

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

-----X  
:  
PEOPLE OF THE STATE OF NEW YORK, by  
ELIOT SPITZER, the Attorney General of :  
the State of New York, :  
:  
Plaintiff, : 04 Civ. 4565 (GEL) (DCF)  
:  
-against- : \*ECF\*  
:  
RICHARD A. GRASSO, KENNETH G. LANGONE :  
and THE NEW YORK STOCK EXCHANGE, INC., :  
:  
Defendants. :  
-----X

**MEMORANDUM OF LAW IN SUPPORT OF MOTION  
TO REMAND ACTION TO NEW YORK STATE SUPREME COURT**

ELIOT SPITZER  
Attorney General of the  
State of New York  
120 Broadway  
New York, NY 10271  
(212) 416-8050

AVI SCHICK  
Deputy Counsel to the Attorney General

DAVID AXINN  
Assistant Solicitor General

GABRIEL HERTZBERG  
Assistant Attorney General  
*Of counsel*

TABLE OF CONTENTS

|   | <u>PAGE</u> |
|---|-------------|
| TABLE OF AUTHORITIES . . . . .  | ii          |
| PRELIMINARY STATEMENT . . . . .   | 1           |
| STATEMENT OF THE FACTS . . . . .  | 4           |
| ARGUMENT - THE ACTION SHOULD BE REMANDED<br>TO NEW YORK STATE SUPREME COURT . . . . .   | 5           |
| A. The Standards Governing Removal and Remand . . . . .   | 5           |
| B. The Action Is Not Removable Under 28 U.S.C.<br>§ 1441(b) . . . . .   | 6           |
| 1. The Complaint Does Not Raise Any<br>Federal Issues . . . . .   | 7           |
| 2. Even If, <i>Arguendo</i> , Federal Issues Were<br>Raised In The Complaint, They Would Not<br>Provide A Basis For Removal . . . . . | 12          |
| C. The Action Is Not Removable Under 28 U.S.C.<br>§ 1442(a)(1) . . . . .  | 14          |
| 1. Grasso's Award Of Excessive Compensation<br>Was Not Directed By The Federal Government<br>Or Federal Law . . . . .                 | 15          |
| 2. There Is No Causal Nexus Between Any<br>Federal Directives And The Conduct In<br>Question . . . . .                                | 19          |
| 3. Defendants Do Not Have A Colorable<br>Federal Defense . . . . .  | 20          |
| a. The N-PCL Is Not Conflict-Preempted<br>By The Exchange Act . . . . .   | 20          |
| b. The N-PCL Is Not Field-Preempted<br>By The Exchange Act . . . . .  | 21          |
| c. Defendants Are Not Entitled To<br>Federal Immunity . . . . .   | 24          |
| CONCLUSION . . . . .  | 25          |

TABLE OF AUTHORITIES

| <u>CASES</u>   | <u>PAGE</u>   |
|--|---------------|
| <u>American Well Works Co. v. Layne &amp; Bowler Co.,</u><br>241 U.S. 257 (1916) . . . . .                             | 7             |
| <u>Barbara v. New York Stock Exchange, Inc.,</u><br>99 F.3d 49 (2d Cir. 1996) . . . . .                                | <i>passim</i> |
| <u>Beneficial National Bank v. Anderson,</u><br>539 U.S. 1 (2003) . . . . .  | 8             |
| <u>Berrios v. Our Lady of Mercy Med. Ctr.,</u><br>99 civ. 21, 1999 WL 92269 . . . . .                                  | 6             |
| <u>Blum v. New York Stock Exchange, Inc.,</u><br>298 A.D.2d 343 (2d Dep't 2002) . . . . .                              | 18            |
| <u>Brown v. National Football League,</u><br>219 F. Supp. 2d 372 (S.D.N.Y. 2002) . . . . .                             | 12            |
| <u>Bruan, Gordon &amp; Co. v. Hellmers,</u><br>502 F. Supp. 897 (S.D.N.Y. 1980) . . . . .                              | 18            |
| <u>Burks v. Lasker,</u><br>441 U.S. 471 (1979) . . . . .   | 22-23         |
| <u>Caterpillar, Inc., v. Williams,</u><br>482 U.S. 386 (1987) . . . . .  | 7,11-12       |
| <u>Conigliaro v. New York Stock Exchange, Inc.,</u><br>2 A.D.3d 767 (2d Dep't 2003) . . . . .                          | 18            |
| <u>Cornell Manuf., Co. v. Mushlin,</u><br>70 A.D.2d 123 (2d Dep't 1979) . . . . .                                      | 22            |
| <u>Curtin v. Port Authority of N.Y.,</u><br>183 F. Supp. 2d 664 (S.D.N.Y. 2002) . . . . .                              | 5             |
| <u>DL Capital Group LLC v. NASDAQ Stock Market, Inc.</u><br>No. 03 Civ. 9730, 2004 WL 993109 (S.D.N.Y. 2004) . . . . . | 18            |

D'Alessio v. New York Stock Exchange,  
125 F. Supp. 2d 656 (S.D.N.Y. 2000)  
aff'd, 258 F.3d 93 (2d Cir. 2001) . . . . . *passim*

Donovan v. Rothman,  
106 F. Supp. 2d 513 (S.D.N.Y. 2000) . . . . . 13

Fischer v. Mastercard International, Inc.,  
No. 03 Civ. 2111, 2003 WL 22110169  
(S.D.N.Y. Sept. 11, 2003) . . . . . 5,17

Franchise Tax Board v. Construction Laborers Vacation Trust,  
463 U.S. 1 (1983) . . . . . 7-8, 10-11

Frayler v. New York Stock Exchange,  
118 F. Supp. 2d 448 (S.D.N.Y. 2000) . . . . . 15

Geier v. American Honda Motor Co.,  
529 U.S. 861 (2000) . . . . . 20

Gully v. First National Bank,  
299 U.S. 109 (1936) . . . . . 11-12

Healy v. Sea Gull Specialty Co.,  
237 U.S. 479 (1915) . . . . . 11

In re Methyl Tertiary Butyl Ether ("MTBE") Products  
Liability Litigation,  
No. M21-88, MDL No. 1358, 2004 WL 515535  
(S.D.N.Y. Mar. 16, 2004) . . . . . 14-16, 19

Kings Choice Neckwear, Inc v. DHL Airways, Inc.,  
02 Civ. 9580 (GEL), 2003 WL 22283814  
(S.D.N.Y. Oct. 2, 2003) . . . . . 5,7-8, 22

Maryland v. Louisiana,  
451 U.S. 725 (1981) . . . . . 21

Matter of the Board of Trustees of the Huntington Free  
Library and Reading Room,  
01 Civ. 2599, 2002 WL 123502  
(S.D.N.Y. Jan. 30, 2002) . . . . . 14, 23

Matter of Herbert H. Lehman College Foundation, Inc.,  
v. Fernandez,  
 292 A.D.2d 227 (1st Dep't 2002) . . . . . 23

Mayo v. Dean Witter Reynolds, Inc.,  
 258 F. Supp. 2d 1097 (N.D. Cal.), amended by,  
 260 F. Supp. 2d 979 (N.D. Cal. 2003) . . . . . 23-24

Merrell Dow Pharmaceuticals, Inc. v. Thompson,  
 478 U.S. 804 (1986) . . . . . 7,12-13

Mesa v. California,  
 489 U.S. 121 (1989) . . . . . 25

New York State Conference of Blue Cross & Blue Shield  
Plans v. Travelers Insurance Co.,  
 514 U.S. 645 (1995) . . . . . 10, 21-22

Piccinich v. New York Stock Exchange, Inc.,  
 257 A.D.2d 438 (1st Dep't 1999) . . . . . 19

Planned Consumer Marketing, Inc. v. Coats and Clark, Inc.,  
 71 N.Y.2d 442 (1988) . . . . . 22

Rice v. Santa Fe Elevator Corp.,  
 331 U.S. 219 (1947) . . . . . 22

Scattered Corp. v. Chicago Stock Exchange, Inc.,  
 701 A.2d 70 (1997) . . . . . 21

Sentry Marketing, Inc. v. Unisource Worldwide, Inc.,  
 42 F. Supp. 2d 188 (N.D.N.Y. 1999) . . . . . 6

Sparta Surgical Corp. v. National Association of  
Securities Dealers, Inc.,  
 159 F.3d 1209 (9th Cir. 1998) . . . . . 17, 20-21, 24

State of New York v. Justin,  
 237 F. Supp. 2d 368 (W.D.N.Y. 2002) . . . . . 12, 21

Wall Street Garage Parking Corp. v. New York Stock Exchange,  
 3 Misc. 3d 1014 (N.Y. Sup. Ct. N.Y. County, 2004) . . . . . 19, 24

Western Capital Design, LLC v. New York Mercantile Exchange,  
180 F. Supp. 2d 438 (S.D.N.Y. 2001)  
aff'd, 25 Fed. App. 63 (2002) . . . . . 18

**STATUTES AND OTHER AUTHORITIES**

15 U.S.C. § 78a . . . . . 3  
15 U.S.C. § 78b . . . . . 11, 21  
15 U.S.C. § 78c(a)(26) . . . . . 4  
15 U.S.C. § 78f . . . . . 4, 21  
15 U.S.C. § 78f(a) . . . . . 8, 16  
15 U.S.C. § 78f(b) . . . . . 9, 16, 21  
15 U.S.C. § 78s . . . . . 16, 23  
28 U.S.C. § 1331 . . . . . 6  
28 U.S.C. § 1441(a) . . . . . 2  
28 U.S.C. § 1441(b) . . . . . *passim*  
28 U.S.C. § 1442(a)(1) . . . . . *passim*  
28 U.S.C. § 1447(c) . . . . . 1  
Not-for-Profit Corporation Law § 112 . . . . . 4  
Not-for-Profit Corporation Law § 202(a)(12) . . . . . *passim*  
Not-for-Profit Corporation Law § 515(b) . . . . . *passim*  
Not-for-Profit Corporation Law § 715(f) . . . . . 2, 4  
Not-for-Profit Corporation Law § 716 . . . . . 4

|  | <u>PAGE</u> |
|--|-------------|
| Not-for-Profit Corporation Law § 717 . . . . .   | 1-2         |
| Not-for-Profit Corporation Law § 720(a) . . . . .  | 1-2, 4, 23  |
| Not-for-Profit Corporation Law § 720(b) . . . . .  | 1-2, 4      |
| 13B Charles Alan Wright et al., Federal Practice<br>and Procedure § 3566, at 105 (2d ed. 1984) . . . . . | 8           |
| NYSE General Rule 22(b) . . . . .  | 10-11       |

## PRELIMINARY STATEMENT

The People of the State of New York by Eliot Spitzer, Attorney General of the State of New York (the "State"), submit this brief in support of their motion under 28 U.S.C. § 1447(c) to remand this action to New York State Supreme Court, New York County.

The defendants in this action have each violated New York's Not-For-Profit Corporation Law ("N-PCL") in connection with the payment of approximately \$190 million to Richard A. Grasso ("Grasso") during his tenure as Chairman and Chief Executive Officer of the New York Stock Exchange, Inc. ("NYSE") from June 1, 1995 through September 17, 2003.

The Complaint<sup>1</sup>, which was filed in New York State Supreme Court, alleges eight causes of action under the N-PCL and two State common law claims arising out of the N-PCL. Defendant Grasso violated both the N-PCL and his common law duties to the NYSE in receiving the \$190 million. (Cplt. ¶¶ 164-205). Defendant Kenneth G. Langone ("Langone"), a former NYSE director and chairman of the Board of Directors' compensation committee, violated N-PCL §§ 717, 720(a)-(b) by misrepresenting to the NYSE's Board the amount of compensation to be paid to Grasso. (Cplt. ¶¶ 206-13). Lastly, the NYSE, a New York not-for-profit corporation, violated the N-PCL by paying the \$190 million to

---

<sup>1</sup> "Cplt." or "Complaint" refers to the complaint in this action filed in New York Supreme Court, New York County, on May 24, 2004; "Not. Rem." refers to Grasso's Notice of Removal dated June 17, 2004.

Grasso. (Cplt. ¶¶ 214-17).

The Complaint thus seeks the return of the illegal and ultra vires compensation paid to Grasso, both because such payments were not "reasonable" and "commensurate with services performed," N-PCL §§ 202(a)(12), 515(b), and because information concerning the amount and details of the payments was not properly disclosed to the NYSE's Board (see N-PCL §§ 715(f), 717(a), 720(a)-(b)). (Cplt. ¶¶ 15-21, 69-89, 112-31, 164-217). The Complaint does not allege any violations of federal law or NYSE rules, or even refer to such law or rules.

Notwithstanding, Grasso has removed this case to federal court under 28 U.S.C. § 1441(a)-(b), arguing that the State's claims necessitate an inquiry into "some construction of federal law." (Not. Rem. ¶ 26). They do not: the Complaint's allegations do not raise federal questions on their face under the well-pleaded complaint rule, and their resolution does not require a construction of federal law. (See Not. Rem. ¶ 30). In an effort to evade the jurisdiction of the State Court, Grasso cites a handful of sentences from among the 54 pages of the Complaint. While these sentences illustrate some of the reasons why the N-PCL imposes restrictions on compensation, they do not themselves constitute causes of action, represent the gravamen of the Complaint, or require any construction of federal law.

Grasso also relies upon 28 U.S.C. § 1442(a)(1), asserting

that in requesting and receiving \$190 million, he was a "person acting under [a] federal officer." (See Not. Rem. ¶ 8). He was not: Grasso, Langone and the NYSE are not federal agencies or officials under § 1442(a)(1). To the extent Grasso argues that because the NYSE is regulated under the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78a et seq., he is entitled to federal immunity and the State is preempted from challenging any action taken by him in his official capacity, he is mistaken. (Not. Rem. ¶¶ 20-22). The Second Circuit has clearly established that the NYSE is entitled to removal only when the underlying state action challenges or involves its regulatory or self-policing function, not when the action relates to traditional internal corporate affairs, such as the payment of compensation to corporate directors and officers. D'Alessio v. New York Stock Exchange, Inc., 258 F.3d 93, 106 (2001); Barbara v. New York Stock Exchange, Inc., 99 F.3d 49, 54 (2d Cir. 1996).

Removal is also inappropriate because nothing in the Exchange Act or the NYSE's General Rules requires or permits Grasso to receive \$190 million in violation of the N-PCL's restrictions on compensation paid to officers and directors.

Accordingly, this action should be promptly remanded to State court so that the exclusively State-law N-PCL claims may proceed against the defendants.

## STATEMENT OF THE FACTS

This action was commenced by summons and complaint filed in the New York State Supreme Court, New York County, on May 24, 2004, against defendants Grasso, Langone and the NYSE. The NYSE is a New York not-for-profit corporation, (Cplt. ¶ 3), which is also registered with the United States Securities and Exchange Commission ("SEC") as a national securities exchange<sup>2</sup> pursuant to the Exchange Act § 78f. Grasso served as the Chairman and Chief Executive Officer of the NYSE from 1995 until September 17, 2003. (Cplt. ¶ 4). Langone joined the NYSE's Board of Directors in June 1998 and served as chairman of its compensation committee from June 1999 until June 2003. (Cplt. ¶ 6).

The Complaint alleges eight causes of action under the N-PCL and two claims under New York State common law.<sup>3</sup> All of the claims arise out of the NYSE's payment, and Grasso's receipt, of

---

<sup>2</sup> National securities exchanges, such as the NYSE, also fall within the Exchange Act's definition of "self-regulatory organizations" ("SROs"). 15 U.S.C. § 78c(a)(26). SROs also include registered securities associations and registered clearing agencies. Id.

<sup>3</sup> The Complaint alleges: five claims against Grasso seeking the restitution of excessive, illegal and ultra vires compensation under N-PCL §§ 202(a)(12), 515(b), 715(f), 716, 717, 720(a), 720(b) and under the State common law theories of constructive trust, restitution and payment had and received (Cplt. ¶¶ 164-205); one claim against Langone seeking money damages for the unlawful, improper, excessive or erroneous payments of compensation caused by him under N-PCL §§ 717, 720(a), 720(b) (Cplt. ¶¶ 206-13); and one claim against the NYSE for paying Grasso compensation that was not "reasonable" and "commensurate with services" under N-PCL §§ 112, 202(a)(12), 515(b) (Cplt. ¶¶ 214-17). The common law claims against Grasso derive from the duties imposed on him under the N-PCL. (Cplt. ¶¶ 164-72, 187-90).

excessive, illegal and ultra vires compensation under the N-PCL. No federal causes of action are alleged against defendants and no federal statutes or regulations are cited in the Complaint.

By notice of removal dated June 17, 2004, Grasso removed the action to this Court citing 28 U.S.C. §§ 1441(b) and 1442(a)(1), and indicating that he had obtained the prior consent of defendant Langone to the removal, but not the NYSE.

#### ARGUMENT

#### **THE ACTION SHOULD BE REMANDED TO NEW YORK STATE SUPREME COURT**

Grasso's notice of removal does not satisfy the prerequisites for removal under either 28 U.S.C. §§ 1441(b) or 1442(a)(1), and accordingly, this action should be remanded back to the New York State Supreme Court.

#### **A. The Standards Governing Removal and Remand**

"Removal statutes are construed narrowly and all uncertainties are resolved in favor of remand in order to promote the goals of federalism, restrict federal court jurisdiction, and support the plaintiff's right to choose the forum." Fischer v. Mastercard Int'l, Inc., No. 03 Civ. 2111, 2003 WL 22110169, at \*1 (S.D.N.Y. Sept. 11, 2003) (quoting Curtin v. Port Auth. of N.Y., 183 F. Supp. 2d 664, 667 (S.D.N.Y. 2002)). When the removal is contested, "the burden falls squarely upon the removing party to establish its right to a federal forum by competent proof." Kings Choice Neckwear, Inc v. DHL Airways, Inc., 02 Civ. 9580

(GEL), 2003 WL 22283814, at \*2 (S.D.N.Y. Oct. 2, 2003)  
(quotations omitted).

**B. This Action Is Not Removable Under 28 U.S.C. § 1441(b)**

An action is removable under 28 U.S.C. § 1441(b) in "any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States."<sup>4</sup> Since the parties in this action are non-diverse, Grasso argues the Complaint gives rise to federal question jurisdiction because its causes of action "arise under" federal law under 28 U.S.C. § 1331. In particular, Grasso contends that the Complaint seeks to redefine the duties he owed to the NYSE as a national securities exchange under the Exchange Act, and to hold him liable for conduct governed by the Exchange Act or the NYSE's General Rules. (Not. Rem. ¶¶ 27-35). Neither contention is true. The Complaint necessarily refers to some of Grasso's Exchange Act

---

<sup>4</sup> As a preliminary matter, Grasso's failure to obtain "unanimous consent by all defendants prior to removal" is fatal to his removal under § 1441. Berrios v. Our Lady of Mercy Med. Ctr., 99 civ. 21, 1999 WL 92269, at \*2 (S.D.N.Y. Feb. 19, 1999). Grasso attempts to excuse his failure to obtain the NYSE's consent by characterizing the NYSE as a nominal defendant aligned in interest with the State. (Not. Rem. ¶¶ 36-39). However, the NYSE is properly aligned as a defendant and adverse party, having been affirmatively sued by the State for paying Grasso illegal compensation under N-PCL §§ 202(a)(12), 515(b) and potentially subject to injunctive or other relief by the State to ensure future compliance. (Cplt. ¶¶ 214-17, Relief Requested paragraph ¶ g). See Sentry Mktg, Inc. v. Unisource Worldwide, Inc., 42 F. Supp. 2d 188, 191 (N.D.N.Y. 1999) ("[a] party is nominal when that party has little or no interest in the outcome of the litigation and no cause of action or claim for relief is or could be stated against it") (quotations omitted).

duties as part of its narrative of the events and processes that led to the awards of excessive compensation, but no cause of action or request for relief seeks to hold him liable for any violation of his federal duties.

1. **The Complaint Does Not Raise Any Federal Issues**

Grasso's argument fails under the well-pleaded complaint rule, which states that "original federal jurisdiction is unavailable unless it appears that some substantial, disputed question of federal law is a necessary element of one of the well-pleaded state claims, or that one of the other claim[s] is 'really' one of federal law." Franchise Tax Bd. v. Construction Laborers Vacation Trust, 463 U.S. 1, 13 (1983).

As this Court has explained, the "rule makes the plaintiff the master of the claim; he or she may avoid federal jurisdiction by exclusive reliance on state law." Kings Choice Neckwear, 2003 WL 22283814, at \*2 (quoting Caterpillar, Inc. v. Williams, 482 U.S. 386, 392 (1987)). The corollary to this rule is that federal question jurisdiction must arise on the face of the complaint and a federal issue may not be raised by defendant as a defense. See Merrell Dow Pharmaceuticals, Inc. v. Thompson, 478 U.S. 804, 808 (1986); Franchise Tax Bd., 463 U.S. at 10.

It is indisputable that none of the Complaint's eight causes of action arises under federal law or implicates a federal issue. See Merrell Dow, 478 U.S. at 808 ("a 'suit arises under the law

that creates the cause of action'") (quoting American Well Works Co. v. Layne & Bowler Co., 241 U.S. 257, 260 (1916)).<sup>5</sup>

Recognizing this difficulty, Grasso also argues that the Complaint implicates federal law because "the vindication of a right under state law necessarily turned on some construction of federal law." (Not. Rem. ¶ 26 (quoting Franchise Tax Bd., 463 U.S. at 9)). To manufacture a federal issue, Grasso cites paragraphs 25-27 and 30 of the Complaint to convey the false impression that the Complaint seeks to impose liability on defendants based upon the composition of the NYSE's Board of directors. (Not. Rem. ¶¶ 14-15). Grasso, however, neglects to mention that there is no cause of action nor relief requested in the Complaint that seeks to impose liability upon any of the defendants based upon the Board's composition. Indeed, the only relief sought against Grasso is the restitution of improperly received sums, and the sole basis for this relief is that defendants violated their N-PCL and State common law duties.

---

<sup>5</sup> Grasso does not argue, and the case does not fall within, the narrowly defined exception to the well-pleaded complaint rule for federal statutes that "have so strong a preemptive effect that they do more than merely provide a defense to a state-law claim." Kings Choice Neckwear, 2003 WL 22283814, at \*2 (quoting 13 B Charles Alan Wright et al., Federal Practice and Procedure § 3566, at 105 (2d ed. 1984)). In those cases "federal law is considered to have taken over [the] entire subject matter and made it inherently federal." Id. The Supreme Court has recognized such an exception only in the context of the Labor Management Relations Act, the Employee Retirement Income Security Act of 1974 ("ERISA"), and the National Bank Act. See Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 8 (2003).

Thus, no relief or cause of action is based upon the composition of the Board.

In particular, Grasso emphasizes 15 U.S.C. § 78f(b)(3), which requires national securities exchanges to "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 exchange, broker, or dealer." (Not. Rem. ¶ 19). This federal provision does not implicate any allegations in the Complaint, as the State is not seeking to hold defendants liable for the composition of the Board or for any denial of "fair representation" to the NYSE's members.<sup>6</sup>

This same flaw is fatal to the balance of Grasso's arguments. Grasso selectively cites paragraphs 29-31 of the Complaint to suggest that it seeks to hold Grasso liable for failing to take various regulatory actions against NYSE member firms. (Not. Rem. ¶¶ 16, 33). Once again, no cause of action in the Complaint nor request for relief seeks to hold Grasso liable for the allegations in paragraph 29-31.

Lastly, Grasso cites paragraphs 25 and 69 of the Complaint,

---

<sup>6</sup> In any event, the "fair representation" rule does not mandate Grasso's decision to place representatives of large member firms on the NYSE's Compensation Committee (Cplt. ¶ 25), a practice since abandoned by the NYSE.

arguing that the State's breach of fiduciary duty claim "purports to define the contours of the duties owed by Mr. Grasso to the Exchange - its central claim is that Mr. Grasso's interactions with the Board regarding his compensation allegedly were inappropriate and constituted a breach of such duties." (Rem. Not. ¶ 27). The State does not disagree that the fiduciary claims against Grasso arise from his failure to exercise the standard of care and loyalty required of a New York fiduciary under the N-PCL in connection with his receipt of excessive compensation. Similarly, the fiduciary duty claims against Langone arise from his failure to adhere to New York fiduciary standards in his communications with the Board concerning Grasso's pay. (Cplt. ¶ 212).

Grasping for any support at all, Grasso cites NYSE General Rule 22(b) in an effort to show that the entire field of State fiduciary duty law, as applied to the NYSE, is now occupied by NYSE rules and federal law. Rule 22(b), however, merely states that "[n]o person shall participate in the consideration, review or adjudication of any matter in which they are personally interested." This generic anti-conflicts clause cannot support Grasso's weighty argument that the entire body of state fiduciary law has been displaced by this single NYSE rule. Such reasoning ignores the long-standing "presumption that Congress does not intend to supplant state law." New York State Conference of Blue

Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 654 (1995). Furthermore, Grasso ignores that the purpose of Rule 22(b) is to avoid conflicts of interest in the discharge of the NYSE's regulatory function, not its internal corporate affairs.<sup>7</sup>

In sum, the paragraphs cherry-picked by Grasso in his notice of removal do not raise federal issues. See Franchise Tax Bd., 463 U.S. at 13 ("original federal jurisdiction is unavailable unless it appears that some substantial, disputed question of federal law is a necessary element of one of the well-pleaded state claims").

These paragraphs, however, do provide the court with some context for the compensation process by describing the events leading up to and surrounding the compensation awards. Furthermore, the cited sentences demonstrate the wisdom of the N-PCL's limitations on compensation by illustrating the apparent and actual conflicts of interest that can arise when the compensation paid to powerful not-for-profit directors and officers goes unchecked. That does not transform the Complaint's State law claims into federal causes of action, nor does it raise federal questions.

Accordingly, this case is focused exclusively on the extent

---

<sup>7</sup> Thus, NYSE General Rule 22(a) is designed to avoid directors' conflicts of interest in the "investigation or consideration of any matter relating to any member, allied member, approved person, or member organization," while NYSE General Rule 22(b) is a more general provision concerning the "consideration, review or adjudication" of NYSE matters.

to which Grasso's \$190 million in compensation was excessive, illegal, and ultra vires under the N-PCL, and the State, as master of its complaint, is entitled to "avoid federal jurisdiction by exclusive reliance on state law." Caterpillar, 482 U.S. at 392. See also Healy v. Sea Gull Specialty Co., 237 U.S. 479, 480 (1915) ("[the] plaintiff is absolute master of what jurisdiction he will appeal to").

**2. Even If, Arguendo, Federal Issues Were Raised In The Complaint, They Would Not Provide A Basis For Removal**

Even if, arguendo, prosecution of the N-PCL and other claims would require reference to federal law in connection with defendants' duties as the operator of, or officials in, a national securities exchange, "the mere presence of a federal issue in a state cause of action does not automatically confer federal-question jurisdiction." Merrell Dow, 478 U.S. at 813; see State of New York v. Justin, 237 F. Supp. 2d 368, 374 (W.D.N.Y. 2002) (mere reference to federal law in action brought by Attorney General alleging violations of New York Blue Sky laws does not invoke district court's federal question jurisdiction); see also Brown v. National Football League, 219 F. Supp. 2d 372, 379-80 (S.D.N.Y. 2002) (GEL) (remanding personal injury action removed under the federal Labor Management Relations Act, finding "the duties asserted by Plaintiffs are [state] duties owed to the general public, not creatures of [federal] contract.")

In determining federal question jurisdiction, courts engage

in "a selective process which picks the substantial causes out of the web and lays the other ones aside." Merrell Dow, at 813-14 (quoting Gully v. First Nat'l Bank, 299 U.S. 109, 117-18 (1936)); see Barbara v. New York Stock Exchange, Inc., 99 F.3d at 54.

In Merrell Dow, the Supreme Court rejected defendant drug manufacturer's efforts to remove a state negligence action even though plaintiff's negligence claim was predicated on defendant's violation of federal drug labeling requirements. 478 U.S. at 805-06, 817. Similarly, in Donovan v. Rothman, 106 F. Supp. 2d 513 (S.D.N.Y. 2000), this Court remanded a shareholders derivative action alleging breach of fiduciary duty against a corporate officer, noting that although the fiduciary duty claims were predicated upon defendant's breach of the federal anti-kickback statute, the federal law "simply informs the inquiry whether [defendant] breached his fiduciary duty" under state law. 106 F. Supp. 2d at 517. The court added: "[t]o the extent New York looks to federal law as a guidepost in assessing a breach of fiduciary duty, therefore, that assessment ultimately remains a creature of New York law." Id.

In this case, the State's N-PCL claims do not rely on the defendants' duties under the Exchange Act or the NYSE's General Rules. To the extent Grasso mischaracterizes the Complaint to suggest that they do, such allegations compose the background to this action and do not constitute the substance of the Complaint

or a "pivotal issue" in determining the instant conflict. Matter of the Board of Trustees of the Huntington Free Library and Reading Room, 01 Civ. 2599, 2002 WL 123502, at \*4 (S.D.N.Y. Jan. 30, 2002) (quotations omitted). Accordingly, no federal question is raised under 28 U.S.C. § 1441(b).

C. The Action Is Not Removable Under 28 U.S.C. § 1442(a)(1)

Grasso's attempt to remove the action under 28 U.S.C. § 1442(a)(1) is equally misplaced.<sup>8</sup> Since defendants are not federal agencies or officers, to establish that they were "acting under" a federal officer for § 1442(a)(1) purposes, Grasso must show: (1) defendants acted under the direction of a federal agency or officer; (2) they have a colorable federal defense; and (3) there is a causal nexus between the federal direction and the conduct in question.<sup>9</sup> See In re Methyl Tertiary Butyl Ether ("MTBE") Products Liability Litigation, No. M21-88, MDL No. 1358,

---

<sup>8</sup> 28 U.S.C. § 1442(a)(1) states:

- (a) A civil action or criminal prosecution commenced in a State court against any of the following may be removed by them to the district court of the United States for the district and division embracing the place wherein it is pending:
- (1) The United States or any agency thereof or any officer (or any person acting under that officer) of the United States or of any agency thereof, sued in an official or individual capacity for any act under color of such office or on account of any right, title or authority claimed under any Act of Congress for the apprehension or punishment of criminals or the collection of the revenue.

<sup>9</sup> For purposes of this discussion, the second and third factors set forth in the MTBE Litigation case are considered in reverse order.

2004 WL 515535, at \*6 (S.D.N.Y. Mar. 16, 2004).<sup>10</sup>

**1. Grasso's Award Of Excessive Compensation Was Not Directed By The Federal Government Or Federal Law**

In order to satisfy the first prong of § 1442(a)(1) removal, Grasso attempts to cloak his receipt of \$190 million in compensation in federal authority. (Not. Rem. ¶¶ 9-12).

While the regulatory function of the NYSE is subject to federal supervision, there is no federal oversight with regard to the NYSE's award of compensation to its directors and officers. Because the NYSE is a New York not-for-profit corporation, that process is governed by the N-PCL. Grasso's attempt to argue that the NYSE was somehow directed, required or permitted to pay Grasso amounts prohibited by the N-PCL is absurd. Equally inapposite are the cases upon which Grasso relies.

For example, in MTBE Litigation, a products liability action, defendant gasoline producers were sued in state court for the harm allegedly caused by oxygenates that they added to their gasoline products. Defendants removed the action under § 1442(a)(1) because federal mandates in the Clean Air Act directed them to add the very oxygenates that were the target of

---

<sup>10</sup> The Second Circuit has held that the NYSE is precluded from removing actions under 28 U.S.C. § 1442(a)(1) because it is not a "person acting under" a federal agency or officer, see Barbara, 99 F.3d at 55. However, on October 19, 1996, just after Barbara was decided, 28 U.S.C. § 1442 was amended, 104 P.L. 317 § 206, 110 Stat. 3847, 3850 (1996), leading one court to suggest, in dictum, that § 1442 removal might now be available to the NYSE. See Frayler v. New York Stock Exchange, 118 F. Supp. 2d 448, 451 n.3 (S.D.N.Y. 2000).

the state court claims. 2004 WL 515535, at \*3, 8. Thus, in MTBE Litigation, "defendants took actions at the express direction of the federal government, and those actions are the basis for the complaints." 2004 WL 515535, at \*8.<sup>11</sup>

In this case, by contrast, Grasso cannot argue that the NYSE's compensation decisions are made at the direction of federal law under § 1442(a)(1). Simply stated, the NYSE and its officers act at the direction of federal law when discharging their regulatory and self-policing functions, but not in carrying out routine acts related to their internal corporate affairs.

Pursuant to the Exchange Act, national securities exchanges, such as the NYSE, may be registered with the SEC, 15 U.S.C. § 78f(a), and as a condition of registration, a national securities exchange must "enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange." 15 U.S.C. §§ 78f(b)(1), 78s(g)-(h).

Because federal law regulates the NYSE in this area, Second Circuit law is clear that a national securities exchange acts at the direction of federal law for acts "arising out of the performance of its federally-mandated conduct of disciplinary

---

<sup>11</sup> Thus, Grasso correctly cites MTBE Litigation for the proposition that where defendants' actions were directed by the federal Clean Air Act, plaintiffs' tort claims based on the directed actions may be preempted. (See Not. Rem. ¶ 20).

proceedings" -- but not for other matters. Barbara, 99 F.3d at 58. In D'Alessio, 258 F.3d at 106, the Second Circuit preserved the basic principle that such entities are subject to state law for their non-regulatory functions, holding that the NYSE was entitled to federal immunity from a state-law suit challenging the NYSE's application of the Exchange Act, SEC rules and the NYSE's rules. The Court stated:

the NYSE's actions fell 'well within the perimeter of the [NYSE's] quasi-governmental duties' because they 'relate to the [NYSE's] development and promulgation of interpretations of statutory and regulatory requirements, the dissemination and implementation of these interpretations, and the provision of information to government agencies.'

Id. (quoting and adopting reasoning in D'Alessio v. New York Stock Exchange, 125 F. Supp. 2d 656, 658 (S.D.N.Y. 2000)).<sup>12</sup>

This Court and the Ninth Circuit have reached a similar conclusion. See Sparta Surgical Corp. v. National Ass'n of Securities Dealers, Inc., 159 F.3d 1209, 1214 (9<sup>th</sup> Cir. 1998) ("self-regulatory organizations do not enjoy complete immunity from suits; it is only when they are acting under the aegis of

---

<sup>12</sup> For purposes of comparison, a copy of the State Court complaint in D'Alessio v. NYSE, index no. 99-605616, filed in New York Supreme State Court on December 14, 1999, is attached to this Memorandum. The D'Alessio complaint alleges in exhausting detail that the NYSE and its officials improperly enforced, or refused to enforce, Section 11(a) of the Exchange Act, SEC rule 11a-1 and the NYSE's General Rules to plaintiffs' detriment, and failed to disclose or falsely represented its enforcement activities to the SEC and United States Attorney. Defendants promptly removed the action to federal court and not surprisingly, plaintiffs did not oppose. D'Alessio, 258 F.3d at 98.

the Exchange Act's delegated authority that they so qualify. When conducting private business, they remain subject to liability") (emphasis added); DL Capital Group LLC, v. NASDAQ Stock Market Inc., No. 03 Civ. 9730, 2004 WL 993109, at \*5 (S.D.N.Y. May 5, 2004) (in private action against the NASDAQ not all conduct of "SROs is immune from private suits, the question in the case at bar is whether defendants' actions fall within the scope of quasi-governmental powers delegated to them pursuant to the Exchange Act"); Western Capital Design, LLC v. New York Mercantile Exchange, 180 F. Supp. 2d 438, 443 (S.D.N.Y. 2001) (in private suit against New York Mercantile Exchange, parties agree "a claim under state law that implicates NYMEX's duties to self-police and regulate as required under the Commodity Exchange Act is pre-empted") (emphasis added), aff'd, 25 Fed. App. 63 (2002); Bruan, Gordon & Co. v. Hellmers, 502 F. Supp. 897, 902 (S.D.N.Y. 1980) ("[w]ith respect to disciplinary proceedings, NASD should be considered as a 'person' acting under the SEC") (emphasis added).

Indeed, in its non-regulatory capacity, the NYSE is not deemed to be "acting under" a federal officer, which is why there are numerous cases in which the NYSE has litigated state-law claims in state court which have not been subject to preemption or removal. See e.g., Conigliaro v. New York Stock Exchange, Inc., 2 A.D.3d 767 (2d Dep't 2003) (dismissing damages suit

against NYSE under New York Workers' Compensation law); Blum v. New York Stock Exchange, Inc., 298 A.D.2d 343 (2d Dep't 2002) (resolving discrimination suit against NYSE under New York Executive Law § 296); Piccinich v. New York Stock Exchange, Inc., 257 A.D.2d 438 (1st Dep't 1999) (considering personal injury action against NYSE under New York Labor Law as owner of building in which plaintiff-laborer's injuries occurred); Wall Street Garage Parking Corp. v. New York Stock Exchange, 3 Misc.3d 1014 (N.Y. Sup. Ct., N.Y. County, 2004) (preliminarily enjoining NYSE from maintaining security blockades and conducting vehicle searches in lower Manhattan under New York public nuisance law).

Because the Complaint alleges eight causes of action arising out of the award of excessive compensation to Grasso under N-PCL §§ 202(a)(12), 515(b), there is no basis under which Grasso can argue the Complaint relates to the NYSE's "development and promulgation of interpretations of statutory and regulatory requirements, the dissemination and implementation of these interpretations, [or] the provision of information to government agencies." D'Alessio, 258 F.3d at 106. Accordingly, Grasso has failed to demonstrate that any of the defendants acted under the direction of a federal agency or officer.

**2. There Is No Causal Nexus Between Any Federal Directives And The Conduct In Question**

For these same reasons, Grasso has not demonstrated a causal relation between any federal directives applicable to the

regulatory functions of the NYSE and his receipt of almost \$190 million in compensation, which serves as the gravamen of the Complaint. At most, Grasso has argued that the NYSE and its officials are subject to federal regulation in matters relating to the NYSE's authority to regulate and discipline its members. However, the cases cited by Grasso himself recognize that defendants cannot automatically remove state actions simply because some portion of their operations is supervised by the federal government. See MTBE Litigation, 2004 WL 515535, at \*8; see also D'Alessio, 258 F.3d at 106; Sparta, 159 F.3d at 1214.

**3. Defendants Do Not Have A Colorable Federal Defense**

Grasso also fails to establish the third factor necessary to remove an action under 28 U.S.C. § 1442(a)(1), a colorable federal defense to the Complaint. Grasso contends he has colorable federal defenses of preemption and federal immunity (Not. Rem. ¶¶ 19-23), but each theory is easily dismissed.

**a. The N-PCL Is Not Conflict-Preempted By The Exchange Act**

Grasso does not specify whether his preemption defense is based on a theory of conflict or field preemption, but he cannot establish either. With regard to the doctrine of conflict preemption, which applies to state laws that conflict with federal law or "prevent or frustrate the accomplishment of a federal objective," Geier v. American Honda Motor Co., 529 U.S. 861, 873 (2000), the Exchange Act simply does not address the

corporate form or organization of national securities exchanges or SROs, and is silent with regard to basic matters of their routine internal corporate affairs, including matters of director and officer compensation. See e.g., Scattered Corp. v. Chicago Stock Exchange, Inc., 701 A.2d 70 (Del. 1997) (applying Delaware law to shareholder's derivative action against directors of the Chicago Stock Exchange, a Delaware non-stock corporation registered with the SEC as a national securities exchange).

Grasso therefore has not and cannot argue that the N-PCL rule that limits the compensation that can lawfully be paid to directors and officers of not-for-profit corporations to amounts that are "reasonable" and "commensurate with services performed" conflicts in any manner with the Exchange Act's purposes or goals (see 15 U.S.C. §§ 78b, 78f(b)(5)), so as to be preempted.

**b. The N-PCL Is Not Field-Preempted By The Exchange Act**

Field preemption applies to areas of law where federal regulation is so pervasive or the federal interest is so dominant that an inference arises that "the federal system will be assumed to preclude enforcement of state laws on the same subject." Maryland v. Louisiana, 451 U.S. 725, 746 (1981). Grasso has put forward no evidence to rebut the long-standing "presumption that Congress does not intend to supplant state law." Travelers Ins., 514 U.S. at 654; see D'Alessio, 258 F.3d at 106; Sparta, 159 F.3d at 1214; Barbara, 99 F.3d at 58; see also Justin, 237 F. Supp. 2d

at 375 (“[t]his Court finds that federal securities law does not dominate the field so as to invoke the complete preemption ‘exception’ to the well-pleaded complaint rule.”); Kings Choice Neckwear, 2003 WL 22283814, at \*2 (Supreme Court has found complete preemption doctrine to apply only to the Labor Management Relations Act, ERISA, and the National Bank Act). Even though the Exchange Act closely regulates activities of national securities exchanges, “the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.” Travelers, 514 U.S. at 655 (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

Oversight of internal corporate affairs, including regulation of directors and officers, is a matter clearly reserved to the states’ historic police powers and not subject to field preemption by federal law. “Corporations are creatures of State law and it is state law which is the font of corporate directors’ powers.” Burks v. Lasker, 441 U.S. 471, 478 (1979) (citations omitted); see Planned Consumer Marketing, Inc. v. Coats and Clark, Inc., 71 N.Y.2d 442, 451 (1988) (corporate “internal affairs are to be governed by State law unless Federal law expressly provides otherwise.”); see also Cornell Manuf. Co. v. Mushlin, 70 A.D.2d 123, 129-32 (2d Dep’t 1979) (no preemption by ERISA of excessive compensation claim under Section of New

York Business Corporation Law parallel to N-PCL § 720 on which claims against Grasso and Langone are based). In holding that the Investment Company and Investment Advisors Act of 1940 does not preempt state laws governing shareholders' derivative actions, the Supreme Court in Burks stated in the context of corporate law, "congressional legislation is generally enacted against the background of existing state law." 441 U.S. at 478.

Indeed, the historic dominance of State law applies with greater force in the not-for-profit corporation context where:

the directors of a not-for-profit corporation do not act on behalf of shareholders who control the corporation's certificate of incorporation, and its Board. They act on behalf of beneficiaries who have no direct voice in governing the corporation and must depend on the State to represent and protect their interests.

Matter of Herbert H. Lehman College Foundation, Inc. v. Fernandez, 292 A.D.2d 227, 228 (1st Dep't 2002).

Grasso cites Mayo v. Dean Witter Reynolds, Inc., 258 F. Supp. 2d 1097 (N.D. Cal.), amended by, 260 F. Supp. 2d 979 (N.D. Cal. 2003), for the proposition that the NYSE's internal rules and policies may preempt state law, but the NYSE's arbitration rule that preempted state law in that case had been formally codified in the NYSE's Arbitration Rules and had been reviewed and approved by the SEC pursuant to 15 U.S.C. § 78s(b)(1). 258 F. Supp. 2d at 1108-09. In addition, the Mayo court found that the preempted California law directly conflicted with the NYSE's

arbitration policies. 258 F. Supp. 2d at 1106. In this case, by contrast, the SEC did not approve Grasso's compensation, there are no federal, SEC or NYSE policies addressing the compensation of NYSE directors and officers, and the N-PCL limitations on compensation are in no way inconsistent with the policies of the Exchange Act.

c. Defendants Are Not Entitled To Federal Immunity

Grasso also argues that as an official of the NYSE, "he is entitled to the same immunity enjoyed by the SEC when it is performing functions delegated to it under the SEC's broad oversight authority."<sup>13</sup> (Not. Rem. ¶ 22 (quoting D'Alessio, 258 F.3d at 105)). To the extent Grasso argues that defendants are entitled to automatic removal to the federal courts and absolutely immunity from State suit because the NYSE is the alter-ego of the SEC, the case law is clear that the NYSE, like other SROs, are private entities that do not enjoy complete governmental immunity. See e.g. D'Alessio, 258 F.3d at 106; Sparta, 159 F.3d at 1214 ("self-regulatory organizations do not enjoy complete immunity from suits"); Wall Street Garage Parking Corp., 3 Misc.3d 1014 (NYSE sued under non-preempted State law for maintaining security blockades and conducting vehicle searches in lower Manhattan).

In addition, Grasso fails to acknowledge that even federal officials are not entitled to federal immunity or removal under

---

<sup>13</sup> It is somewhat ironic that Grasso seeks to identify himself as a public or quasi-public official given his receipt of \$190 million.

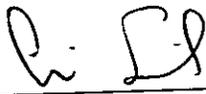
28 U.S.C. § 1442(a)(1) unless they can first demonstrate the existence of a federal question conferring Article III jurisdiction on the federal courts. See Mesa v. California, 489 U.S. 121, 136, 138 (1989) (federal postal workers not entitled to remove action without alleging federal question defense). Here, no colorable federal defense lies. Accordingly, Grasso's bid to remove under § 1442(a)(1) falls short.

**CONCLUSION**

Accordingly, for all of the foregoing reasons, this Court should remand the action to Supreme Court, New York County, and award such other and further relief to the State as may be just and proper.

Dated: New York, New York  
July 19, 2004

ELIOT SPITZER  
Attorney General of the  
State of New York

By: 

AVI SCHICK (AS-6605)  
Deputy Counsel to the Attorney General  
120 Broadway  
New York, New York 10271  
(212) 416-8175

DAVID AXINN (DA-5855)  
Assistant Solicitor General

GABRIEL HERTZBERG (GH-2823)  
Assistant Attorney General  
*Of counsel*