

1989

Western Capital and Securities v. Knudsvig : Brief in Opposition to Certiorari

Utah Supreme Court

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UTAH SUPREME COURT

BRIEF

IN THE SUPREME COURT OF THE
STATE OF UTAH

WESTERN CAPITAL AND
SECURITIES, INC.,

Respondent,

vs.

HELEN KNUDSVIG,

Petitioner.

)
) REPLY TO PETITION FOR A
) WRIT OF CERTIORARI

)
) CASE NO: 890132

)
)
) (CATEGORY NO. 14)

RESPONDENT, WESTERN CAPITAL AND SECURITIES, INC.
REPLY IN OPPOSITION, TO PETITION FOR A
WRIT OF CERTIORARI TO THE
UTAH SUPREME COURT

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FILED
MAY 10 1997

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SECURITIES, INC.,)	REPLY TO PETITION FOR A
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LIST OF PARTIES

Helen Knudsvig, an individual, is the Petitioner herein and was the Defendant in the Trial Court and was Respondent in the Utah Court of Appeals.

Western Capital and Securities, Inc. is the Respondent in this action and was the Plaintiff in the Trial Court and the Appellant in the Utah Court of Appeals.

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)	
HELEN KNUDSVIG,)	
)	
Petitioner.)	(CATEGORY NO. 14)

QUESTIONS PRESENTED BY PETITIONER FOR REVIEW

POINT I. Whether a violation of Federal Securities Law can be raised as a mandatory counterclaim in a State Court action.

POINT II. Whether a violation of Securities Dealers Rules gives rise to a federal question or a state court action.

GROUND FOR JURISDICTION

Jurisdiction of this Court has been requested by the Petitioner pursuant to Utah Code Annotated § 78-2-2(3)(a) and Rule 43 of the Rules of the Utah Supreme Court. The decision of the Court of Appeals was entered on February 7, 1989, and Petitioner's brief was mailed to Respondent's Counsel on April 10, 1989.

STATEMENT OF CASE

The facts as set forth in Petitioners Brief are a recitation of the facts as contained in her brief before the Court of Appeals. The facts set forth by Petitioner in Petitioner's Brief are incorrect and not substantiated by the testimony at trial. However, a lengthy recitation of the errors is not necessary for a determination relating to the present Petition. The pertinent facts are that Respondent filed an action in the State Courts requesting relief based on breach of contract. Petitioner filed a Counterclaim requesting relief pursuant to the Securities Exchange Act of 1934 and Securities and Exchange Rules promulgated thereunder. Petitioner also requested relief pursuant to rules of the National Association of Securities Dealers, Inc. (NASD). The lower court denied Respondent's claim and despite a Finding that Petitioner had no actual damages, granted to Petitioner, judgment for punitive damages. The Respondent appealed the ruling of the lower court.

The Utah Court of Appeals affirmed the denial of Respondent's claim and determined sua sponte that the trial Court lacked jurisdiction to hear or adjudicate any of the issues raised in Petitioner's Counterclaim as those claims were

based in total on the Securities Exchange Act of 1934 and rules promulgated thereunder. The Court found that even if such Counterclaim was a mandatory Counterclaim, Petitioner could not raise a matter of violation of Federal Securities Laws in the State Courts. Jurisdiction of these matters is reserved exclusively to the Federal Courts.

The Utah Court of Appeals also found that rules of the NASD were adopted pursuant to the Securities Exchange Act of 1934 and therefore subject to the exclusive jurisdiction provisions of that Act. The Utah Court of Appeals therefore dismissed Petitioner's Counterclaim and reversed the judgment against Respondent.

REPLY TO ARGUMENT

POINT I.

THE FEDERAL COURTS HAVE EXCLUSIVE
JURISDICTION OVER ACTIONS PURSUANT TO THE
SECURITIES AND EXCHANGE ACT OF 1934 AND
THE DECISION OF THE COURT OF APPEALS WAS
WELL FOUNDED IN LAW AND NO REVIEW IS
NECESSARY

Petitioner contends that subparagraphs 2, 3 and 4 of Rule 43 of the Rules of The Utah Supreme Court provide a basis for the granting of a Petition for a Writ of Certiorari. First, Petitioner claims that the Court of Appeals decided a question of State or Federal law that is in conflict with the decision of this Court. Petitioner claims the case of Cowen and Co. v. Atlas Stock Transfer Co., 695 P.2d 109 (Utah 1984) is in conflict with the decision of the Court of Appeals. However, the Petitioner never states in what manner the Cowen case is in conflict. The Court in Cowen made no determination as to the exclusive jurisdiction of the Federal Courts over matters arising under the Securities Exchange Act of 1934, and merely stated what are the duties of a Securities Broker-Dealer pursuant to the NASD rules. The Court in Cowen did not enforce the NASD rules, but only referred to the rules to determine the responsibility of Cowen and Co. which resulted in damages

awarded to Cowen and Co. The Cowen case does not in any manner conflict with the decision of the Court of Appeals in the present case.

The Petitioner further indicates that the Court of Appeals should have remanded the matter to the trial court to find if relief could have been granted based on a State claim. The Petitioner in her Counterclaim and throughout the trial never raised an issue of State claims or questions, but based her action on Federal claims. A remand by the Court of Appeals would have been an error.

Petitioner further claims that the Court of Appeals determined an important question in the conflict of Federal and State law which should be settled by the Supreme Court of the State of Utah. While the Supreme Court of the State of Utah may not have specifically determined the issue of exclusive jurisdiction of the Federal Courts over claims pursuant to the Securities Exchange Act of 1934, the issue has been determined by numerous other courts including the Tenth Circuit. In the case of deHass v. Empire Petroleum Co., 435 F.2d 1223 (1970) at page 1231, the Tenth Circuit specifically stated, "All actions under Rule 10B-5 must be brought in the Federal Courts, 15 U.S.C. § 78aa. . . ." Even though the present case included

alleged violations of Rules 10B-5 and 10B-10, the decision in the deHass case is applicable and squarely on point in that 15 U.S.C. § 78aa on which the deHass court rendered its decision states:

"The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder. . . . Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder. . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant"

The question of exclusive jurisdiction is specifically set forth in the Securities & Exchange Act of 1934 and was specifically adopted by the deHass court for the Tenth Circuit and has been adopted by numerous other courts. (Securities Investor Protection Corp. v. Vigman, 764 F.2d 1309, 1313 (9th Cir. 1985); Alkoff v. Gold, 611 F.Supp. 63, 66 (S.D.N.Y. 1985); Kinsey v. Nestor Exploration Ltd.- 1981A, 604 F.Supp. 1365, 1368-69 (E.D. Wash 1985); Fradkin v. Ernst, 571 F.Supp. 829, 839 (N.D. Ohio 1983).

The Petitioner states that one of the grounds on which the Petition for Certiorari should be granted is that the Court of Appeals has rendered a decision that has so far departed from accepted and usual course of judicial proceedings as to call

for an exercise of the Supreme Court's power of supervision. The Defendant does not argue this particular issue. However, the decision of the Court of Appeals is clearly in line with accepted judicial pronouncements and the statutory law, and therefore no grounds exist for Writ of Certiorari pursuant to this portion of Rule 43.

POINT II.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. WAS CREATED PURSUANT TO THE SECURITIES EXCHANGE ACT OF 1934 AND RULES PROMULGATED THEREUNDER ARE MANDATED PURSUANT TO THE SECURITIES EXCHANGE ACT OF 1934 AND FEDERAL COURTS THEREFORE HAVE EXCLUSIVE JURISDICTION.

Petitioner argues that Federal Courts are courts of limited jurisdiction and absent a federal question, jurisdiction is not granted in the Federal Courts. Petitioner goes on to misstate the Cowen and Co. case, supra. The NASD is an organization organized pursuant to specific statutory authorization of the Securities and Exchange Act of 1934, Section 15A. Rules promulgated by the NASD are promulgated pursuant to and mandated by Section 15A(b)(6) of the Securities Exchange Act of 1934. The express language of Securities Exchange Act of 1934 § 27, as set forth hereinabove, specifically grants jurisdiction to the District Courts of the United States for

violations of "the rules and regulations thereunder. . . ."

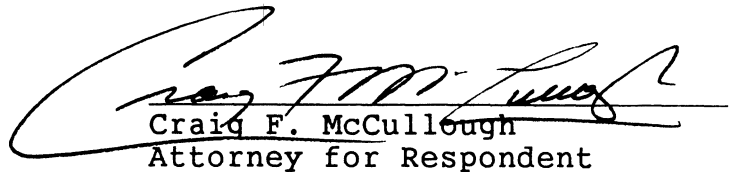
Therefore, by statute, Congress has specifically granted jurisdiction to the Federal Courts and more importantly, has specifically granted exclusive jurisdiction to the Federal Courts for alleged violations of such rules.

The Petitioner again quotes the Cowen case, supra, and claims that this Court has previously decided this issue on appeal. However, the Petitioner never sets forth where in the Cowen case this Court made any such determination. Petitioner apparently mistakes the Court's quote of an NASD rule to be a determination by this Court that State courts have jurisdiction over enforcement of those rules. The Cowen case does not make any such holding.

CONCLUSIONS

The Court of Appeals correctly ruled in the present case. The decision by the Court of Appeals is amply supported by statutory and case law. The decision of the Court of Appeals is not in conflict with the decisions of the Utah Supreme Court. Therefore no basis exists for the granting of a Writ of Certiorari in this matter, and the Petition should be dismissed with costs awarded to the Respondent.

DATED this 10th day of May, 1989.

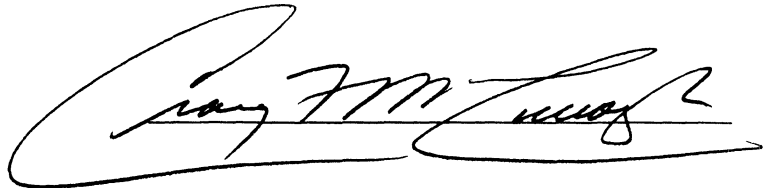

Craig F. McCullough
Attorney for Respondent

CDN9133m

CERTIFICATE OF MAILING

I hereby certify that on the 10th day of May, 1989 I mailed four true and correct copies of the above and foregoing REPLY TO PETITION FOR A WRIT OF CERTIORARI by placing the same in the U.S. Mail, postage prepaid, and addressed to the following:

Gerald A. Wight
Attorney for Petitioner
Legal Forum Building
2447 Kiesel Avenue
Ogden, Utah 84401

A handwritten signature in dark ink, appearing to read "Gary F. M. [unclear]", written over a horizontal line.

Rule 43. Considerations governing review of certiorari.

Review by a writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor. The following, while neither controlling nor wholly measuring the court's discretion, indicate the character of reasons that will be considered:

(1) When a panel of the Court of Appeals has rendered a decision in conflict with a decision of another panel of the Court of Appeals on the same issue of law;

(2) When a panel of the Court of Appeals has decided a question of state or federal law in a way that is in conflict with a decision of this court;

(3) When a panel of the Court of Appeals has rendered a decision that has so far departed from the accepted and usual course of judicial proceedings or has so far sanctioned such a departure by a lower court as to call for an exercise of this court's power of supervision; or

(4) When the Court of Appeals has decided an important question of municipal, state, or federal law which has not been, but should be, settled by this court.

REGISTERED SECURITIES ASSOCIATIONS

SECTION 15A. (a) An association of brokers and dealers may be registered as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 19(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the association and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) An association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that—

(1) By reason of the number and geographical distribution of its members and the scope of their transactions, such association will be able to carry out the purposes of this section.

(2) Such association is so organized and has the capacity to be able to carry out the purposes of this title and to comply, and (subject to any rule or order of the Commission pursuant to section 17(d) or 19(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this title, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the association.

(3) Subject to the provisions of subsection (g) of this section, the rules of the association provide that any registered broker or dealer may become a member of such association and any person may become associated with a member thereof.

(4) The rules of the association assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the association, broker, or dealer.

(5) The rules of the association provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which the association operates or controls.

(6) The rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the association.

(7) The rules of the association provide that (subject to any rule or order of the Commission pursuant to section 17(d) or 19(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of any provision of this title, the rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or the rules of the association, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(8) The rules of the association are in accordance with the provisions of subsection (h) of this section, and, in general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the association of any person with respect to access to services offered by the association or a member thereof.

(9) The rules of the association do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title.

(10) The requirements of subsection (c), insofar as these may be applicable, are satisfied.

(11) The rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be distributed or published by any member or person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing and publishing quotations.

(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association pursuant to subsection (d), to participation in said applicant association as an affiliate thereof, under terms permitting such powers and responsibilities to such affiliate, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and powers of the Commission with respect to any national securities association or any affiliated association shall in no way be limited by reason of any such affiliation.

(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

(1) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (10) inclusive and paragraph (12), of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.

(e)(1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember professional (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

(2) For the purposes of this subsection, the term “nonmember professional” shall include (A) with respect to transactions in securities other than municipal securities, any registered broker or dealer who is not a member of any registered securities association, except such a broker or dealer who deals exclusively in commercial paper, bankers’ acceptances and commercial bills, and (B) with respect to transactions in municipal securities, any municipal securities dealer (other than a bank or division or department of a bank) who is not a member of any registered securities association and any municipal securities broker who is not a member of any such association.

(3) Nothing in this subsection shall be so construed or applied as to prevent (A) any member of a registered securities association from granting to any other member of any registered securities association any dealer’s discount, allowance, commission, or special terms, in connection with the purchase or sale of securities, or (B) any member of a registered securities association or any municipal securities dealer which is a bank or a division or department of a bank from granting to any member of any registered securities association or any such municipal securities dealer any dealer’s discount, allowance, commission, or special terms in connection with the purchase or sale of municipal securities: Provided, however, That the granting of any such discount, allowance, commission, or special terms in connection with the purchase or sale of municipal securities shall be subject to rules of the Municipal Securities Rulemaking Board adopted pursuant to section 15B(b)(2)(K) of this title.

(f)(1) Except as provided in paragraph (2) of this subsection, nothing in this section shall be construed to apply with respect to any transaction by a registered broker or dealer in any exempted security.

(2) A registered securities association may adopt and implement rules applicable to members of such association (A) to enforce compliance by registered brokers and dealers with applicable provisions of this title and the rules and regulations thereunder, (B) to provide that its members and persons associated with its members shall be appropriately disciplined, in accordance with subsections (b)(7), (b)(8), and (h) of this section, for violation of applicable provisions of this title and the rules and regulations thereunder, (C) to provide for reasonable inspection and examination of the books and records of registered brokers and dealers, (D) to provide for the matters described in paragraphs (b)(3), (b)(4), and (b)(5) of this section, (E) to implement the provisions of subsection (g) of this section, and (F) to prohibit fraudulent, misleading, deceptive, and false advertising.

(3) Nothing in subsection (b)(6) or (b)(11) of this section shall be construed to permit a registered securities association to make rules concerning any transaction by a registered broker or dealer in a municipal security.

(g)(1) A registered securities association shall deny membership to any person who is not a registered broker or dealer.

(2) A registered securities association may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification. A registered securities association shall file notice with the Commission not less than 30 days prior to admitting any registered broker or dealer to membership or permitting any person to become associated with a member, if the association knew, or in the exercise of reasonable care should have known, that such broker or dealer or person was subject to a statutory disqualification. The notice shall be in such form and contain such information as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(3)(A) A registered securities association may deny membership to, or condition the membership of, a registered broker or dealer if (i) such broker or dealer does not meet such standards of financial responsibility or operational capability or such broker or dealer or any natural person associated with such broker or dealer does not meet such standards of training, experience and competence as are prescribed by the rules of the association or (ii) such broker or dealer or person associated with such broker or dealer has engaged and there is a reasonable likelihood he will again engage in acts or practices inconsistent with just and equitable principles of trade. A registered securities association may examine and verify the qualifications of an applicant to become a member and the natural persons associated with such an applicant in accordance with procedures established by the rules of the association.

(B) A registered securities association may bar a natural person from becoming associated with a member or condition the association of a natural person with a member if such natural person (i) does not meet such standards of training, experience, and competence as are prescribed by the rules of the association or (ii) has engaged and there is a reasonable likelihood he will again engage in acts or practices inconsistent with just and equitable principles of trade. A registered securities association may examine and verify the qualifications of an applicant to become a person associated with a member in accordance with procedures established by the rules of the association and require a natural person associated with a member, or any class of such natural persons, to be registered with the association in accordance with procedures so established.

(C) A registered securities association may bar any person from becoming associated with a member if such person does not agree (i) to supply the association with such information with respect to its relationship and dealings with the member as may be specified in the

rules of the association and (ii) to permit examination of its books and records to verify the accuracy of any information so supplied.

(D) Nothing in subparagraph (A), (B), or (C) of this paragraph shall be construed to permit a registered securities association to deny membership to or condition the membership of, or bar any person from becoming associated with or condition the association of any person with, a broker or dealer that engages exclusively in transactions in exempted securities.

(4)(A) A registered securities association may deny membership to, or condition the membership of, a government securities broker or government securities dealer if such government securities broker or government securities dealer (i) does not meet standards of financial responsibility under rules adopted pursuant to section 15C(b)(1)(A) of this title, or (ii) has engaged and there is a reasonable likelihood that it will again engage in any conduct or practice which would subject such government securities broker or government securities dealer to sanctions under section 15C(c) of this title. A registered securities association may establish procedures including examination of the books and records of government securities brokers and government securities dealers to verify compliance with the provisions of this title and the rules thereunder.

(B) A registered securities association may bar any person from becoming associated with a member or condition the association of a person with a member (i) if such person has engaged in any conduct or practice and there is a reasonable likelihood that such person will again engage in any conduct or practice which would subject such person to sanctions under section 15C(c) of this title, or (ii) if such person does not agree to supply such association with such information with respect to its relationship and dealings with the member as may be specified in the rules of the association and to permit examination of its books and records to verify the accuracy thereof.

(5) A registered securities association may deny membership to a registered broker or dealer not engaged in a type of business in which the rules of the association require members to be engaged: Provided, however, That no registered securities association may deny membership to a registered broker or dealer by reason of the amount of such type of business done by such broker or dealer or the other types of business in which he is engaged.

(h)(1) In any proceeding by a registered securities association to determine whether a member or person associated with a member should be disciplined (other than a summary proceeding pursuant to paragraph (3) of this subsection) the association shall bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record. A determination by the association to impose a disciplinary sanction shall be supported by a statement setting forth—

(A) any act or practice in which such member or person associated with a member has been found to have engaged, or which such member or person has been found to have omitted;

(B) the specific provision of this title, the rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or the rules of the association which any such act or practice, or omission to act, is deemed to violate; and

(C) the sanction imposed and the reason therefor.

(2) In any proceeding by a registered securities association to determine whether a person shall be denied membership, barred from becoming associated with a member, or prohibited or limited with respect to access to services offered by the association or a member thereof (other than a summary proceeding pursuant to paragraph (3) of this subsection), the association shall notify such person of and give him an opportunity to be heard upon, the specific grounds for denial, bar, or prohibition or limitation under consideration and keep a record. A determination by the association to deny membership, bar a person from becoming associated with a member, or prohibit or limit a person with respect to access to services offered by the association or a member thereof shall be supported by a statement setting forth the specific grounds on which the denial, bar, or prohibition or limitation is based.

(3) A registered securities association may summarily (A) suspend a member or person associated with a member who has been and is expelled or suspended from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization, (B) suspend a member who is in such financial or operating difficulty that the association determines and so notifies the Commission that the member cannot be permitted to continue to do business as a member with safety to investors, creditors, other members, or the association, or (C) limit or prohibit any person with respect to access to services offered by the association if subparagraph (A) or (B) of this paragraph is applicable to such person or, in the case of a person who is not a member, if the association determines that such person does not meet the qualification requirements or other prerequisites for such access and such person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the association. Any person aggrieved by any such summary action shall be promptly afforded an opportunity for a hearing by the association in accordance with the provisions of paragraph (1) or (2) of this subsection. The Commission, by order, may stay any such summary action on its own motion or upon application by any person aggrieved thereby, if the Commission determines summarily or after notice and opportunity for hearing (which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that such stay is consistent with the public interest and the protection of investors.

JURISDICTION OF OFFENSES AND SUITS

SECTION 27. The district courts of the United States, the district court of the United States for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

IN THE UTAH COURT OF APPEALS

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Western Capital and Securities,)
Inc.,)

Plaintiff and Appellant,)

v.)

Helen Knudsvig,)

Defendant and Respondent.)

OPINION

(For Publication)

Case No. 880198-CA

FILED

FEB 7 1989

Mary T. Noonan

Mary T. Noonan
Clerk of the Court
Utah Court of Appeals

Second District, Weber County

The Honorable John F. Wahlquist

Attorneys: Craig F. McCullough, Salt Lake City, for Appellant

Gerald S. Wight, Ogden, for Respondent

Before Judges Billings, Garff and Jackson.

GARFF, Judge:

Plaintiff and appellant, Western Capital and Securities, Inc. (Western), filed an action to recover \$5,402.20 damages incurred when defendant and respondent, Helen Knudsvig, failed or refused to deliver a stock certificate after she allegedly requested Western to sell stock for her. Knudsvig counter-claimed, alleging that Western had violated Rules 10b-5 and 10b-10 promulgated under § 10(b) of the Securities and Exchange Act of 1934, and various rules of the National Association of Securities Dealers (NASD). We affirm in part and reverse in part.

Western is a broker-dealer registered with the United States Securities and Exchange Commission and the Utah Securities Division. Knudsvig is a sixty-one-year-old customer who occasionally purchased penny stocks through Western and other brokerage firms. The trial court found that she was not a sophisticated investor and only traded a few hundred dollars worth of stock per year.

The conditions in the brokers' contract between Western and Knudsvig required settlement of all transactions five days after a sale or purchase. The relevant provisions read:

4. All transactions shall be settled by the fifth full business day following the sale or purchase . . . and at your option, if you shall not have received cash for the securities purchased for my account or delivery of the securities sold for my account, appropriately endorsed and in proper negotiable form, on the fifth full business day following the purchase or sale, as the case may be, you shall have the right, either with or without demand upon or notice to me, such demand or notice being expressly waived, to close my account, or any trade or transaction included herein on any such exchange or market, at public or private sale, or by public or private purchase, with or without advertising such sale or purchase, such advertising being hereby expressly waived, and such sale or purchase may be made in one or a series of sales or purchases as you may elect.

5. You are authorized to accept from me oral or telephonic orders for the purchase or sale of securities and in consideration of your acceptance of this agreement, I hereby waive any defense that I may have because any such order was not in writing or evidenced by a memorandum in writing as required by the Statute of Frauds, or other statute.

9. Communications of every kind referring in any way to my account may be sent to me at my address given hereon . . . and all communications so sent, whether by mail, telegraph, messenger or otherwise, shall be deemed given to me personally whether actually received by me or not.

Kim Johnson, secretary/treasurer of Western, testified that this language meant that, on the fifth business day following

the sale or purchase, Western had the option (1) to close the transaction by buying in, or (2) to allow the contract to remain open.

In about June 1983, Knudsvig purchased 20,000 shares of Venture Consolidated, Inc. (Venture) for \$200 through Western. This offering was a new issue of penny stock for which Western was a market maker. Knudsvig claimed that she never received a stock certificate, but had attempted to obtain a duplicate certificate in August or September of 1983 and also in November of 1984.

In July 1984, Venture shareholders approved an acquisition and merger with several Big O Tire franchises. They changed the name of the corporation to Tires, Inc. and approved a 20 to 1 reverse stock split. On September 14, 1984, Louis Babcock, Western's Ogden representative, who was acquainted with Knudsvig through past dealings, notified Knudsvig that her Venture shares had increased in value from \$.01 to \$.17 per share, and asked her if she wanted to sell. Knudsvig declined. Later, excited about the rise in value of her stock, she unsuccessfully attempted to contact Babcock. She then contacted Western's office in Salt Lake City and spoke to Richard Davis. After a lengthy discussion, Davis concluded that Knudsvig wanted to sell her stock and wished to credit the sales commission to Babcock. While Knudsvig was still on the telephone, Davis contacted Richard C. Parker, Western's executive vice president, for instructions on how to consummate the transaction, which was complicated by Knudsvig's confusion, the lack of a stock certificate, and having to credit the commission to Babcock. Parker, in spite of these difficulties, immediately approved the purchase from Knudsvig for \$.16114 per share through Western's market making account. Davis returned to the phone, informed Knudsvig of the sale and selling price, and told her that she had to mail in the stock certificate. He informed her that it was possible for a trade to take place without possession of the certificate since she had ten [sic] days after the trade to bring in the certificate. Parker stated that the sale was handled in this manner because Knudsvig was an established, sophisticated customer who had paid for and delivered stock in a timely manner over a long period of time.

Knudsvig disputes Davis's statements, although her testimony is somewhat unclear. Initially, she denied that this phone call ever took place, but then admitted to making the call. She denied that she ever requested the sale of her

stock. She further testified that she had no intention of making a sale, thought that Western could not sell her stock without possession of the certificate, and in 1983, Western had cancelled a similar sale because she could not find her stock certificate. The trial court found that she had assumed there could be no final sale until she was able to get a stock certificate.

Knudsvig stated that, at this point, she was unaware that her stock had been sold because she never received a written confirmation of the sale. Western, however, stated that, within the five day period following the sale, it had sent a written confirmation to Knudsvig's address. Western did not close Knudsvig's account for seventy-five days after the purported sale, at which time the value of the stock had risen to \$8.00 per share.¹ Johnson testified that Western had waited for this unusually long period of time to cover Knudsvig's short position because she was a good customer, she had indicated that she was replacing the certificate, and Johnson thought that he was acting in Knudsvig's best interest. Western's eventual buy-in resulted in a \$5,402.20 deficit in Knudsvig's account, which is the basis for Western's complaint.

In its memorandum decision, entered on October 23, 1986, the trial court found that Knudsvig continued to be the owner of the stock, that the alleged sale never occurred, and that Western's activity was unconscionable. The trial court dismissed Western's complaint and awarded punitive damages to Knudsvig in the amount of \$10,000.

Appellant asserts that the trial court erred: (1) in finding that Knudsvig did not authorize the sale of her stock; (2) in finding that Western violated Rules 10b-5 and 10b-10 of the Securities Exchange Act of 1934; (3) in finding that Western violated various National Association of Securities Dealers (NASD) rules, and in finding that there is a private right of action for violation of NASD rules; and (4) in awarding punitive damages.

The trial court's findings of fact will not be disturbed on appeal unless they "are against the clear weight of the evidence, or if the appellate court otherwise reaches a

1. At the time of the trial, October 16, 1986, the value of the stock was approximately \$30.00 per share.

definite and firm conviction that a mistake has been made." State v. Walker, 743 P.2d 191, 193 (Utah 1987); see also Cove View Excavating & Const. Co. v. Flynn, 758 P.2d 474, 477 (Utah Ct. App. 1988). Factual findings are given considerable deference because of the trial court's ability to assess the witnesses's credibility. Utah R. Civ. P. 52(a); Power Systems, 97 Utah Adv. Rep. at 36; Southland Corp. v. Potter, 760 P.2d 320, 321 (Utah Ct. App. 1988). Findings of fact are clearly erroneous if the appellant can show that they are without adequate evidentiary foundation or if they are induced by an erroneous view of the law. State v. Walker, 743 P.2d 191, 193 (Utah 1987).

In carefully examining the record, we note that there is much conflicting evidence and inconsistent testimony, especially regarding Knudsvig's telephone call to Western, in which Knudsvig purportedly authorized the sale of her stock, and regarding whether or not Knudsvig received written confirmation of the alleged sale from Western. The trial court found that Knudsvig had no intention of selling her stock, that she was the rightful owner of the 20,000 shares of Venture stock, and that Western failed to establish, by a preponderance of the evidence, that written notice of the transaction was mailed to Knudsvig.

In essence, Western argues that the trial court should have believed its evidence rather than Knudsvig's. However, the clear weight of the evidence supports the trial court's findings that the sale was not authorized and did not take place, and we defer to the trial court's advantaged position in evaluating the witnesses's demeanor and credibility. We find no error in the court's rulings on this issue.²

JURISDICTION

Western asserts that the trial court erred in finding that it violated Rules 10b-5 and 10b-10 of the Securities Exchange

2. Although Knudsvig raises affirmative defenses to Western's action under Utah Code Ann. § 70A-8-301, the Securities Exchange Act of 1934 § 10b-10, and § 12 of the NASD manual, we do not consider them because: (1) we sustain the trial court's finding that no sale of the securities occurred, thus obviating the need for a defense to the sale, and (2) the parties did not raise the issue on appeal.

Act of 1934 and various NASD rules. Before we examine the merits of this argument, however, we raise sua sponte the issue of subject matter jurisdiction over this claim. As stated in Carreathers v. Carreathers, 654 P.2d 871 (Colo. Ct. App. 1982),

[t]he parties have not raised the issue of . . . subject matter jurisdiction . . . in the trial court or in this appeal. However, the question of subject matter jurisdiction may be raised at any stage of an action without an assignment of error, and an appellate court may decide a question of subject matter jurisdiction where it appears on the face of the record.

Id. at 871; see also Thompson v. Jackson, 743 P.2d 1230, 1232 (Utah Ct. App. 1987). Furthermore, "this Court may, on its own motion, determine lack of jurisdiction." Bailey v. Sound Lab, Inc., 694 P.2d 1043, 1044 (Utah 1984); see also State v. Brandimart, 720 P.2d 1009, 1010 (Haw. 1986). "Jurisdiction cannot be conferred upon this Court by stipulation" of the parties. Bailey, 649 P.2d at 1044.

Exclusive jurisdiction over causes of action stemming from violations of the Securities Exchange Act of 1934 is vested in the federal courts. The 1934 Act, at 15 U.S.C. § 78aa (1981), states in relevant part:

The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder. . . . Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder . . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant

Federal courts generally interpret this statute to mean what it says: federal jurisdiction is exclusive over actions brought to enforce the 1934 Act. See, e.g., Securities Investor Protection Corp. v. Vigman, 764 F.2d 1309, 1313 (9th Cir. 1985); DeHaas v. Empire Petroleum Co., 435 F.2d 1223, 1231 (10th Cir. 1971); Alkoff v. Gold, 611 F. Supp. 63, 66 (S.D.N.Y. 1985); Kinsey v. Nestor Exploration Ltd.--1981A, 604 F. Supp. 1365, 1368-69 (E.D. Wash. 1985); Fradkin v. Ernst, 571 F. Supp.

829, 839 (N.D. Ohio 1983); Kleckley v. Hebert, 464 So. 2d 39, 42 (La. Ct. App. 1985).

There is a split in authority as to whether the 1934 Act can be used as an affirmative defense in state actions. Some jurisdictions assert that state courts do not have jurisdiction to adjudicate federal securities law questions brought under the 1934 Act, even when raised as an affirmative defense. Instead, they "squarely endorse" the proposition that "[w]here exclusive jurisdiction exists, only the federal courts can provide affirmative relief." Alkoff, 611 F. Supp. at 66 (quoting Levy v. Lewis, 635 F.2d 960, 967 (2nd Cir. 1980)).

While recognizing that the statute precludes state court adjudication of direct claims based upon the violation of the 1934 Act, other jurisdictions allow state courts to consider claims based on the 1934 Act which are raised as affirmative defenses in state court actions. Andrea Theatres, Inc. v. Theatre Confections, Inc., 787 F.2d 59, 63 (2nd Cir. 1986); Scope Indus. v. Skadden, Arps, Slate, Meagher & Flom, 576 F. Supp. 373, 379 (C.D. Cal. 1983); Birenbaum v. Bache & Co., 555 S.W.2d 513, 514-15 (Tex. Civ. App. 1977).

Even so, these jurisdictions do not allow state courts to grant affirmative relief to a defendant who prevails on such federal claims, but, instead, force the defendant to go to federal court to seek affirmative relief. Andrea Theatres, 787 F.2d at 63. Further, these jurisdictions distinguish between "cases," wherein state determination is precluded, and "questions," which the state may adjudicate, which arise under the 1934 Act. Scope Indus., 576 F. Supp. at 378-79; Birenbaum, 555 S.W.2d at 515. The Birenbaum court adopted the United States Supreme Court's reasoning regarding jurisdiction over patent claims in making this distinction:

There is a clear distinction between a case and a question arising under the patent laws. The former arises when the plaintiff in his opening pleading--be it a bill, complaint, or declaration--sets up a right under the patent laws as ground for a recovery. Of such the state courts have no jurisdiction. The latter may appear in the plea or answer or in the testimony. The determination of such question is not beyond the competency of the state tribunals.

Birenbaum, 555 S.W.2d at 515 (quoting Pratt v. Paris Gaslight & Coke Co., 168 U.S. 255, 259 (1897) (emphasis in Birenbaum)). The Birenbaum court found that the state court was competent to adjudicate a 10b-5 violation issue because it "only appeared by way of defense, it is merely a question in the case, rather than a claim for relief." Birenbaum, 555 S.W.2d at 515.

Similarly, the Scope Industries court, in determining that the state court had jurisdiction to consider a defense based on the 1934 Act, also distinguished between cases, which the state court could not adjudicate, and questions, which the state court was competent to consider. It stated that whether a "colorable claim existed under the Exchange Act at the commencement of the underlying action is different in kind than the question of whether or not Scope violated the Exchange Act, as alleged in the underlying action." Scope Indus., 756 F. Supp. at 378-79.

We do not find it necessary today to decide which of these lines of cases we will follow. Although Knudsvig asserted Rule 10b-10 as an affirmative defense, her claims under the 1934 Act were brought in the form of a counterclaim for violation of Rule 10b-5 as well as Rule 10b-10. Thus, even under the more liberal authority, she does not qualify jurisdictionally. These claims are in the nature of a case rather than a question and, accordingly, we do not have jurisdiction to consider them.

VIOLATION OF NASD RULES

Section 15A(b)(6) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3(b)(6) (1981), requires securities associations, such as the NASD, to adopt disciplinary rules. See Emmons v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 532 F. Supp. 480, 483 (S.D. Ohio 1982). Section 15 U.S.C. § 78s(g) requires that "[e]very self-regulatory organization shall comply with the provisions of this chapter, the rules and regulations thereunder, and its own rules." Thus, the NASD comes under the regulatory provisions of the Act and is subject to the exclusive jurisdiction provision of 15 U.S.C. § 78o(a). Therefore, any action based on violation of NASD rules must be brought in the federal courts.

That Knudsvig's counterclaim may be construed to be compulsory under Utah R. Civ. P. 13(a) still does not confer jurisdiction upon this Court to hear the merits of her claim. "A party is not required to file a compulsory counterclaim in

the district court if the claim exceeds the jurisdiction of that court." Brewer v. Bradley, 431 So. 2d 544, 545 (Ala. Civ. App. 1983).³

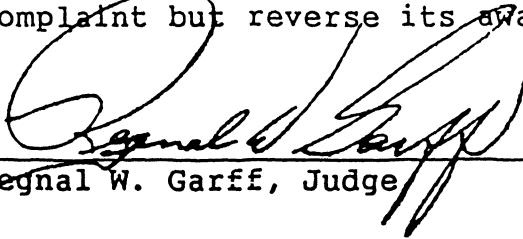
To summarize, Knudsvig's counterclaim relies exclusively upon alleged violations of the 1934 Act and NASD rules, which are regulated under the 1934 Act, all of which come under exclusive federal jurisdiction. Once we have determined that we have no jurisdiction over a claim, all we may do is dismiss the action. See In re Marriage of Passiales, 144 Ill. App. 3d 629, 494 N.E.2d 541, 547, 98 Ill. Dec. 419 (1986); Wells v. Noldon, 679 S.W.2d 889, 891 (Mo. Ct. App. 1984). Therefore, we dismiss Knudsvig's entire counterclaim.

PUNITIVE DAMAGES

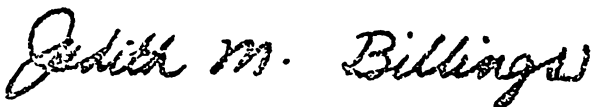
The trial court dismissed Western's complaint and, even though the court failed to find any actual damages stemming from the alleged violations of the Securities Exchange Act of 1934 in Knudsvig's counterclaim, it awarded punitive damages to Knudsvig. Since we have found that the trial court had no jurisdiction to hear the counterclaim, it follows that Knudsvig's associated request for damages fails. See Howard v. Miller, 108 Ill. App. 3d 1, 438 N.E.2d 680, 685, 63 Ill. Dec. 749 (1982); see also DeWitt County Pub. Bldg. Comm'n v. County of DeWitt, 128 Ill. App. 3d 11, 469 N.E.2d 689, 694, 83 Ill. Dec. 82 (1984). Further, "a court without jurisdiction cannot order affirmative relief." Chadwick v. Pillard, 536 F. Supp. 73, 75 (E.D. Tenn. 1982). Therefore, the trial court could not award punitive damages.

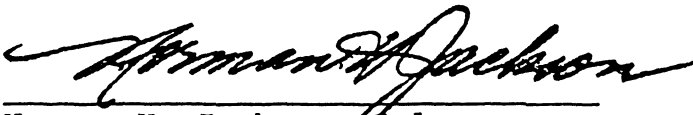
3. Federal practice is similar: If a federal court has jurisdiction over a plaintiff's claim, it will also have jurisdiction over a counterclaim arising from the same action or occurrence. However, "if the counterclaim is entirely beyond the competence of the federal courts, as for example, an action precluded by sovereign immunity or one involving a purely probate matter, the court may not adjudicate it even if the claim would otherwise be treated as compulsory." Wright & Miller, Federal Practice & Procedure, § 1414 at 72 (1971).

We affirm the trial court's dismissal of Western's complaint but reverse its award of punitive damages.


Regnal W. Garff, Judge

WE CONCUR:


Judith M. Billings, Judge


Norman H. Jackson, Judge

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IN THE DISTRICT COURT OF WEBER COUNTY
STATE OF UTAH

WESTERN CAPITAL AND
SECURITIES, INC.,

Plaintiff,

-vs-

HELEN KNUDSVIG,

Defendant.

JUDGMENT

CIVIL NO: 92290

57/429

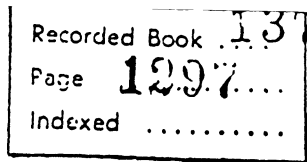
This matter having come before the Court for trial on the 16th day of October, 1986, at the hour of 9:30 a.m., the Court having taken the matter under advisement at the close of testimony and oral argument, and having previously rendered its Memorandum Decision and entered Findings of Fact and Conclusions of Law, does hereby award judgment as follows:

1. That the Complaint of the Plaintiff is dismissed no cause of action.

2. That the Defendant is the sole owner of the 20,000 shares of Venture Consolidated which has since been

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OGDEN, UTAH 84401



converted by the company to 1,000 shares of Tires, Inc., and has been at all times and places in that the Plaintiff has not and does not have any claim whatsoever on said shares or against the Defendant.

3. That the Plaintiff has acted in violation of Rule 10B(5) and 10B(10) of the Securities Exchange Act of 1934 and the NASD Rules of which the Plaintiff is a member and has further acted in a manner so as to deceive and cheat the public in general and the Defendant in particular by its involvement and hold and control over the subject corporation with the knowledge and inside information of its dealings in up coming business activities, and has used all such to the detriment and damage of the Defendant in attempting to convert her stock, all in violation of all applicable rules and regulations thus entitling the Defendant to judgment against the Plaintiff in the amount of \$10,000.00 punitive damage in addition to costs of Court in the amount of \$35.00.

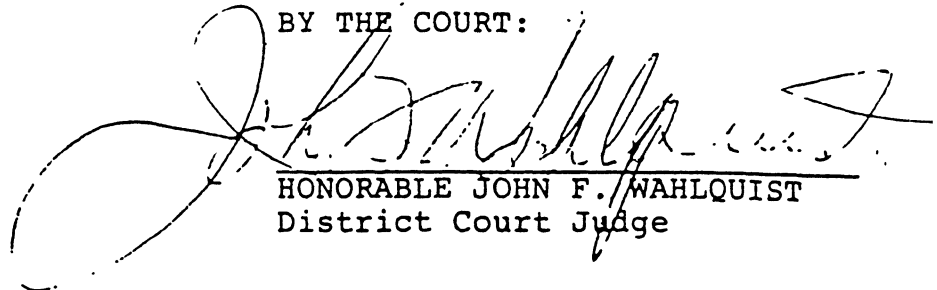
4. It is further Ordered that Interwest Transfer or any other entity which has previously been served with or notified of any restraining order restraining the obtaining of the certificate by the Defendant shall forthwith release any such certificate and issue the same to the Defendant upon appropriate application.

ATTORNEYS AT LAW
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OGDEN, UTAH 84401

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DATED this 10 day of October, 1986.

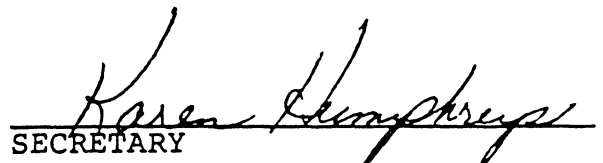
BY THE COURT:


HONORABLE JOHN F. WAHLQUIST
District Court Judge

CERTIFICATE OF MAILING

I HEREBY CERTIFY that on this 20 day of October, 1986, I mailed a true and correct copy of the above and foregoing JUDGMENT by placing same in the U.S. Mail postage prepaid and addressed to the following:

Craig F. McCullough
Attorney for Plaintiff
185 South State Street, #528
Salt Lake City, Utah 84111


SECRETARY

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