Supreme Court, New York County, Index No. 401720/2005

State of New York
Court of Appeals

PEOPLE OF THE STATE OF NEW YORK BY ERIC T. SCHNEIDERMAN,
ATTORNEY GENERAL OF THE STATE OF NEW YORK,

Plaintiff-Respondent,

v.

MAURICE R. GREENBERG and HOWARD I. SMITH,

Defendants-Appellants.

BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF PLAINTIFF-RESPONDENT

ANNE-VALERIE MIRKO
General Counsel

NORTH AMERICAN SECURITIES
ADMINISTRATORS ASSOCIATION, INC.
750 First Street, NE, Suite 1140
Washington, D.C. 20002
Tel.: (202) 737-0900
Fax: (202) 783-3571 (fax)

Counsel for *amicus curiae*

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DISCLOSURE STATEMENT PURSUANT TO RULE 500.1(f)

In compliance with Rule 500.1(f) of the Rules of Practice for the Court of Appeals of the State of New York, the North American Securities Administrators Association, Inc. ("NASAA") states that it is a non-profit corporation located in and organized under the laws of the District of Columbia. It does not have a parent entity and does not have any subsidiaries or affiliates.

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<u>IDENTITY AND INTEREST OF *AMICUS CURIAE*</u>

Formed in 1919, the North American Securities Administrators Association, Inc. ("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. The Office of the Attorney General is the member from the State of New York.

The U.S. members of NASAA are the state agencies responsible for administering state securities laws, commonly known as "Blue Sky Laws." *See generally* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 31-34 (3d ed. 1989). Ultimately, NASAA's mission, and the mission of its members, is to protect investors from fraud and abuse.

NASAA and all of its U.S. members have an interest in this case because the Defendants seek a ruling that the New York Attorney General is preempted by federal law from pursuing an enforcement action that includes claims for equitable relief including disgorgement. Such a ruling would substantially narrow the states' traditional antifraud authority in a way that Congress did not intend. The decision below should be upheld to preserve the states' ability to pursue remedies designed to protect investors by deterring misconduct in the securities marketplace and forcing wrongdoers to forgo their ill-gotten gains.

NASAA supports the work of its members by promulgating model rules and providing training opportunities for state regulatory personnel. NASAA frequently represents the interests of its members in the federal legislative and rulemaking processes by offering testimony in Congress and submitting comment letters to the Securities and Exchange Commission ("SEC") and other regulatory agencies. NASAA also coordinates multi-state enforcement actions in which state regulators exercise their broad antifraud authority to eradicate dishonest practices originating not just in local communities but at large firms with a national scope, serving clients across all U.S. jurisdictions. Drawing from this experience, NASAA offers its legal analysis and policy perspective to state and federal courts as *amicus curiae* in significant enforcement actions and other cases involving the interpretation of the securities laws and the rights of investors.

This case has enormous significance for NASAA members for two reasons. First, it is critical that this Court preserve the right of the New York Attorney General to deter serious fraudulent practices and not allow fraudsters to retain the funds gained by their fraud. NASAA members support the efforts of the New York Attorney General to combat fraud and protect the integrity of the securities markets because each state has a legitimate interest in discouraging anyone—including a powerful business executive—from engaging in fraudulent conduct.

Second, this case has important implications for state securities regulators and investors on a broader level. As explained below, state securities regulators often look to the courts' equitable powers when seeking disgorgement of ill-gotten gains or enjoining fraudulent conduct, and these remedies are vital weapons in the regulatory arsenal. By asserting a strained interpretation of federal law and preemption, the Defendants attempt to eliminate one of the states' most effective tools for deterring future misconduct. The states' historic role in policing national securities offerings for fraud is at risk in this appeal, and such a dramatic restriction of the states' authority cannot be reconciled with Congress's language and intent.

State regulators play a vital role in policing the securities markets, a role which Congress allowed to continue unhindered after the passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), the National Securities Markets Improvement Act of 1996 ("NSMIA"), and the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). While Congress has preempted certain aspects of state registration requirements, Congress has consistently acknowledged the importance of state securities regulators and has explicitly preserved their antifraud authority. The Defendants-Appellants' arguments should be rejected by this Court because they are wholly without merit and contrary to the plain language of the applicable statutes and the legislative history behind them.

Preserving state power as Congress intended is vital, not only in this case, but for the sake of promoting investor confidence in our securities markets.

QUESTION PRESENTED

Whether the Attorney General's authority to obtain equitable remedies, including disgorgement and injunctive relief in this enforcement action under the Martin Act and Executive Law § 63(12) is preserved rather than preempted by two federal statutes that (a) preclude certain private securities class actions under state law and (b) preempt certain state-law securities registration requirements, but expressly preserve state officials' longstanding authority to enforce state securities fraud statutes.

STATEMENT OF THE CASE

NASAA relies upon the Statement of the Case provided by the New York Attorney General in the Brief for Respondent.

ARGUMENT

The Defendants argue that the civil enforcement action brought against them by the New York Attorney General is preempted by federal law because the defendants have settled similar allegations with the SEC. Joint Br. for Defs.-Appellants, at 69. They further assert that the action is impliedly preempted by a supposed interplay between NSMIA, the PSLRA, and SLUSA. *Id.*, at 69-72. The Defendants' arguments rest on a fundamental misunderstanding of the complementary state-federal regulatory structure in the United States and, more specifically, the role of state securities regulators in pursuing enforcement actions. The clear, unambiguous language of these statutes *preserves*, not preempts, state enforcement authority, including the authority of the New York Attorney General to seek disgorgement and injunctive relief in an enforcement action against the Defendants for alleged violations of state law.

I. The Authority of State Securities Regulators to Bring Enforcement Actions to Protect Investors and Maintain the Integrity of the Capital Markets was Preserved by NSMIA.

To understand the impact of NSMIA and the later changes brought about by the PSLRA and SLUSA, it is important to understand the historic role of the states in regulating securities. Governmental regulation of securities began in 1911 at the state level, not the federal level, when Kansas became the first state to adopt a blue sky law. *See* Rick A. Fleming, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, 50 WASHBURN L.J. 583 (2011). The law was intended to place the offer and sale of securities under "rigid governmental control" for the protection of investors. *State v. Short*, 247 P. 114, 116 (Kan. 1926). Nearly every state soon followed suit, including New York, which adopted the Martin Act in 1921. *CPC Int'l, Inc. v. McKesson Corp.*, 120 A.D. 2d 221, 234 (N.Y. App. Div. 1986). Like other blue sky laws, the purpose of the Martin Act is to "protect the public by curbing abuses in the offer and sale of securities and commodities in and from New York." *Id.*

A. NSMIA Preserved State Antifraud Authority While Selectively Preempting Certain Registration and Licensing Requirements.

In general, blue sky laws build upon three fundamental rules. *See* LOUIS LOSS JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION ch. 1.B.4 (4th ed. 2012); *see also* Fleming, 50 WASHBURN L.J. 583, 601. First, before securities can be sold, they must be properly registered with the government or qualify for an exemption from registration. *See* Uniform Securities Act (1956) § 301; Uniform Securities Act (2002) § 301.[1] The registration process requires the filing of detailed offering materials designed to provide full disclosure to investors of the terms and risks of the offering.[2] Second, a person selling securities (a "broker-dealer") or giving advice concerning securities (an "investment adviser") must be properly licensed, thereby subjecting the licensed person to ethical rules and a full panoply of regulatory requirements. *See* Uniform Securities Act (1956) § 201; Uniform Securities Act (2002) §§ 401 & 403. Third, a person is prohibited from engaging in fraudulent or deceptive conduct in connection with a transaction in securities, which may involve either affirmative misrepresentations or omissions of

[1] 28 states have adopted versions of the Uniform Securities Act of 1956, while 17 states have adopted versions of the Uniform Securities Act of 2002. *See* 12A Blue Sky Law § 12:1 (Nov. 2015).

[2] New York's Martin Act is distinctive among state blue sky laws because it does not impose registration requirements for securities offerings, except in limited circumstances not relevant here.

material fact. *See* Uniform Securities Act (1956) § 101; Uniform Securities Act (2002) § 501. NSMIA preserved antifraud authority while only selectively preempting state oversight in the registration of securities and the licensing of firms and individuals.

As background, with respect to the first fundamental rule, states took two different philosophical approaches to the registration requirements. LOUIS LOSS, SECURITIES REGULATION 36-37 (1st ed. 1951); Uniform Securities Act (2002) § 306(a)(7), Official Comment #8. Some states, known as "disclosure" states, granted registration to any security, regardless of whether it was offered on fair terms or was otherwise equitable, provided that accurate and adequate information was made available to the public so that each investor could make an informed investment decision. *Id.* Other states, known as "merit" states, required the disclosure of all material risks to investors but retained the authority to deny registration if a securities offering was deemed unfair to investors. *Id.* These competing philosophies led to disparities in the registration requirements of different states. *See* Kenneth I. Denos, Blue and Gray Skies: *The National Securities Markets Improvement Act of 1996 Makes the Case for Uniformity in State Securities Law*, 1997 UTAH L. REV. 101, 110 (1997). Furthermore, when the federal government began to regulate the sale of securities in 1933, Congress chose to follow the model of disclosure regulation. LOUIS LOSS, JOEL SELIGMAN, AND TROY PAREDES, SECURITIES REGULATION, at ch. 1.G. (4th ed. 2012).

Critics complained that the varying registration requirements were unduly burdensome and made it too difficult to conduct nationwide securities offerings. They sought relief in the form of federal legislation that would streamline state and federal regulatory requirements for nationwide securities offerings. *See, e.g.*, Brian J. Fahrney, *State Blue Sky Laws: A Stronger Case for Federal Pre-Emption Due to Increasing Internationalization of Securities Markets*, 86 NW. U. L. REV. 753 (1992). The result was the passage of NSMIA in 1996.

The Congressional intent underlying NSMIA is clear. Congress was primarily focused upon solving the problem of a patchwork of varying state securities registration requirements—especially merit standards—as applied to nationwide offerings. S. REP. NO. 104-293 at 5 (1996) ("This 'crazy quilt' of regulation has made registration of mutual fund shares unnecessarily cumbersome"); *see also* LOUIS LOSS, JOEL SELIGMAN, AND TROY PAREDES, SECURITIES REGULATION, at 1.B.4.c.ii. (4th ed. 2012) ("In the period before enactment of [NSMIA], the wisdom of merit standards emerged as the leading policy debate concerning state securities regulation."). Toward this end, Congress amended Section 18 of the Securities Act of 1933, 15 U.S.C. § 77r, to preclude state registration of any "covered security." National Securities Markets

Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 § 102 (1996). A covered security was defined to include securities sold on national stock exchanges, securities issued by investment companies (i.e., mutual fund shares), and securities sold in certain offerings that are exempt from federal registration requirements. *Id.*

While NSMIA made significant changes in the regulation of securities offerings, it had a far smaller impact on the regulation of securities professionals such as broker-dealers and investment advisers. Congress preempted some of the state-level regulations governing broker-dealers, including certain requirements related to record-keeping and the use of margin. Congress, however, ensured that states retained their full authority to license broker-dealers and regulate their sales practices. *Id.* at § 103.

B. NSMIA's Broad Savings Clause Expressly Retained State Antifraud Authority.

NSMIA had even less impact on the states' ability to police fraud. Denos, 1997 UTAH L. REV. 101, 131 ("The preservation of state police power to prosecute fraud, regardless of the size of the transaction, remains one of the last vestiges of state authority unhindered by the NSMIA"). NSMIA included a broad savings clause that expressly retained state-level authority to institute enforcement proceedings for fraudulent or deceptive conduct:

(c) PRESERVATION OF AUTHORITY. –

> (1) FRAUD AUTHORITY. – Consistent with this section, the securities commission (or any agency or office performing like functions) of any state shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.

15 U.S.C § 77r, as adopted in NSMIA § 102.

The plain language of NSMIA makes it clear that the Act does not preempt an enforcement action by the New York Attorney General that is based upon fraud or deceit, regardless of the state law remedies that are sought. When the text of a statute is unambiguous, "judicial inquiry is complete," and there is no need to look beyond the language for interpretive guidance. *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (internal citations omitted).

Despite the plain language of the savings clause, the Defendants argue that the New York Attorney General's enforcement action against them will obstruct Congressional intent to establish national standards for the securities markets. Joint Br. for Defs.-Appellants, at. 69-72. However, the legislative history of NSMIA confirms its plain language and shows an unmistakable intent on the part of Congress to permit this type of enforcement action.

The legislative history of NSMIA reveals that Congress was well aware of the states' important role in combating fraud and clearly intended to preserve their enforcement authority. The Congressional record accompanying the passage of NSMIA repeatedly affirmed this goal:

- "The Committee intends to **preserve** the ability of the States to investigate and bring enforcement actions under the laws of their own State with respect to fraud and deceit." H.R. REP. NO. 104-622, at 34 (1996) (emphasis added).

- "It is also the Committee's intention **not to alter**, limit, expand, or otherwise affect in any way any State statutory or common law with respect to fraud and deceit . . . ." *Id.* at 34 (emphasis added).

- "The Managers have preserved the authority of the states to protect investors through application of state antifraud laws. This preservation of authority is intended to permit state securities regulators to **continue to exercise** their police power to prevent fraud and broker-dealer sales practice abuses . . . ." H.R. CONF. REP. NO. 104-864, at 40 (1996) (emphasis added).

C. Pursuant to the Savings Clause in NSMIA, State Antifraud Cases Have Provided Important Investor Remedies and Protections.

Consistent with the savings clause in Section 18(c), states have continued to bring significant antifraud cases, including those involving securities sold on national exchanges. For example, the states and their federal counterparts discovered in 2002 that research analysts at the country's leading investment banking firms issued inflated stock ratings in order to attract and retain lucrative underwriting business from the companies rated by the firms' analysts. After a coordinated state and federal investigation, ten of the country's largest investment banks consented to what has come to be known as the "global settlement," resolving claims for fraud and other misconduct in connection with their false and misleading analyst reports. *See* Joint Press Release, SEC, NASD, NYSE, and

NASAA, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003).[3]

Another dramatic example of the states' contribution to investor protection occurred in 2003, when the New York Attorney General uncovered two widespread trading schemes in the mutual fund industry. Mutual funds allowed favored companies and individuals to engage in practices known as "late trading" and "market timing" to the detriment of average citizens holding mutual fund shares and in contravention of prospectus language disavowing such practices. New York first brought an enforcement action under the Martin Act and Executive Law § 63(12) against a hedge fund known as Canary Capital Partners, LLC, and it resulted in a settlement that included restitution payments of $30 million for the benefit of injured investors and a fine of $10 million. *See* State of New York v. Canary Capital Partners, LLC, Complaint, at 41-43 (Sept. 3, 2003)[4]; *see also* Press Release, Office of New York State Attorney General, State Investigation Reveals Mutual Fund Fraud (Sept. 3, 2003).[5] Then, New York's continuing investigation exposed similar misconduct at other mutual funds and triggered a wave of enforcement actions by federal and state regulators. *See*, *e.g.*, Press Release, SEC,

[3] *Available at* https://www.sec.gov/news/press/2003-54.htm
[4] *Available at* http://www.sec.gov/news/speech/2006/spch050906cc.htm.
[5] *Available at* http://www.ag.ny.gov/press-release/state-investigation-reveals-mutual-fund-fraud.

Prudential to Pay $600 Million in Global Settlement of Fraud Charges in Connection With Deceptive Market Timing of Mutual Funds (Aug. 28, 2006).[6]

A third example of state-level policing of the securities markets occurred after the collapse of the market for auction rate securities in 2008. Wall Street firms had assured investors that the securities were safe and liquid—calling these securities "cash equivalents"—despite warning signs known to the firms. When the market collapsed and liquidity froze, thousands of investors were left without access to the money they needed and expected to be readily available to purchase homes, make tuition payments, and in some instances pay employees. As complaints to the states increased, state regulators formed a multi-state task force to investigate whether the nation's most prominent brokerage firms had misled investors. *See* NASAA Auction Rate Securities Information Center, *available at* http://www.nasaa.org/regulatory-activity/enforcement-legal-activity/auction-rate-securities-information-center/. In the end, twelve firms were ordered to repay more than $61 billion to harmed investors. *Id.*

These multistate cases—the research analyst conflict of interest cases, the mutual fund market timing cases, and the auction rate securities cases—were national in their scope and illustrate the value of collaborative state enforcement work in addressing large scale misconduct in the securities markets. In these cases

[6] *Available at* http://www.sec.gov/news/press/2006/2006-145.htm.

alone, billions of dollars have been returned to investors. Such results would not have been possible had Congress preempted state authority as suggested by the Defendants. Moreover, the SEC would not be able to fill the enforcement gap if states were preempted because "[f]ederal regulators are unable to cope with all the enforcement that needs to be done." Richard B. Smith, *A New Uniform Securities Act,* 6 No. 9 WALLSTREETLAWYER.COM: SEC. ELEC. AGE 8, at 2 (2003).

Fortunately, when Congress adopted NSMIA, it preserved the enforcement authority of state securities regulators. Its intent is evidenced in both the plain language of the Act and its legislative history. The very heading of Section 18(c) makes the Congressional intent crystal clear—the "*preservation*" of state antifraud authority—and states have relied upon this preservation of authority to carry out important work on behalf of investors. This Court should categorically reject any argument that NSMIA somehow places limits on the authority of states to bring enforcement actions that are grounded upon fraud or deceit.

II. SLUSA Did Not Alter the Role of State Securities Regulators or Limit Their Ability to Pursue Enforcement Actions.

Two years after the passage of NSMIA, Congress adopted SLUSA as part of an effort to reform private securities litigation, but did so in a way that maintained the significant role of state securities regulators. Like NSMIA, the text of SLUSA and the legislative record express a clear Congressional intent to preserve state enforcement authority.

A. The PSLRA and SLUSA Share the Common Goal of Lessening Abusive Private Class Action Lawsuits.

As a predecessor to SLUSA, Congress passed the PSLRA to reduce the risk that companies would be sued in abusive private class action lawsuits for making forward-looking statements about their future prospects. Statement on Signing the Securities Litigation Uniform Standards Act of 1998, 2 PUB. PAPERS 2247 (Nov. 3, 1998). These companies had been subjected to "strike suits," the purpose of which was "to extract a sizeable settlement from companies that are forced to settle, regardless of the lack of merits of the suit, simply to avoid the potentially bankrupting expense of litigating." H.R. REP. NO. 105-803 at 13 (1998) (Conf. Rep.). The reforms adopted in the PSLRA were designed to allow companies to "provide the public with valuable information about their prospects, thus benefiting investors by enabling them to make wiser decisions." 2 PUB. PAPERS p. 2247 (Nov. 3, 1998) (statement of President William J. Clinton).

The formal Congressional findings contained in Section 2 of SLUSA indicate the reasons Congress adopted it so soon after the PSLRA:

> Sec. 2. FINDINGS. The Congress finds that –
>
> (1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;
>
> (2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;
>
> (3) this shift has prevented that Act from fully achieving its objectives.

Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227 (1998). Members of the Conference Committee on Senate Bill 1260 ("S. 1260"), the bill enacted as SLUSA, were explicit in explaining the need for SLUSA. The goal of the legislation, according to Congressman Mike Oxley, was "preventing lawyers from using securities class actions filed in State court for their personal gains." 144 CONG. REC. H10779 (1998). Congressman Christopher Cox alleged that "[t]rial lawyers, using professional plaintiffs, were filing class action lawsuits against publicly traded companies alleging fraud, often with no more evidence than a drop in the price of these companies' stock." 144 CONG. REC. H10781 (1998). Similarly, Congressman Billy Tauzin characterized the strike suits that were being brought in state court to avoid the PSLRA as "shakedown lawsuits" and complained that "no grandmother ever got a dime out of this, just the unscrupulous trial lawyers who brought these kinds of lawsuits." 144 CONG. REC. H10786 (1998).

From the Congressional record, it is clear that Congress adopted the PSLRA to prevent unscrupulous private plaintiffs and their attorneys from profiting through meritless class action litigation and adopted SLUSA to prevent an end run around the PSLRA through state-level class actions. Congress was focused on reigning in the activities of *private actors, not public officials*, and nothing in the Congressional record indicates any concern with litigation by government officials.

On the contrary, the legislative history shows a deliberate choice by Congress to preserve state enforcement authority.

Senator Chris Dodd, a sponsor of S. 1260, explained during its introduction that "[t]he legislation does not affect any State enforcement action, whether civil or criminal. State regulators retain their full authority to bring enforcement actions in any venue allowed under State law." 143 CONG. REC. S10477 (1997). He went on to "emphasize what the bill does not do: ...***it does not impact [] State regulators***." *Id.* (emphasis added).

B. SLUSA's Savings Clause Preserves State Authority.

S. 1260 was later amended, and the final version of the bill made the Congressional intent explicit. In addition to the three formal Congressional findings in Section 2 of SLUSA as set forth above, the findings contain two statements that reveal what the legislation was *not* intended to change:

> (4) **State securities regulation is of continuing importance**, together with Federal regulation of securities to protect investors and promote strong financial markets; and
>
> (5) In order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, **while preserving the appropriate enforcement powers of State securities regulators** and not changing the current treatment of individual lawsuits.

Pub. L. No. 105-353, § 2 (emphasis added). For these reasons, Congress expressly preserved state enforcement authority by inserting a "savings clause" in SLUSA, as codified in subsection 16(e) of the Securities Act of 1933 and subsection 28(f)(4) of the Securities Exchange Act of 1934. 15 U.S.C. §§ 77p & 78bb. These sections, both entitled "Preservation of State Authority," contain identical language: "The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions." *Id.* As explained by Congressman Tauzin, the bill was carefully designed to make sure that "States themselves and our own Securities Exchange Commission can still exercise its authority to prevent abuses of fraud in securities trading in America." 144 CONG. REC. H10786 (1998).[7]

III. <u>The New York Attorney General's Action is not Preempted by NSMIA or SLUSA.</u>

Under the Supremacy Clause of the Constitution, federal law displaces state law where (1) Congress expressly preempts state law; (2) Congress establishes a comprehensive regulatory regime over an entire field; or (3) state law "directly conflicts with federal law or interferes with the achievement of federal objectives." *Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F.Supp.2d 189, 191 (S.D.N.Y. 2001) (internal citations omitted). However, there remains a presumption against

[7] Interestingly, in a separate section of SLUSA, Congress demonstrated an intent to *enhance* state enforcement authority in multi-state cases, not restrict it. Section 102 of SLUSA directs the Securities and Exchange Commission to encourage state regulators to provide for reciprocal enforcement of out-of-state subpoenas issued by other state securities regulators. Pub. L. No. 105-353, 112 Stat. 3227 (1998).

preemption. "In the interest of avoiding unintended encroachment on the authority of the States ... a court interpreting a federal statute pertaining to a subject traditionally governed by state law will be reluctant to find pre-emption." *Id.* at 191-92 (quoting *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 663-64 (1993)). To overcome the presumption that federal law does not preempt a state's police powers, a party must show that preemption was the "clear and manifest purpose of Congress." *Id.* at 192 (internal citations omitted).

In the instant case, the Defendants continue to assert that the Attorney General's action is expressly preempted by SLUSA to the extent that the Attorney General seeks "disgorgement as a proxy for money damages on behalf of the AIG investors that NYAG previously claimed to represent." Joint Br. for Def's-Appellants at 72 n.34. The Defendants also argue that the action is impliedly preempted because it conflicts with NSMIA, SLUSA, and the PSLRA, or that it interferes with the objectives sought by those acts. The Defendants do not assert a field preemption argument. [8]

[8] Field preemption requires the extraordinary showing that the federal scheme of regulation is "so pervasive as to make reasonable the inference that Congress left no room for the State to supplement it," or that the federal statute in question "touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." *See Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F. Supp. 2d 189, 195 (S.D.N.Y. 2001) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 219 (1947)). Few statutes have been held to preempt state regulation entirely, and "[i]t is well-settled that federal law does not enjoy complete preemptive force in the field of securities." *Zuri-Invest AG*, 177 F. Supp. 2d at 195; *see also Jevne v. Superior Court*, 111 P.3d 954, 964 (Cal. 2005) (noting that because the 1934 Act contains two savings clauses, field preemption is not at issue).

A. The New York Attorney General's Action Is Not Expressly Preempted by SLUSA.

The Defendant's argue that the New York Attorney General is precluded[9] from pursuing its state law antifraud claims because of the following section of SLUSA:

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging –
>
> (1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

Pub. L. No. 105-353, § 101 (codified at 15 U.S.C. § 77p(b)).

The Defendants stretch the plain statutory language of SLUSA beyond its breaking point to essentially argue that the action brought by the New York Attorney General is a covered "class action" by a "private party." They also strain plain language in an attempt to convince the Court that the action does not qualify for the express savings clause in SLUSA that preserves state jurisdiction "under the laws of such State to investigate and bring enforcement actions." Pub. L. No. 105-353, § 101 (codified at 15 U.S.C. § 77p(e)).

[9] The Defendants assert "preemption" under SLUSA, but this is a mischaracterization of the statute. The Supreme Court has explained that "SLUSA does not actually pre-empt any state cause of action. It simply denies plaintiffs the right to use the class-action device to vindicate certain claims." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 87 (2006).

The Defendants' arguments are wholly without merit and should be rejected by this Court. An action brought by a state regulator seeking equitable relief is a traditional "enforcement action" that falls within the SLUSA savings clause for state regulators. Moreover, a state regulator is not transformed into a "private party," nor is an enforcement action converted into a "class action," merely because the regulator seeks monetary relief in the form of disgorgement.

1. An Action Brought By a State Securities Regulator Seeking Disgorgement and Injunctive Relief is an Enforcement Action that Qualifies for the SLUSA Savings Clause.

Like the New York Attorney General, many state securities regulators have the authority to seek disgorgement and injunctive relief.[10] State securities administrators in at least 40 states have specific statutory authority to pursue disgorgement and injunctive relief, along with a broad range of other civil enforcement remedies.[11] Many other states have the general authority to seek other

[10] The Office of the Attorney General persuasively argues that these remedies are available under the Martin Act and Executive Law § 63, contrary to Defendants position.
[11] ALA. CODE § 8-6-1; ARIZ. REV. STAT. ANN. § 44-2032; ARK. CODE ANN. § 23-42-209; CAL. CORP. CODE § 25530; COLO. REV. STAT. ANN. § 11-51-602; CONN. GEN. STAT. ANN. § 36b-72; DEL. CODE ANN. tit. 6 § 73-602; D.C. CODE § 31-5606.03; FLA. STAT. ANN. § 517.191; GA. CODE ANN. § 10-5-72; HAW REV. STAT. § 485A-603; IDAHO CODE ANN. § 30-14-603; ILL. COMP. STAT. ANN. 5/11; IND. CODE § 23-19-6-3; IOWA CODE ANN. § 502.603; KAN. STATE. ANN. § 17-12a603; KY. REV. STAT. ANN. § 292.470; ME. REV. STAT. ANN. tit. 32 § 16603; MASS GEN LAWS ANN. CH.110A, § 408; MICH. COMP. LAWS ANN. § 451.2603; MINN STAT. ANN. § 80A.80; MISS. CODE ANN. § 75-71-603; NEB. REV. STAT. § 8-1116; N.H. REV. STAT. ANN. § 421-B:6-603; N.J. STAT. ANN. 49:3-69; N.M. STAT. § 55-13C-603; N.C. GEN. STAT. ANN. § 78C-28; N.D. CENT. CODE § 51-23-13; OKLA. STAT. ANN. tit. 71, § 1-603; OR. REV. STAT. § 59.255; 70 PA. STAT. ANN. § 1-509; S.C. CODE ANN. § 35-1-603; S.D. CODIFIED LAWS § 47-31B-603; TEX. REV. CIVIL STAT. ANN. art. 581-32; UTAH CODE ANN. § 61-1-20; VT. STAT. ANN. tit. 9 § 5603; WASH. REV. CODE ANN. § 21.20.390; W. VA. CODE § 32B-2-3; WIS. STAT. ANN. § 551.603.

relief as the court considers appropriate.[12] The pursuit of disgorgement and injunctive relief is frequently used by state securities regulators as part of their enforcement arsenals. *See, e.g.*, *Hoffman v. Falci*, No. Mon-C-160-14, (N.J. Sup. Ct. Sept. 18, 2015) (consent order and final judgement ordering disgorgement of more than $5 million in connection with a scheme to sell unregistered securities); *In re Jeffrey B. Pierce*, No. E-2014-0015, (Mass. Sec. Div. June 30, 2015)[13] (seeking disgorgement in connection with a fraudulent scheme in which nearly $500,000 was diverted from a client's retirement account); *Oklahoma Dep't. of Sec. ex rel. Faught v. 2001 Trinity Fund LLC*, No. CJ-2012-6164 (final order of permanent injunction March 11, 2016) (enjoining defendant from serving as an officer or director or selling or offering to sell securities in Oklahoma); *see also* Research Analyst Cases, *supra* n.3 (joint actions by state regulators and the SEC resulting in disgorgement of more than $380 million).

To promote its preferred interpretation of SLUSA, Defendants argue that the NYAG's suit does not meet the definition of enforcement action contained in SLUSA because it is "advanced on behalf of private interests." Joint Br. for Defs.-Appellants, at 72 n.34. However, the very text of the SLUSA savings clause says

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[12] *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 11-702; NEV. REV. STAT. ANN. § 90.640; OHIO REV. CODE ANN. § 1707.261; R.I GEN. LAWS § 7-11-603;*see also* Uniform Securities Act (2002) § 603(b)(3).

[13] *Available at* https://www.sec.state.ma.us/sct/current/sctpierce/Pierce%20Administrative%20Complaint.pdf

that a state securities regulator shall retain jurisdiction to investigate and bring enforcement actions "under the laws of such State." Pub. L. No. 105-353, 112 Stat. 3227, (codified at 15 U.S.C. 77p(e)). As explained by Congresswoman Anna Eshoo, the chief Democratic sponsor of the House version of SLUSA that was ultimately adopted, "State regulators would continue to have the ability to *enforce State laws* and bring civil actions." 144 CONG. REC. H10780 (1998) (emphasis added). This obviously means that members of Congress intended for state authorities to pursue the enforcement remedies available to them under state statutes.

Under state law, an action brought by a state securities regulator for disgorgement and injunctive relief is clearly an "enforcement action." The Uniform Securities Act of 1956 included disgorgement as an enforcement remedy in section 408. Later, when the 1956 model act was replaced by the Uniform Securities Act (2002), the new section that empowered regulators to seek disgorgement was specifically entitled "Civil *Enforcement*."[14] Since 1956, these model statutes have been adopted in many states to provide the authority for the state securities regulators to obtain disgorgement in their lawsuits against securities law violators.[15] As discussed above, when Congress adopted SLUSA, it was aware

[14] Uniform Securities Act (2002), § 603 (emphasis added).

[15] *See*, *supra*, n.1. Interestingly, according to the Prefatory Note to the 2002 Act, the drafters were consciously attempting to reconcile the 2002 Act with the preemption contained in NSMIA and SLUSA. As a result, the private cause of action in Section 509 expressly refers to SLUSA.

of the states' important role in policing the markets and expressed an unambiguous intent to preserve state enforcement authority.

2. An Action By a State Securities Regulator Is Not a "Class Action" By a "Private Party."

The Defendants continue to argue that the instant case should be treated as a covered "class action" by a "private party" for purposes of SLUSA because the Attorney General's disgorgement claim somehow seeks recompense for victims who purchased a security traded on a national securities market. Even if the Attorney General's equitable disgorgement claim is somehow deemed by the Court to be a claim for damages, the pursuit of damages serves a broader public interest than merely the repayment of investors. *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 296 (2002) (an enforcement action may "vindicate a public interest...even when it pursues entirely victim-specific relief"). An action by a public official is clearly distinct from a private class action, even if the official seeks damages that flow to the investor.

To create a meaningful deterrent, regulators must be able to rely on the full arsenal of enforcement remedies, including the ability to require wrongdoers to fully forfeit their ill-gotten gains. Even though state regulators commonly seek recompense for investors, they retain independent enforcement objectives and act

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However, Section 603 authorizes civil actions by regulators and makes no reference to SLUSA, presumably because the drafters saw no conflict between SLUSA and an enforcement action brought by a state regulator in which restitution is sought.

on behalf of the State, not as a personal representative of the investors. In fact, the interests of a single investor or group of investors may be inconsistent with the interests of the public at large. For example, a regulator may choose to revoke a stock broker's license to protect the general public, even though the revocation could impair the broker's ability to pay restitution to the harmed investors. As a result, regulators commonly advise investors to retain their own independent counsel to protect their interests. *See, e.g.*, Alabama Securities Commission, *Procedure for Filing a Complaint within the Alabama Securities Commission*, *available at* http://asc.alabama.gov/complaints.aspx (last visited March 16, 2016) ("[A]ny action by the [Alabama Securities Commission] would not necessarily result in any monetary benefit to you. If you have suffered monetary loss, you should consider contacting a private attorney to discuss your legal rights and remedies under the Alabama Securities Act or other statutes.").

State regulators are best situated to determine the types of remedies they pursue. By necessity, a regulator must have the flexibility to not only decide how it will conduct its enforcement actions but also which remedies to pursue based on several factors, including the egregiousness of the conduct, the broader deterrent effects of the action, and available resources. Thus, even if a regulator chooses to pursue damages, restitution, or disgorgement in a particular case, the choice to bring the case was influenced by factors beyond the investors' personal interests.

The Defendants would have this Court impair the discretion of public officials by second-guessing their enforcement priorities and the remedies they seek to deter misconduct.

B. The New York Attorney General's Action is not Impliedly Preempted by Federal Law.

The Defendants next argue that the New York Attorney General's action is impliedly preempted because it would conflict with Congressional intent to create uniform securities litigation standards through the passage of NSMIA and SLUSA. However, Congress expressly *preserved* the authority of states to bring antifraud enforcement actions under NSMIA, and it likewise preserved state enforcement authority under SLUSA, as discussed *supra*. When Congress has expressly preserved the authority of states to bring antifraud enforcement actions, this Court should look no further to determine whether preemption is "implied."

Conflict preemption can occur in two forms: where it is "impossible for a private party to comply with both state and federal requirements . . . or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Zuri-Invest AG v. Natwest Fin., Inc.*, 177 F. Supp. 2d at 195. In this case, the action by the New York Attorney General presents no such conflict.

The antifraud provisions of the Martin Act do not require a person to choose between obeying state law or federal law. On the contrary, New York law is consistent with federal law. The Defendants were sued under General Business Law §§ 352(1) and 353, which grant the Attorney General authority to redress "deceptions, misrepresentations, concealments, suppressions, frauds, false pretenses, false promises," and other "fraudulent practices" in connection with the sale of securities. This is similar to Section 17(a) of the Securities Act of 1933, which prohibits the use of any "device, scheme, or artifice to defraud," any "untrue statement of a material fact or any omission to state a material fact...," or any "transaction or course of business which operates or would operate as a fraud or deceit." Therefore, it is entirely possible to comply with both state and federal requirements—a person simply has to disclose all material facts to investors.

For similar reasons, the enforcement of New York law also does not stand as an obstacle to the accomplishment of Congressional objectives or frustrate Congressional intent. "The overriding purpose of our nation's securities laws is to protect investors and to maintain confidence in our capital markets." H.R. CONF. REP. NO. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731. Rather than frustrating this objective of investor protection, state antifraud laws further the same goal.

Notably, there is no "patchwork quilt" of state securities fraud statutes, so the application of state antifraud law imposes no particular burden upon the national markets. As stated in *Zuri-Invest*, "'[s]tate law prohibitions on false statements of material fact do not create 'diverse, non-uniform, and confusing' standards.'" *Zuri-Invest AG,* 177 F. Supp. 2d at 197, quoting *Cippollone v. Liggett Group Inc.,* 505 U.S. 504, 528-29 (1992). Thus, the complaints that drove the passage of NSMIA do not apply to antifraud enforcement, where the interests of the states are aligned with each other and with the federal government. *See* LOSS, SECURITIES REGULATION, at 4134.

Defendants also argue that the Attorney General's action is impliedly preempted because the defendant's settlement with the SEC included an agreed upon injunction for Mr. Smith and that an injunction for Mr. Greenberg was considered but rejected. Joint Br. of Defs.-Appellants at 72-74. Defendants' argue that the injunctive relief sought by the Attorney General would "frustrate the carefully crafted scheme that Congress devised." *Id.* at 74. Defendants' arguments are without merit.

Here, Defendants' again point to language designed to preempt state *registration of offerings* of certain securities. The language contained in 15 U.S.C. § 77r does not limit a state's ability to enforce the antifraud provisions of its laws, nor does it prevent a state from pursuing all remedies that may be available. As noted above, Congress expressly preserved the states' antifraud authority in the very section on which Defendants rely. *See* 15 U.S.C. § 77r(c)(1). The only limit Congress placed upon the states' antifraud authority over covered securities was that such enforcement actions be pursued under state law, which undoubtedly includes any and all remedies available. *Id.*

Disgorgement and injunctive relief are traditional remedies available to state securities regulators. *See* Uniform Securities Act (1956) § 408; *see also* Uniform Securities Act (2002) § 603. And while New York has not adopted the uniform acts, these remedies are available under New York law. *See generally* Br. of Resp't at 31-54. Further, the power to order the return of ill-gotten gains is an inherent equitable power of the court that can be ordered without express statutory authorization. *See e.g.*, *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d. 1301, 1307-08 (2nd Cir. 1971).

Defendants also argue that an injunction barring them from serving as an officer or director or participating in the securities industry would frustrate the purposes of the federal securities laws. However, similar injunctive relief was included as part of Defendants' settlement with the SEC. It is difficult to imagine how similar relief, if ordered by a state court, would frustrate the purpose of federal law when such relief was already federally ordered. Further, as stated above, Congress has expressly preserved state antifraud enforcement authority under state law, including the available remedies. As the court below noted, "The Martin Act expressly confers the Attorney General with authority to seek a permanent injunction barring a defendant from "selling or offering for sale to the public within this state, as principal, broker or agent, or otherwise, any securities issued or two [sic] be issued" *People ex rel. Schneiderman v. Greenberg*, 43 Misc. 3d 1229(A), 993 N.Y.S.2d 645 (Sup. Ct. 2014), *aff'd sub nom. People v. Greenberg*, 127 A.D.3d 529, 8 N.Y.S.3d 68 (N.Y. App. Div. 2015). The trial court continued, "[m]oreover, officer and director bars are an appropriate remedy in public enforcement actions against corporate executives who engage in fraudulent securities transactions, including under the Martin Act." *Id.* The appropriateness and scope for any such injunctive relief is a matter for the trial court to consider in its discretion, but federal law does not prevent the Attorney General from pursuing it.

CONCLUSION

By seeking to curtail the enforcement power of a state securities regulator, it is the Defendants who seek to frustrate Congressional intent. Congress recognized the important role of state securities regulators by adopting a savings clause in NSMIA and SLUSA to preserve their authority to bring actions for fraud and deceit. Defendants' position contradicts the explicit non-preemptive language of those acts.

For these reasons, the Court should affirm the decision of the Appellate Division that federal law does not preempt the Attorney General's claim.

Respectfully Submitted,

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

By:

Anne-Valerie Mirko, General Counsel
750 First Street, N.E., Ste. 1140
Washington, D.C. 20002
202-737-0900
202-783-3571 (Fax)

Counsel for NASAA

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