9-20-2007

Summary of Nanopierce Tech. v. Depository Trust, 123 Nev. Adv. Op. No. 38

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Nevada Law Journal

Nanopierce Tech. v. Depository Trust, 123 Nev. Adv. Op. No. 38 (Sept. 20, 2007)[1]

CORPORATE LAW – SECURITIES FRAUD

Summary

Appeal from a district court order dismissing a securities fraud action.

Disposition/Outcome

Affirmed district court order dismissing Appellants' securities fraud action.

Factual and Procedural History

Appellants Nanopierce Technologies, Inc. brought several claims relating to securities fraud against Respondents for misuse of the Stock Borrower Program, which Appellants assert resulted in a dilutive effect of Nanopierce's stock value.

The Securities Exchange Act of 1934[2] regulates and controls securities transactions in interstate commerce. Congress amended the Securities Exchange Act of 1934 to include section 17A, which called for the establishment of a national system to facilitate the clearance and settlement of securities transactions. Agencies registered under Section 17A are self-regulatory agencies and stand in the stead of the Securities Exchange Commission[3] to provide clearance and settlement of broker-to-broker securities transactions.[4] Respondent's subsidiaries, The Depository Trust Company (DTC) and The National Securities Clearing Corporation (NSCC), are registered clearing agencies under Section 17A.

The DTC primarily operates as a "stock depository" and maintains the physical stock certificates that brokers deposit on behalf of investors.[5] The NSCC, by contrast, actually facilitates the clearance and settlement of securities by both acting as a broker intermediary and by tracking brokers' transactions. The NSCC operates as a broker intermediary by assuming payment and delivery obligations of individual brokers. The NSCC tracks transactions by calculating individual brokers' payments or delivery obligations due for particular securities over a designated period. After payment and delivery obligations are calculated, the NSCC transmits these figures to the DTC. In instances in which delivery obligations are due, the DTC automatically performs a comparison of the individual broker's delivery obligations with the amount of shares the individual broker has on deposit.

If the broker has sufficient shares on deposit to fulfill his or her delivery obligation, those shares are sent through the NSCC to the DTC account of the buying broker. If the broker has sold more shares than he or she has on deposit, however, the broker must then exercise one of two options. One option permits the broker to "buy-in" by purchasing the requisite number of

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[1] By Jamie Zimmerman.
[2] 15 U.S.C. § 78b (2000).
[3] *See* Dexter v. Depository Trust and Clearing Corp., 406 F. Supp. 2d 260, 263 (S.D.N.Y. 2005).
[4] 15 U.S.C. §78q-1(b)(3)(A) (2000).
[5] Stock certificates are held by the DTC in the name of the DTC's nominee, Cede & Co. For efficiency purposes, changes in stock ownership are only recorded electronically.

shares owed on his or her delivery obligation in the open market. In the alternative, the broker can wait for shares to become available through the NSCC as it processes transactions.

In effort to eradicate situations in which brokers sell more shares than they have on deposit, the NSCC created the Stock Borrower Program (SBP). The SBP permits brokers to lend shares from their DTC accounts to another broker before a failure to deliver takes place. In effect, the SBP permits brokers to loan securities that they have on deposit with the DTC to cover a fellow broker's delivery obligation.

Appellants argued that Respondents manipulated the SBP by generating so-called "phantom shares" that diluted the value of Nanopierce's stock. Appellants assert that Respondents misrepresent their compliance with the SBP procedures as follows: (1) the NSCC falsely represents its compliance with curing delivery obligations by purchasing stocks from the open market, asserting that the NSCC instead buys broker requests through the SBP; (2) Respondents falsely represent that buying broker requests are purchased through the open market, asserting that Respondents instead purchase stocks through the SBP; (3) Respondents falsely represent that they efficiently clear and settle securities transactions, asserting that Respondents permit delivery commitments to remain unfulfilled for extended periods of time; (4) Respondents falsely represent the number of shares they actually retain, asserting that Respondents do not include shares "on loan" to other brokers with outstanding delivery obligations in their figures. In addition, Appellants assert the following non-misrepresentation based claims: engagement in unfair trade practices, market manipulation, conversion, intentional interference with contractual relations, breach of the implied covenant of good faith and fair dealing, and conspiracy.

The district court dismissed Appellants' claims, holding that federal law pertaining to clearance and settlement of securities preempted Appellants' claims. This appeal followed.

Discussion

The issue before the court was whether Section 17A of the Securities Exchange Act of 1934 preempts Appellants' state law claims. The preemption doctrine provides that federal law trumps conflicting, but otherwise valid, state law.[6] Preemption is a question of law and is subject to de novo review.[7]

At the outset, the Court noted that although the SBP and the rules prescribing its operation are not federal law per se, the Securities Exchange Commission promulgated the SBP at the direction of Congress pursuant to Section 17A, and thus the SBP trumps otherwise valid and conflicting state law.[8] The court noted that although Congress did not expressly preempt state law in this arena by statutory language, Appellants' state law claims could still be impliedly preempted. The court then discussed the implied preemption doctrines of field preemption and conflict preemption in turn.

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[6] The preemption doctrine arises from the Supremacy Clause, found in Article VI of the United States Constitution. The Supremacy Clause provides "the Laws of the United States . . . shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." *See also* Crosby v National Foreign Trade Council, 530 U.S. 363, 372 (2000) (stating that "[a] fundamental principle of the Constitution is that Congress has the power to preempt state law").

[7] SIIS v. United Exposition Services Co., 109 Nev. 28, 30, 846 P.2d 294, 295 (1993).

[8] *See* Hillsborough County v. Automated Medical Labs., 471 U.S. 707, 713 (1985) (noting that "state laws can be pre-empted by federal regulations as well as by federal statutes").

Field Preemption

State law is impliedly preempted under the doctrine of field preemption in instances in which Congress has legislated in an arena in such a manner that the federal interest is so dominant that it can be said to "occupy a legislative field."[9]

In the present case, the court concluded that although Congressional legislation indicates that Congress intended to occupy much of the field in the arena of clearing and settling securities transactions, the statutory scheme does not warrant the inference that Congress intended to occupy this entire field. To the contrary, after analyzing the statutory scheme, the court concluded that Congress intended to preserve all non-conflicting state securities laws.

The court specifically referenced Section 78bb(a) of the Securities Exchange Act of 1934 in support of its finding. Section 78bb(a) provides: "[N]othing in this [Act] shall affect the jurisdiction of the securities commission . . . of any State over any securities or any person insofar as it does not conflict with the provisions of this [Act]."[10] In addition, the court relied upon a provision of Section 17A that provided for the construction of this provision to the same effect.[11] Moreover, the court referenced an amendment to Section 17A in 1990, which also provided for states to supplement the federal statutory scheme in the field of clearing and settling transactions.[12]

Conflict Preemption

State law is impliedly preempted under the doctrine of conflict preemption when a party cannot conceivably comply with both applicable federal law and its intended purpose as well as applicable state law.[13] The court performed a claim-by-claim analysis of Appellants' claims to determine whether compliance with applicable state law presented an obstacle in complying with Section 17A's purpose and effect.[14] The court divided Appellants' claims into two separate groups, misrepresentation claims and non-misrepresentation claims, and analyzed them in turn.

The court assessed each of Appellants' misrepresentation claims and concluded that the NSCC preempted all claims. The court construed each claim, in essence, to challenge either the procedures or rules prescribed by the NSCC. The court reasoned that the Securities Exchange Commission approved the procedures and rules of the NSCC and thus any state regulations in conflict with the operation or existence of the SBP are necessarily preempted.

Just as the court concluded that each of Appellants' misrepresentation claims were preempted for confliction with the SBP, the court also found that all of Appellants' non-misrepresentation based claims were preempted because each of those claims also overtly challenged the operation or existence of the SBP.

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[9] Nanopierce Tech. v. Depository Trust, 123 Nev. Adv. Op. No. 38 (Sept. 20, 2007); *See also* Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992); Hillsborough County, 471 U.S. at 713.
[10] *Accord* Herman & MacLean v. Huddleston, 459 U.S. 375, 383 (1983) (interpreting Section 78bb(a) as providing that Congress "rejected the notion that the express remedies of the securities law would pre-empt all other rights of action").
[11] 15 U.S.C. § 78q-1(d)(4) (2000).
[12] 15 U.S.C. § 78q-1(f)(1) (2000); 15 U.S.C. § 78q-1(f)(3) (2000).
[13] Crosby v National Foreign Trade Council, 530 U.S. 363, 373 (2000).
[14] Cipollone, 505 U.S. at 524-30 (the Court performed a claim-by-claim analysis to determine whether federal law preempted state law in that case).

Concurring/Dissenting Opinions

HARDESTY, J., with whom DOUGLAS, J. agrees, concurring in part and dissenting in part:

Justice Hardesty generally agreed with the majority's analysis of the doctrine of conflict preemption. He dissented, however, with the majority's characterization of Appellants' claims as overtly attacking the language of the NSCC. Justice Hardesty reasoned that Appellants' claims did not directly challenge the language of any of the NSCC rules, but rather the manner in which Respondents misrepresent their compliance with those rules. Justice Hardesty called for the reversal of the district court order with respect to Appellants' misrepresentation claims and remand of the matter for further proceedings.

Conclusion

The court concluded that the doctrine of conflict preemption operated to preempt all of Appellants' state law claims because it found that a party could not be in compliance with both the federal enactments in the arena of clearing and settling securities as well as Appellants' state law claims. The court reasoned that Appellants' claims were preempted because each claim in essence challenged the operation or existence of the SBP, which the court found to enjoy the same status as federal law in a preemption analysis as the Securities Exchange Commission promulgated the SBP. Therefore, the court affirmed the district court order dismissing Appellants' securities fraud action.