamas Bonnell

Oklahoma Department of Securities

120 North Robinson, Suite 860

Oklahoma City, OK 73102

Phone: (405) 280-7700

Email: [mhall@securities.ok.gov](mailto:mhall@securities.ok.gov);

[tbonnell@securities.ok.gov](mailto:tbonnell@securities.ok.gov)

*Attorneys for Department*

## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing response was emailed and mailed, with postage prepaid, this 27<sup>th</sup> day of August, 2012, to:

Mr. Bruce R. Kohl  
201 Camino del Norte  
Santa Fe, NM 87501  
[Bruce.kohl09@gmail.com](mailto:Bruce.kohl09@gmail.com)

Donald A. Pape, Esq.  
Donald A. Pape, PC  
401 W. Main, Suite 440  
Norman, OK 73069  
[don@dapape.com](mailto:don@dapape.com)

Susan E. Bryant  
Bryant Law  
P.O. Box 596  
Camden, ME 04843  
[sbryant@bryantlawgroup.com](mailto:sbryant@bryantlawgroup.com)

Melvin R. McVay, Jr.  
Jason M. Kreth  
PHILLIPS MURRAH P.C.  
Corporate Tower, 13<sup>th</sup> Floor  
101 North Robinson  
Oklahoma City, OK 73102  
[jmkreth@phillipsmurrah.com](mailto:jmkreth@phillipsmurrah.com)  
[MRMcVay@phillipsmurrah.com](mailto:MRMcVay@phillipsmurrah.com)

  
Terra Bonnell