NO. 45364

IN THE
SUPREME COURT OF NEVADA

NANOPIERCE TECHNOLOGIES, INC., A NEVADA CORPORATION; STEPHEN SEITZ, AN INDIVIDUAL; JANE SEITZ, AN INDIVIDUAL; KATHY KNIGHT-MCCONNELL, AN INDIVIDUAL; JAMES STOCK, AN INDIVIDUAL; MAUREEN O'SULLIVAN, AN INDIVIDUAL; AND HELEN KOLADA, AN INDIVIDUAL,

Appellants,

-against-

THE DEPOSITORY TRUST AND CLEARING CORPORATION; THE DEPOSITORY TRUST COMPANY; AND THE NATIONAL SECURITIES CLEARING CORPORATION,

Respondents.

Appeal from the Second Judicial District Court, Washoe County, Nevada
Judge Brent Adams, Case No. CV04-01079

BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF APPELLANTS

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I. IDENTITY AND INTEREST OF THE *AMICUS CURIAE*

North American Securities Administrators Association, Inc. (hereinafter, "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. Their jurisdiction extends to the offer and sale of a wide variety of securities, including those traded on the national exchanges, intrastate offerings, and investment scams sold entirely outside the legitimate marketplace. NASAA's members also regulate the activities of a wide variety of securities professionals, including broker-dealers, investment advisers, and the agents of each.

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, offering 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 Respondents' (hereinafter, "Clearing Agencies") misrepresentations, concealment of material information, and market manipulation. 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. This Court and others have recognized the "substantial interest" that each state has in providing remedies for the tortious treatment of its citizens, and this interest is at stake here. *See D'Angelo v.* Gardner, 107 Nev. 704, 722 n.12, 819 P.2d 206, 218 n. 12 (1991) (holding that federal Mine Safety and Health Act did not preempt state law claims of worker injured by

employer's abuse). 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.

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. In this case, 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. 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.

Especially today, as financial frauds of all kinds continue to proliferate, barriers to the courts should be removed, not fortified. In keeping with this outlook, some courts have recognized the need to re-evaluate obstacles to civil actions alleging securities fraud. The California Supreme Court, for example, has cited the troubling increase in corporate fraud as a reason to recalibrate the balance between the interests of investors and the interests of corporations, in favor of providing greater judicial recourse to victims of fraud:

> When Congress enacted the Private Securities Litigation Reform Act of 1995 and the Uniform Standards Act of 1998, it was almost entirely concerned with preventing nonmeritorious suits. (Stout, supra, 38 Ariz. L. Rev. 711). But events since 1998 have changed the perspective. The last few years have seen repeated reports of false financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct. "To open the newspaper today is to receive a daily dose of scandal, from Adelphia to Enron and beyond. Sadly, each of us knows that these newly publicized instances of accounting-related securities fraud are no longer out of the ordinary, save perhaps in scale alone." (Schulman, et al., The Sarbanes-Oxley Act: The Impact on Civil

> Litigation under the Federal Securities Laws from the Plaintiff's Perspective (2002 ALI-ABA Cont. Legal Ed.) p.1.) The victims of the reported frauds, moreover, are often persons who were induced to hold corporate stock by rosy but false financial reports, while others who knew the true state of affairs exercised stock options and sold at inflated prices. (See Purcell, The Enron Bankruptcy and Employer Stock in Retirement Plans, Congressional Research Service (Mar. 11, 2002).) Eliminating barriers that deny redress to actual victims of fraud now assumes an importance equal to that of deterring nonmeritorious suits.

See Small v. Fritz Cos., 65 P.3d 1255, 1263-64 (Cal. 2003) (holding that a person wrongfully induced to hold stock may bring an action for fraud under state common law). For these reasons, NASAA supports the Investors in this appeal and urges the Court to reverse the ruling below.

II. ISSUES PRESENTED FOR REVIEW

1. Whether federal law has occupied the field of securities regulation to the exclusion of state law where (1) state securities regulation was in place and serving the interests of investors decades before the federal securities laws were enacted, (2) state securities statutes and principles of state common law have broad application to modern-day securities transactions, and (3) Congress has repeatedly and expressly preserved state law in the broad field of securities regulation as well as in the specific domain of clearing and settlement of securities transactions on national exchanges.

2. Whether the state law claims asserted by the Investors conflict with federal securities laws or regulations where (1) the state law standards of conduct being invoked are substantially the same as the applicable federal standards, (2) it is not impossible to comply with both the state laws and the federal laws or regulations at issue, and (3) allowing the Investors' claims to proceed will not interfere with Congressional policies and objectives but will in fact advance those policies and objectives.

III. STATEMENT OF THE CASE

As its Statement of the Case, the *Amicus Curiae* incorporates the statement of facts contained in the Respondents' Opening Brief at pages 3-8.

IV. ARGUMENT

A. **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 largely on a finding of field preemption, should be reversed.

1. 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)). Where the field in question is one that states have traditionally occupied, congressional intent to supersede state laws must be "clear and manifest." *Id.* (quoting *Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977)). 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., Jevne v. Superior*

Court, 111 P.3d 954, 964 (Cal. 2005) (noting that because the 1934 Act contains two savings clauses, field preemption is not at issue, but holding that California ethics rules for arbitrators were preempted under a conflicts analysis); *see also Guice v. Charles Schwab & Co.*, 674 N.E.2d 282, 291-92 (N.Y. 1996) (savings clauses have been interpreted as negating field preemption).

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.

2. 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). Kansas passed the first comprehensive securities law in 1911. *Id.* at 34. 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). Among the earliest state securities laws was a Nevada statute passed in 1909 that was "intended to achieve full disclosure in the sale of mining stock." LOSS, SECURITIES REGULATION, at 34. It required every mining company offering its shares publicly to file a sworn statement containing material information about the mining property, the use of offering proceeds, and the anticipated expenditures. *Id.* It also required each stock certificate to bear a legend in specified type-face alerting investors that the shares were "Treasury" or "Promotion Stock." *Id.*[1]

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. Most states have adopted a version of the 1956 Uniform Act. *See* UNIF. SEC. ACT § 101, U.L.A. 1 (1956) (table of adopting

[1] In 1907, Missouri passed an early version of exchange regulation in the form of a statute that outlawed "the keeping of places for dealing in stocks" unless trades were properly documented. LOSS, SECURITIES REGULATION, at 32.

states). A number of states, including Nevada, have adopted a version of the 1985 Uniform Act. *See* NRS Ch. 90; *see also* UNIF. SEC. ACT § 101, U.L.A. 1 (1985) (table of adopting states). The 2002 Uniform Act is in the relatively early stages of consideration in the state legislatures, but it too is gaining adherents. *See* UNIF. SEC. ACT § 101, U.L.A. 1 (2002) (table of adopting states). The three uniform acts are similar, in part because the drafters modeled many of the core provisions on corresponding language in the federal securities laws to promote uniformity and state-federal coordination. The Uniform Act provisions prohibiting fraud and imposing civil liability both reflect this approach. *See* LOSS, SECURITIES REGULATION, at 4134 (UNIF. SEC. ACT § 410(a) of 1956 Act imposing civil liability tracks Section 12 of the Securities Act of 1933); *id.* at 70 (UNIF. SEC. ACT § 101 of the 1956 Act 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, not only with respect to enforcement actions against those who commit fraud and other abuses, but also with respect to regulatory matters. 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 – NRS 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 (describing dollar thresholds distinguishing state licensed and federally licensed investment

advisers).[2] 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.[3]

The states, with the support of NASAA, also play a critical regulatory role in the testing and licensing of the 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 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.

Historically, the states have exercised the authority to register and regulate all securities offerings, whether the securities were nationally issued 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

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[2] Even federally licensed investment advisers must submit notice filings, pay fees, and consent to service of process under the laws of the states in which they transact business. *See* UNIFORM SEC. ACT § 405 (2002); NRS 90.350.

[3] The Investment Advisers Act of 1940 contains no provision for the licensing of investment adviser representatives, whereas all but five states have a licensing regime governing such representatives. *See, e.g.,* Table from IARD, *available at* http://www.iard.com/pdf/rep_fee_sch.pdf.

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 (same); NRS 90.660 (same). 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) (motion to compel arbitration denied in 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.[4] 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 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

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[4] *See* NASAA Member Enforcement Statistics for the 2002/2003, *available at* http://www.nasaa.org/issues___answers/enforcement___legal_activity/1002.cfm.

> 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) (observing that the private cause of action for violations of Section 10(b) and Rule 10b-5 constitutes an "essential tool for enforcement of the 1934 Act's requirements"); *see also* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4137 (3d ed. 1989) (civil liability is an essential adjunct to blue sky law).

As a result of these private and governmental actions, a vast body of judicial and administrative decisions has developed under state law. While state courts and state administrative agencies often consult federal decisions for guidance on securities issues, s*ee, e.g., Payable Accounting Corp. v. McKinley*, 667 P.2d 15, 17 (Utah 1983) (states frequently rely on federal case law in interpreting state securities acts), the reverse is also true. In some respects, state law has 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 U.S. Supreme Court in *Howey* expressly adopted state judicial interpretations of the term "investment contract" as a guide to its meaning under federal law. *Id.*

All of the foregoing factors demonstrate that state law has played a vital role in the evolution of securities regulation and in the ongoing oversight of the securities markets. Thus the notion that federal law has occupied the field of securities regulation is plainly wrong.

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

The prominent role of state law in securities regulation outlined above is fully consistent with Congressional intent as expressed in numerous federal statutes. Far from eliminating state law from the field of securities regulation, Congress has repeatedly and explicitly made clear that state law applies. 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. Moreover, in each instance, Congress was careful to limit and clarify the preemptive reach of federal law with additional savings language. 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 1930's, nor did it limit state common law fraud claims. *Zuri-Invest AG v. Natwest Fin., Inc.,* 177 F. Supp.

189, 193-94 (S.D.N.Y. 2001).[5] 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 securities or securities transactions." 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. 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* 15 U.S.C. § 77p(a) (reiterating 1933 savings clause "except as provided" in the amendments); 77p(d)(1) (preserving certain class actions for fraud under law of state of issuer's incorporation); 77p(d)(2) (preserving class actions by states or subdivisions). Thus, with certain exceptions, Congress has left the field of securities regulation largely open to state statutory and common law.

4. <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* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 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

[5] Even as to the purely regulatory activities addressed in NSMIA, Congress preserved certain state rights. *See* 15 U.S.C. § 77r(c)(2) (states entitled to receive all filings with the SEC, fees, and consent to service of process); 15 U.S.C. § 77r(c)(3) (states entitled to suspend offerings within the state if filings and fees are not submitted).

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 has continued to occupy this central role.[6] 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[7], "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).

The UCC has undergone a series of major revisions since it was first adopted. The most recent update occurred in 1994. These changes reflect the continuing relevance of state law to the regulation of clearance and settlement. The 1994 revisions were "made necessary by the fact that the 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

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[6] The UCC has been adopted by virtually every state, including Nevada. *See* NRS Ch. 104.

[7] While no Nevada cases are on point, courts typically have recognized that the Official Comments of the UCC are "a permissive and persuasive aid in determining legislative intent." *Blue Ridge Bank & Trust Co. v. Hart*, 152 S.W. 3d 420, 430 (Mo. App. 2005); *see also U.S. Nat'l Bank of Or. v. Boge*, 814 P.2d 1082, 1090 (Or. 1991) (recognizing that "the purpose of the Official Comments is to promote uniform construction of the UCC"); *Rad Concepts, Inc. v. Wilks Precision Instrument Co.*, 891 A.2d 1148, 1169 (Md. 2006); *Burchett v. Allied Concord Fin. Corp.*, 396 P.2d 186, 188 (N.M. 1964).

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' Amended Complaint. In fact, one of the Investors' main contentions is that the Clearing Agencies have misrepresented the nature of the SBP as a loan program when in fact it actually entails a transfer of ownership. This in turn gives rise to phantom shares and potential market manipulation. The commentary to the UCC directly supports the Investors' claims in its description of securities lending transactions: "The securities lender does not retain any property interest in the securities that are delivered to the borrower. The transaction is an outright transfer in which the borrower obtains full title." *See* Prefatory Note to UCC, at 18.

While the UCC obviously addresses issues at the very heart of the Investors' case, the drafters nevertheless caution that the UCC is "in no sense a comprehensive codification of the law governing securities or transactions in securities." *See id.* at 10. They go on to note that securities transactions are really governed by a multiplicity of laws, including the "common law of contract and agency, supplemented or supplanted by federal and state regulatory law." *Id.* at 12. This truth eliminates any argument that federal law, even in the specific area of clearing and settlement, has occupied the field of securities regulation to the exclusion of state law.[8]

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.*

[8] The UCC reflects a "conflicts" approach to the variety of laws applicable to clearing and settlement issues. *See* UCC § 8-111 (1994) (rules adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with [the UCC]); *see also* NRS 104.8111 (same). As argued below, of course, there is no clearing agency rule or any other authority that conflicts with the Investors' allegations of fraud, manipulation, and conversion.

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 preempt state claim). Other activities of exchanges, not necessarily related to clearing and settlement, are also traditionally the subject of state law. *See 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).

Federal statutory provisions once again remove any doubt that state law occupies a prominent place in the regulation of the clearing and settlement process. In the 1975 Amendments, Congress actually instituted reverse preemption in favor of the states, granting them plenary authority to adopt laws that differ from the provisions of any SEC rule adopted under the amendments, provided that the states act within two years after the SEC adopts its rule. *See* 15 U.S.C. § 78q-1(f)(3). Congress *also* added a separate savings clause for state laws and enforcement actions as follows:

> Nothing in this section shall be construed to impair the authority of any State banking authority or other State or Federal regulatory authority having jurisdiction over a person registered as a clearing agency, transfer agent, or person associated with a transfer agent, to make and enforce rules governing such person which are not inconsistent with this chapter and the rules and regulation thereunder.

15 U.S.C. § 78q-1(d)(4); s*ee 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). The significant role of state law in the regulation of clearance and settlement, historically and under the modern UCC, lays the Clearing Agencies' field preemption argument entirely to rest.

B. 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.

Although the lower court's ruling is couched in terms of field preemption, a fair reading of the court's Order suggests that the basis for the decision is, at least in part, conflict preemption. *See* Order at 3. However, 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. Accordingly, this aspect of the lower court's ruling also should be reversed.

1. Establishing Conflict Preemption Requires a Showing That Irreconcilable Obligations Are Being Imposed Upon a Party or That Congressional Purposes Are Being Thwarted.

State law may also be preempted to the extent it actually conflicts with federal law. *See Zuri-Invest AG v. Natwest Fin., Inc.,* 177 F. Supp. 2d 189, 195 (S.D.N.Y. 2001). 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." *Id.* (internal quotations and cited authorities omitted).

2. It Is Not Impossible for the Clearing Agencies to Comply Simultaneously With the State Laws Underlying the Amended 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' Amended Complaint. In principle, of course, state laws prohibiting fraud are necessarily in harmony 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 and conversion.

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). The Investors also allege that the Clearing Agencies made these misrepresentations and omissions with scienter and for the purpose of perpetuating the use of the SBP and the revenue stream that it generates. *See, e.g.,* Amended Compl. ¶ 105.

Assuming these allegations of fraud are true, it is difficult to see how such misconduct could have been shielded from the application of state law by Congress, the SEC, or any SRO. 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 federal standards of conduct that relate specifically to clearing agencies easily accommodate the state law standards of conduct being applied in this lawsuit. The 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). As discussed above, the statute incorporates state law standards of conduct by preserving the authority of state regulatory authorities to make and enforce rules governing clearing agencies. *See* 15 U.S.C. § 78q-1(d)(4).

In addition, the SEC's release approving the registration of the Clearing Agencies declares that, at least with respect to safeguarding participant funds and securities, there will be no "unique federal standard of care for registered clearing agencies." 48 Fed. Reg. at 45,179. The release goes on to say that as limited-purpose trust companies, the Clearing Agencies will be "responsible under state or federal law, or both, to protect participants' securities and funds."[9] 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 Amended Complaint. There is no clash between the Investors' state law claims and federal law.

A similar analysis applies to the other allegations in the Amended Complaint. For example, the Investors claim that the Clearing Agencies operate the SBP for a manipulative purpose and with a manipulative effect. *See* Amended Compl. ¶¶ 152, 153. Here again, federal laws and regulations do not permit, let alone require, market manipulation. On the contrary, under federal law, manipulation is a species of fraud prohibited under Section 10(b) of the 1934 Act. *See, e.g., In re Blech Sec. Litig.,* No. 94 Civ. 7696 RWS, 2002 WL 31356498, at *3 (S.D.N.Y. Oct. 17, 2002). The analysis here is only slightly more complex than it is as to representational fraud, because unlawful manipulation may sometimes be comprised of a series of actions that are by themselves lawful. *See id.* at *17 ("[A]n otherwise innocent act if undertaken with an intent to manipulate the market can become a contrivance to accomplish a security fraud."). But this hardly means that the Investors' claims are preempted; rather, it

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[9] This provision in the SEC's release is further proof that state law does indeed apply to the regulation of clearing and settlement operations and that dismissal on grounds of field preemption is inappropriate.

creates issues of fact to be resolved at a later stage of the case. *See id.* (issue of fact is created as to manipulation).

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), an exchange member leased his seat on the exchange to a firm that became delinquent. The firm accrued penalties and those penalties were deducted from proceeds that the plaintiff received upon the sale of his exchange membership. The plaintiff filed a claim against the exchange for failure to suspend the delinquent firm. The court rejected the plaintiff's private right of action under exchange rules, but allowed the common law claims for fraud and breach of fiduciary duty to proceed. *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. In *Guice,* the plaintiffs alleged that disclosure of the order flow payments was inadequate. *Id.* at 284-85. The court explained, however, that the SEC had promulgated and repeatedly amended 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. The court also

rested its decision on a finding that Congress and the SEC had carefully weighed the benefits of order flow payments in terms of promoting efficiency and competition. *Id.* at 289-90. The court concluded that allowing the state law claims would therefore interfere with Congress's policy objectives. *Id.* at 290-91. The instant case is different on both counts: there is no SEC regulation that permits the misconduct presented in the Investors' Amended Complaint, 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.[10]

3. <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.

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[10] A recent case against the New York Stock Exchange and various specialist firms also provides a useful parallel, even though it did not involve conflict preemption. *See In re NYSE Specialist Sec. Litig.,* 405 F. Supp. 2d 281 (S.D.N.Y. 2005). The plaintiffs alleged that the specialists traded ahead of customer orders and that the exchange acted in concert with them. *Id.* at 298. The complaint also alleged that the exchange misrepresented to the public that it was overseeing exchange operations in accordance with the law, in order to conceal the wrongdoing and sustain the fee revenue it derived from the specialists' activities. *Id.* The court dismissed the misrepresentation claims based on lack of standing under the federal fraud statute, but acknowledged that such misrepresentations would otherwise be actionable. *Id.* at 304-05. Specifically, the court held that the misrepresentations could not qualify as legitimate quasi-governmental activities and therefore would not fall within the ambit of the exchange's immunity. *Id.* Similarly in this case, the Clearing Agencies' alleged misrepresentations and manipulations are not legitimate regulatory activities required or permitted by federal law, and they consequently do not fall within the ambit of a conflicts preemption defense.

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* Respondents' Answering Brief, at 1 (Jan. 9, 2006) (NSCC "is responsible for clearing and settling virtually all of the nation's daily equity, corporate, and municipal bond transactions"), and at 8 ("DTC is the nation's principal securities depository"). 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.[11] If changes are adopted, then public investors and companies will benefit from more disclosure about the workings of the system, and the system itself will benefit from whatever regulatory improvements the SEC adopts.[12] None of these outcomes, however, will make the system any less national or centralized.

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[11] The SEC suggests that its recent rulemaking steps, specifically adoption of regulation SHO, support dismissal of the Investors' claims. *See* Brief of the Securities and Exchange Commission, *Amicus Curiae,* on the Issue Presented, at 28-29 (Feb. 2, 2006). Regulation SHO institutes some new measures to help address abuses in short selling and fails to deliver. *See* 69 Fed. Reg. 48,008 (Aug. 6, 2004). However, it can have no impact on this case because it was not in effect during the time period relevant to the Amended 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. In *New York v. Grasso,* 350 F. Supp. 2d 498, 507 (S.D.N.Y. 2004), the New York Attorney General alleged that the NYSE violated state law by paying its CEO excessive compensation based upon conflicts of interest and misinformation. The court held there was no conflict between the duties and prohibitions that the AG sought to enforce and any federal regulatory interest. *Id.* at 507. The court also brushed aside the argument that rules *proposed* by the SEC would in the future exert greater control over internal exchange governance. *Id.* at 506 n.7. The court observed that the agency's future intention to address the problems revealed in the 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. *Id.* Similarly here, the SEC's attempt to address some aspects of abusive short selling through regulation SHO does not bar the Investors' claims.

[12] The harmful effects of naked short selling, including market manipulation, have been the subject of increasing public discourse. The role of the Stock Borrow Program in connection with these abuses has received some attention but is not widely understood. That situation that will undoubtedly change if the Investors prove their claims at trial. *See generally* Helen Avery and Peter Koh, *The Curious Incident of the Shares that Didn't Exist,* EUROMONEY, April 2005

To support their preemption claim, the Clearing Agencies resort to a familiar scare tactic, arguing that unless this lawsuit is dismissed, they will be faced with the impossible task of conforming to the disparate laws of 50 states. *See* Respondents' Answering Brief, at 19 ("to hold otherwise would require Respondents somehow to tailor uniform practices with respect to the SBP to the potentially disparate interpretation of the laws of the 50 states"), and at 20 (litigants could utilize state law around the country to attack the uniform clearing and settlement system).

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), and it more generally preserves the right of the states to impose and enforce varying requirements, provided they do not conflict with the provisions of Section 17A, *see* 15 U.S.C. § 78q-1(d)(4).[13]

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

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(arguing that the SBP has numerous flaws that contribute to manipulative short selling and dilution of shareholder equity).

[13] The Clearing Agencies' dire scenario conflicts with the SEC's own approach to the application of varying state laws to the participants in the clearing and settlement process. The SEC has acknowledged the possibility that different state standards of care may apply to bailees for hire, such as clearing agencies. *See* Standards for the Registration of Clearing Agencies, 45 Fed. Reg. at 41930 (June 23, 1980). The SEC accordingly recommends that clearing agencies adhere to a high standard of care to minimize the risk of liability. *Id.*

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.[14] 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.

Finally, and most important, this lawsuit will serve the cause of investor protection. 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

[14] The SEC takes strong issue with the claim that the SBP creates "artificial securities." *See* Brief of the Securities and Exchange Commission, *Amicus Curiae,* on the Issue Addressed, at 14-17. Rather than supporting dismissal of the case, the SEC's point favors the Investors' contentions in two respects. First, it implicitly concedes the materiality of a factual issue at the heart of the Investors' claims – a factual issue more appropriately addressed in discovery and at trial. Second, it obfuscates the distinction between issued and outstanding shares, and artificial or phantom shares. The SEC argues that the number of securities issued and outstanding is determined solely by the issuer, not by the Stock Borrow Program. *Id.* at 14. This truism does not negate the creation of phantom shares through the operation of the SBP (shares that carry certain entitlements and that lead to dilution and price suppression). The SEC concedes as much in its footnote: "the aggregate number of positions reflected in customer accounts at broker-dealers may in fact be greater than the number of securities issued and outstanding." *Id.* at 16 n. 6.

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.

V. CONCLUSION

For the reasons set forth above, the *Amicus Curiae* respectfully suggests that this Court should, in accordance with the law and the public interest, reverse the lower court's decision to dismiss the Amended Complaint.

DATED this 1st day of May, 2006.

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CERTIFICATE OF COMPLIANCE

I hereby certify that I have read this amicus brief, and to the best of my knowledge, information and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular N.R.A.P. 28(e), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page of the transcript or appendix where the matter relied on is to be found. I understand that I may be subject to sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

DATED this 1st day of May, 2006.

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CERTIFICATE OF SERVICE

I hereby certify that I am an employee with the Bailey❖Merrill, counsel of record for *Amicus Curiae* North American Securities Administrators Association, Inc., and that on the 1st day of May, 2006, a copy of the foregoing Brief of Amicus Curiae in Support of Appellants was served on the parties by sending it via first class mail, postage prepaid and addressed to the following at their last known address:

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