UNITED STATES DISTRICT COURT
NORTHERN DISTRCT OF TEXAS
DALLAS DIVISION

HENRY MITCHELL, et al.	)	
	)	
Plaintiffs,	)	
	)	
v.	)	**Case No. 3:11-cv-1948-F**
	)	
SECURITIES AMERICAN, INC., et al.	)	
	)	
Defendants.	)	
	)	

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.'S MEMORANDUM IN OPPOSITION TO DEFENDANT'S MOTION FOR TERMPORARAY RESTRATINING ORDER AND PERMANENT INUNCTION TO ENFORCE SETTLEMENT ORDER AGAINST THE MONTANA COMMISSIONER OF SECURITIES AND INSURANCE

The North American Securities Administrator's Association, Inc. ("NASAA)[1] hereby submits this memorandum in opposition to the Defendant's Motion for Temporary Restraining Order and Permanent Injunction.

[1] 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, NASAA 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 that are responsible for regulating securities transactions under state law. Their fundamental mission is protecting investors, and they have broad authority to regulate the offer and sale of securities within their respective jurisdictions. This authority includes the express statutory power to conduct investigations and, where necessary, initiate administrative or civil proceedings designed to punish those who violate the law and deter future misconduct. The authority of state regulators expressly extends to the very types of violative conduct that the defendants have allegedly perpetrated.

I. BACKGROUND

NASAA has previously submitted a brief in the related case, *Billitteri v. Securities America*, Case No. 3:09-cv-01568-F. At that time, there was before the court a similar issue of potential enjoinder of two state enforcement actions under the All-Writs Act, the Montana action at issue and a Massachusetts enforcement action that settled out of court, for an amount that provided full restitution to the residents of that state. However, the issue of a federal court enjoining a state securities commissioner from seeking restitution under state law was never resolved by this Court. Accordingly, NASAA submits this Memorandum in opposition to the Defendants' efforts to prevent the State of Montana from seeking all of the remedies available under its state securities law, and to continue to advocate on behalf of its members for the rightful preservation of their unfettered ability to enforce their respective state securities laws using their full arsenal of statutory remedies, including restitution.

II. ARGUMENT

A. Enjoining Pending State Court Proceedings Would Violate Supreme Court Precedent Preventing Federal District Courts From Invoking The All-Writs Act Where There Is No *In Rem* Jurisdiction.

As NASAA has previously noted in its brief in the *Billiterri v. Securities America* action, U.S. Supreme Court precedent has explicitly and consistently limited the power of Federal Courts to invoke the All Writs Act to only *in rem* actions. *See Kline v. Burke Constr. Co.*, 260 U.S. 226, 229 (1922); *Vendo Co. v. Lektro Vend Corp*., 433 U.S. 623, 641 (1977). The Montana enforcement action and the instant case are clearly separate *in personam* actions that seek to resolve controversies under both state and federal securities laws.

NASAA maintains that the principal case relied upon by the Defendants, *In re Baldwin-United Corp. (Single Premium Deferred Annuities Ins. Litig.),* 770 F.2d 328 (2d Cir. 1985), improperly diverged from U.S. Supreme Court precedent by permitting the enjoinder of a concurrent state court *in personam* proceeding. Several courts still adhere to the traditional rule against enjoining concurrent state *in personam* proceedings. *In re Life Investors Ins. Co.,* 589 F.3d 319 (6th Cir.2009); *Negrete v. Allianz Life Ins. Co*., 523 F.3d 1091 (9th Cir.2008); *In re General Motors Corp.*, 134 F.3d 133 (3d Cir.1998); *Standard Microsystems Corp. v. Texas Instruments, Inc*., 916 F.2d 58 (1 st Cir.1990). NASAA urges this Court to refrain from further exacerbating the *Baldwin* divergence by declining to issue All-Writs Act injunction to a parallel *in personam* state enforcement action.

B. The Instant Case Is Materially Distinguishable From Baldwin.

Despite *Baldwin's* errant divergence from Supreme Court precedent, at best the case stands for the narrow proposition that a federal court can enjoin a parallel state lawsuit only where the court is facing "vexatious and harassing" attacks upon its jurisdiction from parallel lawsuits. *Baldwin*, 770 F.2d at 336-38. The instant case is materially distinguishable from *Baldwin* because the harm contemplated in *Baldwin* stems from future, not pre-existing claims. If this Court grants Securities America's request to extend and expand *Baldwin* to pre-existing state enforcement actions that pose no threat to the court's jurisdiction or judgment, there will be severe consequences for state enforcement proceedings.

1. <u>The harm contemplated in *Baldwin* stems from future, not pre-existing claims.</u>

In *Baldwin*, the court issued an injunction to prevent the "commencing of any [subsequent] action or proceeding" because it was faced with a situation wherein "multiple and harassing actions by the states" were threatened **only after** the majority of the parties in a multi-

district securities action had settled the case. *Baldwin*, 770 F.2d at 331, 337. *Baldwin* did not speak to instances involving an action that commenced prior to settlement of the private action, such as the instant case where Montana filed its complaint on August 4, 2010, well before this Court approved the settlement.

The Montana actions came as no surprise to the parties seeking settlement, as it was always on the table. Moreover, Securities America's opposition to Montana's longstanding effort to obtain restitution is weakened in light of the settlement Securities America recently concluded with the Massachusetts Securities Division. Therefore, because the same harm is not at issue in the instant case, *Baldwin* is not instructive.

2. Expanding *Baldwin* to pre-existing state enforcement actions will have a chilling effect on state securities regulation.

Not only does the Defense improperly rely on *Baldwin,* it uses the attack *Baldwin* was designed to prevent in reverse. Unlike *Baldwin*, the instant case does not involve state court Plaintiffs attempting to thwart a federal settlement, but rather a federal court Defendant trying to attack state regulation. Defendants are fully aware that if this court enjoins the Montana action, the Defendants can limit their liability and prevent further negative publicity. If this Court enjoins the state proceeding presents them with the opportunity to do so, it will undoubtedly result in future defendants facing state enforcement racing to the plaintiffs' bar in search of a settlement to avoid liability.

C. The Settlement Order is Not Res Judicata with Respect to the State's Claim for Restitution.

In addition to arguing that the All Writs Act provides a basis for injunctive relief, the Defendants argue that res judicata provides an additional basis for the remedy they seek. To reach this conclusion, Defendants assert that a class action settlement is res judicata not only

with respect to actions brought by members of the settling class, but also with respect to an action brought by a state. However, the case upon which this assertion rests, *Spitzer v. Applied Card Systems, Inc.*, 894 N.E.2d 1 (N.Y. 2008), was constructed upon a weak foundation, and this Court should decline to build further upon it.

In order to apply res judicata, four requirements must be met: "(1) the parties must be identical in both suits; (2) the prior judgment must have been rendered by a court of competent jurisdiction; (3) there must be a final judgment on the merits; and (4) the same cause of action must be involved in both cases." *Meza v. General Battery Corp*., 908 F.2d 1262, 1265-66 (5th Cir. 1990) (citations omitted). The requirement of identical parties springs from the "fundamental principle of American jurisprudence that a person cannot be bound by a judgment in litigation to which he was not a party." Id., at 1266. However, common law has extended the preclusive effect of res judicata to persons who are in privity to parties to the litigation. Id.

In *Applied Card Systems*, the Court of Appeals of New York held that a class action settlement was res judicata against a non-party, the New York State Attorney General, with respect to the state's claim for restitution for members of the class. 894 N.E.2d at 13. The res judicata analysis ultimately turned on the question of whether the Attorney General was in privity with the settling class members. But, in finding that there was privity, the court struggled to find a basis for its determination:

> Our precedents have repeatedly explained that privity is not susceptible to a hard-and-fast definition…. (T)he term privity does not have a technical and well-defined meaning…. (P)rivity is an amorphous term not susceptible to ease of application…. Although we have provided examples of cases in which privity is present…, none of those are applicable here. Ultimately, we must determine whether the severe consequences of preclusion flowing from a finding of privity strike a fair result under the circumstances.

Id., at 12-13 (citations omitted).

In contrast to this decision, in which the court freely admitted to a lack of precedent finding privity between the government and private plaintiffs, there is much precedent to the contrary. A "well established general principle" is that the state may not be bound by private litigation where the state's action seeks to enforce a "statute that implicates both public and private interests." *Herman v. South Carolina Nat'l Bank*, 140 F.3d 1413, 1425 (11th Cir. 1998); see also *Hathorn v. LoVorn*, 457 U.S. 255, 269 (1982).

In *Minnesota v. Cross Country Bank*, 703 N.W.2d 562, (Minn. Ct. App. 2005), the court expressly recognized the state's interest in restitution. The court said that even when the state seeks specific relief for victims, the state's purpose is not merely to obtain relief for individual victims, but also to vindicate a "quasi-sovereign" interest that "grows out of, but surpasses, the interest of individual citizens." Id. at 569. For similar reasons, the Eleventh Circuit ruled a settlement for a private class action pursuant to ERISA where more than $12 million was compensated to injured parties did not preclude the government from bringing an enforcement action under ERISA which sought restitution and other equitable relief. *Herman v. South Carolina Nat'l Bank*, 140 F.3d 1413, 1424.

In *Meza*, the Fifth Circuit held that privity exists "in just three, narrowly-defined circumstances: (1) where the non-party is the successor in interest to a party's interest in property; (2) where the non-party controlled the prior litigation; and (3) where the non-party's interests were adequately represented by a party to the original suit." 908 F.2d at 1266. The first two of these elements clearly do not apply in the instant case, and the third does not provide grounds for res judicata because the interests of Montana were not adequately represented by the parties to the class action settlement.

In state enforcement actions – particularly those brought to enforce securities laws – regulators are given an array of tools to pursue remedies that promote the general public interest, and restitution is one of those tools. While restitution undoubtedly benefits its direct recipients, a securities regulator has broader interests in mind as well. For example, by seeking full restitution, the regulator can protect future investors by deterring future misconduct and promoting fair and safe markets. Other remedies, such as disgorgement, may not be adequate in all cases. For example, a securities violator may be subject to little disgorgement of "ill-gotten gains" when he profited comparatively little but lost huge sums of investor funds by putting them into speculative investments.

The state's interests are very different from those of the private plaintiff, who seeks to maximize his or her return by factoring in not only the amount of the loss, but also the costs of litigation, the likelihood of success, etc. These private interests are further complicated by the fact that the plaintiff's counsel may have incentives to settle for a relatively small amount. (For a criticism of class action settlements in securities cases, see John C. Coffee, Jr., Reforming Securities Class Action: An Essay on Deterrence and its Implementation, 106 Columbia L.R. 1534 (2006)).

Courts have recognized the broader public interest that is served by restitution. See *CFTC v. Commercial Hedge Services*, 422 F. Supp. 2d at 1057, 1060 (N.D. Neb 2006) ("Full and ample restitution, and other equitable remedies such as disgorgement of profits, serve distinct deterrence functions that are vital to the national interest"); *United States v. Friedman*, 89 F. Supp. 957 (S.D. Iowa 1950) (the state "in seeking restitution" does so "not primarily to benefit the tenant but to discourage violations of the Act and in the public interest to dissipate the inflationary effect of what the parties have done"). Applying the logic of these cases, this Court

should find a lack of privity between the State of Montana and the private claimants who participated in the class settlement because the interests of the private parties are distinct and separate from the broader public interest with respect to restitution.

In the face of these cases, this Court should decline to follow the amorphous test of "a fair result" that was used to find privity in *Applied Card Systems*. Supra. However, even under this fairness standard, this Court should find that there is a lack of privity between the settling claimants and the State of Montana. This is not a case in which the State of Montana sat idly by until fault was determined. The State of Montana filed its action long before the class action reached a settlement, and even voiced its displeasure with the settlement before this Court. Montana was not a party to the case, and it clearly demonstrated that its interests were not aligned with those of the investors who chose to settle. Because Montana had no real opportunity to participate in the settlement, it would be fundamentally unfair for this Court to cut off Montana's action that was pending when the settlement was reached.

It would also be unfair to bar Montana's claims when Massachusetts received full restitution on behalf of Massachusetts investors for the same misconduct. Securities America, which now asserts that Montana should not be allowed to seek additional restitution for Montana investors, entered into a settlement with the Commonwealth of Massachusetts on May 23, 2011. In that settlement, Securities America agreed to pay full restitution to its Massachusetts customers, over and above what had already been agreed to in the class settlement. See Consent Order, *In re: Securities America*, Docket No. 2009-0085, Office of the Secretary of the Commonwealth of Massachusetts, available at http://www.sec.state.ma.us/sct/sctsa/sa_order.pdf.

By granting an injunction as sought by the Defendants, this Court could cause far-reaching consequences that are of particular concern to NASAA and its members throughout the

United States. If a state regulator is precluded from seeking restitution after a settlement has been reached with investors, violators would quickly learn to pursue swift, low-ball settlements with the victims in order to undercut the state's ability to insist on full restitution in matters that are already under investigation by the state. This Court should not enter an injunction against the State of Montana that will be used to encourage this tactic.

CONCLUSION

For the foregoing reasons the Court should deny the Defendants' Motion For A Temporary Restraining Order and Permanent Injuction to Enforce the Settlement Order and allow the State of Montana to pursue all available remedies against the Defendants.

February 10, 2012.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served on the following counsel of record on this 10th day of February, 2012, via electronic mail, first class and on the Court's CM/ECF system:

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