

Federal Securities Laws Do No Preempt State Regulators' Abilities To Combat Fraud, Nor Do Securities Laws Preempt State Common Law Fiduciary Claims

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Capital Research vs. Brown (2007): Federal Securities Laws Do Not Preempt States' Anti-Fraud Authority. Despite preemption of state authority on securities regulation in some areas by NSMIA, state regulatory authority with respect to regulation against fraudulent sales or advisory activities was retained. This was made clear by an early 2007 decision, *Capital Research and Management Company v. Brown*, Decision No. B189249 (Cal. App. 1/26/2007) (Cal. App., 2007), wherein the court stated: "NSMIA's savings clause is sufficiently broad to permit the Attorney General of California to pursue injunctive relief and penalties against a covered security's investment advisor and wholesale broker-dealer who allegedly made inaccurate or inadequate representations to purchasers ... The plain language of the savings clause and its legislative history persuade us that Congress intended to preserve the states' anti-fraud authority to control the conduct of brokers and dealers, notwithstanding that the exercise of such controls might prospectively influence the disclosures made by a covered security. ... The Joint Conference Report of both houses offers a similar insight into the purpose of the savings clause. 'The [statute preserves] 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, such as churning accounts or misleading customers.'" The Court went on to note the following: "Our conclusion is supported by the clear statement of Congressional intent expressed at the time the savings clause was enacted. By way of example, a Senate Report explained that the statute preserved the states' authority to "continue their role in regulating broker-dealer conduct whether or not the offering is subject to state review. The [Senate] Committee believes that allowing the states to oversee broker-dealer conduct in connection with preempted offerings will ensure continued investor protection. As long as states continue to police fraud in these offerings, compliance at the federal level will adequately protect investors. In preserving this authority, however, the Committee expects the states only to police conduct — not to use this authority as justification to continue reviewing exempted registration statements or prospectuses. The Committee clearly does not intend for the 'policing' authority to provide states with a means to undo the state registration preemptions." (Sen. Rep. No. 104-293, 2d Sess. (1996) [1996 WL 367191 at *15], emphasis added.) The Attorney General's enforcement action, which challenges broker-dealer conduct, cannot reasonably be construed as an effort to regulate a non-party issuer."

There Is No Preemption Of State Common Law Breach Of Fiduciary Duty Claims By Securities Legislation. Neither federal nor state securities laws generally preempt common law claims based upon breach of fiduciary duty. This is because the securities statutes were modeled after the common law actions of fraud and deceit. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-215, 96 S.Ct. 1375, 1381-1391, 47 L.Ed.2d 668 (1976) (review of legislative history); *see also* Securities Regulation, 69 Am.Jur.2d Sec. 1 et seq. The fiduciary concept derives from trust and agency principles. Actions contrary to the duties of loyalty and care are remedied by giving the beneficiary of the relationship the right to recover for the fiduciary's breach. See RESTATEMENT (2d) of Agency Secs. 387-398 (1957); Weinrib, *The Fiduciary Obligation*, 25 U. Toronto L.J. 1 (1975); Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex.L.Rev. 2347, 2348 n. 9 (1983). *See Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042 (C.A.11 (Fla.), 1987).

However, ERISA and SLUSA Do Preempt Certain Claims. Generally, and as discussed above, state common law fiduciary claims, and state securities laws in general with regard to the fraudulent conduct of brokers, investment advisers, and financial planners, are not preempted by the federal securities acts. However, specific instances of preemption do occur under ERISA and SLUSA.

While beyond the scope of this article, ERISA preempts many state law claims which would otherwise arise in connection with the rendering of financial advice as to qualified retirement plans. Section 514(a) of ERISA, 29 U.S.C. § 1144(a), provides that the statute will "supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title [29 U.S.C. § 1003(a)] and not exempt under section 1003(b) of this title [29 U.S.C. § 1003(b)]." However, there are significant exceptions to this general preemption statute.

On March 21, 2006, the Supreme Court of the United States issued a decision addressing the viability of securities fraud class action lawsuits based on state law that are brought on behalf of holders—owners of a security who allege that they were damaged when misleading statements caused them to retain securities they otherwise would have sold. In an 8-0 decision authored by Justice Stevens, the Court held that class action suits asserting so-called "holder" claims under state law are preempted by the Securities Litigation Uniform Standards Act of 1998 (SLUSA). *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, No. 04-1371 (U.S. March 21, 2006).