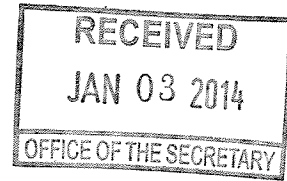


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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Admin. Proc. File No. 3-15508



In the Matter of the Application of

SMARTHEAT INC.

c/o James Kopecky
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Chicago, Illinois 60601

For Review of Action Taken by
The NASDAQ Stock Market, LLC

Reply Brief of Applicant SmartHeat, Inc.

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INTRODUCTION

Applicant SmartHeat, Inc. (“Company”) provides its reply in support of its application for review of the decision of the NASDAQ Stock Market LLC (“NASDAQ”) to delist Company’s shares.

NASDAQ’s brief presents a false clarity. It initially argues that its decision to delist company is insulated from review by an indulgent “abuse of discretion” standard. It then argues that the factual conclusions that NASDAQ made in connection with its delisting decision are accurate. Therefore, NASDAQ reasons, its decision should be affirmed by the Commission.

The problem with this argument is that it is wrong on the law and the facts. Contrary to NASDAQ’s position, the “abuse of discretion” standard does not compel the Commission unthinkingly to rubber stamp the decision of NASDAQ. Moreover, the facts supposedly found by NASDAQ to support its decision are irrelevant, misstated, or both. The result is that the decision of NASDAQ is fundamentally flawed and should be reversed.

1. Abuse Of Discretion Is Not A Rubber Stamp.

NASDAQ states repeatedly that its decision to delist is reviewed on an abuse of discretion basis. *See* NASDAQ Brief at 2, 12, 22, 25, 29. “Abuse of discretion” review, however, does not mean “absence of review.” An abuse of discretion exists when the decisionmaker “has made an error of law or of fact.” *Reuters Ltd. v United Press Int’l*, 903 F.2d 904, 909 (2d Cir. 1990). “When reviewing the action of a trial court, an appellate court is not limited to reversing only when the lower court’s action exceeds any reasonable bounds and to rubber-stamping with the imprimatur of an affirmance when it does not. A trial court’s discretion is exceeded when the decision reached is not within the range of decision-making authority a

reviewing court determines is acceptable for a given set of facts." *Id.* (internal citations and quotations omitted). Far from giving NASDAQ carte blanche, abuse of discretion review requires that NASDAQ's decision be subject to searching review to ensure that the decision is both factually correct, and the product of proper analysis of the law.

2. NASDAQ Misapplied The Factors On Which It Based Its Decision To Delist.

NASDAQ's brief cites four supposed facts about Company that it claims justify Company's delisting. These are 1) Company's structure; 2) changes in Company's management; 3) Company's prior liquidity problems; and 4) Company's obtaining a line of credit from its former chairman, James Jun Wang. NASDAQ also disclaims a factor that its staff relied upon previously to delist Company – the connection of Ben Wey to Company's initial listing. These factors, singly and taken together, do not justify NASDAQ's decision

A. Company's Structure

Company is a holding company, with its primary operating subsidiary in China. Company receives cash from its subsidiary through the form of dividends; it has a limited capacity otherwise to compel cash from China. This structure is due, in great part, to the requirements of Chinese law. Company is one of numerous listed companies that are structured this way. Opening Br. at 9-11.

NASDAQ cites this structure as a factor favoring delisting, writing that cash in the Chinese subsidiary can be "trapped" by the corporate structure "that would not allow repatriation of the funds." NASDAQ Br. at 20. In light of this fact, NASDAQ claims it could "reasonably conclude, within its broad discretion that [it] demonstrated that continued listing was unwarranted." *Id.*

NASDAQ's argument is disingenuous. As Company pointed out in its opening brief, Company's structure was clearly disclosed prior to Company being listed. Opening Br. at 9-11. Indeed, NASDAQ understood this structure, and the risks it posed, but decided to list Company's shares.

The structure that NASDAQ concluded did not prevent listing has not changed. The only thing that has changed is NASDAQ's attitude toward Company. Highlighting the capriciousness of NASDAQ's position is the fact that it apparently has not taken steps to delist other holding companies from the exchange. NASDAQ's choice to cite this structure as a basis for delisting is unprincipled, and an abuse of discretion.

B. Changes in Management.

In May 2012, as part of a restructuring, Company's CEO, CFO, and other corporate officers resigned. They were replaced by knowledgeable executives and directors who have experience managing publicly-traded companies. Significantly, these management changes were presented to the shareholders for approval, and the shareholders voted overwhelmingly in favor of them. SmartHeat, Inc., Form 8-K (Dec. 14, 2012).

NASDAQ cites this change in management as a basis for delisting, asserting that "an unannounced, unplanned resignation of a company's entire management is far from a best practice, and it shows a company unqualified for listing by NASDAQ." NASDAQ Br. at 18. Company has pointed out that this change was an improvement because it upgraded management. NASDAQ dismisses this fact, claiming that "the experience and intentions of the new management team are not at issue." *Id.* at 19.

NASDAQ's position is nonsensical. NASDAQ claims that management change itself is a basis for delisting, even if the change is beneficial. But the value of change is determined by

its consequences, and NASDAQ refuses to consider the consequences of Company's management reshuffling. Indeed, NASDAQ's position puts perverse incentives on listed companies. If boards or shareholders intervene to change management, they run the risk of delisting, notwithstanding "the experience and intentions of the new management team." If NASDAQ's argument is credited, it would be a strong disincentive for companies to improve management.

Indeed, NASDAQ appears to have trouble keeping its story straight about the effect of management change. At the same time that NASDAQ claims that Company should be delisted for changing management, it scolds Company for maintaining the prior management of its Chinese subsidiary. NASDAQ Br. at 18. In addition, it cites as support for delisting *Fog Cutter Capital Group, Inc. v. SEC*, 474 F.3d 822 (D.C. Cir. 2007), in which a company was delisted when it did *not* change management. NASDAQ Br. at 25-26.

In short, NASDAQ's position is a muddle. If NASDAQ can criticize Company for changing management (notwithstanding the benefits) *and* for keeping management, then the standard NASDAQ invokes means nothing. Relying upon it to delist is an abuse of NASDAQ's discretion.

C. Liquidity Issues

NASDAQ also cites Company's May 2012 liquidity problems as a basis for delisting. NASDAQ Br. at 14-15. Admittedly, liquidity issues existed in Company at that time. Company, however, responded forcefully by bringing in a restructuring expert and making management changes. Moreover, Company never was insolvent, and the liquidity issues were quickly resolved.

Liquidity problems are not, in and of themselves, a basis for delisting. Company is far from the first NASDAQ entity to have a temporary liquidity issue, nor will it be the last. In order to get around this fact, NASDAQ tries to paint a harrowing picture of Company's finances. For example, NASDAQ notes that in May 2011, Company had \$33 million in cash, and then transferred \$25 million to its Chinese subsidiary. *Id.* Approximately a year later, Company had cash reserves of approximately \$25,000. *Id.* The clear implication is that Company spent this money on something untoward.

At the same time, however, NASDAQ admits that Company is a holding company, and that its Chinese subsidiaries are the "*actual* revenue-generating parts of the business." NASDAQ Br. at 14, 18 (emphasis in original). In this situation, a holding company does not reasonably hold on to \$33 million. The holding company does not produce anything. Instead, the money will be directed to an operating subsidiary, in order to invest in its operations and increase revenue. There is nothing sinister in this; indeed, this is why Berkshire Hathaway (a holding company) famously has a staff of only 24 persons. Berkshire Hathaway, Inc. 2012 Letter to Shareholders at 5, <http://www.berkshirehathaway.com/letters/2012ltr.pdf>. (visited January 2, 2014). Berkshire itself does not produce anything, but rather allocates capital, either to its subsidiaries or to new ventures.

Moreover, NASDAQ's argument is a red herring. Company's liquidity issues were the product of past management, and were resolved almost two years ago. There is no justification for NASDAQ continuing to use them as a cudgel to punish Company and its shareholders today.

D. Line of Credit

NASDAQ also claims that Company should be delisted because it agreed to a line of credit with a company insider named James Jun Wang. NASDAQ Br. at 15-17. This line of

credit was used by Company in part to resolve its former liquidity problems. As in the case of the management changes, Company's shareholders voted overwhelmingly to approve entering into this line of credit. SmartHeat, Inc., Form 8-K (Dec. 14, 2012).

Interestingly, NASDAQ does not argue that Company should not have entered into this credit arrangement. Instead, it tries to term the arrangement "questionable," and complains that Company did not take steps adequately to value the security for the loan.

Company, however, has explained why a line of credit with an insider made sense. Opening Br. at 14-17. Seeking a loan with an outside lender would have required time and money, which were in short supply. In addition, Company had been asked by the SEC and the US Attorney not to disclose that it had received subpoenas related to Ben Wey. In light of that fact, Company was not in a position to make the types of disclosures that an outside lender would require. *Id.*

Moreover, deciding whether to enter into a credit agreement is a decision for Company's management through the exercise of business judgment. If that decision was wrong, Company's board and shareholders have adequate means to correct it. It is a usurpation of power by NASDAQ to micromanage corporate decisions. It is further an abuse of discretion to delist Company based on this decision.

E. NASDAQ Ignores Entirely The Effect of Ben Wey

In Company's opening brief, it discussed the role of Ben Wey and NASDAQ's effort to imply Company's guilt through its former association with Wey. Opening Br. at 7-9.

In response, NASDAQ ignores those arguments, simply stating that the Listing Council said that it did not consider Wey. NASDAQ Br. at 22.

The problem with this argument is that ignores reality. Wey was clearly a person of interest to NASDAQ, as illustrated by NASDAQ's decision in *Cleantech Innovations, Inc.*, Exchange Act

Release No. 69968 (July 11, 2013). Moreover, NASDAQ staff made the initial determination to delist Company, and staff's decision discussed Wey at length. Although NASDAQ avers that Wey had nothing to do with its decision, his presence clearly shaped and affected NASDAQ's investigation and punishment of Company.

3. The *Fog Cutter* Case is Inapposite

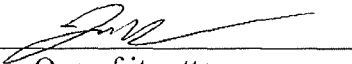
As Company argued in its earlier brief, NASDAQ's decision is unprecedented. The primary case that NASDAQ relies upon to support its decision is *Fog Cutter Capital Grp., Inc.*, 474 F.3d at 824. *See* NASDAQ Br. at 25-26. But *Fog Cutter* demonstrates how anomalous NASDAQ's decision is. In *Fog Cutter*, the CEO, who was also controlling shareholder, pleaded guilty to multiple felonies. The company nonetheless retained the CEO in his job (although he was on leave of absence while in prison), and paid him millions of dollars to satisfy his restitution obligations.

In this case, NASDAQ has delisted a solvent Company based on a corporate structure of which NASDAQ was aware, and on management changes that improved Company's governance. Moreover, there is no hint of Company engaging in illegal activity. In addition, in *Fog Cutter*, the company's board and shareholders had no meaningful oversight, as the CEO who was convicted of the felonies was in total control. In the case of Company, however, the decisions at issue were made by independent board members, and were overwhelmingly ratified by Company's shareholders. The fact that NASDAQ is forced to rely upon an inapposite case like *Fog Cutter* to explain its actions against Company demonstrates how irrational those decisions are.

CONCLUSION

Accordingly, Company requests that NASDAQ's delisting decision be reversed.

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