

IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

FILED IN THE DISTRICT COURT
OKLAHOMA COUNTY, OKLA.

AUG 22 2008

PATRICIA PRESLEY, COURT CLERK
by _____
DEPUTY

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel. Irving L. Faught, Administrator,)
)
Plaintiff,)
vs.)
)
FARMERS & MERCHANTS BANK, et al.)
)
Defendants,)
and)
)
ROBERT LYNN POURCHOT, Trustee of the)
Robert Lynn Pourchot Trust, et al.,)
)
Intervenors.)

Case No. CJ-2006-3311

DEFENDANTS' REPLY REGARDING OUTSTANDING DISCOVERY ISSUES

I. "RELEVANCE" IS SHAPED BY THE ELEMENTS OF THE CLAIM.

In Plaintiff's opening discovery brief ("Plaintiff's Brief") at 3, ODS contends:

[T]he Department must show (i) that a securities violation occurred; (ii) that the Defendants rendered substantial assistance to the primary wrongdoer; and (iii) that the Defendants had knowledge, or in the exercise of reasonable care, could have known of the violation(s). *See* 71 O.S. § 1-509 (G)(5); *see also State ex rel. Goettsch v. Diacide Distributors, Inc.*, 561 N.W.2d 369, 377 (Iowa 1997).¹

These are simply the *wrong* elements. 71 O.S. § 1-509(G)(5), on which both ODS and Intervenors now rely (and must to assert the "joint and several" aspect of their claim), imposes liability on any "person who materially aids in the *conduct giving rise to the liability* under subsections B through F..." In turn, ODS has alleged that Ms. Schubert's untrue statements of material fact and/or omissions – *i.e.*, § 1-509(B) – give rise to

¹ ODS repeated this standard in its Response ("Plaintiff's Response") at 2. In addition, the Intervenors, who had applied the wrong statute in their opening discovery brief ("Inter. Brief") at 2, adopted these elements in their Reply Brief in Support of Inadmissibility of Investors' Negligence ("Inter. Response") at 2.

Defendants' alleged "materially aiding" liability. *See* Petition at 58, Petition in Intervention at ¶ 105. Section 1-509(B) expressly provides: "A person is liable to a purchaser if the person *sells* a security in violation of Section 10 of this section, or *by means of an untrue statement of a material fact or an omission....*" (Emphasis added.) Thus, the plain language of the statute requires that the "person who materially aids" must aid in the conduct giving rise to the primary actor's liability – here, "an untrue statement of a material fact or an omission." 71 O.S. § 1-509(B) and (G)(5).²

71 O.S. § 408, the relevant statute from the Predecessor Act, provides:

(a) Any person who...(2) offers or sells or purchases a security by means of any untrue statement of a material fact or any omission...is liable...;

(b) Every person who materially participates or aids in a *sale or purchase* made by any person liable under paragraph (1) or (2) of subsection (a) of this section...shall also be liable jointly and severally....(Emphasis added.)

Accordingly, in *Southwestern Oklahoma Development Authority v. Sullivan Engine Works, Inc.*, 1996 OK 9, 910 P.2d 1052, 1058, the Oklahoma Supreme Court expressly established the elements of liability under § 408: "(1) that the defendant was a material participant or aided in the *sale* of securities by a seller, and (2) that the seller is 'liable' under § 408(a)." *Id.* (Emphasis added). Similarly, *Lillard v. Stockton*, 267 F.Supp.2d 1081 (N.D. Okla. 2003) provides "[p]laintiffs must plead and prove...(1) That some person committed a primary violation of § 408(a)...and (2) That the Defendants...materially participated or aided in the

² Importantly, 71 O.S. § 1-509 is only controlling for a fraction of Ms. Schubert's activities. ODS alleges that Ms. Schubert's conduct began in January of 2000 and ended in October 2004. *See* Petition, ¶ 10; Petition in Intervention, ¶ 7. Section 1-509 (as part of the 2004 Act) became effective on July 1, 2004. The 2004 Act includes a "transition" provision, which provides: "The predecessor act exclusively governs all actions or proceedings that...may be instituted on the basis of conduct occurring before the effective date of this act...." 71 O.S. § 1-701. Thus all sales occurring before July 1, 2004 – the vast majority here – must be addressed under the Predecessor Act.

sale of securities by the primary violator.” (Emphasis added.) See also *Nikkel v. Stifel, Nicolaus & Co.*, 1975 OK 158, 542 P.2d 1305, 1308-1309 (“408(b)...places liability on one who materially participates or aides in a sale made by one liable under subsection (a)). Notably, neither ODS nor the Intervenors address these authoritative cases.

Despite the clear statutory language and controlling Oklahoma case law, ODS turns to an Iowa case, *State ex Rel. Goettsch v. Diacide Distributors, Inc.*, 561 N.W.2d 269, 377 (Iowa 1997),³ to support its three prong test. However, the Iowa Supreme Court specifically stated, in the paragraph preceding the elements advanced by ODS and the Intervenors, that those elements are *not* proper for evaluating material participant liability. Rather, the parties and lower court had “*ignored*” the appropriate standard under Iowa’s “material aider” statute. Thus, *Diacide* simply does not support the application of ODS’ standard.

ODS would have the Court believe that it only need prove that *any* securities violation has occurred. If all that is required is that an individual somehow permitted the scheme to continue, then any bank or investment company involved in any way with Ms. Schubert, and any investor who provided funds to Ms. Schubert (including the Intervenors) would be material participants.⁴ However, Oklahoma law is clear that it is the use an untrue statement to make a sale that confers liability under §§ 408(a)(2) and 1-509(B) – not the operation of a “Ponzi” scheme. Thus, the participant’s material assistance in the making of the untrue statement relating to the sale is necessary for liability under § 408(b) and § 1-

³ Ironically, while the standard asserted by ODS and Intervenors is sourced from an Iowa case, Intervenors argue that cases from foreign jurisdictions do not have any bearing on the current state of the Oklahoma law. See Inter. Response at 3-5. While the statutes of other jurisdictions discussed in *Defendants’ Brief* are not uniform, the cases all recognize the conduct must be directly tied to the sale and not simply some broader tangential conduct.

⁴ While satisfying the elements of liability, at least some of these material participants could, like the Defendants, assert a successful “lack of knowledge” defense.

509(G)(5), and discovery surrounding the circumstances of *each sale* is wholly relevant.

II. BROAD DISCOVERY FOR DETERMINING LIMITATIONS PERIOD

Intervenors discuss at length the relevant statute of limitations for: (1) common law fraud (Inter. Response at 7); (2) breach of trust (*id.* at 8); and (3) a fraudulent concealment (*id.* at 10-11). However, none of these claims have been asserted by Intervenors, and, therefore, have no relevance to the statute of limitations analysis in this securities case.⁵

Moreover, as Defendants previously discussed in prior briefing, the statute of limitations for a claim arising under the civil liability provisions of the Oklahoma Securities Act is exclusively dictated by the standards prescribed therein. *See* 71 O.S. § 408(f) of the Predecessor Act and 71 O.S. § 1-509(J) of the Successor Act; *see also Adams v. Smith*, 1986 OK CIV APP 32, ¶ 8, 734 P.2d 843 (“[t]he Oklahoma securities statutes contain their own statutes of limitations”). Those statutes provide an explicit and detailed scheme for determining the time frame within which claims must be asserted to be timely.

Under the Predecessor Act, “no person may sue...more than two (2) years after the untruth of omission was discovered, but in no event more than three (3) years after the sale.” By setting an outer limit of three (3) years from the date of sale, irrespective of the investor’s actual or constructive knowledge, Oklahoma has rejected the doctrine of equitable tolling with regard to violations of securities regulations.⁶ *Adams, supra*, at ¶¶ 12, 16. Similarly, under the Successor Act, an action must be brought “within two (2) years after discovery of

⁵ In this regard, the Intervenors’ analysis is akin to their misguided reliance upon 71 O.S. § 1-501 as the purported basis of Defendants’ alleged liability, which Defendants have already addressed and dismissed in their response brief. Both the Intervenors and ODS have taken inconsistent or irreconcilable positions regarding the bases for their respective claims, the elements required to prevail on their respective claims, and the remedies allowed for their varying theories of liability. These “shifting sands” are unfair to the Defendant and to the Court. Therefore, the Defendants believe the proper elements must be established now.

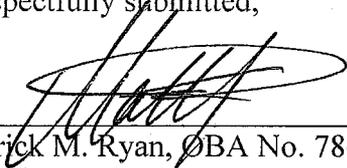
⁶ Not surprisingly, the Intervenors argue that equitable tolling applies in this case.

the facts constituting the violation or five (5) years after such violation.” The “discovery of facts” provision is phrased identically to the federal statute of limitations governing securities actions⁷ and involves inquiry into the circumstances of each sale, the investor’s sophistication, and the reasonableness of the investor’s handling their investments.

Even citing to the wrong case law, the Intervenor’s concede that the statute of limitations inquiry focuses on whether they exercised reasonable diligence in discovering the alleged violation(s). *See* Inter. Response at 6. However, in doing so, they argue that Defendants should be deprived from conducting discovery into this broad and relevant area since there was no way they could have known about Defendants’ alleged participation in Marsha Schubert’s sales activities until the BKD report was filed on March 23, 2005. *Id.* at 9. Suffice it to say, Defendants are not obligated to simply take Intervenor’s at their word on this issue under Oklahoma’s Discovery Code. “The purpose of modern discovery practice and procedure is to promote the discovery of the true facts and circumstances of the controversy, rather than to aid in their concealment.” *Boswell v. Schultz*, 2007 OK 94, ¶ 14, 175 P.3d 390, 395 (citation omitted). Defendants are entitled to obtain information bearing on the liability-defeating defense of statute of limitations so that they may “obtain the fullest possible knowledge of the issues and facts before trial....” *State ex rel. Protective Health Serv. v. Billings Fairchild Center, Inc.*, 2007 OK CIV APP 24, ¶ 17, 158 P.3d 484, 489. Moreover, since ODS is pursuing restitution for the private interests of the Loser Investors, broad discovery should be allowed into the circumstances surrounding every sale to all investors, not just the Intervenor’s, for determining the appropriate limitation period.

⁷ “[W]e find highly persuasive the federal cases determining this issue in relation to both federal and state limitation periods.” *Adams*, 734 P.2d at 845.

Respectfully submitted,



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CERTIFICATE OF SERVICE

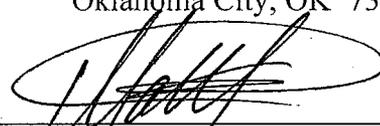
I hereby certify that on this 22nd day of August 2008, a true and correct copy of the above and foregoing instrument was mailed, via U.S. Mail, first-class, postage prepaid, to the following attorneys of record:

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