Case No. 06-16088
In the United States Court of Appeals
For the Ninth Circuit

Whistler Investments, Inc., a Nevada Corporation;
Salim S. Rana Investments Corp., a Corporation; and
American Dreams Holdings, Inc., a Corporation,

Plaintiffs-Appellants,

v.

The Depository Trust and Clearing Corporation;
The Depository Trust Company; and
The National Securities Clearing Corporation,

Defendants-Appellees.

On Appeal from an Order of Dismissal
Issued by the United States District Court
for the District of Nevada

Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae*, in Support of Appellants and in Support of Reversal

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, *Amicus Curiae* North American Securities Administrators Association, Inc. ("NASAA") states that it has no parent corporation and that there is no publicly held corporation that owns 10% or more of NASAA's stock.

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IDENTITY AND INTEREST OF THE *AMICUS CURIAE*

North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in connection with the offer and sale of securities.

The members of NASAA include the state agencies responsible for regulating the securities markets and industry participants under state law – a body of law that first emerged nearly 150 years ago. Their fundamental mission is two-fold: protecting investors from fraud and abuse, and protecting the integrity of the marketplace so that capital formation is fair and efficient. The principal activities of state securities regulators include registering certain types of securities offerings; licensing the firms and agents who offer and sell securities; and educating the public about investment fraud. Perhaps most important, state securities regulators investigate violations of state securities law and file enforcement actions where appropriate, typically against those who have committed fraud against the investing public.

NASAA supports the work of its members in many ways: coordinating multi-state enforcement actions, conducting training programs, publishing investor education materials, and offering its views on proposed laws and regulations – both state and federal – governing financial services. Another core function of the association is to represent the membership's position, as *amicus curiae*, in significant cases involving financial services regulation. In its briefs, NASAA addresses legal issues arising not only in governmental enforcement actions but also in private actions in which wronged investors seek relief under the securities statutes or the common law. *See, e.g.*, Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae*, in Support of Respondents Broudo et. al., in *Dura Pharmaceuticals, Inc. v. Broudo*, Case No. 03-932 (S. Ct. Nov. 17, 2004) (supporting investors' position on the pleading requirements for loss causation in securities fraud action), *available at* http://www.nasaa.org/issues_answers/enforcement_legal_activity/968.cfm.

NASAA and its members have a stake in the outcome of this case for two reasons. Of paramount importance is protecting the right of these appellants (hereinafter, "Investors") and similarly-situated companies and investors to seek redress under state law for any fraud or similar abuses they may have suffered at the hands of the nation's clearing agencies. The Investors are alleging that they have lost substantial sums of money in securities transactions as a direct consequence of the Appellees' (hereinafter, "Clearing Agencies") misrepresentations and market manipulations. While the Investors' claims may be novel, they nonetheless deserve a fair hearing. In a rapidly changing marketplace where financial crime is increasingly subtle and sophisticated, plaintiffs who have suffered injury must often fashion new theories to reach those who are responsible for their losses.

In essence, the Clearing Agencies contend that their role in the clearing and settlement process is too important, that the national market system is too fragile, and that the disruption threatened by the fraud claims at issue is too great to permit this case to go forward. This defense is legally unsupportable and also unacceptable from the standpoint of investor protection and public policy. If the Investors' claims are taken as true, as they must be on a motion to dismiss, then the entrepreneurs and investors before the Court have been the victims of fraud and manipulation at the hands of the very entities that should be serving their interests by maintaining a fair and efficient national market. Allowing the Clearing Agencies to avoid accountability for this conduct through the preemption defense deprives the Investors of a chance for redress. Dismissal of this case may also allow unlawful conduct to persist, to the detriment of other emerging companies, investors, and the marketplace as a whole.

At the same time, the Clearing Agencies' alarming scenarios are unfounded. The Investors are invoking traditional state causes of action that provide remedies for fraud and similar misconduct. They do not seek through this lawsuit to replace or restructure the nation's clearing agencies or any legitimate mechanisms that Congress and the SEC have established for clearing and settling securities transactions. Their claims are aimed at unlawful conduct in connection with the operation of those mechanisms, and they should not be extinguished in the name of preemption.

NASAA and its members have a second, more general interest in resisting the preemption of state laws that protect the public. State statutes governing securities transactions and other financial services all play a vital role in protecting consumers. Congress can and does set limits on the scope of those laws, but those limits should be sparingly applied, not only because Congress and the courts have said so, but because investors and consumers usually suffer when they are denied access to state courts to seek redress for unlawful conduct. Limiting the scope of preemption in accordance with a fair interpretation of federal law and Congressional intent is vital, not only in this case, but for the sake of other consumers whose best, and perhaps only, recourse is in state court under state law. Thus, if the preemption arguments advanced by the Clearing Agencies are validated, then other plaintiffs with legitimate claims regarding other types of securities fraud may also be denied redress. Especially today, as financial frauds of all kind continue to proliferate, barriers to the courts should be removed, not fortified.

For all of the foregoing reasons, NASAA supports the Investors in this appeal and urges the Court to reverse the ruling below.

ARGUMENT

I. The Investors' Claims Are Not Barred Under the Doctrine of Field Preemption, Because the Federal Government Has Not Occupied the Field of Securities Regulation, Either Generally or With Respect to the Clearance and Settlement of Securities Transactions.

The long history of state securities regulation, the extensive application of state law to modern securities transactions, and above all, the repeated enactments of Congress expressly preserving state jurisdiction all establish that federal law does not occupy the broad field of securities regulation. A similar analysis, tracing the history of state regulation and federal law, demonstrates that even in the more narrow realm of clearing and settlement on national exchanges, Congress has never intended to occupy the field of regulation. Accordingly, the lower court's ruling, which was based in part on a finding of field preemption, should be reversed.

A. Field Preemption Is Disfavored Where States Have Traditionally Exercised Jurisdiction and it Is Impossible to Establish Where Congress Has Expressly Preserved the States' Role.

To establish field preemption, a party must show that the federal scheme of regulation is "so pervasive as to make reasonable the inference that Congress left no room for the State to supplement it," or that the federal statute in question "touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." *See Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F. Supp. 2d 189, 195 (S.D.N.Y. 2001) (National Securities Markets Improvement Act of 1996 ("NSMIA") does not preempt state common law claims for fraud and conspiracy) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Few statutes possess this "extraordinary pre-emptive power." *Id.* (quoting *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58, 65 (1987)). And if, in a savings clause, Congress has expressly allowed for the application of state law, then a finding of field preemption cannot properly be made. *See, e.g., International Paper Co. v. Ouellette*, 479 U.S. 481, 493 (1987) (savings clause in environmental statute "negates inference that Congress 'left no room' for state causes of action); *Jevne v. Superior Court*, 111 P.3d 954, 964 (Cal. 2005) (finding conflict preemption but noting that because the Securities Exchange Act of 1934 Act contains two savings clauses, field preemption was not at issue).

The Clearing Agencies have failed to establish field preemption under the foregoing standards. The states have traditionally played a major role – at times an exclusive one – in the regulation of securities transactions. Furthermore, Congress has very clearly preserved the application of state law in numerous savings clauses found throughout the federal securities acts. Accordingly, a finding of field preemption cannot be made in this case.

B. State Law Has Occupied a Central Role in Securities Regulation Since the Inception of Such Regulation 150 Years Ago.

States began adopting statutory provisions regulating securities transactions in the mid-19th century, long before the federal securities laws were conceived. *See generally* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 31-32 (3d ed. 1989). Among the earliest state securities laws was a Missouri statute passed in 1907 that regulated the operation of exchanges by outlawing "the keeping of places for dealing in stocks" unless trades were properly documented. *Id.* at 32. Kansas passed the first comprehensive securities law in 1911, *id.* at 34, and by 1929 and the Great Depression, "virtually all the states had some sort of securities act," *see* 12 JOSEPH C. LONG, BLUE SKY LAW § 1.1 (2005).

Early state securities law had a profound impact on the evolution of federal securities law. For example, the term "investment contract" – one of the most important definitional concepts in securities law – originated in state securities laws and judicial decisions dating back to the early 1900's, before Congress had enacted the federal securities laws. *See S.E.C. v. W. J. Howey Co.,* 328 U.S. 293, 298 (1946). For this reason, the United States Supreme Court in *Howey* expressly adopted state judicial interpretations of the term "investment contract" as a guide to its meaning under federal law. *Id.*

In the modern era, state securities laws have been refined and unified in a series of model statutes – the Uniform Securities Acts of 1956, 1985, and 2002 – and most states have adopted a version of those uniform laws. *See* UNIF. SEC. ACT § 101, U.L.A. 1 (1956) (table of adopting states); UNIF. SEC. ACT § 101, U.L.A. 1 (1985) (table of adopting states); UNIF. SEC. ACT § 101, U.L.A. 1 (2002) (table of adopting states). All three acts share fundamental similarities, in part because the drafters modeled their core provisions on corresponding language in the federal securities laws to promote uniformity and state-federal coordination. For example, the uniform act provisions imposing civil liability and prohibiting fraud reflect this approach. *See* SECURITIES REGULATION, *supra*, at 4134 (Section 410(a) of the 1956 uniform act, which imposes civil liability, tracks Section 12 of the Securities Act of 1933); *id.* at 70 (Section 101 of the 1956 uniform act, which prohibits fraud, tracks Section 17(a) of the Securities Act of 1933 and Rule 10b-5 promulgated under the Securities Exchange Act of 1934).

The end result of this evolution is a dual system of securities regulation in which state law continues to play a central role, alongside federal law, not only in the enforcement arena but also with respect to regulation. For example, the states now regulate broker-dealers, their branch offices, and their representatives in areas ranging from licensing and books and records requirements to a wide array of misconduct including sales fraud, churning, manipulation, conversion, and failure to supervise. *See generally, e.g.*, UNIF. SEC. ACT (1956) and annotations thereto; NRS Chapter 90. State law also plays a major role in the regulation of investment advisers and investment adviser representatives. *See generally* UNIF. SEC. ACT, Art. 4 (2002) (provisions on investment advisers); NRS 90.310 – 90.450 (licensing of investment advisers and other industry participants). Under the 1996 amendments to the Investment Advisers Act of 1940, state securities regulators bear sole responsibility under state law for the licensing and regulation of all investment advisers with less than $25 million in assets under management, while the SEC regulates the larger investment advisers. *See* 15 U.S.C. § 80b-3a; 17 C.F.R. § 275.203A-1.[1] State regulators are also responsible for licensing and overseeing all of the individual representatives of investment advisers, regardless of the amount of money their firms have under management. *See* Unif. Sec. Act § 404(a) (2002) (requiring investment adviser representatives to be registered in the states in which they do business); NRS 90.330.

The states, with the support of NASAA, also play a critical regulatory role in the testing and licensing of firms and individuals in the retail securities industry. Through a contractual relationship, NASAA and The National Association of Securities Dealers ("NASD") jointly operate the Central Registration Depository ("CRD"), a computerized database used to collect and house licensing information

[1] Congress expressly preserved the application of state antifraud laws even to federally licensed investment advisers. *See* 15 U.S.C. § 80b-3a(b)(2).

on broker-dealer firms and their agents. NASAA has contracted with the NASD as a vendor for the operation of the Investment Adviser Registration Depository ("IARD"), a system similar to the CRD. Industry participants obtain their licenses through the CRD and IARD systems. Information in these systems concerning testing results, disciplinary histories, and licensing status is available to the public via the web or from state securities regulators.

For most of the 20th century, the states exercised the authority to register and regulate all securities offerings, whether the securities were nationally traded or strictly local in character. *See* 12 JOSEPH C. LONG, BLUE SKY LAW § 5.1 (2005) (states exercised plenary parallel authority with federal regulators after 1933 and 1934 Acts). Although Congress substantially reduced the state role in registering national securities offerings with the passage of the National Securities Markets Improvement Act of 1996 ("NSMIA"), the states nevertheless continue to register local securities offerings. *See* UNIF. SEC. ACT §§ 301-307 (2002); NRS 90.460. Even as to federally registered securities, the states are entitled to receive notice filings, collect fees, and issue stop orders in the event of non-compliance with these filing and fee requirements. *See* UNIF. SEC. ACT § 302 (2002); NRS 90.565.

State law is also a powerful weapon used by regulators and private plaintiffs against all types of business entities and individuals who commit fraud, manipulation, and related abuses in connection with securities transactions. *See,* *e.g.*, UNIF. SEC. ACT §§ 101, 410 (1956) (anti-fraud and civil liability provisions); NRS 90.570; NRS 90.660. These egalitarian provisions apply regardless of licensing status, and they may be brought to bear with equal force against the unscrupulous boiler room operator, the large Wall Street brokerage firm, or any number of other market participants – including clearing agencies – who have deceived or exploited the investing public to advance their own economic interests. *See, e.g., Goldstein v. Depository Trust Co.*, 717 A.2d 1063, 1064 (Pa. Sup. Ct. 1998) (suit brought under state law for breach of fiduciary duty arising from depository's failure to segregate and account for interest owed on funds paid for IPO shares), *appeal denied*, 736 A.2d 605 (Pa. 1999).

State securities regulators bring an enormous number of enforcement actions each year under their securities codes, seeking remedies that include restitution, injunctions, administrative orders, fines, licensing sanctions, and criminal penalties.[2] Private plaintiffs also routinely invoke state law under state securities statutes, private rights of action, or the common law, to obtain monetary relief for misconduct in connection with securities transactions. For years, Congress and the courts have recognized the important role that private actions play not only as means of personal redress but also as an important complement to the enforcement efforts of governmental authorities defending the integrity of the marketplace. The

[2] http://www.nasaa.org/issues___answers/enforcement___legal_activity/1002.cfm.

Senate Report accompanying the Private Securities Litigation Reform Act of 1995 ("PSLRA") described the importance of private rights of action at the federal level as follows:

> The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of the securities laws. As noted by SEC Chairman Levitt, "private rights of action are not only fundamental to the success of our securities markets, they are an essential complement to the SEC's own enforcement program." [citation omitted]

See S. REP. NO. 104-98, at 8 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 687; *see also Basic Inc. v. Levinson*, 485 U.S. 224, 230-32 (1988) (private cause of action is an "essential tool for enforcement of the 1934 Act's requirements").

The foregoing summary demonstrates that state law has played, and continues to play, a vital role in regulating the securities markets in the United States. Thus the notion that federal law has occupied the field of securities regulation to the exclusion of state law is plainly wrong.

C. Far From Occupying the Field, Congress Has Expressly and Repeatedly Preserved State Law in the Area of Securities Regulation.

Congress has made clear in numerous savings clauses that state law applies to securities transactions. The federal securities Acts of 1933 and 1934 each contain broad savings clauses that preserve state regulatory and state common law remedies in the securities field. Section 16 of the 1933 Act provides that "the rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. § 77p(a).

Section 28 of the 1934 Act contains an identical provision, as well as a separate clause that expressly preserves the authority of state regulatory authorities: "[N]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." 15 U.S.C. § 78bb(a). These savings provisions apply to state common law as well as statutory law, and they also preserve state laws that were enacted subsequent to 1933 and 1934. *See Rousseff v. Dean Witter & Co.*, 453 F. Supp. 774 (N.D. Ind. 1978).

Courts and commentators have repeatedly observed that by virtue of these savings clauses, a finding of field preemption as to securities regulation is inappropriate. *See id.* at 780 (two savings clauses are "a clear and unequivocal congressional expression not to preempt state securities laws"); *see also Raul v. Am. Stock Exch.*, Nos. 95 Civ. 3154 (SAS) & 95 Civ. 8361 (SAS), 1996 WL 381781, at *5 (S.D.N.Y. May 2, 1996) (1934 Act savings clause "has consistently been interpreted by courts as a protection of state authority in the field of securities regulation, not as a limitation on that power"); 69A AM JUR. 2D SECURITIES REGULATION – FEDERAL § 1070 (two savings clauses "make it absolutely clear that Congress was not preempting the field").

It is true that over the last 10 years, Congress has enacted provisions expressly limiting the application of state securities law in discrete areas.

However, none of those limitations effected a general repeal of the savings clauses discussed above. For example, in NSMIA, enacted in 1996, Congress preempted the regulatory authority of state regulators to register nationally traded securities. *See* 15 U.S.C. § 77r. However, Congress did not otherwise disturb the general savings clauses from the 1930s, nor did it limit state common law fraud claims. *See Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F. Supp. 189, 193-94 (S.D.N.Y. 2001). Moreover, Congress clarified the scope of its preemption by expressly preserving the authority of state securities regulators to "bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer," in connection with all types of securities, including those traded on the national exchanges. *See* 15 U.S.C. § 77r(c)(1).

Similarly, in 1998, Congress passed the Securities Litigation Uniform Standards Act to restrict certain causes of action based on state law. However, those restrictions were targeted at specific abuses unique to class action lawsuits. *See* 15 U.S.C. § 77p(b) (preempting certain class actions alleging fraud under state law). And, as with NSMIA, Congress expressly preserved state jurisdiction both generally and with respect to specific types of class actions under state law. *See, e.g.,* 15 U.S.C. § 77p(a) (reiterating 1933 savings clause preserving state common law "except as provided" in the amendments); 15 U.S.C. § 77p(d)(1) (preserving certain class actions for fraud under law of state where issuer was incorporated).

Thus, with certain limited exceptions, Congress has left the field of securities regulation open to state statutory and state common law.

D. <u>A Finding of Field Preemption Also Is Unwarranted in the Specific Area of Clearing and Settlement.</u>

A similar analysis based upon the history of state regulation and Congressional enactments shows that state law also plays a significant role in the specific area of clearance and settlement of securities transactions. Here too, a case for field preemption cannot be made.

Prior to the Securities Acts Amendments of 1975 ("1975 Amendments"), the clearing and settlement of securities transactions on the nation's exchanges was unquestionably regulated as a matter of state law. *See* SECURITIES REGULATION, *supra,* at 2897 (3d ed. 1989); *see also People v. Ruskay*, 152 N.E. 464 (N.Y. 1926) (under New York law and exchange's clearing and settlement procedures, broker's criminal conviction for cross-trading with customer could not be sustained). During that era, state common law and state statutes modeled after the Uniform Commercial Code ("UCC") defined the property rights and liabilities of parties to securities transactions.

Notwithstanding the increased prominence of federal law in the area of clearing and settlement as of 1975, the UCC, which has been adopted by virtually every state, has continued to occupy this central role. Part 5 of Article 8 of the UCC is headed "Security Entitlements," and it sets forth an extensive body of legal principles governing the transfer of securities. As stated in the commentary, "Article 8 deals with the settlement phase of securities transactions. It deals with the mechanisms by which interests in securities are transferred, and the rights and duties of those who are involved in the transfer process." *See* Prefatory Note to UCC, at 11. The topics include the acquisition of security entitlements from securities intermediaries, UCC § 8-501 (1994); NRS 104.8501; the property interests of entitlement holders in financial interests held by intermediaries, UCC § 8-503 (1994); NRS 104.8503; the duties of intermediaries with respect to payments and distributions, UCC § 8-505 (1994); NRS 104.8505; and the priorities among security interests and entitlement holders, UCC § 8-511 (1994); NRS 104.8511.

Revisions to the UCC over the years confirm the ongoing relevance of state law to the regulation of clearance and settlement in securities transactions. For example, the drafters made significant changes to the UCC in 1994, to ensure that state law kept pace with changes in the way securities were being owned and transferred. "[T]he prior version of Article 8 did not adequately deal with the system of securities holding through securities intermediaries that has developed in the past few decades." *See* Prefatory Note to UCC, at 3. The method of owning securities and recording that ownership has evolved from a "direct system" (involving the recordation of ownership in the name of the beneficial owner through either paper certificates or book entry) to an "indirect system" (involving the recordation of ownership in the name of a central intermediary, such as the DTC or its designee, in book entry). It is precisely this innovation in securities ownership – now governed by the amended provisions of Article 8 of the UCC – that creates the potential for manipulation through the Stock Borrow Program ("SBP"), as elucidated in the Investors' Complaint.[3]

There are numerous cases illustrating the point that the UCC and other state laws govern disputes between exchanges and market participants over securities transfers. *See Delaware v. New York*, 507 U.S. 490, 504-05 (1992) (UCC and additional state law governed determination that depositories and other intermediaries holding securities were the "debtors" for purposes of interstate escheat claims); *Lucas v. Lucas*, 946 F.2d 1318, 1323-24 (8th Cir. 1991) (court applied state law to determine that stocks transferred by book entry at DTC rather than by paper certificate could be the subject of conversion); *Dean Witter Reynolds, Inc. v. Selectronics, Inc.*, 594 N.Y.S. 2d 174, 176-77 (N.Y. 1993) (UCC § 8-204 applied so that broker had cause of action against clearing house, transfer agent, and others for their failure to note transfer restrictions on face of stock; federal private offering regulations dealing with transfer restrictions did not

[3] The UCC's "conflicts" provision also negates field preemption. It states that a rule adopted by a clearing corporation governing certain rights and obligations is effective even if the rule conflicts with the UCC. *See* UCC § 8-111 (1994); NRS 104.8111. Such a provision is antithetical to the notion of field preemption: resolving potential conflicts in the law is only necessary when different bodies of law concededly apply to the same regulated activity.

preempt state claim); *see also Carapico v. Philadelphia Stock Exch., Inc.*, 791 A.2d 787, 790-93 (Del. Ch. 2000) (request by member of exchange to examine books and records in relation to charges of mismanagement held proper under Delaware law).

Congress has made clear in numerous savings clauses that the UCC and other state laws are to apply not only in the general field of securities regulation, but specifically in the area of clearance and settlement. In the 1975 Amendments, Congress actually instituted reverse preemption in favor of the states. It granted the states plenary authority to adopt laws that differ from the provisions of any SEC rule relating to the transfer of securities, provided that the states act within two years after the SEC adopts its rule. *See* 15 U.S.C. § 78q-1(f)(3). Congress further provided that even when states have not invoked their authority to override federal law, the SEC's rules and regulations take precedence over state law only if the SEC can make certain findings regarding the need for the rule and its impact on the rights of shareholders and other persons under state law. *See* 15 U.S.C. § 78q-1(f)(1), (2). Finally, Congress added yet another savings clause preserving the authority of state regulators to enforce rules governing clearing agencies and transfer agents, provided those rules are not inconsistent with the 1975 Amendments. *See* 15 U.S.C. § 78q-1(d)(4); *see also Raul v. Am. Stock Exch.*, Nos. 95 Civ. 3154 (SAS) & 95 Civ. 8361 (SAS), 1996 WL 381781, at *7 (S.D.N.Y.

May 2, 1996) (although the 1975 Amendments expanded SEC's oversight of the SROs, they do not reveal a Congressional intent to "preclude previously established causes of action;" state law claim for exchange's failure to enforce own rules was not preempted). In light of these Congressional enactments that expressly preserve state law with respect to clearing agencies and their activities, the Appellees' field preemption argument simply cannot be sustained.

II. <u>The Investors' Claims Are Not Barred Under the Doctrine of Conflict Preemption, Because Actions for Fraud and Related Misconduct Under State Law Do Not Interfere with the Federal Regulation of Clearing and Settlement and Actually Advance Some Goals of Federal Law.</u>

The lower court also predicated its ruling on a finding of conflict preemption. Conflict preemption can occur in two forms: where it is "impossible for a private party to comply with both state and federal requirements, . . . or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F. Supp. 2d 189, 195 (S.D.N.Y. 2001) (internal quotations and cited authorities omitted). The lower court's ruling should be reversed on this issue as well, because the investors' state law claims do not conflict either with the obligations that federal law imposes upon the Clearing Agencies or with the policies and objectives that Congress intended to achieve through federal law.

A. It Is Not Impossible for the Clearing Agencies to Comply Simultaneously with the State Laws Underlying the Complaint and With Federal Laws and Regulations.

In this case, it is not impossible for the Clearing Agencies to comply with federal law and at the same time refrain from engaging in the fraudulent misconduct alleged in the Investors' Complaint. In principle, of course, state laws prohibiting fraud are thoroughly compatible with federal law, insofar as state and federal securities laws parallel each other so closely and reflect a shared commitment to the eradication of securities fraud.

This general principle holds true as applied to this case. While the Investors may indeed believe that the SBP is inherently flawed and contrary to the public interest, that is not the essence of their complaint. They allege that the Clearing Agencies have engaged in a pattern of deceiving the public about the SBP and fostering its use as an instrument of market manipulation. For example, the alleged misrepresentations and omissions include false statements about the nature of the "loans" of stock made to satisfy delivery obligations through the SBP (First Claim for Relief); false statements about the efficacy of the program as a prompt and accurate settlement mechanism (Second Claim for Relief); and false statements about the dilutive impact of the program when shares are credited to borrower and lender accounts in the "loan" process (Third Claim for Relief). *See, e.g.,* Compl. at 15-20.

Assuming these allegations of fraud are true, it is difficult to see how Congress, the SEC, or any SRO could have shielded such misconduct from the application of state law. No federal law, SEC regulation, or SRO rule requires or authorizes the Clearing Agencies or anyone else to commit fraud. And nothing in those laws and rules prevents the Clearing Agencies from describing the SBP truthfully and accurately in their communications with the public.

In fact, the state law standards of conduct being applied in this lawsuit easily coexist with the federal standards of conduct that govern clearing agencies. The federal requirements applicable to clearing agencies are set forth in a variety of sources, including Section 17A of the 1975 Amendments, 15 U.S.C. § 78q-1; the SEC's release approving the registrations of the NSCC and the DTC, 48 Fed. Reg. 45,167 (Sept. 23, 1983); and the guidelines adopted by the SEC for registering clearing agencies, 45 Fed. Reg. 41,920 (June 23, 1980). Although the requirements generally concern operational capabilities and internal governance, some provisions relate, directly or indirectly, to standards of honesty and ethics. For example, Section 17A of the statute provides that clearing agency rules must be designed in part to "protect investors and the public interest." *See* 15 U.S.C. § 78q-1(b)(3)(F). In addition, the statute requires that clearing agencies be capable of complying with "the provisions of this chapter," a reference that encompasses the antifraud provisions of the 1934 Act. *See* 15 U.S.C. § 78q-1(b)(3)(A); *see also*

48 Fed. Reg. at 45,179 (with respect to safeguarding participant funds and securities, there will be no "unique federal standard of care for registered clearing agencies"); Standards for the Registration of Clearing Agencies, 45 Fed. Reg. at 41930 (June 23, 1980) (state standards of care apply to bailees for hire, such as clearing agencies).

Insofar as these provisions collectively require clearing agencies to protect investors, observe the federal prohibitions against fraud, and conform to state law standards of care, they are compatible with the provisions of Nevada law underlying the Complaint. There is no clash between the Investors' state law claims and federal law.

A number of cases highlight the distinction between prohibitions on misconduct that are compatible under state and federal law, and regulatory obligations that cannot be reconciled for purposes of a conflicts analysis. For example, in *Raul v. American Stock Exchange, Inc.*, No. 95 Civ. 3154 (SAS) & 95 Civ. 8361, 1996 WL 381781 (S.D.N.Y May 2, 1996), the court allowed claims for common law fraud and breach of fiduciary duty to proceed against an exchange. *See id.* at *6. It held that conflict preemption did not apply because the exchange was subject to essentially the same obligations under its own rules and under state law. *Id.*

In *Raul*, the court differentiated other cases in which the relief sought pursuant to state law was in direct conflict with the SEC's directives. *Id.* Those cases are typically ones in which the plaintiffs seek remedies under state law for practices that are expressly and specifically permitted under SEC regulations. For example, in *Guice v. Charles Schwab & Co.*, 674 N.E.2d 282 (N.Y. 1996), the plaintiffs sought damages under state common law agency principles in connection with the defendants' receipt of order flow payments – payments that wholesale dealers make to retail broker-dealers to attract order volume. The court dismissed the claims on the basis of conflicts preemption, finding that the claims "directly conflict[ed] with SEC regulations" and would furthermore interfere with the achievement of Congress's objectives in passing the 1975 Amendments. *Id.* at 289.

Guice and similar cases are distinguishable from the one before this Court. Although the plaintiffs in *Guice* alleged inadequate disclosure of the order flow payments, *id.* at 284-85, the court explained that the SEC had promulgated detailed regulations addressing the precise timing, form, and degree of disclosure that was required in connection with order flow payments. *Id.* at 286-88. Hence a conflict arose specifically as to disclosure obligations. The court also perceived the threat of an even more profound conflict: the imposition of additional disclosure requirements under state law might induce firms to abandon the practice of order flow payments altogether – a practice that Congress and the SEC had carefully weighed and chosen to permit in the interest of promoting efficiency and competition. *Id.* at 290-91. The court concluded that allowing the state law claims would therefore interfere with Congress's policy objectives. *Id.*

The instant case is different: there is no SEC regulation that creates an informational "safe harbor" for the Clearing Agencies; there can be no suggestion that the imposition of state antifraud provisions will imperil the existence of the nation's clearing and settlement system; and there is no conceivable Congressional policy that could justify allowing the Clearing Agencies to commit fraud and market manipulation unimpeded. Accordingly, even under *Guice* and similar cases, no conflict preemption arises. *Cf. In re NYSE Specialist Sec. Litig.*, 405 F. Supp. 2d 281, 298, 304-05 (S.D.N.Y. 2005) (dismissing claims on technical grounds but finding that misrepresentations by exchange would not qualify as legitimate quasi-governmental activities and therefore would not fall within the ambit of the exchange's immunity).

B. <u>Allowing the Investors' Claims to Proceed Will Not Interfere with the Attainment of Congressional Objectives, and Will Actually Advance the Goals of Federal Securities Law.</u>

Allowing this case or similar actions to be brought against the Clearing Agencies will not "create an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." On the contrary, this case actually advances some of the most fundamental policies underlying the federal securities laws – transparency and investor protection.

Congress had essentially three objectives in mind when it passed Section 17A: (1) to establish a national system, (2) for the prompt and accurate clearance and settlement of securities transactions, (3) that would be fair to investors. *See* 15 U.S.C. § 78q-1(a). The Investors' lawsuit does not interfere with the attainment of any of these goals.

First, it does not imperil the national nature of the current market system. As the Clearing Agencies are at pains to emphasize, they are by far the most dominant clearing agencies in the country and they process the overwhelming majority of securities trades executed on our nation's exchanges. *See, e.g.*, Appellees' Opening Brief, at 1, 8. (Feb. 16, 2007). If the Investors prevail, this configuration will not change. The result will be that the Investors are made whole for any damages they can prove. If the lawsuit also reveals unacceptable flaws in the SBP and in the manner in which the Clearing Agencies have operated it, then it will be up to the federal authorities to institute any regulatory fix they deem appropriate. *Cf. Capital Research and Management Co. v. Brown,* No. B189249, 2007 WL 195785, *4 (Cal. Ct. App. Jan. 26, 2007) (possible impact of fraud action on behavior of mutual fund does not limit application of NSMIA savings clause). None of these outcomes will make the system any less national or centralized.[4]

The Investors' lawsuit also will not make the clearing and settlement system any less prompt or accurate. It will either have no effect whatsoever, or it will lead to improvements on both counts. If the Investors' allegations are true, then it is the Clearing Agencies' manipulative operation of the SBP that is undermining prompt and accurate settlement. Settlements are not prompt to the extent the SBP enables short sellers to shirk their delivery obligations for long periods, and settlements are not accurate to the extent the Clearing Agencies use the SBP to manipulate share prices through the proliferation of phantom shares. Any changes in the system that address those problems – assuming they exist and are revealed in the litigation – will only enhance prompt clearing and settlement.

To support their preemption claim, the Clearing Agencies resort to a familiar scare tactic, arguing that unless this lawsuit is dismissed, the uniform regulatory scheme governing clearance and settlement will be converted into "an

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[4] Contrary to the SEC's suggestions, *see* SEC Brief at 27-28, the adoption of regulation SHO, 69 Fed. Reg. 48,008 (Aug. 6, 2004), can have no impact on this case because it was not in effect during the time period relevant to the Complaint, it does not address the Stock Borrow Program at all, and it could not possibly remedy the Investors' specific injuries from fraud. The case law supports this analysis. *See New York v. Grasso*, 350 F. Supp. 2d 498, 507 (S.D.N.Y. 2004) (SEC's future intention to address problems revealed in litigation through rulemaking had no bearing on the case, not only because the proposals had not yet taken effect, but also because the suit was predicated on fundamentally distinct state law claims).

incomprehensible 'Tower of Babel." *See* Appellees' Opening Brief, at 25. This argument is groundless for a number of reasons. The Investors are invoking traditional state law provisions prohibiting fraud, manipulation, conversion, and related misconduct. Those provisions are simply not disparate among the states. On the contrary, they share a high degree of uniformity throughout the country. Furthermore, experience to date does not justify the Clearing Agencies' fears. Neither state regulators nor private litigants have shown an inclination to superimpose myriad, conflicting regulatory demands upon the nation's clearing and settlement system. At issue in this case is abuse: lying about the true nature of the system to facilitate and perpetuate manipulation. Finally, even if "disparate" state laws and regulations were brought to bear upon the system, the result would not offend Congress. In Section 17A, Congress expressly allowed for a significant degree of variation in the regulation of clearing and settlement under state law. As discussed above, the law permits states to adopt regulations in direct conflict with SEC rules, subject to specified rule-making procedures, *see* 15 U.S.C. § 78q-1(f)(3).

Rather than undermining Congressional objectives, this lawsuit will advance them. The overriding purpose of the securities laws is protecting investors and maintaining their confidence in our markets. When Congress enacted PSLRA, it made this point clear by opening the Conference Report with the following declaration: "The overriding purpose of our nation's securities laws is to protect investors and to maintain confidence in our capital markets . . . ." *See* H.R. Conf. Rep. No. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731 (emphasis added). The core postulate of all securities regulation is that investors are best served through transparency: give them the truth, either through a prospectus or an antifraud provision, and they will protect themselves. *See, e.g., Rousseff v. Dean Witter & Co.*, 453 F. Supp. 774, 781 (N.D. Ind. 1978) (primary purpose of federal securities laws is protecting investing public by insuring it receives full disclosure of information necessary to effect informed securities transactions; longer state statute of limitations enhances that purpose and therefore does not conflict with federal law); 12 JOSEPH C. LONG, BLUE SKY LAW § 1.44 (2005) (main focus of 1933 Act is full disclosure). By holding the Clearing Agencies to a standard of honest disclosure and fair trade practices, the Investors' claims promote the goals of the securities laws. The company and the individual investors before the Court seek the truth about an important mechanism used in the clearing and settlement process, a mechanism they believe is being used unlawfully to devalue their investments. Their claims should be put to the test at trial, not extinguished on grounds of preemption.

CONCLUSION

For the reasons set forth above, the *Amicus Curiae* respectfully suggests that this Court should reverse the lower court's decision to dismiss the Complaint.

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PURSUANT TO FED. R. APP. P. 32(A)(7)(C)
AND CIRCUIT RULE 32-1 FOR CASE NUMBER 06-16088

I hereby certify that pursuant to Fed. R. App. P. 29(d) and Ninth Circuit Rule 32-1, the attached *amicus* brief is proportionately spaced, has a typeface of 14 points or more, and contains 7,000 words or less.

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