NO. 04-1362

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

JAMES B. ROPP,
Securities Commissioner for the Division of Securities of the State of Delaware Department of Justice,

Appellant,

v.

1717 CAPITAL MANAGEMENT COMPANY, INC.,
A Delaware Corporation,

Appellee.

Appeal From Order and Judgment of the
United States District Court for the District of Delaware,
Civil Action No. 02-1701 (KAJ)

BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF APPELLANT ROPP AND IN SUPPORT OF REVERSAL

Stephen W. Hall, Associate Counsel
Mark Davis, Associate Counsel
North American Securities
Administrators Association, Inc.
10 G Street, N.E., Suite 710
Washington, D.C. 20002
202-737-0900

CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and 29(c), NASAA hereby represents that it has no parent corporation and that there is no publicly held corporation that owns 10% or more of NASAA's stock.

TABLE OF CONTENTS

CORPORATE DISCLOSURE STATEMENT i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

IDENTITY, INTEREST, AND AUTHORITY OF *AMICUS CURIAE*....................1

STATEMENT OF ISSUES 5

SUMMARY OF ARGUMENT 5

ARGUMENT 6

I. The Federal Arbitration Act Does Not Restrict The Long-Standing Authority Of State Securities Regulators To Seek Victim-Specific Relief In Enforcement Actions 6

A. The Federal Arbitration Act Does Not Establish Contract Rights That Override The Authority Of State Securities Regulators To Seek Victim-Specific Relief................................6

B. The Federal Arbitration Act Does Not Preempt The Authority Of State Securities Regulators To Seek Victim-Specific Relief 12

II. The Court Should Overrule *Olde* To Prevent Far-Reaching Harm To Investors 16

CONCLUSION 21

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATIONS, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENT 22

CERTIFICATE OF APPLICATION
FOR ADMISSION TO THE BAR
OF THIS COURT 23

CERTIFICATE OF SERVICE 24

TABLE OF AUTHORITIES

CASES

Department of Fair Employment & Housing v.
Harvest Buick Pontiac GMC, Inc., No. HO23608,
2002 WL 1939172 (Cal. Ct. App. Aug. 21, 2002) 9

Eastern Vanguard Forex, Ltd. v.
Arizona Corporation Commission,
79 P. 3d 86 (Ariz. Ct. App. 2003)..12

EEOC v. Rappaport,
273 F. Supp. 2d 260 (E.D.N.Y. 2003) 7

EEOC v. Waffle House, Inc.,
534 U.S. 279 (2002)...5,7,8,11,13,15

Feigin v. Alexa Group, Ltd.,
19 P.3d 23 (Colo. 2001)..9

General Telephone Co. v. EEOC,
446 U.S. 318 (1980)..8

Hubbard v. Hibbard Brown & Co.,
633 A. 2d 345 (Del. 1993) 17

In re Forex Investment Services Corp.,
No. S-03177A-98-0000, 2000 WL 390498,
(Ariz. Corp. Comm'n Mar. 31, 2000)
(Op. and Order)...20

Olde Discount Corp. v. Tupman,
1 F.3d 202 (3d Cir. 1993)...*Passim*

Prima Paint Corp. v. Flood & Conklin Mfg Co.,
388 U.S. 395 (1967)..6

Ralph's Grocery Co. v. Massie,
No. DO42249, 2004 WL 440467
(Cal. Ct. App. Mar. 11, 2004) 10

Ray v. Atlantic Richfield Co.,
435 U.S. 151, 157 (1978) 12

Rodriguez de Quijas v. Shearson/American Express, Inc.,
490 U.S. 477 (1989) 16

Shearson/American Express, Inc. v. McMahon,
482 U.S. 220 (1987) 16

Shields v. Texas,
27 S.W.3d 267 (Tex. Ct. App. 2000) 9

State v. DeAngelis, 747 A.2d 289
(N.J. Super. Ct. App. Div. 2000) 19

State v. Harris, 362 A.2d 32 (1976) 19

STATUTES

9 U.S.C. §§ 1-16 5

Del. Code Ann. tit. 6 § 7316(a)(7) 8

Del. Code Ann. tit. 6 § 7316(a)(10) 8

Del. Code Ann. tit. 6 § 7320 .... 11, 18

Del. Code Ann. tit. 6 § 7325(b) 10

N.J. Stat. Ann. § 49:3-69(a)(2) 4

Or. Rev. Stat. § 59.255(2)(a) 15

70 Pa. Cons. Stat. Ann. § 1-509(a) 4

Wash. Rev. Code § 21.20.390(4) 15

REGULATIONS

Md. Regs. Code tit. 2 § .02.01.04 19

RULES OF COURT

3d Cir. R. 46.1 23

Fed. R. App. P. 26.1 i

Fed. R. App. P. 29(a) 2

Fed. R. App. P. 29(c) i

Fed. R. App. P. 32(a)(5) 22

Fed. R. App. P. 32(a)(6) 22

Fed. R. App. P. 32(a)(7)(B) 22

Fed. R. App. P. 32(a)(7)(B)(iii) 22

OTHER

Complaint, filed Aug. 11, 2003, *In re Morgan Stanley DW, Inc.*, No. E-2003-35 (Mass. Sec. Div.), available at http://www.state.ma.us/sec/sct/sctpdf/mscmp081103.pdf 20

Motion to Strike Division's Claim for Rescission, filed Mar. 14, 2004, *In re Morgan Stanley DW, Inc.,* No. E-2003-35 (Mass. Sec. Div.) 20

NASD Dispute Resolution Statistics, available at http://www.nasdadr.com/statistics.asp 13, 14

Press Release, *Commission Orders Over $9 Million for Investors Defrauded in Factoring Program, "Investment Club," and Mining Operation,* available at *http://www.ccsd.cc.state.az.us/news_releases/2003/jan23-03.pdf* (Ariz. Corp. Comm'n, Jan. 23, 2003) 17

Press Release, No. 2002-179, *SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices,* available at http://www.sec.gov/news/press/2002-179.htm (SEC, Dec. 20, 2002) 3

Press Release, *Seized Assets Returned to Investors – 9,500 Checks Being Mailed to Victims,* available at http://asc.state.al.us/News/8-19-02IBFT-ChecksReturned.htm (Ala. Sec. Comm'n, Aug. 20, 2002) 18

Press Release, *State Investigation Reveals Mutual Fund Fraud,* available at http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html (Office of New York Attorney General, Sept. 3, 2003) 3

Remarks of NASAA President Ralph Lambiase, Sept. 16, 2003, attached to press release entitled *State Securities Regulators Install New President, Board of Directors,* available at www.nasaa.org under "Top Stories" 14, 17

Wall Street and the States, Wash. Post (July 23, 2003) (editorial) 3

IDENTITY, INTEREST, AND AUTHORITY OF AMICUS CURIAE

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 66 members, including the securities regulators in all 50 states, the District of Columbia, and Puerto Rico.

The members of NASAA are responsible for administering state securities laws and regulations for the purpose of protecting investors from fraud and abuse in securities transactions. Their principal activities include enforcement, licensing of agents, registration of securities, and investor education.

NASAA supports the work of its members in all of these endeavors. For example, it helps coordinate multi-state enforcement actions, conducts training seminars for regulators, publishes investor education materials, and presents the views of its members in testimony before Congress. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

One of the association's core functions is to represent the membership's position, as *amicus curiae,* in significant legal proceedings that may have a

widespread impact upon securities regulators and investors.[1] The lower court's decision in this case is of great concern to NASAA and its members. The district court's ruling, coupled with the Third Circuit's decision in *Olde Discount Corp. v. Tupman,* 1 F.3d 202 (3d Cir. 1993), poses a major threat to the ability of state securities regulators to protect investors from securities law violations and to remediate the financial harm those violations cause. The court has declared that, by virtue of an arbitration agreement between private parties, the Delaware Securities Commissioner ("Commissioner") may not seek restitution, or any other form of victim-specific relief, in an enforcement action initiated to redress violations of the Delaware Securities Act. *See* Mem. Op. at A-5, A-10. As explained in more detail below, victim-specific remedies such as restitution and rescission are powerful tools that state securities regulators have used for decades not only to help make injured investors whole, but also to deter future violations and to vindicate the larger public interest in seeing justice done. Eliminating those remedies seriously undermines investor protection.

Because arbitration agreements between investors and securities firms are now commonplace in the securities industry, the rule embodied in the lower court decision and in *Olde* threatens to restrict the availability of restitution in a

---

[1]Pursuant to Fed. R. App. 29(a), NASAA states that all parties to this appeal have consented to the filing of this brief.

significant number of cases. That number is likely to grow, for two reasons. First, over the last several years, there has been a marked rise in the incidence of securities law violations by established Wall Street brokerage firms and mutual funds, where arbitration agreements are the norm. *See, e.g.,* Press Release, No. 2002-179, *SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices,* available at http://www.sec.gov/news/press/2002-179.htm (SEC, Dec. 20, 2002); *see also* Press Release, *State Investigation Reveals Mutual Fund Fraud,* available at http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html (Office of New York Attorney General, Sept. 3, 2003). Those violations have had an adverse impact on millions of investors nationwide. Given this trend, it is an inopportune time to limit the enforcement powers of securities regulators. As the Washington Post observed:

> [T]he recent problems in the securities markets have involved the absence of adequate enforcement, not the burden of too much regulation. And whatever the right balance may be between the SEC and the states, diminishing state officials' power . . . is the wrong way to go, at the wrong time.

Wall Street and the States, Wash. Post (July 23, 2003) (editorial).

The *Olde* decision and the district court's adherence to it are worrisome for a second reason. There is nothing to prevent the most shameless con artists, peddling the worst kind of off-market investment scams, from writing arbitration clauses into their documents once they realize the benefits of the rule in *Olde.*

Absent a reversal in this case, those promoters will increasingly resort to arbitration clauses as a handy shield against claims for restitution by regulators. Such claims often provide investors with the only realistic hope of recovering any portion of their losses.

The lower court's decision has the most immediate impact on the efforts of the Delaware Securities Commissioner to obtain restitution in this and future cases. However, the threat extends beyond Delaware to New Jersey and Pennsylvania, the other states in the Third Circuit. Those states, like Delaware, have explicit statutory authority to seek restitution in enforcement actions. *See* N.J. Stat. Ann. § 49:3-69(a)(2); 70 Pa. Cons. Stat. Ann. § 1-509(a). To the extent the rule enunciated below and in *Olde* remains viable in this Circuit, those states are also likely to face successful challenges from securities law violators who would prefer not to compensate their victims. And to the extent the ruling gains currency in other circuits, state securities regulators across the country – all of them NASAA members – face the loss of these powerful remedial sanctions.[2] The harm to investors is potentially enormous. For these reasons, NASAA and its members have a strong interest in the outcome of this case.

---

[2] As discussed below, a major brokerage firm has recently invoked *Olde* to challenge a claim for rescission made by the Massachusetts Securities Division in an important enforcement action. *See* Motion to Strike Division's Claim for Rescission, filed Aug. 11, 2003, *In re Morgan Stanley DW, Inc.,* No. 2003-53 (Mass. Sec. Div.), discussed *infra* at 20.

STATEMENT OF ISSUES

Whether an arbitration agreement between a firm and an investor bars a state securities regulator from seeking restitution for the investor, where the regulator is independently authorized by statute to seek such relief, where the regulator is not a party to the arbitration agreement, and where the regulator is acting in the public interest.

Whether the Federal Arbitration Act preempts the authority of a state securities regulator to seek victim-specific relief, where there is no conflict in principle or in practice between the goals of the FAA and the state law authorizing such relief.

SUMMARY OF ARGUMENT

The lower court's ruling should be reversed on three grounds. First, the Supreme Court's decision in *EEOC v. Waffle House, Inc.,* 534 U.S. 279 (2002), makes abundantly clear that an arbitration agreement between private parties does not preclude a government agency, which is not a party to the agreement, from seeking duly authorized victim-specific relief in an enforcement action. Second, the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, does not preempt Delaware's authority under state law to seek victim-specific relief because there is no actual conflict, in principle or in practice, between government enforcement actions where such relief is sought and the policies underlying the FAA. Third and

finally, the district court's ruling deprives state securities regulators of an enormously important tool for restoring losses to investors, deterring violations of the securities laws, and effecting justice.

ARGUMENT

I. The Federal Arbitration Act Does Not Restrict The Long-Standing Authority Of State Securities Regulators To Seek Victim-Specific Relief In Enforcement Actions

A. The Federal Arbitration Act Does Not Establish Contract Rights That Override The Authority Of State Securities Regulators To Seek Victim-Specific Relief

The Delaware Securities Commissioner is not precluded from pursuing victim-specific relief in his enforcement action for the simple reason that he was never a party to the arbitration agreement at issue. Decades of jurisprudence under the Federal Arbitration Act have established that "the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, *but not more so*." *See, e.g., Prima Paint Corp. v. Flood & Conklin Mfg Co.,* 388 U.S. 395, 404 n.12 (1967) (emphasis added) (arbitration clause is subject to challenge on traditional contract theory of fraud in the inducement). Accordingly, the FAA does not exempt arbitration agreements from the well-established principles that govern all contracts.

Relying on those fundamental principles, the U.S. Supreme Court has squarely rejected the claim that a government agency with statutory enforcement

powers is precluded from seeking victim-specific relief by virtue of an arbitration agreement to which it is not a party. In *EEOC v. Waffle House, Inc.,* 534 U.S. 279 (2002), the Court held that an arbitration agreement between an employer and an employee did not preclude the EEOC from seeking victim-specific relief (including backpay and damages) on behalf of the employee for the employer's violations of the Americans With Disabilities Act. In its opinion, the Court first emphasized that the FAA was not intended to restrict a nonparty's choice of forum:

> [I]t is the language of the contract that defines the scope of disputes subject to arbitration . . . . For nothing in the [FAA] authorizes a court to compel arbitration of any issues, or by any parties, that are not already covered in the agreement. The FAA does not mention enforcement by public agencies; it ensures the enforceability of private agreements to arbitrate, but otherwise does not purport to place any restrictions on a nonparty's choice of a judicial forum.

Id. at 289. The Court then applied these principles to hold that the arbitration agreement did not bar the EEOC's enforcement action because the EEOC was not a party to the agreement:

> No one asserts that the EEOC is a party to the [arbitration] contract, or that it agreed to arbitrate its claims. It goes without saying that a contract cannot bind a nonparty. Accordingly, the proarbitration policies of the FAA do not require the agency to relinquish its statutory authority if it has not agreed to do so.

Id. at 294; *see also EEOC v. Rappaport,* 273 F. Supp. 2d 260 (E.D.N.Y. 2003) (relying on *Waffle House* to hold EEOC not subject to arbitration agreement); *Olde*

Discount Corp. v. Tupman, 1 F.3d 202, 218 (3d Cir. 1993) (Nygaard, J., dissenting).

The same analysis applies here. The Delaware Securities Commissioner was never a party to the arbitration agreement between 1717 Capital Management Company, Inc. ("1717") and its clients, the Shaffers. Accordingly, notwithstanding the proarbitration policies of the FAA, that agreement cannot limit the Commissioner's otherwise unquestioned statutory authority to seek victim-specific relief against 1717 for violations of the Delaware Securities Act.[3]

Nor is there any basis in this case for the argument that the Commissioner is merely a surrogate or agent for the Shaffers and therefore bound by their arbitration agreement. The Supreme Court in *Waffle House* disposed of a similar claim, holding that the EEOC seeks to "vindicate a public interest, not simply provide make-whole relief for the employee, *even when it pursues entirely victim-specific relief*." 534 U.S. at 295-96 (emphasis added); c*f. General Telephone Co. v. EEOC,* 446 U.S. 318 (1980) (EEOC not required to comply with Rule 23 class certification requirements because agency is not merely a proxy for the victims of discrimination and its enforcement actions are not representative).

---

[3] The violations at issue in this case are dishonest and unethical practices, under Del. Code Ann. tit. 6 § 7316(a)(7), and failure reasonably to supervise an agent, under Del. Code Ann. tit. 6 § 7316(a)(10), all in connection with the Shaffers' brokerage account at 1717.

State appellate courts also have consistently rejected the "surrogate" argument. For example, the Colorado Supreme Court held that injured investors could not intervene in an enforcement action brought by the Colorado Securities Commissioner under the Colorado Securities Act, reasoning that the Commissioner's claims for restitution were not derived from the investors' claims and did not make the Commissioner a fiduciary or agent for those investors. *See Feigin v. Alexa Group, Ltd.,* 19 P.3d 23 (Colo. 2001). The court explained that the Commissioner's discretion to claim damages on behalf of defrauded investors was supportive of his enforcement role, not derivative of investors' rights. *Id.* at 29-30.

In *Shields v. Texas,* 27 S.W.3d 267 (Tex. Ct. App. 2000), the Texas Court of Appeals held that the statute of limitations governing private claims under the Texas Securities Act did not apply to the state's enforcement action seeking restitution under the Act, because that action was "an exercise of the legislature's police power to constrain the conduct of securities dealers for the public's protection," as distinguished from a private suit. *Id.* at 275. With respect to the State's claim for restitution, the court held as follows:

> The fact that the money the State recovers benefits individual investors does not in any way alter the character of the suit as one to enforce the state's securities laws. We therefore hold that the State acted in its sovereign capacity in suing for restitution . . . .

Id.; see also Department of Fair Employment & Housing v. Harvest Buick Pontiac GMC, Inc., No. HO23608, 2002 WL 1939172 (Cal. Ct. App. Aug. 21, 2002)

(arbitration agreement did not preclude state agency from seeking damages against employer for discrimination). *But cf. Ralph's Grocery Co. v. Massie,* No. DO42249, 2004 WL 440467 (Cal. Ct. App. Mar. 11, 2004) (misconstruing *Waffle House* and holding that state employment agency stood in shoes of private claimant and was therefore barred by arbitration agreement from pursuing administrative proceeding).

It is clear that the Commissioner in this case was discharging his public duty to enforce the Delaware Securities Act, not acting as a proxy for the Shaffers, even though he sought restitution. As the dissent in *Olde* explained, the authority for the Commissioner's enforcement action and the purposes it serves under Delaware law are distinct from those underlying a private claim. Judge Nygaard stated that "[T]he Commissioner is not a surrogate for a plaintiff's attorney, but is a public official who administers the state's blue sky laws 'in the public interest . . . . '" *Olde,* 1 F.3d at 217. The Judge added that "the Commissioner's authority to sue and seek remedies exists independently of a plaintiff's right to sue and thus is not derivative of the Engelhardt's rights." *Id.* at 218.

Support for this conclusion is found in the Delaware Securities Act itself. The Act provides that the Commissioner may order restitution or other relief "which the Commissioner determines to be in the public interest." *See* Del. Code Ann. tit. 6 § 7325(b). Similarly, the Act provides that restitution and other

ancillary relief may be sought from a court "as may be appropriate in the public interest." *Id.* at § 7320. These provisions are typical under state securities law.

The fact that the Commissioner seeks restitution in this case for the benefit of only one 1717 client does not change the result. In *Waffle House,* the EEOC sought backpay and damages for only one complainant, but the Supreme Court rejected the notion that the agency was acting as a surrogate. *See* 534 U.S. at 283-84. This stands to reason: the number of investors injured in a given case, or the number who choose to come forward, has no logical bearing on the fundamental nature of the government's enforcement action or the remedies sought.[4]

In short, the Commissioner was not a party to the arbitration agreement between 1717 and the Shaffers, and the Commissioner filed its enforcement action against 1717 in furtherance of its public duty, not as a surrogate for the Shaffers. For these reasons, the Court should hold that there is no contractual impediment under the FAA to the Commissioner's request for victim-specific relief.

[4] The Supreme Court did suggest in *Waffle House* that the degree of control exerted by a complainant over the agency's enforcement action *might* alter the analysis – if for example, the complainant could dictate the prayer for relief or even determine whether the government could proceed at all. *See* 534 U.S. at 291. There is certainly no evidence to suggest that the Shaffers controlled the Commissioner's enforcement action in this case, and under state securities laws generally, injured investors do not exert that type of influence.

B. <u>The Federal Arbitration Act Does Not Preempt The Authority Of State Securities Regulators To Seek Victim-Specific Relief</u>

The FAA does not preempt the Commissioner's statutory authority to seek restitution from those who violate the state's securities laws. As a threshold matter, any party claiming preemption bears the burden of overcoming the assumption that a federal law does not supersede the historic police powers of the states. *See Eastern Vanguard Forex, Ltd. V. Arizona Corporation Commission,* 79 P. 3d 86, 92 (Ariz. Ct. App. 2003) (Commodity Exchange Act does not preempt authority of state securities regulator to take enforcement action against off-exchange foreign currency trader) (citing *Ray v. Atlantic Richfield Co.,* 435 U.S. 151, 157 (1978)). That burden has not been met in this case, nor was it met in *Olde.*

It is clear that the FAA "contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration," much less the entire field of securities regulation. *See Olde,* 1 F.3d 202, 216 (Rosenn, J., concurring). The third form of preemption, conflict preemption, is also absent in this case, because in principle and in practice, Delaware's statutory restitution authority does not actually conflict with the FAA.

First, of course, the Delaware Securities Act does not expressly deal with arbitration, and it certainly has never prohibited the Shaffers from commencing an arbitration proceeding against 1717. In addition, as the authorities discussed above

make clear, *supra* at 8-11, the state's enforcement action and the Shaffers' arbitration claim serve fundamentally distinct purposes, the former aimed at protecting the public and serving justice, the latter aimed at strictly personal recovery.

The claims and remedies available through a state enforcement action and a private arbitration proceeding also differ. State enforcement actions can only be brought for violations of the state's securities act; arbitration actions brought by individuals may encompass other claims, such as breach of contract. And, depending on the parties' agreement, private claimants may seek forms of relief, such as punitive damages, that they could not receive through a state action for restitution. *See* NASD Dispute Resolution Statistics, available at http://www.nasdadr.com/statistics.asp (showing $30 million in punitive damages awarded in 2003 through NASD arbitrations).

On a more practical level, government claims for restitution do not undermine the arbitration process. The Court in *Waffle House* concluded that allowing the EEOC to seek victim-specific relief even where employees had agreed to binding arbitration would have a "negligible effect on the federal policy favoring arbitration." 534 U.S. at 290 n.7. It drew this inference because the EEOC files suit in a small percentage of the cases where complainants have filed charges. *Id.* Similarly, the number of enforcement actions filed by state securities

regulators is small relative to the number of complaints they receive, and many of those enforcement actions do not involve investors with arbitration agreements. *See* Remarks of NASAA President Ralph Lambiase, at 5, Sept. 16, 2003, attached to press release entitled *State Securities Regulators Install New President, Board of Directors,* available at www.nasaa.org under "Top Stories" (12,500 complaints v. 2,500 actions in 2001/2002). At the same time, investors are filing record numbers of arbitration proceedings. *See* NASD Dispute Resolution Statistics, available at http://www.nasdadr.com/statistics.asp (showing 7,704 arbitration cases filed in 2002 and 8,945 in 2003).

Even when regulators do file actions and seek restitution for the benefit of those who have been defrauded, the resulting conflict with arbitration is illusory. The unstated and faulty premise of the *Olde* decision is that state enforcement actions for restitution invariably displace arbitration claims. The notion seems to be that, "but for" the state's action, investors would assuredly arbitrate their claims.

There is no basis for this assumption generally, or in the record of this case. It is more reasonable to conclude that many individuals who suffer financial loss from violations of the securities laws are unwilling or unable to pursue their claims in arbitration. The time, burden, and expense of arbitration can discourage investors. And arbitration is unlikely to be pursued if the investor's losses, although significant, are still not large enough to justify the expense and

inconvenience of the process. In practical terms, enforcement actions for restitution do not stifle arbitration; rather they provide remedial benefits where there would otherwise be none.[5]

The preemption rationale in *Olde* also leads to plainly unreasonable consequences. If a securities firm can prevent a regulator from seeking restitution because restitution impairs the right to arbitration, then the firm can presumably stop the enforcement action altogether. After all, any enforcement action might lead to findings of violations, and those findings, so it goes, are solely within the province of the arbitrator under *Olde*. The Supreme Court in *Waffle House* voiced exactly this concern with the following rhetorical observation: "[I]f the federal policy favoring arbitration trumps the plain language of Title VII and the contract, the EEOC should be barred from pursuing *any* claim outside the arbitral forum." 534 U.S. at 295 (emphasis added). Fortunately, the Court was unwilling to adopt a rule leading to this extreme result. *Id.* The dissent in *Olde* expressed a similar concern, noting that under the rationale in *Olde*, private parties could also contract away the regulator's right to seek an injunction. *Olde*, 1 F.3d at 217 (Nygaard, J.,

---

[5] Support for this argument can be found in some state securities statutes. In Oregon and Washington, the state securities regulator may seek *damages,* in addition to restitution, for injured investors, and the court may award those forms of relief if it finds that private civil action by investors "would be so burdensome or expensive as to be impractical." *See* Or. Rev. Stat. § 59.255(2)(a); Wash. Rev. Code § 21.20.390(4).

dissenting).[6] Congress clearly did not intend these results when it passed the FAA, and any interpretation of the law permitting them should be rejected.

For all of the foregoing reasons, the Court should overrule its decision in *Olde* and hold that the FAA does not prevent the Commissioner, on either preemption or contract grounds, from seeking restitution.[7]

II. The Court Should Overrule *Olde* To Prevent Far-Reaching Harm To Investors

Preserving the right of state securities regulators to seek restitution for victims of securities fraud, regardless of the existence of arbitration agreements, is critically important for the protection of investors. In the vast majority of states (including all three states in the Third Circuit), the securities regulator has the explicit statutory authority to seek restitution or rescission through civil injunctive proceedings, administrative actions, or both.[8] State securities regulators routinely

---

[6] The rationale of *Olde* produces other absurd results. For example, investors could cite *Olde* for the proposition that heavy fines, insolvency proceedings, or even incarceration of a defendant under state law all would be preempted insofar as those measures would incapacitate the defendant and thereby deprive investors of a meaningful opportunity to have their claims heard in arbitration.

[7] Reversing *Olde* will create no conflict with the Supreme Court precedents holding that securities claims under the federal securities laws (the 1933 and 1934 Acts) are subject to arbitration. Those cases involved private claimants who were parties to arbitration agreements, rather than non-party governmental authorities seeking to vindicate the public interest. *See Rodriguez de Quijas v. Shearson/American Express, Inc.* 490 U.S. 477 (1989); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

[8] States with the statutory authority to seek restitution or rescission in either civil or administrative proceedings include Alabama, Alaska, Arizona, California,

exercise this authority to seek victim-specific relief. *See, e.g., Hubbard v. Hibbard Brown & Co.,* 633 A. 2d 345, 348, 354 (Del. 1993) (affirming $48,000 in restitution against broker-dealer in enforcement action); Press Release, *"Commission Orders Over $9 Million for Investors Defrauded in Factoring Program, 'Investment Club,' and Mining Operation,* available at *http://www.ccsd.cc.state.az.us/news_releases/2003/jan23-03.pdf* (Ariz. Corp. Comm'n Jan. 23, 2003).

Restitution serves the public interest in many ways, both direct and indirect. First, of course, it offers the remedial benefit of restoring to investors the money they have lost through a wrongdoer's illegal conduct. Every year, state securities regulators recover a substantial amount of restitution for the benefit of investors. For example, statistics compiled by NASAA show that for 2001/2002, state securities regulators obtained orders for $309 million in restitution. *See* Remarks of NASAA President Ralph Lambiase, at 5, Sept. 16, 2003, attached to press release entitled *State Securities Regulators Install New President, Board of Directors,* available at www.nasaa.org under "Top Stories."

Colorado, Connecticut, Delaware, D.C., Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, Pennsylvania, South Dakota, Texas, Utah, Vermont, Virginia, Washington, and Wyoming.

Although not inherently punitive, restitution sought by a regulator also acts as a laudable deterrent by instilling in potential wrongdoers the knowledge that they may be forced to make their victims whole. While the threat of private claims by individual investors furthers this interest, the specter of an enforcement action by a regulator seeking restitution for the benefit of all victims of a violation undoubtedly intensifies the deterrent effect.

Restitution in enforcement actions also promotes basic fairness. In many cases, especially where a large-scale securities fraud has been perpetrated, the wrongdoer will not have sufficient assets to make full restitution to all victims. The authority of a regulator to seek restitution on behalf of all investors helps ensure that any recovery is distributed proportionately among the investors, not on the basis of a race to the courthouse – or arbitration forum – by individual claimants. *See, e.g.,* Press Release, *Seized Assets Returned to Investors – 9,500 Checks Being Mailed to Victims,* available at http://asc.state.al.us/News/8-19-02IBFT-ChecksReturned.htm (Ala. Sec. Comm'n, Aug. 20, 2002) ("pro rata distribution" of $1.8 million). Statutory provisions for receiverships, which are common under state securities laws, are intended to help accomplish this orderly and fair distribution of assets to those who have been victimized. *See, e.g.,* Del. Code Ann. tit. 6 § 7320 (Commissioner may seek appointment of a receiver or conservator, along with restitution and rescission, in civil injunctive actions).

Restitution at the insistence of the government serves the public interest in yet another way. It has a rehabilitative effect on the wrongdoer. The New Jersey Appellate Division aptly described the benefit to society in these terms:

> [R]estitution has an understandable logic. It is directly related to the offense and the attitude of the offender. There is a reality involved: society does not sanction fraud or other forms of theft; it does not approve injury inflicted upon an innocent person. Society wants to make sure the offender realizes the enormity of his conduct, and it asks him to demonstrate this by making amends to the individual most affected by the defendant's depredations.

See State v. DeAngelis, 747 A.2d 289, 293 (N.J. Super. Ct. App. Div. 2000) (quoting *State v. Harris,* 362 A.2d 32 (1976)). The court held that in light of these important societal considerations, the defendant could not alter the government's restitution order through a separate agreement with his victims. *See id.* Although *DeAngelis* was a criminal prosecution for securities fraud, the court's observations about the inherent value of restitution also apply to civil enforcement actions. State securities laws and regulations reflect this rehabilitative aspect of restitution, by stipulating that when determining the appropriate amount of a fine, securities regulators should consider the level of restitution the violator has made. *See, e.g.,* Md. Regs. Code tit. 2 § .02.01.04. In all of the foregoing ways, restitution obtained by regulators serves the larger public interest, as well as investors' interests, and it should be preserved as a remedy separate and distinct from private arbitration claims.

The threat to restitution under the *Olde* decision is real, not only within the Third Circuit but in other jurisdictions as well. In a number of enforcement actions, respondents have challenged the authority of state securities regulators to seek restitution or rescission, relying specifically on the *Olde* decision. For example, the Massachusetts Securities Division has filed an administrative action against Morgan Stanley alleging that the firm engaged in high-pressure, fraudulent sales practices to promote its proprietary mutual fund products over external funds. *See* Complaint, filed Aug. 11, 2003, *In re Morgan Stanley DW, Inc.,* No. E-2003-53 (Mass. Sec. Div.), available on the website for the Massachusetts Securities Division at http://www.state.ma.us/sec/sct/sctpdf/mscmp081103.pdf). Among the relief requested is rescission for all Massachusetts investors who purchased Morgan Stanley mutual fund products in the relevant time period. *Id.* at 29.

Relying principally on this Court's decision in *Olde*, Morgan Stanley has moved to strike the Division's claim for rescission. *See* Morgan Stanley's Motion to Strike Division's Claim for Rescission, filed Mar. 15, 2004, *In re Morgan Stanley DW, Inc.,* No. E-2003-53 (Mass. Sec. Div.). That motion is pending, but if granted, it will strike a terrible blow not only against the Massachusetts investors who lost money in that case, but also against the ability of state securities regulators to protect future investors. *See also In re Forex Investment Services Corp.,* No. S-03177A-98-0000, 2000 WL 390498, at *7 (Ariz. Corp. Comm'n Mar.

31, 2000) (Op. and Order) (respondent relied upon *Olde* to challenge agency's claim for restitution, although entire arbitration clause was deemed invalid).

These cases highlight the need to overrule the decision in *Olde* so that investors will continue to receive the full measure of protection allowed under the nation's state securities laws.

CONCLUSION

For the reasons set forth above, this Court's decision in *Olde* should be overruled and the district court's ruling in this case should be reversed.

Respectfully submitted,

____

Stephen W. Hall, Associate Counsel
Mark Davis, Associate Counsel
North American Securities
Administrators Association, Inc.
10 G Street, N.E., Suite 710
Washington, D.C. 20002
(202) 737-0900

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATIONS, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 4,906 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Word 2000 in font size 14 and in Times New Roman type style.

____
Stephen W. Hall
Counsel for *Amicus Curiae*
North American Securities
Administrators Association, Inc.

CERTIFICATE OF APPLICATION FOR ADMISSION TO THE BAR OF THIS COURT

Pursuant to 3d Cir. R. 46.1, the undersigned hereby certifies that he has filed an application for admission to the bar of this Court, and that the application has been submitted with the foregoing brief and with an accompanying Notice of Appearance.

____

Stephen W. Hall
Counsel for *Amicus Curiae*
North American Securities
Administrators Association, Inc.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 15th day of April, 2004, two copies of the foregoing brief of *amicus curiae* North American Securities Administrators Association, Inc., were served by next day delivery service, on each of the following persons, at the following addresses:

Peter O. Jamison, III
Deputy Attorney General
Department of Justice
State Office Building, 5th Floor
820 N. French Street
Wilmington, DE 19801
Counsel for Appellant

Henry E. Gallagher, Jr.
Connolly, Bove, Lodge & Hutz, LLP
The Nemours Building
1007 North Orange Street
P.O. Box 2207
Wilmington, DE 29899
Counsel for Appellee

____
Stephen W. Hall
Counsel for *Amicus Curiae*
North American Securities
Administrators Association, Inc.