IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
FT. LAUDERDALE DIVISION

IN RE: Elliot S. Simon Debtor.	Cause No. 03-20713-BKC-RBR
Joseph Fishbach, Mae Fishbach, Michael Fishbach, Paul D. Giles, Ruben Hertz, Jacqueline P. Hertz, Nancy J. Rakowsi, Richard Sears, Ohmer Jack Anderson, Opal Anderson, Ohmer Jack Anderson, as Trustee of the Ohmer Jack Anderson Trust, Brian Grothe, Brian Grothe, as Trustee of the Brian Grothe Revocable Trust, Louis Meucci, Herbert Myers and Evelyn Ruben, Evelyn Rubin, as Trustee of the Evelyn Rubin Living Trust, Plaintiffs, vs. Elliot S. Simon, Defendant.	Adv. Pro. No.: 03-2300-BKC-RBR-A

AMICUS CURIAE BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION SUPPORTING THE CONSTITUTIONALITY OF 11U.S.C. § 523(a)(19)

INTRODUCTION

This brief is filed on behalf of the North American Securities Administrators Association (NASAA) in support of the constitutionality of 11 U.S.C. § 523(a)(19).

NASAA will address the policy considerations that led to the enactment of 11 U.S.C. § 523(a)(19).

Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 66 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, Canada, and Mexico. In the United States, NASAA is the voice of the 50 state securities agencies responsible for efficient capital formation and grass-roots investor protection.

NASAA has a particular interest in 11 U.S.C. § 523(a)(19)[1], which was enacted as part of the Sarbanes-Oxley Act of 2002.[2] In connection with the legislative effort to enact Sarbanes-Oxley, state securities regulators strongly supported changing the bankruptcy law to prohibit the discharge of securities fraud judgments. Indeed, in his remarks in introducing the bankruptcy amendment, Senator Leahy noted:

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[1] This section prohibits discharges of debts that arise under claims relating to

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulations or orders issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results, in relation to any claim described in subparagraph (A), from--

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor."

[2] S. 2673 (Public Company Accounting Reform and Investor Protection Act of 2002).

> State securities regulators have indicated their strong support for this change in the bankruptcy law, and I have received letters supporting the passage of this bill from the North American Securities Administrators Association, whose membership includes the securities administrators in all 50 States and Vermont's chief banking and securities regulator. Under current laws, State regulators are often forced to "reprove" their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action. Moreover, settlements may not have the same collateral estoppel effect as judgments obtained through fully litigated legal proceedings. In short, with their resources already stretched to the breaking point, these State regulators have to plow the same ground twice in securities fraud cases. By ensuring securities fraud judgments and settlements in State cases are non-dischargeable, precious state enforcement resources will be preserved and directed at preventing fraud in the first place.[3]

Prior to the enactment of 11 U.S.C. § 523(a)(19), state securities regulators in many cases were required to relitigate fraud cases in bankruptcy court to prevent discharge of restitution judgments they secured for their defrauded citizens. By requiring state regulators to litigate securities fraud cases twice, the bankruptcy law before the enactment of 11 U.S.C. § 523(a)(19) drained the limited enforcement resources of securities regulators. By ensuring securities law judgments and settlements in state cases are non-dischargeable, Congress intended to preserve limited enforcement resources to assist state securities regulators to prevent fraud from its inception. *See Smith v. Gibbons (In Re Gibbons)*, 289 B.R. 588, 592 (Bankr. S.D.N.Y. 2003) (In holding that Section 523

[3] 148 Cong. Rec. S1785-1788 (daily ed. March 12, 2002)(statement of Senator Leahy).

(a)(19) applied to Chapter 7 cases filed prior to its enactment, the Court discussed the legislative history of the Sarbanes-Oxley Act).

LEGISLATIVE HISTORY OF 11 U.S.C. § 523(a)(19)

The Sarbanes-Oxley Act, of which 11 U.S.C. § 523(a)(19) is a part, has been described as a means to "[a]ddress systemic and structural weaknesses ... revealed in ... a breakdown in corporate financial and broker- dealer responsibility."[4] Its stated purpose is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." Pub.L. No. 107-204, 116 Stat. 745 (2002). The various provisions of the Act institute major changes in accounting practices, the oversight of companies, corporate governance and executive responsibility. Section 523 (a)(19) was originally part of the "Corporate and Criminal Fraud Accountability Act of 2002," S. 2010 ("Accountability Act"), which was introduced by Senator Patrick Leahy on March 12, 2002. The purpose of the Accountability Act is:

> To provide for criminal prosecution and enhanced penalties of persons who defraud investors in publicly traded securities or alter or destroy evidence in certain Federal investigations, *to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy,* to protect whistleblowers who report fraud against retaliation by their employers, and for other purposes.[5]

[4] 148 Cong. Rec. S6327 (daily ed. July 8, 2002)(statement of Senator Sarbanes).
[5] S. Rep.107-146, at 2 (emphasis added).

The Accountability Act was incorporated into the Sarbanes-Oxley Act of 2002 by amendment on July 10, 2002.[6]

The Sarbanes-Oxley and Accountability Acts were proposed in the wake of the financial and accounting scandals involving the Enron Corporation that the Congress found seriously eroded investors trust in the nation's securities markets. Congress concluded that this erosion of trust damaged the securities markets and the national economy. One of the purposes of the Accountability Act was to ensure that victims of securities fraud have a fair chance not only to litigate their claims, but also to recover their losses. Accordingly, it was concluded that the ability to discharge securities judgments in bankruptcy was a "loophole in the law that should be closed to help defrauded investors recoup their losses and to hold accountable those who incur debts by violating our securities laws."[7]

Another reason cited for amending the bankruptcy code was to assist state securities regulators to secure recoveries for defrauded investors and to maximize their enforcement resources. It was concluded that the bankruptcy statute "unfairly disadvantaged" state regulators by requiring them "to 're-prove' their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action." Requiring state regulators to "plow the same ground twice in securities fraud cases" was bad public

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[6] Senate Amendment 4185 to S. 2673 (Public Company Accounting Reform and Investor Protection Act of 2002)
[7] S. Rep.107-146, at 10.

policy that 11 U.S.C. § 523 (a)(19) changed.[8] Congress changed the rules of game by taking away from securities violators the procedural hurdles that faced regulators and private litigants in enforcing monetary judgments. See e.g. *Idaho v. McClung (In re McClung)*, 304 B.R. 419 (Bankr. D.Idaho 2004) (The Court held that Congress intended state and federal regulators to be able to enforce the limitation on discharge found in Section 523); *Peterman v. Whitcomb (In re Whitcomb)*, 303 B.R. 806 (Bankr. N.D.Ill. 2004) (The Court excepted from discharge a settlement agreement entered by the debtor for payment of damages in connection with a securities fraud claim filed by a private litigant).

11 U.S.C. § 523 (A)(19) IS A IMPORTANT TOOL IN ACCOMPLISHING CONGRESS'S GOAL TO DETER SECURITIES FRAUD

The securities regulatory scheme in the United States rests on several layers involving federal and state securities regulation as well as private remedies. The federal government through the Securities and Exchange Commission regulates the national markets and prosecutes fraudulent schemes that are interstate in scope. The states through their securities regulators protect investors at the local level by pursuing restitution remedies for their citizens. *See e.g. Idaho v. McClung (In re McClung)*, 304 B.R. at 423-424. The federal and state securities laws also allow individuals who have been defrauded to pursue private remedies. *See e.g.* Florida Statute § 517.301 (Fraudulent Transactions). By making monetary judgments in securities cases non-dischargeable, the bankruptcy amendment, 11 U.S.C. § 523 (a)(19), enhances the

[8] S. Rep.107-146, at 10.

protections afforded by federal and state securities acts. As noted in the Senate Report on the Accountability Act:

> (V)ictims of securities fraud can be thwarted from fair recovery when a debtor, such as Enron, declares bankruptcy. Current bankruptcy law permits wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations. This loophole in the law should be closed to help defrauded investors recoup their losses and to hold accountable those who incur debts by violating our securities laws.[9]

This adversary proceeding is a good example of how individuals can use the state and federal securities laws to recover from a securities violator. This layered enforcement system deters securities violations by taking away the unlawful gains from them. This remedial system, however, would fail if the law did not provide a reasonable opportunity to the victims of securities fraud to recover their losses.

The Sarbanes-Oxley Act intentionally lessens the burdens on federal and state regulators required to preserve their securities fraud judgments. In order to preserve a securities fraud judgment prior to the Sarbanes-Oxley Act, the bankruptcy laws required state or federal securities regulators to show that the debtor had an actual intent to defraud in violating securities acts. *Cf. McCrory v. Spigel (In re Spigel)*, 260 F.3d 27, 32 (1st Cir. 2001).[10] (Although *McCrory v. Spigel* does not involve a securities fraud

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[9] S. Rpt.107-146

[10] "A creditor must show that (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth, (2) the debtor intended to deceive, (3) the debtor intended to induce the creditor to rely upon the false statement, (4) the creditor actually relied upon the misrepresentation, (5) the creditor's reliance was justified, and (6) the reliance upon the false statement caused damage."

judgment, it does involve a state fraud judgment and illustrates the burdens that the preexisting law placed on creditors to preserve a state judgment from discharge under Chapter 7. The Court, however, saw no problem in applying state law in deciding if the state court's judgment preclusively determined whether the debtor committed fraud.). Since regulators generally are not required under federal and state securities fraud statutes to prove the elements of fraud, as set forth in *McCrory*, the securities judgments they obtained were not given preclusive effect. *See e.g. Aaron v. S.E.C.*, 446 U.S. 680, 696 (1980) (In order to prove a violation of securities fraud by misrepresentation or omission of a material fact under the Securities Act of 1933, the Securities and Exchange Commission is not required to prove scienter or an intent to defraud); *Merrill Lynch, Pierce, Fenner & Smith v. Byrne*, 320 So. 2d 436, 440 (Fla. App. 1975) (Proof of scienter is not necessary to prove a violation of the Florida securities fraud statute); *State v. Gunnison*, 618 P. 2d 604, 606-07 (Ariz. 1980) (Under Arizona's securities fraud statute, a party is not required to proved intent to defraud in a case involving a misrepresentation or omission of material fact). In order to preserve their securities fraud judgments prior to the Sarbanes-Oxley Act, regulators were required to litigate in bankruptcy court issues such as reliance and intent to defraud. The amendment to Section 523 removes that burden from regulators who may rely on the preclusive effect of a prior state or federal judgment or consent agreement, whether or not they are based on a finding of intent to defraud.

In excluding securities fraud restitution judgments from discharge under Chapter 7, Congress made the policy decision that securities fraud judgments providing for restitution or disgorgement, whether obtained by a contested proceeding or by agreement, should not be subject to discharge. Congress, therefore, chose to combat securities violations not only by increasing regulatory oversight and criminal penalties, but by eliminating the shelter that the bankruptcy laws had afforded violators. This shelter should not be rebuilt by declaring 11 U.S.C. § 523 (a)(19) unconstitutional.

CONCLUSION

The North American Securities Administrators Association requests that the Court determine that 11 U.S.C. § 523 (a)(19) is constitutional.

I hereby certify that the undersigned attorney is appearing pro hac vice in this matter pursuant to court order dated April , 2004.

Respectfully submitted this 15th day of April, 2004.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Amicus Curiae Brief was served by U.S. Mail this 15th day of April, 2004 to:

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