IN THE UTAH COURT OF APPEALS

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| RICHARD W. MACK,<br><br>Plaintiff and Appellee,<br><br>v.<br><br>UTAH DEPARTMENT OF COMMERCE, DIVISION OF SECURITIES,<br><br>Defendant and Appellant, | **AMICUS CURIAE BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**<br><br>Case No. 20070301 |

**APPEAL FROM JUDGMENT**
**ENTERED BY THE THIRD JUDICIAL DISTRICT COURT**
**IN AND FOR SALT LAKE COUNTY,**
**JUDGE JOSPEH C. FRATTO, JR.**

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## INTEREST OF THE *AMICUS CURIAE*

NASAA is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the state 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 the offer and sale of securities.

The members of NASAA are the state securities agencies, including the Utah Department of Commerce, Division of Securities ("Division"), that are responsible for regulating securities transactions and securities professionals under state law. These state securities agencies are charged with the fundamental mission of protecting investors, and their jurisdiction extends to a wide variety of investment products and financial services. Their principal activities include registering certain types of securities; licensing the firms and agents who offer and sell securities or provide investment advice; investigating violations of state law; and initiating enforcement actions where appropriate. Through the licensing of financial companies and individuals who interact with the investing public, state securities regulators protect investors from those who are unfit to serve in the industry.

NASAA supports the work of its members in many ways: coordinating multi-state enforcement actions, conducting training programs, publishing investor education materials, and representing the membership's position, as *amicus curiae*, in significant

cases involving financial services regulation.[1] NASAA also plays a vital role in supporting the states' licensing function. NASAA and the National Association of Securities Dealers ("NASD") developed a centralized system used by states and other regulators to process applications for securities industry licenses. This system, which is jointly operated by NASAA and the NASD, is known as the Central Registration Depository ("CRD"). The CRD system enables state and federal regulators to license broker-dealer firms and their agents electronically. The CRD system is an important component of the state licensing function and makes licensing information widely available to members of the public, permitting them to check background information, disciplinary history, and the licensing status of their brokers, via the web or through contact with state securities regulators.

NASAA and its members have a stake in the outcome of this case because the Court's disposition of the issues will significantly affect the ability of the Division, and other state securities regulators, to protect investors. Specifically, the lower court's refusal to require exhaustion of administrative remedies and its misapplication of res judicata prevent the Division from pursuing administrative sanctions expressly provided by statute. Those remedies are critical to state securities regulators as they police the individuals and companies that call upon public investors to buy and sell securities. For example, through their licensing authority, state securities regulators help ensure that registered representatives have the knowledge and character necessary to assist the public

[1] *See* NASAA's website to view all of NASAA's amicus curiae briefs, *available at* http://www.nasaa.org/issues___answers/enforcement___legal_activity/968.cfm.

in making sound investment decisions. In order to exercise this authority in a meaningful way, states must have not only the discretion to grant licenses, but also the ability to revoke licenses when an individual or company violates the law. The revocation of a securities license for alleged wrongdoing is thus central to the ability of the Division to carry out its statutory mandate to protect the public.

Furthermore, the administrative remedies specified in the Utah Securities Act ("Act"), which include the issuance of cease and desist orders, license revocation, and the imposition of fines, are similar, if not identical, to the administrative remedies found in state securities statutes throughout the United States. Reversal of the lower court's ruling will help ensure that the misapplication of the law by the court below will not adversely influence other courts applying similar provisions in state securities laws.

## ARGUMENT

This case involves an enforcement action properly brought by an administrative agency charged with protecting the citizens of Utah, to address serious violations of the Act. The alleged misconduct by Richard W. Mack ("Mack") poses a threat to the investing public in Utah, and it is critical that this Court reverse the lower court's ruling and preserve the Division's ability to seek all available remedies under the Act.

The Division's action in this case stems from the operation of a ponzi scheme perpetrated by various individuals who cheated Utah investors out of over $2 million. Among the false promises made to the investors victimized by this scheme were assurances of large, guaranteed returns with no risk of loss. While Mack was not directly involved in selling the investments, his allegedly negligent supervision allowed Roy

Hafen ("Hafen"), a broker-dealer agent over whom Mack had supervisory responsibility, to defraud investors.

The Division Director initially filed a civil action for fraud against Mack and others in an effort to obtain injunctive relief exclusively available in civil court. Although the Division was successful in obtaining relief against some of the defendants, the lower court dismissed the Division's action against Mack on purely legal grounds. It held that the allegations of fraud and deceit against Mack could not be sustained, as a matter of law, on the basis of a failure to supervise. *See* Order at 2, ¶1, July 14, 2006. However, the lower court made no findings concerning whether or not Mack had in fact failed to supervise, or whether the allegations in the complaint stated a proper claim for failure to supervise under the Act or the Division's regulations. In the subsequent administrative action, the Division Director alleged different violations by Mack (failure to supervise) and sought different remedies (license revocation and a bar order).[2] Instead of raising his res judicata defense in the administrative action, Mack immediately sought and obtained an injunction from the lower court.

Relying on the doctrine of res judicata, rather than any claims of innocence, Mack asserts the Division is barred by the earlier civil action from taking administrative action against his securities license. However, despite Mack's arguments to the contrary, the

[2] In addition to license revocation, the Division is seeking a permanent bar against Mack to prevent him from associating with a broker-dealer or investment adviser in Utah. This sanction is not only another unique remedy available only from the administrative forum, as discussed further in text, but it also reflects the seriousness of the allegations against Mack in this case.

elements required for the application of res judicata are not present in this case. Moreover, Mack has circumvented the administrative tribunal and failed to exhaust his administrative remedies, in violation of Utah's Administrative Procedures Act ("APA"). Therefore, the Court should vacate the judgment below and allow the administrative action to proceed.

## I. MACK FAILED TO EXHAUST HIS ADMINISTRATIVE REMEDIES AS REQUIRED BY THE ADMINISTRATIVE PROCEDURES ACT AND THEREFORE THE LOWER COURT SHOULD HAVE DISMISSED MACK'S REQUEST FOR INJUNCTIVE RELIEF

As argued more fully below, the lower court's decision on the merits was incorrect because the doctrine of res judicata does not apply in this case. However, this Court does not need to resolve that issue. The lower court committed a fundamental procedural error by failing to dismiss Mack's injunctive action for lack of jurisdiction. Instead of pursuing his res judicata defense in the context of the administrative enforcement action, Mack by-passed the administrative forum and sought immediate injunctive relief from the lower court. Utah law, however, does not permit litigants to short-circuit the administrative process in this fashion.

The APA expressly requires all parties to exhaust their administrative remedies before seeking judicial review of an agency's action. *See* UTAH CODE ANN. § 63-46b-14(2). If a party fails to exhaust those remedies, then a court asked to review an agency proceeding lacks jurisdiction over the controversy and has "no choice but to dismiss it." *See Maverik Country Stores, Inc. v. Industrial Comm'n of Utah,* 860 P. 2d 944, 948 (Utah Ct. App. 1993) (employer failed to exhaust administrative remedies in dispute with

employee). The exhaustion doctrine serves a valuable purpose by allowing "an administrative agency to perform functions within its own special competence—to make a factual record, to apply its expertise, and to correct its own errors so as to moot judicial controversies." *Id.* at 947. The APA contains three exceptions to the exhaustion requirement, but they are sparingly applied. *See Patterson v. Am. Fork City,* 2003 UT 7, ¶17, 67 P. 3d 466 (finding that real estate developer failed to exhaust administrative remedies and observing that where the legislature has imposed a specific exhaustion requirement, the court will enforce it strictly). Judicial review may be obtained before administrative remedies are exhausted only if (1) a statute expressly excuses compliance; (2) administrative remedies are inadequate; or (3) exhaustion would result in irreparable harm disproportionate to the public benefit derived from requiring exhaustion. *See* UTAH CODE ANN. § 63-46b-14(1), (2); *see also Nebeker v. Utah State Tax Comm'n,* 2001 UT 74, ¶14, P. 3d 180 (recognizing "unusual circumstances" in which exhaustion might be obviated on grounds of oppression, injustice, or lack of useful purpose, but finding that interstate trucker nevertheless failed to exhaust administrative remedies in challenge to fuel tax).

In this case, the exhaustion doctrine applies in both letter and spirit, while none of the exceptions excuse Mack's premature resort to the judicial forum. The Utah Securities Act expressly provides that the Division's administrative enforcement proceedings, including those in which licensing sanctions are imposed, are subject to the APA. *See* UTAH CODE ANN. § 61-1-6(1). Under the APA, Mack is not entitled to judicial review of the Division's enforcement proceeding until it is "final," *see id.,* and it will not be final

until the initial hearing and all phases of administrative review have been concluded, *see* UTAH CODE ANN. § 61-1-6(3) (Securities Advisory Board must approve licensing sanctions before they are imposed by Director); UTAH CODE ANN. § 61-1-23 (providing for review of Director's final orders by Executive Director of the Utah Department of Commerce). Instead of allowing the administrative action to proceed, Mack "leap frogged" the administrative process and sought immediate relief for his grievances in court. *See Patterson*, 2003 UT at ¶17. This failure to exhaust remedies precludes judicial review. *Cf. Johnson v. Utah State Ret. Office*, 621 P.2d 1234, 1237 (Utah 1980) (initiation of administrative process and pursuit of all agency review procedures are prerequisites to judicial review); *see also Merrihew v. Salt lake Planning & Zoning Comm'n,* 659 P. 2d 1065, 1067 (Utah 1983) (holding that "where a subsequent dispute addresses legal and factual matters different from those involved in a prior review, an aggrieved person must use established [administrative] procedures rather than resorting to extraordinary [judicial] writs").

Requiring Mack to litigate his defenses in the administrative enforcement action serves the laudable purposes underlying the exhaustion doctrine. Resolving Mack's res judicata defense requires an appreciation of the important distinctions between fraud and failure to supervise, and between injunctive relief and administrative remedies such as license revocation. Any court ultimately asked to review this case will benefit from the record that the Division will develop on these issues and from the expertise that the Division can bring to their resolution. In addition, under the Act, the Division's initial determination on the merits will be subject to administrative appeal, and that process will

help ensure a correct outcome—one that is free from "error" and therefore less likely to generate controversy requiring judicial review. *See* UTAH CODE ANN. § 61-1-6(3) (Securities Advisory Board must approve licensing sanctions); UTAH CODE ANN. § 61-1-23(3) (right to review by Executive Director of the Utah Department of Commerce).

None of the exceptions to the exhaustion requirement are applicable here. There is no statute that suspends Mack's obligation to exhaust his administrative remedies. Furthermore, the administrative remedies available to Mack are more than adequate. The Division has the authority to decide a wide variety of issues and defenses, both legal and factual, including Mack's res judicata argument. *See, e.g.*, UTAH CODE ANN. § 61-1-6(2)(b) (Director is empowered to make findings that persons have "willfully violated or willfully failed to comply with *any* provision" of the Securities Act) (emphasis added); *see also Gunn v. Utah State Ret. Bd.*, 2007 UT App 4, ¶10, 155 P.3d 113 (finding a failure to exhaust administrative remedies in part because nothing in the applicable statute "limit[ed] the agency from interpreting questions of law relating to the legal rights" of the parties). Even the presence of constitutional issues will not excuse a litigant from exhausting his administrative remedies.[3] *See Patterson*, 2003 UT at ¶18 ("We have no reason to believe that the City's administrative procedures were insufficient to resolve Patterson's complaints, including the alleged state constitutional violations").

[3] The lower court's notion that the res judicata defense represents an exception to the exhaustion requirement, *See* Op. at 3, October 30, 2006, has no support whatsoever in the law or as a matter of public policy.

Finally, Mack will not suffer irreparable harm from application of the exhaustion requirement to his claims. He is not currently laboring under any sanctions for his alleged misconduct, and he will not be subject to any sanctions until the administrative hearing is concluded. As a willing member of a highly regulated industry, he suffers no cognizable harm from the Division's perfectly legitimate effort to hold him accountable for serious violations of the Act—violations that are distinct from those raised in the agency's initial civil action. In any event, whatever conceivable harm Mack suffers from application of the exhaustion requirement is far outweighed by the public benefit derived from allowing the Division to proceed with its case. If the Division can prove its allegations against Mack, then it can impose licensing sanctions that will protect the public from further harm. If Mack is able to exonerate himself, then the administrative process will have done its job without further burdening the judicial system.

## II. THE DIVISION'S ADMINISTRATIVE ACTION AGAINST MACK'S SECURITIES LICENSE IS NOT BARRED BY RES JUDICATA AND SHOULD PROCEED

The application of the doctrine of res judicata has the overall effect of binding the outcome of a previous adjudication on a subsequent adjudication and "embraces two distinct branches: claim preclusion and issue preclusion." *Macris & Assocs. v. Neways, Inc.*, 2000 UT 93, ¶ 19, 16 P.3d 1214, *aff'd* 2000 UT 93. Claim preclusion "bars a party from prosecuting in a subsequent action a claim that has been fully litigated previously." *Brigham Young Univ. v. Tremco Consultants, Inc.*, 2005 UT 19, ¶ 26, 110 P.3d 678. Issue preclusion, on the other hand, "'prevents parties or their privies from relitigating

issues which were once adjudicated on the merits and have resulted in a final judgment.'" *Id.* (quoting *Culbertson v. Bd. of County Comm'rs*, 2001 UT 108, ¶13, 44 P.3d 642).

In this case, neither claim preclusion nor issue preclusion applies. The Division Director has brought an administrative proceeding expressly provided for by statute, is seeking relief unobtainable in the prior civil action, and is attempting to litigate new and undecided issues. Therefore, the lower court erred by applying res judicata to the Division's administrative enforcement action, and the Division should be allowed to proceed with its case.

### A. CLAIM PRECLUSION DOES NOT PREVENT THE DIVISION FROM PROCEEDING WITH ITS ADMINISTRATIVE ACTION BECAUSE THE DIVISION'S LICENSING SANCTION CLAIM WAS NEVER SOUGHT IN THE INITIAL CIVIL ACTION AND WAS UNAVAILABLE AS A REMEDY FROM THE DISTRICT COURT.

In order for claim preclusion to restrain a second action from proceeding, "three requirements must be met: (1) the subsequent action must involve the same parties, their privies, or their assigns as the first action, (2) the claim to be barred must have been brought or have been available in the first action, and (3) the first action must have produced a final judgment on the merits." *Brigham Young Univ.*, 2005 UT at ¶26. For claim preclusion to apply, all three of these elements must be met. *Macris*, 2000 UT at ¶20. In this case, the second element is not satisfied because the licensing sanction claim was never brought, nor could it have been brought, in the first civil proceeding.

Initially, pursuant to section 61-1-20 of the Act, the Division Director commenced an action in district court. *See* UTAH CODE ANN. § 61-1-20. The Division Director

stated a cause of action against Mack for *securities fraud* under the Act's antifraud provisions in section 61-1-1(3), seeking an injunction, restitution, fines, and attorney's fees and costs. *See* UTAH CODE ANN. § 61-1-1(3). The Division's action as to Mack was dismissed for failure to state a claim for securities fraud.[4] Later, pursuant to the authority granted in section 61-1-6(1) of the Act, the Division Director commenced an administrative action asserting a licensing sanction claim based on Mack's negligent supervision in violation of section 61-1-6(2)(g) & (j) of the Act and rule R164-6-1g(C)(28). *See* UTAH CODE ANN. § 61-1-6(1). The claim for securities fraud in the civil proceeding is not the same as the supervision claim raised in the subsequent administrative proceeding. Moreover, not only are the claims different, but the Division Director could not have brought the claim for licensing sanctions in the prior district court action.[5] This is a fatal flaw in Mack's argument for claim preclusion in this case.

The civil courts in Utah lack jurisdiction to adjudicate the Division's licensing sanction claim or its request for a bar order against Mack. While district courts in Utah are courts of general jurisdiction, their authority can be constrained by statute, as was

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[4] Of course, because licensing sanctions are exclusively an administrative remedy, Utah would be entitled to seek them against Mack in the administrative action even if the court had ruled *in favor* of the Division on its securities fraud claim against Mack.

[5] The lower court made several errors in its opinion with respect to the application of res judicata. The court erroneously concluded that the district court judge in the injunctive proceeding had the authority to hear any and all claims related to the matter. Further, the lower court erred in stating that the Division had to make a choice to pursue their claims against Mack in *either* an administrative or civil forum. *See* Op. at 3, October 30, 2006.

done in the Act. UT CONST. 1935, ART 8, § 5; *State v. Johnson*, 114 P.2d 1034 (Utah 1941) (the legislature may generally prescribe the methods or means by which the jurisdiction of the courts may be invoked). In section 61-1-20(2)(b), the legislature limited the availability of remedies from a district court, and granted licensing sanction powers solely to the Division Director through administrative actions. Section 61-1-20 of the Act explicitly delineates the forms of relief available to the Division from a district court, and they generally include the issuance of injunctions to halt ongoing violations, disgorgement, and rescission. *See* UTAH CODE ANN. § 61-1-20(2)(b)(i)-(viii). Clearly absent from the civil court's power is the ability to revoke or suspend a securities license or to impose a bar against affiliation with a licensed broker-dealer. The statute does not grant such power to the civil court, and it therefore provides no means for the Division Director to seek a licensing sanction in a civil court action.

Instead, the legislature made the decision to confer this power exclusively upon the Division Director, who possesses the necessary expertise to properly determine the fitness of an individual to maintain a securities license. The Act gives the Division Director the express authority to issue licensing sanctions "by means of an adjudicative process conducted in accordance with the Administrative Procedures Act." UTAH CODE ANN. § 61-1-6(1). These licensing sanctions, which include "denying, suspending, or revoking any securities license," may only be imposed by the Division Director pursuant to a properly adjudicated administrative action, thereby making licensing sanctions exclusively an administrative remedy. UTAH CODE ANN. § 61-1-6(1)(a). As the Division alleged in its administrative action, these licensing sanctions may be imposed

based on findings that a licensee has "engaged in dishonest or unethical practices in the securities business" and has "failed reasonably to supervise his agents or employees." *Id* at §§ 61-1-6(2)(g) & (j); § 61-1-6(1)(a).

Because of this allocation of jurisdiction to separate civil and administrative tribunals, claim preclusion cannot apply in this case. "It is axiomatic that before . . . apply[ing] res judicata to the prior adjudication of a claim, the prior adjudicating tribunal must have had subject matter jurisdiction to adjudicate the claim on its merits." *SMP, Inc. v. Kirkman*, 843 P.2d 531, 533 (Utah Ct. App. 1992). In *SMP, Inc.*, the court held that because the Industrial Commission lacked adjudicative authority to entertain contractual disputes between the parties, claim preclusion would not bar the defendant's later action in circuit court even though it arose out of the same set of facts. Further, because the Industrial Commission was without statutory authority to hear the contract claim, the court noted the defendant was not even under an obligation to raise the contract claim in the first administrative proceeding. *Id.* at 534. Similarly here, the district court had no authority to hear the Division Director's claim for licensing sanctions or a bar order, and the Division could not have sought that relief against Mack. Therefore, claim preclusion does not prevent the Division from bringing its administrative action.

Other courts have also held that plaintiffs should not be precluded from seeking all available relief where plaintiffs are unable to consolidate matters in a single proceeding. In *Waid v. Merrill Area Public Schools*, the plaintiff brought an initial action against school officials for gender discrimination with the state agency charged with enforcing the Wisconsin Fair Employment Act. *Waid v. Merrill Area Public Schools*, 91 F.3d 857

(7th Cir. 1996). The state agency ruled in the plaintiff's favor, and awarded all remedies available to the plaintiff under state law. Seeking additional remedies under federal law, the plaintiff later filed suit against school officials in federal court.

Despite the fact that the plaintiff's claims in both cases arose out of the same set of facts, the court held that the plaintiff's successful pursuit of her state discrimination claims before the state agency did not preclude her from later bringing her federal claims in federal court. In so holding, the court noted that preclusion will occur "only where the plaintiff's choice of fora is really unconstrained. If some of the plaintiff's claims are *exclusively* committed to one forum with limited jurisdiction, she would have to surrender some of her claims by making a choice between the forum with limited jurisdiction and the forum with broader jurisdiction." *Waid*, 91 F.3d at 865. The court did not require the plaintiff to choose among her available remedies or surrender some of her claims. Instead, the court rejected the defendant's claim preclusion argument, and allowed the plaintiff the opportunity to proceed in the forum of limited and exclusive jurisdiction, "without losing the opportunity to later litigate the claims not within that forum's jurisdictional competency." *Id.*

While the proceedings in *Waid* were in reverse order, the principles of the case are equally applicable here. The Division Director brought an action in district court seeking injunctive relief unavailable from the more limited jurisdiction of the administrative forum and later initiated an administrative action to obtain licensing sanctions and a bar order. As in *Waid*, the Division's ability to seek these remedies was constrained by statute and unavailable in a single proceeding. Just as the plaintiff in *Waid* was not

forced to surrender certain claims, the Division should not be required to forego its effort to secure appropriate administrative relief against Mack. Such a result would be inimical to the statutory scheme the Division is charged with enforcing. Claim preclusion, therefore, must not hinder the Division's ability to seek all remedies available.

In *People v. Damon*, the state brought a successful administrative proceeding against an automobile repair dealer and suspended its registration for a three year period. *People v. Damon*, 51 Cal.App.4th 958 (Cal. Ct. App. 1996). Subsequently, the state filed a civil action alleging that the defendants were engaged in unlawful business practices. The state sought injunctive relief, civil penalties, restitution, and costs. The defendant argued that the civil action was barred by res judicata because the first count of the complaint alleged the same misconduct that was the subject of the prior administrative proceeding. In response, the court held that "an adjudicative determination of a claim by an administrative tribunal does not preclude relitigation in another tribunal of the same claim or related claim based on the same transaction if the scheme of remedies permits assertion of the second claim notwithstanding the adjudication of the first claim." *Id.* at 970. The court recognized that the statutory scheme at issue had contemplated proceedings in different tribunals, with each affording different remedies intended to be cumulative and not mutually exclusive. *See Blinder v. Robinson*, 837 F.2d 1099, 1107 (D.C.Cir. 1988), *cert. denied*, 488 U.S. 869 (1988) (where U.S. Securities and Exchange Commission sought injunction in civil court and later brought an administrative action, court determined administrative action did not constitute a "second bite at the apple")

The remedies available to the Division Director are also meant to be cumulative. The Act contemplates proceedings will be brought in both an administrative and civil forum, each having the ability to afford different remedies. The Court in *Damon* recognized that res judicata should not be applied "if the statutory scheme explicitly or implicitly shows a contrary intent." *Damon*, 51 Cal.App.4th at 970. In this case, the Act is explicit: it states that the ability of the Division Director to bring an action in district court to enjoin acts or practices is "*in addition* to any specific powers granted in this chapter." UTAH CODE ANN. § 60-1-20 (emphasis added). This clearly provides that the ability to bring an action for injunctive relief in district court does not preclude or extinguish the Division Director's ability to initiate an administrative action for licensing sanctions—a power "specifically" granted to the Division Director in the Act. Therefore, the application of claim preclusion would be inappropriate and contrary to the Act.

Moreover, it is not sound policy to force the Division to choose among available remedies, none of which by themselves can adequately protect the public. While the doctrine of res judicata serves the important purposes of promoting "finality and stability of judgment and . . . foster[ing] judicial economy by preventing redundant litigation," the Division's administrative action does not compromise the underlying policies of the doctrine. *State v. Ruschetta*, 742 P.2d 114, 116 (Utah Ct. App. 1987); *3D Construction & Development, LLC v. Old Standard Life Insurance Company.*, 2005 UT App 307, ¶21, 117 P.3d 1082 (quoting *Buckner v. Kennard*, 2004 UT 78 at ¶14, 99 P.3d 842) (purposes of res judicata include preventing inconsistent judicial outcomes, promoting judicial economy by preventing relitigation of issues, and protecting litigants from vexatious

litigation.). As explained above, the licensing sanction claims against Mack were never put before the district court, and therefore no judgment on these claims was rendered. Further, the Division's licensing sanction claims could not have been entertained by the district court. Therefore, no inconsistent judgment can possibly result from the administrative action, and judicial economy remains unharmed. In fact, the Division has obeyed the commands and limitations of the statute by first bringing its injunctive action seeking to halt ongoing violations, a remedy only available in civil court, and then pursuing licensing sanctions available exclusively from the administrative tribunal.

Moreover, upholding the lower court's ruling would produce absurd and unintended consequences. Envision a scenario where the Division brings a successful civil action against a defendant for securities fraud and obtains an injunction. If the lower court's application of res judicata under the Act were to be upheld, then resolution of the fraud claim in civil court—favorable or otherwise—would presumably bar the Division from seeking appropriate licensing sanctions in a subsequent administrative proceeding. Such a defendant would retain, notwithstanding a proven history of fraudulent conduct, an unfettered ability to maintain a securities license and solicit the public to invest in securities. Not only would the Division's hands be tied with regard to the imposition of licensing sanctions against the defendant based on the earlier civil action, the Division would be unable to institute a criminal prosecution, despite its statutory authority to do so. *See* UTAH CODE ANN. § 60-1-21.5. Certainly, the lower court did not intend that, as the price for an injunction, criminals would be free from prosecution and individuals who have committed securities fraud would be immune from licensing sanctions. In order to

prevent this result, the Court should vacate the lower court's ruling that res judicata bars the Division's administrative action and permit the Division to pursue all appropriate remedies provided under the Act for the benefit of the investing public.

### B. THE ISSUE ADJUDICATED IN THE FIRST ACTION IS NOT THE SAME AS THE ISSUE PRESENTED IN THE ADMINISTRATIVE ACTION AND THEREFORE COLLATORAL ESTOPPEL DOES NOT PRECLUDE THE DIVISION FROM PROCEEDING WITH ITS ADMINISTRATIVE ACTION

"[I]ssue preclusion, also referred to as collateral estoppel, 'prevents parties or their privies from relitigating issues which were once adjudicated on the merits and have resulted in a final judgment.'" *Brigham Young Univ.*, 2005 UT at ¶27 (quoting *Murdock v. Springfield Mun. Corp.*, 368 Utah Adv. Rep. 9, ¶18. 982 P.2d 65). To invoke collateral estoppel, the party claiming preclusion must establish the following four elements: "(1) The party against whom issue preclusion is asserted must have been a party to or in privity with a party to the prior decision; (2) the issue decided in the prior adjudication must be identical to the one presented in the instant action: (3) the issue in the first action must have been completely, fully, and fairly litigated; and (4) the first suit must have resulted in a final judgment on the merits. *Brigham Young Univ.*, 2005 UT ¶34. "If any one of these requirements is not satisfied, there can be no preclusion." *Zufelt v. Haste, Inc.*, 2006 UT App 326, 142 P.3d 594.

The issue decided by the district court and the issue presented in the administrative action are not identical. In the prior district court action, the court decided the purely legal issue of whether the Division's allegations of failure to supervise could state a claim

for securities fraud under § 61-1-1(3) of the Act. Ruling against the Division, the court dismissed the action for failure to state a claim under Rule 12(b)(6).

The issue presented to the administrative tribunal is whether or not Mack actually failed to supervise, whether such acts and omissions violated sections 61-1-6(2)(g) & (j) of the Act and Utah Admin. Code R164-6-1g(C)(28), and whether licensing sanctions and a bar order are appropriate sanctions for such violations. Those issues have yet to be determined because they were never addressed in the Division's injunctive action. Issue preclusion only prevents parties from using judicial resources to relitigate issues that have *already* been contested and resolved. Consequently, Mack's attempt to assert collateral estoppel fails. *See Career Service Review Bd. v. Utah Department of Corrections*, 942 P.2d 933, 940 (Utah 1997) (rejecting collateral estoppel defense where the issues decided by the Career Services Board were not identical to those before the district court, and holding that "to the extent that the Board did not consider these issues, they cannot be precluded from the district court's determinations in the enforcement action").

While the first district court action did result in a judgment on the merits, "it is axiomatic that a party will be precluded by collateral estoppel from relying on an argument only where the determination as to the argument relied on was essential to the judgment." *Murdock v. UTE Indian Tribe of Uintah and Ouray Reservation*, 975 F.2d 683, 686 (10th Cir. 1992) (holding res judicata precluded plaintiff from relitigating an issue because the Supreme Court addressed and decided the issue). The issue of whether or not Mack actually failed to supervise has never been litigated or resolved. Therefore, a determination of Mack's culpability for failure to supervise was not made, and was not

essential to the final judgment entered by the lower court. Three of the requirements of collateral estoppel cannot be established in this case. As a result, the Division is not collaterally estopped.

From the standpoint of public policy, the courts have recognized that "collateral estoppel can yield an unjust outcome if applied without reasonable consideration and due care." *3D Constr.*, 2005 UT App at ¶22. Precluding an agency from bringing an administrative action to remedy violations of the law, to uphold standards of conduct in a regulated industry, and to protect the public from predatory business practices is not sound policy. The Court should avoid such an outcome and permit the agency to pursue its enforcement action on the merits. *See Brigham Young Univ.*, 2005 UT ¶28 (quoting *Baxter v. Utah Dep't of Transp.*, 705 P.2d 1167, 1169 (Utah 1985)) (parties should be permitted to reach the merits of their controversy).

## CONCLUSION

For the reasons set forth above, NASAA respectfully suggests that the judgment of the court below be reversed.

RAY QUINNEY & NEBEKER P.C.

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July 26, 2007

## CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, postage prepaid, two (2) true and correct copies of the foregoing NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION AMICUS BRIEF this 26th day of July, 2007 to the following:

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