THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

BILLITTERI v. SECURITIES AMERICA, INC., *et al.* (*Provident Royalties Litigation*)	:	3:09-CV-01568 AND RELATED CASES
THIS DOCUMENT RELATES TO: ALL ACTIONS	:	
C. RICHARD TOOMEY, *et al.* v. SECURITIES AMERICA, INC., *et al.*	:	3:10-cv-01833-F
IN RE: MEDICAL CAPITAL SECURITIES LITIGATION	:	Case No. ML 10-2145 DOC (RNBx) (C.D. Cal.)
THIS DOCUMENT RELATES TO: *McCoy*, SACV09-1084 DOC (RNBx) (C.D. Cal.)	:	Limited transfer for settlement purposes as Case No.3-11-cv-00191-F (N.D. Tex.)

THE SECRETARY OF THE COMMONWEALTH OF MASSACHUSETTS AND THE COMMISSIONER OF SECURITIES AND INSURANCE, MONTANA STATE AUDITOR'S BRIEF IN OPPOSITION TO PLAINTIFFS' MOTION FOR PRELIMINARY APPROVAL OF PARTIAL CLASS ACTION SETTLEMENT

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The Secretary of the Commonwealth of Massachusetts, as the chief securities regulator in the State of Massachusetts and the Commissioner of Securities and Insurance, Montana State Auditor ("the States"), through their undersigned counsel, hereby respectfully file this memorandum of law in Opposition to Plaintiffs' Motion for Preliminary Approval of Partial Class Action Settlement ("Plaintiffs' Motion").

INTRODUCTION

On February 18, 2011, this Court entered an order in this matter (Order Granting Plaintiffs' Motion for Temporary Restraining Order, the "Order") to temporarily stay various arbitration proceedings against Securities America, Inc. ("SAI") and Securities America Financial Corporation ("SAFC") (together, "Defendants"). The Court has not yet determined whether to grant preliminary approval of the partial class action settlement and whether to preliminarily enjoin all federal, state and arbitration proceedings related to the sale of Medical Capital Notes or Provident Securities. The Court indicated in its subsequent scheduling order that any interested non-party may submit a brief for the Court's consideration of the Plaintiffs' Motion. The States are such interested non-parties that, as more fully explained below, oppose the entry of any order that would enjoin the pending adjudicatory actions by the States and respectfully request that the Court deny Plaintiffs' Motion in its entirety.

1. Background to the Massachusetts Action

The Massachusetts Securities Division ("Massachusetts Division") is an administrative agency of the office of the Secretary of the Commonwealth that seeks to protect investors from fraud and abuse in the offer and sale of securities and investment advice. The Massachusetts Division's regulatory powers are derived from Massachusetts General Laws Chapter 110A, the

Massachusetts Uniform Securities Act and the corresponding regulations. MASS. GEN. LAWS ch.110A (2007); 950 MASS CODE REGS 10.00 *et seq.* (2007).

On January 26, 2010, the Enforcement Section of the Massachusetts Division filed an administrative complaint (the "Complaint") against SAI, a broker-dealer owned by Ameriprise Financial, Inc. ("Ameriprise"). The Complaint is based on SAI's failure to supervise its registered representatives, material omissions and misleading statements by its registered representatives, and unsuitable sales of promissory notes issued by special purpose corporations wholly owned by Medical Capital Holdings, Inc. ("Medical Capital Notes"). The Complaint alleged that SAI fraudulently sold Medical Capital Notes to more than sixty Massachusetts investors. These allegations were limited to the offer and sale of Medical Capital Notes and do not address whether SAI violated Massachusetts securities laws by offering and selling stock and partnership interests issued by Provident Royalties, LLC ("Provident Securities").

Pre-trial hearings in the Massachusetts matter began in mid-April 2010. Between April and September 2010, multiple discovery related motions were filed, over one hundred and forty pages of pre-hearing memoranda were filed, and one hundred and ten pages of summary decision briefing were filed. No fewer than five pre-trial hearings were held during this period to argue the merits of the various motions and memoranda and to set forth scheduling of the proceeding. The adjudicatory hearing in Massachusetts commenced on September 30, 2010. Over the course of four months of trial, over thirty witnesses testified including fifteen investors, eleven SAI employees and former employees, five expert witnesses, a former Medical Capital employee, and a public accountant that reviewed Medical Capital financial statements. One hundred and ninety-three exhibits were entered into evidence. The adjudicatory hearing concluded on

January 31, 2011. The Presiding Officer has scheduled trial briefs to be filed on March 25, 2011. A decision on the merits is imminent.

2. Background to the Montana Action

The Montana State Auditor is the ex officio Commissioner of Insurance ("Commissioner"). MONT. CODE ANN. §§§ 2-15-1901, 2-15-1903, 30-10-107 (2009). The Commissioner is charged with administering the Securities Act of Montana, Mont. Code Ann. § 30-10-101 *et seq.* including protecting investors, persons engaged in securities transactions, and the public interest. MONT. CODE ANN. § 30-10-102. The Montana Securities Department ("Montana Department") is an office under the Commissioner. The Montana Department is a criminal justice agency as defined by the Montana Code Annotated. MONT. CODE ANN. § 30-10-304.

On August 4, 2010, the Montana Department issued a Cease and Desist and Notice of Proposed Agency Action against SAI, alleging two distinct violations of the Securities Act of Montana in connection with the sale of Medical Capital Notes. The first is a factually-specific finding that SAI's registered representatives recommended unsuitable investments to certain unsophisticated Montana investors. The second allegation is that SAI violated the Act by concealing material facts in connection with the sale of the Medical Capital Notes. This allegation applied to all Montana investors in connection with the sale of Medical Capital Notes. The Montana Department did not allege any violations in connection with the separate offering of Provident Securities. At present, discovery has concluded. Pre-hearing motions are due on March 23, 2011. The adjudicatory hearing is set for May 16, 2011.

Specifically, the States contend that the Court should deny the Motion to preliminarily enjoin state adjudicatory proceedings against SAI for claims arising from the offer and sale of

Medical Capital Notes. Granting a stay of the States' actions or limiting the proceedings in any way will set a dangerous precedent and will have a debilitating effect on the ability of the States to bring future state enforcement actions.

ARGUMENT

I. STATES REGULATE SECURITIES FRAUD AS SOVEREIGN ENTITIES

A. States Rights Have Been Expressly Authorized by Congress

Both Congress and the courts have repeatedly preserved state authority to regulate securities fraud independent of federal law. The National Securities Markets Improvement Act of 1996 (hereinafter "NSMIA") expressly reveals Congressional intent to preserve state authority in the realm of fraud and deceit in securities offerings. *See, e.g.,* 15 U.S.C. § 77r(c) (NSMIA savings clause); 15 U.S.C. § 77p(a) (savings clause in Securities Act of 1933, preserving "all other remedies that may exist at law or in equity"); 15 U.S.C. § 77p(e) (savings clause in Securities Litigation Uniform Standards Act, providing that state securities commissions retain jurisdiction to investigate and bring enforcement actions).

In review of the complementary, but distinguishable responsibilities of federal and state securities regulators, courts have noted the purposes for which each statutory regime exists. "One reason for this dual system of securities regulation is that the state and federal laws were adopted to serve different purposes . . . states enacted securities regulation to protect investors." *King v. Pope*, 91 S.W.3d 314, 319 (Tenn. 2002) (citations omitted). "Federal securities regulations, on the other hand, were enacted to serve the broader purpose of protecting the integrity of the increasingly nationalized market." *Id.* at 320 (citations omitted).

An examination of the legislative history of NSMIA further illustrates the importance of state regulation of securities. During the Congressional debate of NSMIA, Representative

Dingell acknowledged the critical role of state anti-fraud enforcement as a "first line of defense" that was not to be disturbed:

> State securities regulators play an essential role in the regulation of the U.S. securities industry. State regulators are often the first line of defense against developing problems. They are the "local cops" on the beat who can quickly detect and respond to violations of law. [sic] I strongly agree with those sentiments. Nothing that we do in this legislation should undercut the authority and ability of the States to detect and take action against securities fraud and sales practice abuses.

142 CONG. REC. H6436, at H6446-47 (Jun. 18, 1996) (statement of Rep. Dingell) (emphasis added). House Report 104-622, which summarized various provisions of H.R. 3005, emphasized that the bill preserved state authority to bring actions for fraud and deceit:

> The Committee intends to preserve the ability of the States to investigate and bring enforcement actions under the laws of their own State with respect to fraud and deceit (including broker-dealer sales practices) in connection with any securities or any securities transactions, whether or not such securities or transactions are otherwise preempted from State regulation by Section 18. It is the Committee's intent that the limitations on State law established by Section 18 apply to State law registration and regulation of securities offerings, and do not affect existing State laws governing broker-dealers, including broker-dealer sales practices.

H.R. REP. NO. 104-622, at 33-34 (1996) as *reprinted* in 1996 U.S. Code Cong. & Ad. News at 3896-97 (emphasis added). In the Senate, S1815, a bill similar to H.R. 3005, was co-sponsored and introduced by Senator Dodd, who explained that the "legislation we are introducing today . . . preserve[s] the state's necessary ability to protect consumers through anti-fraud and other statutes." 142 CONG. REC. S5593, at 5597 (May 23, 1996) (statement of Sen. Dodd).

Since Congress enacted NSMIA, federal courts have followed it's recognition of the critical role state securities regulators take in policing and enforcing anti-fraud prohibitions in connection with the offer and sale of securities. After review of the Congressional records, a federal judge in the Southern District of New York noted states retain the ability to protect investors through application of state anti-fraud laws. *See Zuri-Invest AG v. Natwest Fin. Inc.,* 177 F. Supp. 2d 189, 193-94 (S.D.N.Y. 2001). "A more clear cut statement against preemption would be hard to find." *Id.* at 194.

Another federal judge in the Western District of Washington observed, "[i]n deference to state sovereignty, there is a presumption against preemption in matters, such as securities regulation, traditionally regulated by states." *Chamberlin v. Advanced Equities, Inc.*, 2002 U.S. Dist. LEXIS 28307, at *5 (W.D. Wash. Jan. 17, 2002) (citations omitted). The opinion also noted "'[i]t is well-settled that federal law does not enjoy complete preemptive force in the field of securities.'" *Id.* at *7 (citing *Zuri-Invest*, 177 F. Supp. 2d at 195).

The Third Circuit observed "Congress, the courts, and the SEC have made explicit that federal regulation was not designed to displace state securities laws that regulate interstate securities transactions." *A.S. Goldmen & Co. v. New Jersey Bureau of Sec.,* 163 F.3d 780, 781 (3d Cir. N.J. 1999). The court further recognized that "federal and state regulations each continue to play a vital role in eliminating securities fraud and abuse." *Id.* at 782.

"Congress and the courts, most recently the Supreme Court in dicta, have repeatedly recognized state authority to regulate and enforce its own fraud statutes in the securities realm independent of federal law." *Houston v. Seward & Kissel, LLP*, 2008 U.S. Dist. LEXIS 23914, at *10-11 (S.D.N.Y. Mar. 27, 2008) (footnoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 166 (2008)). Thus, it would be contrary to Congress's expressed intent to enjoin the proceedings. It would be equally violative of Congress's intent to enjoin any remedy the state may levy. Federal courts have stated:

> NSMIA did not amend the saving provisions of either the Securities Act of 1933 or the Securities Exchange Act of 1934, see 15 U.S.C. §§ 77p(a), 78bb(a). Both provisions state that the rights and remedies provided by the federal statutes shall

> be "in addition to any and all other rights and remedies that may exist at law or in equity."

Zuri-Invest, 177 F. Supp. 2d at 194 (emphasis added); *see also Gold v. Blinder, Robinson & Co.*, Inc., 580 F. Supp. 50, 53 (S.D.N.Y. 1984) ("existing state remedies are by federal statute coexistent with causes of action created by the 1934 Act") (emphasis added).

Where courts have properly recognized that "states enacted securities regulation to protect investors," such investor protection would be rendered meaningless to the harmed consumer if the ability of the states to order restitution is enjoined. *King v. Pope*, 91 S.W.3d at 319. It is axiomatic that a state's ability to exercise its anti-fraud authority in connection with the offer and sale of securities would be eviscerated if one of the most effective means to simultaneously both protect the investor and punish the offender is removed. The judicial recognition of such a principle would be inconsistent with both NSMIA and the investor protection purposes of the States' securities acts. *See, e.g.,* 15 U.S.C. § 77r(c); MASS. GEN. LAWS ch. 110A; MONT. CODE ANN. § 30-10-102.

B. Comity Requires Proper Respect for States Rights Under *Younger*

In light of state sovereignty and principles of federalism, the Court should abstain from enjoining the pending States' adjudicatory proceedings because such enjoinment would amount to an undue interference of the legitimate activities of Massachusetts and Montana. An underlying reason for limiting federal courts' interference in state actions is the notion of comity, which requires:

> [A] proper respect for state functions, recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways.

Younger v. Harris, 401 U.S. 37, 44 (1971). Additionally, it has been said that the concept of "Our Federalism" represents:

> [A] system in which there is sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with legitimate activities of the States.

Id. In *Younger v. Harris*, the Supreme Court took into account the notions of comity and federalism to prohibit federal courts from enjoining pending state court criminal prosecutions and this doctrine has been expanded to apply to certain state administrative proceedings. 401 U.S. 37, 41, 43-44 (1971); *see also Ohio Civil Rights Comm'n v. Dayton Christian Sch.*, 477 U.S. 619, 627 (1986). The adjudicatory proceedings brought by the States are judicial in nature, ongoing, relate to important state interests and allow for federal questions to be raised. Therefore, this Court should abstain from enjoining the States' adjudicatory proceedings.

The *Younger* abstention doctrine requires that state administrative proceedings be judicial in nature. *Dayton Christian*, 477 U.S. at 627. The States' proceedings satisfy this element. First, the States are both statutorily empowered to administer their respective securities acts and to bring adjudicatory hearings in order to enforce their Acts. *See* MASS. GEN. LAWS ch. 110A; 950 MASS CODE REGS 10.00 *et seq.*; MONT. CODE ANN. § 30-10-101 *et seq.* Second, both state actions brought against SAI were initiated by a complaint. *See Kendall v. Russell*, 572 F.3d 126, 131 (3d Cir. 2009). Finally, the States' actions are both adjudicative in nature because SAI received notice of the proceedings, had the right to attend and be represented by counsel, and was allowed to present evidence, cross-examine witnesses, bring motions, and make oral arguments at the proceedings. *See* 950 MASS CODE REGS 10.09(h); MONT. CODE ANN. § 2-4-612; *Kendall*, 572 F.3d at 131-32.

The States' adjudicatory proceedings are ongoing because each were underway and moved beyond the "embryonic stage" prior to the Plaintiffs' Motion. *See Fresh Int'l Corp. v. Agric. Labor Relations Bd.*, 805 F.2d 1353, 1358 (9th Cir. 1986). The Massachusetts Division's proceeding is clearly ongoing and has advanced beyond the embryonic stage because, prior to the Plaintiffs' Motion, the Massachusetts Division had already concluded not only its investigation, but also its hearing at which both parties presented and cross-examined witnesses and introduced evidence. The parties are currently in the post-hearing stage and are awaiting the hearing officer's final order. The Montana Department's proceeding is also sufficiently ongoing because, prior to the Plaintiffs' Motion, the Montana Department engaged in a thorough investigation of SAI, issued a Cease and Desist Notice and set a date for the adjudicatory hearing.

Important state interests must be present in order for the *Younger* abstention doctrine to apply. *Dayton Christian*, 477 U.S. at 627. Both the Massachusetts Division and the Montana Department aim to protect investors by administering their respective securities acts and by utilizing their anti-fraud enforcement authority which has been preserved for the States by NSMIA. *See* 15 U.S.C. § 77r(c)(1); MASS. GEN. LAWS ch. 110A; 950 MASS CODE REGS 10.00 *et seq.*; MONT. CODE ANN. § 30-10-101 *et seq.* The ability of the States to administer and enforce their securities acts and their anti-fraud jurisdiction is a sufficiently important state interest. Exercising "federal judicial power [here] would disregard the comity between the States and the National Government" because such exertion of judicial authority would result in severely diminishing the States' ability to perform these essential functions. *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 11 (1987).

The *Younger* abstention doctrine also requires there be an adequate opportunity to raise federal questions during the administrative proceedings. *Dayton Christian*, 477 U.S. at 627. Federal claims may be raised and decided during a state's adjudicatory proceedings if there is no state law barring the interposition of such claims. *Moore v. Sims*, 442 U.S. 415, 425-26 (1979) (asserting abstention is appropriate unless state law clearly bars the interposition of constitutional claims). Here, neither Massachusetts nor Montana has any state law barring the interposition of federal claims from being raised and decided on during their adjudicatory proceedings. *See* 950 MASS CODE REGS 10.00 *et seq.;* MONT. CODE ANN. § 30-10-101 *et seq.* Furthermore, there is sufficient opportunity to raise federal questions because after the issuance of a final order, SAI has the right to seek judicial review of that order by filing an appeal with the appropriate state court. *See Dayton Christian*, 477 U.S. at 628-29 (stating sufficiency of raising constitutional claims in state-court judicial review of administrative proceeding); *see also* 950 MASS CODE REGS 10.09(s); MONT. CODE ANN. § 30-10-308.

The States will not be permitted to enforce their securities acts if the Court enjoins these proceedings. The States' adjudicatory proceedings are judicial in nature, ongoing, relate to important state interests and provide an opportunity for federal questions to be raised. The Court should abstain from enjoining the States' adjudicatory proceedings because the requirements of the *Younger* abstention doctrine are met. Notions of comity and federalism occupy "a highly important place in our Nation's history and its future" and must be employed here to protect the legitimate activities of the States. *Younger*, 401 U.S. at 44-45.

II. THE COURT LACKS JURISDICTION TO ENJOIN NON-PARTY STATES' ENFORCEMENT ACTIONS UNDER THE ALL WRITS ACT

The All Writs Act does not provide an independent grant of jurisdiction to the federal courts. *See Texas v. Real Parties in Interest*, 259 F.3d 387, 392 (5th Cir. 2001). The All Writs

Act authorizes federal courts only to "issue all writs necessary and appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651(a). Consequently, any such writ must be in aid of jurisdiction previously obtained. *See id*. Whatever limited power there is to enjoin state proceedings, a federal court "may not interfere even temporarily when it lacks jurisdiction." *Schell v. Food Mach. Corp.*, 87 F.2d 385, 387 (5th Cir. 1937).

Invocation of a federal court's power pursuant to the "necessary in aid of jurisdiction" authority under the All Writs Act requires first, a determination of the basis for jurisdiction under the All Writs Act and second, whether the injunction sought is reasonably necessary in the aid of such jurisdiction. *See* 28 U.S.C. § 1651(a). The Supreme Court has held that the nature of the proceeding in federal court affects the ability to enjoin parallel state proceedings under the All Writs Act's "in aid of . . . jurisdiction" authority. *See Kline v. Burke Constr. Co.,* 260 U.S. 226 (1922) (whether a federal court action is characterized as in rem or in personam greatly affects whether the federal court may enjoin related state proceedings).

In this case, the Court's jurisdiction over the non-party States is predicated upon the flawed theory that the existence of a purported "limited fund" under Rule 23(b)(1)(B) of the Federal Rules of Civil Procedure is tantamount to falling within in rem or quasi in rem jurisdiction. This is in error.

A. The Proposed Class Fails to Meet the Threshold Requirements of Rule 23(a)

1. The claims are not typical of Massachusetts and Montana Investors

To gain class certification under Rule 23 of the Federal Rules of Civil Procedure, the Plaintiffs must establish that each of Rule 23(a)'s four requirements are met, and that at least one requirement under Rule 23(b) is also met. Rule 23(a) requires that: (1) the class be so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties be typical of the claims or defenses of the class; and (4) the representative parties fairly and adequately protect the interests of the class. FED. R. CIV. P. 23(a). In this case, the Plaintiffs fail to meet the requirements of Rule 23(a) because the claims of the proposed class are not typical of, and do not adequately represent the claims and interests of Massachusetts and Montana investors. Rather, the approval of the proposed class certification would substantially impair the rights of Massachusetts and Montana investors by frustrating the imminent announcement of an adjudicatory decision and impending hearing regarding longstanding claims for relief.

The Plaintiffs veiled attempt to cobble together the various claims of investors under a blanket theory of Defendants' faulty due diligence is spurious. In reality, the investors' claims require independent consideration well beyond the marketing materials and private placement memoranda utilized in connection with each separate securities offering. For example, both of the States' actions focus on whether SAI's registered representatives recommended unsuitable investments. Fact specific suitability analysis includes individual review of factors such as: age, education, sophistication, current income, investment objectives, employment status/retirement, and risk tolerance. The States' actions have also focused on misleading sales practices employed by various registered representatives of SAI. Additionally, the Massachusetts Division alleged that SAI failed to supervise its registered representative agents under Massachusetts General Laws Chapter 110A. These legal theories are distinct from those solely associated with mere negligent due diligence failures and provide entirely different bases for relief under state securities statutes. Finally, the States make no allegations of SAI's due diligence or lack thereof with respect to an entirely separate issuer, Provident Securities. Indeed, the States make no allegations regarding Provident Securities whatsoever. These are just a few of a plethora of distinctions that exist between the different suits against SAI. Ignoring these distinctions infringes on the sovereign rights of the States and the individual constitutional rights of investors. *See, e.g., Gen. Tel. Co. v. Falcon*, 457 U.S. 147, 161 (1982) (emphasizing "the error of the 'tacit assumption' underlying the across-the-board rule that 'all will be well for surely the plaintiff will win and manna will fall on all members of the class.'") (citation omitted).

2. The class does not adequately represent Massachusetts and Montana investors

The proposed class also fails to meet the requirements of Rule 23(a)(4) because the representative parties do not fairly and adequately represent the interests of Massachusetts and Montana investors. The States contend that the self-interested agreement between the Plaintiffs' class action counsel and the Defendants directly conflicts with the interests of numerous investors who have pending claims in the final stages of adjudication. *See Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997) (the adequacy inquiry "serves to uncover conflicts of interest between the named plaintiffs and the class they seek to represent."); *see also East Tex. Motor Freight Sys., Inc. v. Rodriguez*, 431 U.S. 395, 403 (1977) (stating that "[a] class representative must be part of the class and 'possess the same interest and suffer the same injury' as the class members.").

Having an adverse judgment entered in arbitration and facing the prospect of an imminent and potentially adverse decision in the States' actions, Defendants now have endeavored to find a federal forum that will allow SAI to retreat in order to limit its liability and allow Plaintiffs' counsel to turn a quick profit. These procedural tactics may benefit Defendants and Plaintiffs' counsel, but point specifically to the potential conflicts of interest that exist. Together, they are simultaneously attempting to undermine the securities regulation framework prescribed by Congress and extinguish the interests of individual investors who have exercised their individual rights in arbitration. Defendants cannot reasonably be allowed to test the waters with securities regulators and arbitrators to see whether conditions are favorable and after determining that litigation may not be successful, be permitted to avoid regulatory and civil liability by working out a mutually beneficial settlement with Plaintiffs' class action counsel in another forum. The courts have recognized as generally "unwanted and highly undesirable [the] race by each party to obtain a decision from the particular . . . court reacting most favorably to its position." *ACF Indus., Inc. v. Guinn,* 384 F.2d 15, 19 (5th 1967). Plaintiffs' acquiescence to this impermissible forum shopping evidences that the representative parties do not "fairly and adequately" represent the interests of investors; particularly those investors in Massachusetts and Montana who might potentially receive full restitution, nor do they "fairly and adequately" represent the interests of other numerous investors who have initiated arbitration actions that may result in full restitution. *See Hansberry v. Lee*, 311 U.S. 32, 45 (1940) (noting that, "[a]part from the opportunities [conflicts of interests] would afford for the fraudulent and collusive sacrifice of the rights of absent parties, [is] that the representation . . . no more satisfies the requirements of due process than a trial by a judicial officer who . . . may have an interest in the outcome of the litigation in conflict with that of the litigants").

Therefore, because the class certification does not meet the requirements under Rule 23(a)(3) or (4), the States assert that the Plaintiffs' request for class certification must be denied.

B. The Purported "Limited Fund" Under Rule 23(b)(1)(B) Does Not Properly Constitute a Res Over Which This Court Can Exercise Jurisdiction

This case is not a "limited fund" class action under Rule 23(b)(1)(B). In addition to satisfying the requirements of Rule 23(a), the proposed class must also meet one of the requirements under Rule 23(b) in order to be certified as a class. *See* FED. R. CIV. P. 23(b)(1)(B);

see also Katrina Canal Breaches Litig. v. Bd. of Comm'rs, 628 F.3d 185, 191-92 (5th Cir. 2010). Here, the Plaintiffs assert that the proposed class fits within the scope of Rule 23(b)(1)(B) because the proposed settlement fund is "limited" in its amount and insufficient to settle all outstanding claims. (*See* Pl. Mem. at 17-18). The Plaintiffs also assert, that because the settlement fund is "limited", the court must further find that the proposed class treatment should be extended—and mandated—as to all potential class members in accordance with *Ortiz v. Fibreboard Corp.,* 527 U.S. 815 (1999). Because the purported "limited fund" settlement fails under section (b)(1)(B), the proposed class does not meet the requirements of a mandatory settlement only class action.

Rule 23(b)(1)(B) provides that a class action may be maintained if "(1) the prosecution of separate actions by or against individual members of the class would create a risk of . . . (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of other members not parties to the adjudications or substantially impair or impede their ability to protect their interests." FED. R. CIV. P. 23(b)(1)(B). The facts offered in support of a Rule 23(b)(1)(B) class action simply cannot be satisfied as a matter of law.

In the absence of the existence of the limited fund and a mandatory non opt-out class, the Court does not have jurisdiction, and therefore does not have the authority to enjoin state enforcement proceedings under the All Writs Act.

1. The "limited fund" in this case is a fiction

The Court is being asked to administer a nationwide mandatory class action settlement that is designed to appear to be a Rule 23(b)(1)(B) limited fund, but it is plainly a negotiated limited fund class action that has been prohibited under the Supreme Court's ruling in *Ortiz v.*

Fibreboard Corp., 527 U.S. 815 (1999). As such, it cannot create the predicate for mandatory class certification under Rule 23(b)(1)(B) and therefore does not create the res necessary for in rem jurisdiction under the All Writs Act.

Although declining to rule specifically on the issue, the Supreme Court in *Ortiz* expressed doubt that Rule 23(b)(1)(B) limited fund mandatory class actions involving money damages in the context of aggregated unliquidated torts are valid under Rule 23. *See Ortiz*, 527 U.S. at 842-44. The Supreme Court noted that if these class actions were to be considered valid, each should conform closely to the types of traditional limited fund cases that predated Rule 23. *See id.* at 838-42. Historically "'[c]lassic limited fund class actions 'include claimants to trust assets, a bank account, insurance proceeds, company assets in a liquidation sale, proceeds of ship sale in a maritime accident suit, and others.'" *Id.* at 834 (quoting 1 H. Newberg & A. Conte, Class Actions § 4.09, at 4-33 (3d ed. 1992)). Finally, the Court warned in interpreting Rule 23(b)(1)(B), "the greater the leniency in departing from the historical limited fund model, the greater likelihood of abuse . . ." *Id.* at 842.

In light of the potential for abuse in purported "limited fund" mandatory class actions under Rule 23(b)(1)(B), the Supreme Court provided that the following characteristics must be present to justify binding non-class members under Rule 23(b)(1)(B): (1) "the totals of the aggregated liquidated claims and the fund available for satisfying them, set definitely at their maximums, demonstrate the inadequacy of the fund to pay all the claims"; (2) "the whole of the inadequate fund [is] to be devoted to the overwhelming claims"; and (3) "the claimants identified by a common theory of recovery were treated equitably among themselves." *Id.* at 838-39. These three requirements are not satisfied in this case.

2. The "limited fund" does not satisfy the conditions precedent in order to certify a Rule 23(b)(1)(B) class under *Ortiz*

First, the purported limited fund is not fixed at its maximum. By their own admission, Defendants are "paying the maximum amount into the Settlement Fund that they can pay without affecting the ability of the companies to remain in business (and make the additional payments required under the terms of the settlement)." (Pl. Mem. at 18). The Plaintiffs and Defendants have agreed that the fund will be limited, and comprised of: (1) net excess capital that FINRA has determined will not place SAI in imminent jeopardy of a net capital deficiency; (2) reserve payments that were established for potential losses in arbitrations; (3) future earnings (1% of SAI's gross revenue each year for a three year period) and SAFC (1.5% of its gross revenue excluding SAI for each year for a three year period); (4) $800,000 payment by SAFC; and (5) excess liability insurance policy proceeds. (Pl. Mem. at 2). These terms in and of themselves indicate that the totals are not "set definitely at their maximums." *Ortiz*, 527 U.S. at 839.

For example, future earnings are capped at 1% for SAI and 1.5% for SAFC. This is clearly a cap set by negotiation between the parties as to what percentage of future earnings will be set aside for the settlement. This term, similar to the excess net capital contribution, is predicated on the Defendants remaining in business. Further, these percentages do not demonstrate a finite amount of property that will be insufficient to resolve all claims. *See In re Simon II Litig.*, 407 F.3d 125, 137-38 (2d Cir. 2005) (limited fund not certified due to failure to identify upper limit). Presumably, the fund could be enlarged, by SAI and SAFC agreeing to increase those percentages to 2% or 3%. Similarly, the timeframe for payment is set arbitrarily at three years. Again, the payments could be extended by agreement of SAI and SAFC to five or ten years. The settlement fund is therefore only limited in that there is a maximum amount that the Defendants are willing to pay. The "limited fund" in this instance did not exist prior to the proposed settlement and independent of facts and circumstances beyond the parties' control. Similar to the global settlement at issue in *Ortiz*, there is no adequate demonstration of the fund's limits in this case other than the figures agreed upon by the parties defining the fund's limits. *See Ortiz*, 527 U.S. at 827.

Second, the whole of the purported limited fund is not devoted to the claims of class members when the fund itself does not have a definitive maximum. Under the proposed settlement, the class members are receiving no recovery from the true parent company, Ameriprise. SAI is a wholly owned subsidiary of SAFC, which in turn is a wholly owned subsidiary of Ameriprise. In an effort to circumvent litigation on the merits and resolve all of its claims at once, Defendants entered into a proposed mandatory non opt-out settlement that would allow SAI and SAFC to limit liability to $25,053,440, leave the majority of Ameriprise's assets intact, and force the class members to seek compensation through this settlement. Punitive damages are also not recoverable. Thus, certification of the settlement ensures that class members' ability to obtain relief from Ameriprise will be eliminated.

Rule 23(b)(1)(B) certification is justified when "claims are made by numerous persons against a fund insufficient to satisfy all claims." FED. R. CIV. P. 23(b)(1)(B) *Advisory Committee Note* (1966 Amends.). Rule 23(b)(1)(B) focuses on whether the fund is "insufficient" (i.e., too small to satisfy all outstanding claims), not on whether the fund is "limited." *Id.* In the instant case, the parent company Ameriprise has been eliminated from the proposed settlement without making any contribution to the settlement fund. Ameriprise had net revenue in 2010 of approximately $10 billion and a net income of $1.1 billion. (Ameriprise Financial, Inc., Annual Report (Form 10-K), at 95-96 (Feb. 28, 2011)). An annual report filed by Ameriprise indicates that the public company has set aside $40 million in legal reserves for class actions and legal claims arising from the sale of private placements by its broker-dealer subsidiary, SAI. (Ameriprise Financial, Inc., Annual Report (Form 10-K), at 157 n.27 (Feb. 28, 2011)). "Securities America sold approximately $47 million of Provident Securities, all of which are in default, and $697 million of Medical Capital Notes, of which approximately $379 million are in default." (Pl. Mem. at 17). The reserve amount set aside by the parent company, Ameriprise, comprises approximately "10% of the total that [investors] have lost in the two series of investments."[1] SAI received $29.5 million in gross commissions for the sale of Medical Capital Notes alone. (Answer of SAI at 18, ¶ 31, In the matter of Securities America, Inc., (Massachusetts Securities Division Docket No. 2009-0085), Feb. 16, 2010). Furthermore, two weeks after the proposed $25 million "limited fund" settlement by SAI and SAFC in this case, it was reported that Ameriprise reached a $27 million settlement with investors who bought private placements from representatives at its broker-dealer subsidiary, SAI.[2] Together, these facts clearly show that there are additional funds available outside the proposed settlement fund, from Ameriprise specifically, to satisfy claims outside of this settlement.

The facts surrounding potential contributions to the settlement fund by the parent company here are similar to issues presented in *In re Teletronics Pacing Systems, Inc.*, 221 F.3d 870, 880 (6th Cir. 2000). In *Teletronics*, the Sixth Circuit refused to certify a class action under Rule 23(b)(1)(B) in part because assets of the parent companies were at issue. As the Sixth Circuit observed:

[1] *See* Bruce Kelly, *Ameriprise sets aside $40M for private placement claims*, INVESTMENT NEWS, Feb. 28, 2011 (http://www.investmentnews.com/article/20110228/FREE/110229939).

[2] *See* Bruce Kelly, *Ameriprise reaches $27M settlement over private placements: Attorney*, INVESTMENT NEWS, March 2, 2011 (http://www.investmentnews.com/article/20110302/FREE/110309947).

> There seems to be no dispute that the parent corporations have sufficient funds to undertake individual litigation and to pay claims that might result. Their release, therefore, undermines the appropriateness of the settlement even more than the settlement in *Ortiz*. Like the settlement in *Ortiz*, the funds available are limited only by agreement of the parties, not because the funds do not exist as a factual matter, and the amount contributed by the parent is small compared to their potential liability.

Teletronics, 221 F.3d at 874. Therefore, there is no assurance that claimants are receiving the whole of a maximum fund. In fact, claimants could receive significantly less if the Court accepts this purported limited fund rationale for mandatory treatment of a settlement under Rule 23(b)(1)(B).

Third, even if the fund were set at its maximum, the "limited fund" theory still fails because there is no common theory of recovery. This requirement ensures that "the class will comprise everyone who might state a claim on a single or repeated set of facts, invoking a common theory of recovery, to be satisfied from the limited fund as the source of payment." *Ortiz*, 527 U.S. at 839. In light of the requirement of equity among members of the class, the settlement certification likewise falls short. Each claimant is situated differently. As the Supreme Court stated in *Amchem Prods. Inc. v. Windsor*, the same concerns that drive the threshold findings under Rule 23(a) may also influence the propriety of the certification decision under subdivisions of Rule 23(b). *Amchem*, 521 U.S. at 623 n.18.

The factual and legal questions presented in the States' complaints are not common to each class member as noted above. Whether certain risks were disclosed to each investor at the point of sale and whether the securities were appropriate investments for each investor given certain suitability criteria are just two examples. The States' allegations are also limited specifically to sales of Medical Capital Notes and are unrelated to the issues raised in entirely separate lawsuits regarding Provident Securities. Although the claimants may share a common defendant broker-dealer, the facts relating to the damages of the class members with respect to suitability and failure to supervise will necessarily differ from person to person. Given this disparity, the claimants are not identified by a common theory of recovery with respect to all claims.

Therefore, while the mandatory class certification here proposes a pro-rata distribution among class members, the class itself is not identified by a common theory of recovery and thus fails to meet this condition.

III. EVEN IF THE COURT HAS JURISDICTION, IT SHOULD NOT EXERCISE IT OVER NON-PARTY STATES ENGAGED IN LEGITIMATE ENFORCEMENT PROCEEDINGS

An injunction is "an extraordinary remedy which requires the movant to unequivocally show the need for its issuance." *Valley v. Rapides Parish Sch. Bd.*, 118 F.3d 1047, 1050 (5th Cir. 1997) (citing *Allied Mktg. Group Inc. v. CDL Mktg. Inc.,* 878 F.2d 806, 809 (5th Cir. 1989)). It is especially extraordinary to request a federal court to enjoin state securities regulators, which are well within their statutory authority and jurisdiction to pursue enforcement actions in their respective states. In fact, Congress has specifically preserved for the states the ability to pursue enforcement actions concerning fraud in connection with the offer and sale of securities, as Massachusetts and Montana are doing in their adjudicatory proceedings. *See, e.g.,* 15 U.S.C. § 77r(c); 15 U.S.C. § 77p(a); 15 U.S.C. § 77p(e). "When a federal court enjoins state proceedings, at whatever level, it disrupts the delicate balance of power between the state and federal systems, and it should have a substantial justification for doing so." *SMA Life Assurance Co. v. Sanchez-Pica*, 960 F.2d 274 (1st Cir. 1992). For this reason, the All Writs Act should only be used "sparingly and in the most critical and exigent circumstances." *Wis. Right to Life, Inc. v. Fed. Election Comm'n*, 542 U.S. 1305, 1306 (2004).

The language of the All Writs Act is clear that the purpose of such an injunction must be *necessary* in aid of the court's jurisdiction. 28 U.S.C. § 1651(a). The Fifth Circuit has noted on numerous occasions that its courts should be reluctant to read the language "necessary in aid of jurisdiction" under the All Writs Act more broadly than Congress originally intended. *See, e.g. Newby v. Enron Corp.*, 302 F.3d 295, 301 (5th Cir. 2002) (stating that "the principles of federalism lie behind our reluctance to adopt an expansive reading of 'necessary in aid of jurisdiction' . . ..")*.* Further, the Court should be guided by the overarching principle that federal courts are to be cautious about infringing on the legitimate exercise of state judicial power. *See generally Younger v. Harris*, 401 U.S. 37 (1971). In the instant case, the States' enforcement actions do not present a necessary challenge to the Court's jurisdiction and as such, the All Writs Act does not justify the extraordinary relief the Plaintiffs seek.

A. Necessary in Aid of Jurisdiction

The "necessary in aid of jurisdiction" language under the All Writs Act is identical to the language found under the second exception to the Anti-Injunction Act. *Compare* 28 U.S.C. § 1651(a) and 28 U.S.C. § 2283. Accordingly, courts routinely have read case law on both Acts together to determine the proper meaning of the "necessary in aid of jurisdiction" exception. *See, e.g.*, *Newby*, 302 F.3d at 301; *In re Diet Drugs Prods. Liab. Litig.*, 282 F.3d 220, 239 (3d Cir. 2002); *Winkler v. Eli Lilly & Co.,* 101 F.3d 1196, 1203 (7th Cir. 1996); *In re Baldwin-United Corp.*, 770 F.2d 328, 335 (2d Cir. 1985).

The language of the second exception of the Anti-Injunction Act has been construed narrowly, "finding a threat to the court's jurisdiction only where a state proceeding threatened to dispose of property that formed the basis for federal in rem jurisdiction or when the state proceeding threatened the continuing superintendence by a federal court." *Newby*, 302 F.3d at

301 (citing *State of Texas v. United States*, 837 F.2d 184, 186 n.4 (5th Cir. 1988). The exception may be invoked in extraordinary circumstances where "some federal injunctive relief may be necessary to prevent a state court from so interfering with a federal court's consideration or disposition of a case as to seriously impair the federal court's flexibility and authority to decide that case." *Atl. Coast Line R. Co. v. Bhd. of Locomotive Eng'rs*, 398 U.S. 281, 295 (1970). "Any doubts as to the propriety of a federal injunction against state court proceedings should be resolved in favor of permitting the state courts to proceed in an orderly fashion to finally determine the controversy." *Id.* at 297. Further, "a district court may not issue an injunction simply to be the first court to reach a judgment and thereby avoid issues" of preclusion and duplicative litigation. *Vernitron Corp. v. Benjamin*, 440 F.2d 105, 108 (2d Cir. 1971).

B. ***Baldwin-United*** **Does Not Support the Issuance of an Injunction in This Matter**

The Plaintiffs have failed to cite to any cases which support the proposition that the Court may use the All Writs Act to enjoin two ongoing and legitimate state regulatory actions in the limited fund class action context. This is unsurprising given that no such cases exist. Instead, as described below, Plaintiffs erroneously attempt to construe *Baldwin-United* to require that an injunction be issued. (*See* Pl. Mem. at 26-67). A closer reading of the case actually leads to the opposite conclusion. *See In re Baldwin-United Corp.*, 770 F.2d 328 (2d Cir. 1985).

1. The States have not filed vexatious and harassing lawsuits

The Plaintiffs argue that the All Writs Act permits this Court to take the extraordinary step of staying all pending state actions, however, the seminal case relied upon by the Plaintiffs for this proposition is clearly distinguishable. *See id.* In *Baldwin-United*, the court narrowly addressed whether federal courts may enjoin state attorneys general from bringing "vexatious and harassing" parallel lawsuits. *Id.* at 337. The court focused on the threats of future state claims aimed at undermining a federal settlement. *Id. Baldwin-United* did not address legitimate state regulatory actions filed *prior* to federal court involvement, nor did it address near-complete regulatory actions. *See id.* The facts of *Baldwin-United* are clearly distinguishable from those present here and the corresponding concerns that motivated the court to issue an injunction do not mandate the same conclusion under the facts of this case.

Baldwin-United is expressly limited, in that it narrowly applied the All Writs Act to enjoin vexatious and harassing state litigants. *Id.* ("[t]o the extent that the state court suits were vexatious and harassing, our interest is in preserving federalism and comity with state courts is not significantly disturbed by the issuance of injunctive relief.") (emphasis added). *See also Newby*, 302 F.3d at 301 ("it is widely accepted that federal courts possess power under the All Writs Act to issue narrowly tailored orders enjoining repeatedly vexatious litigants from filing future state court actions without permission from the court"); *Harrelson v. U.S.*, 613 F.2d 114, 116 (5th Cir. 1980) (the district court has the power under 28 U.S.C. § 1651(a) to enjoin litigants who are abusing the court system by harassing their opponents). In *Baldwin-United*, the court found that an injunction was proper, only where the state courts sought to re-litigate matters previously decided by the federal court and as a result, significantly undermine the settlement. *In re Baldwin-United*, 770 F.2d 328, 342 (2d Cir. 1985).

Unlike *Baldwin-United*, the Massachusetts and Montana actions are not vexatious, harassing, or actions brought to undermine or intentionally interfere with federal authority. The States had already filed their regulatory complaints long before Plaintiffs' proposed settlement. Both States have invested considerable time and resources to litigating these ongoing regulatory matters, brought to enforce state-specific securities laws and should be allowed to continue to do so unimpeded.

2. The States have not malevolently interfered in the federal action

The same interference concerns which motivated the court in *Baldwin-United* to issue the injunction, mandate that the court *not* issue an injunction here. *See Baldwin-United*, 770 F.2d at 337. In fact, the current facts before the Court are the *exact opposite* of what occurred in *Baldwin-United*, wherein the court observed that "the states waited until the eve of settlement approval to take any significant actions" against the defendants. *Id.* To the contrary, the dubious timing of Plaintiffs' negotiated resolution, based on a purported "limited fund," occurred shortly after Defendants were fined $1.2 million by a Financial Industry Regulatory Authority arbitration panel. Here, Defendants have attempted to test the waters in arbitration and among the state actions, and have now rushed into federal court with a purported "limited fund" settlement. Before this, Defendants asserted no liability and were more than willing to pursue extensive litigation. It is the Defendants that have waited until the eve of judgment and trial in the state actions, to make an end run attempt to federal court in order to circumvent the pending state actions and present a "limited fund" settlement with Plaintiffs' counsel. This strategy may promote the interests of the Defendants in limiting damage awards, but it offends the traditional notions of federalism and comity. This procedural gamesmanship by way of class action should not be permitted to succeed.

The States should rightfully be able to exercise their authority to prove issues of fact and state law violations, as well as continue to seek sanctions and remedies in each case. Again, *unlike* the state attorneys general in *Baldwin-United*, previously filed state regulatory actions will not so interfere with the pending federal litigation "as to seriously impair the federal court's flexibility and authority to decide th[e] case." *Baldwin-United*, 770 F.2d at 335 (citing *Atl. Coast Line R. Co. v. Bhd. of Locomotive Eng'rs*, 398 U.S. 281, 295 (1970)). The mere possibility of inconsistent judgments "is not an interference with a court's jurisdiction because the doctrine of res judicata provides a way for the court to deal with prior judgments "as it would determine any other question of fact or law arising in the progress of the case." *Kline*, 260 U.S. at 230. Because a stay of the States' proceedings is not necessary to aid the Court's jurisdiction to prevent a potentially competing judgment, the States' adjudicatory actions should not be enjoined.

Finally, the other cases proffered by Plaintiffs in line with *Baldwin-United* are similarly inapposite of the facts of the present case. *Liles v. Del Campo* addressed a court's injunction to prevent private litigants from bringing parallel lawsuits, draining a limited fund. *Liles v. Del Campo*, 350 F.3d 742, 746 (8th Cir. 2003). *Del Campo* did not address a court injunction of an ongoing or future state regulatory action. *See id.* *Painewebber Ltd. Partnerships Litigation* involved enjoinder of parallel private state lawsuits as well as private arbitration to protect settlement of a non-mandatory class action lawsuit. *Painewebber Ltd. P'ships Litig.*, 1996 WL 374162, at *3 (S.D.N.Y 1996). However, *Painewebber* did not involve a limited fund, nor did the case address any aspect of state regulatory action in any way, including enjoinder. *See id.* *Reserve Fund* addressed enjoinder of private state court proceedings under a limited fund theory. *Reserve Fund Secs. & Derivative Litig. v. Reserve Mgmt. Co.,* 673 F. Supp. 2d 182 (S.D.N.Y. 2009). However, the injunction explicitly did not encompass state regulatory proceedings. *Reserve Fund*, 673 F. Supp. 2d at 204 n.53.

The Plaintiffs are encouraging the Court to greatly exceed its authority under the All Writs Act to enjoin the non-party States and prevent state regulatory authorities from seeking redress under state law, even before a federal class has been formed and a settlement has been approved. Ultimately, the States' legitimate securities enforcement actions will be restrained in a way that the Second Circuit did not contemplate in *Baldwin-United*. The Court should not issue an injunction where there is no history of repeated and vexatious litigation and where there is no showing that the States' actions will interfere with the Court's jurisdiction under the All Writs Act.

CONCLUSION

For all the reasons set forth herein, the Court should not enjoin any aspect of the States' adjudicatory proceedings and deny Plaintiffs' Motion in its entirety.

Dated: March 14, 2011 Respectfully submitted,

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CERTIFICATE OF SERVICE

On March 14, 2011, I electronically submitted the foregoing document with the Clerk of the Court for the United States District Court, Northern District of Texas, using the electronic case filing system of the Court. I hereby certify that I have served all counsel and/or parties of record electronically or by any other manner authorized by Federal Rule of Civil Procedure 5(b)(2).

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