

APR 20 2009

IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

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' RESPONSE IN OPPOSITION TO OKLAHOMA
DEPARTMENT OF SECURITIES' MEMORANDUM OF LAW ASSERTING
DEFENDANTS ARE NOT ENTITLED TO A JURY TRIAL**

COME NOW Defendants Farmer & Merchants Bank, Farmers & Merchants Bancshares, Inc., John V. Anderson and John Tom Anderson ("Defendants") and respectfully submit their Response in Opposition to the Oklahoma Department of Securities' ("ODS") Memorandum of Law Asserting Defendants are Not Entitled to a Jury Trial. As discussed below and in Defendants' Memorandum in Support of Jury Trial, Defendants are entitled to a jury trial on the claims brought by ODS.

The parties are in agreement on many of the issues discussed in their respective briefs, such as:

- ***Parties are entitled to a jury trial in legal actions.***

Defendants quoted Article 2, Section 19 of the Oklahoma statutes which recognizes that the right to a jury trial is inviolate. *Defendants' Brief*, p. 2. ODS also acknowledges the right to a jury trial under the Oklahoma Constitution and that in certain suits the recovery of money shall be tried by a jury. *ODS Brief*, p. 1, and n. 1.

- ***Parties in purely equitable actions do not have a right to jury trial.***

Both parties acknowledge that, despite the constitutional right to a jury trial, a party is not entitled to a jury in a case of purely equitable cognizance. *Defendants' Brief*, p. 2; *ODS Brief*, p. 1.¹

- ***Actions involving issues of both law and equity may be tried by the Court if the legal issues are incidental to the equitable issues.***

Both parties agree that in certain circumstances, an incidental legal issue may be tried by the Court. *Defendants' Brief*, p. 7, n. 3; *ODS Brief*, p. 5. ODS, however, does not address the general rule, to which the incidental legal issue is the exception: “[W]hen an equity cause of action and law claim are involved in one suit, the trial court at its discretion may submit the equity case to the jury, but it is its duty to

¹ ODS contends that “Defendants argue that restitution and civil penalties are legal matters...” See *ODS Brief*, p. 2. To the contrary, Defendants have made no such argument. While it is possible that restitution may be legal in nature, ODS has long contended that restitution here is equitable. To prove its case, ODS, with regard to Ms. Schubert, must establish all elements of equitable restitution, including the tracing of the specific funds belonging to each short investor to Ms. Schubert. In addition, Defendants are entitled to assert equitable defenses such as unclean hands to defeat such attempts by ODS to obtain equitable relief against Ms. Schubert (and Defendants via the legal joint and several liability determination).

submit the law case to the jury for determination.” *I.C. Gas Amcana, Inc. v. Hood*, 1992 OK 119, 855 P.2d 597, 599.

- ***Defendants are only jointly and severally liable if they are found to have materially aided Ms. Schubert.***²

ODS has presented a two-part argument to support its claims against Defendants. First, ODS contends that Marsha Schubert was ordered to make restitution and that such restitution was equitable in nature.³ *See Defendant’s Brief*, p. 2; *ODS Brief*, p. 2-5. Then, by borrowing from the civil liability statute, ODS argues that Defendants, if shown to have materially aided/participated with Schubert, should be jointly and severally liable for Ms. Schubert’s restitution. *See Defendant’s Brief*, p. 2; *ODS Brief*, p. 2. While not specifically discussed in ODS’s brief, ODS agrees,

² On multiple occasions, ODS refers to Defendants “materially aid[ing] Marsha Schubert’s fraudulent conduct”; “Defendants...aid[ing] the fraud”; “Defendants materially aided Marsha Schubert’s fraudulent scheme.” However, the scope of conduct prohibited by the statutory text of 71 O.S. § 1-509(G)(5) and § 408(b) relates only to material participation/aid in the sales transaction between Ms. Schubert and the Short Investor. *See* 71 O.S. § 1-509(B) and (G)(5) (one must “materially aid in the conduct giving rise to the liability” – here, the primary actor “sells a security”); *see also* § 408(b) (finding joint and several liability may attach where one “materially participates or aids in the sale or purchase made by any person liable [under the preceding subsections]”).

³ ODS, relying upon a dependent portion of the Black’s Law Dictionary entry for “restitution” and a state bar disciplinary case, *State ex rel. Okla. Bar. Assn. v. Leigh*, 1996 OK 37, 914 P.2d 661, provides, at best, an incomplete definition. Black’s definition of restitution begins: “A body of substantive law in which liability is based not on tort or contract but on the defendant’s unjust enrichment...the set of remedies associated with that body of law, in which the measure of recovery is usu[ally]...the defendant’s gain...restoration of some specific thing to its rightful owner...” *See Black’s Law Dictionary* (8th ed. 2004), *restitution*. Despite ODS’s suggestion to the contrary, the focus of restitution in the civil context is on the defendant’s gain, not the plaintiff’s loss.

see *Journal Entry* (2/17/09), that Defendants' liability is wholly predicated on the application of the joint and several liability portion of the civil liability statute (12 O.S. § 1-509 or its predecessor § 408).

While the parties thus agree on a number of issues (at least in the context of the jury trial issue), there are three questions remaining for the Court:

- 1. *Are the material participant/aider provisions of §§ 1-509 and 408 legal in nature thus providing the right to a jury trial?***

As discussed in *Defendants' Brief*, the Oklahoma Supreme Court has discussed the litigation premised on the statute as "a law action." *Nikkel v. Stifel, Nicolaus & Co., Inc.*, 1975 OK 158, 542 P.2d 1305, 1308. (Emphasis added). Similarly, the Oklahoma Supreme Court in *Waugh v. Heidler*, 1977 OK 78, 564 P.2d 218, 221, held that, "the legislative intent is that joint and several liability as it relates to contracts was intended because of the statutory phrase, 'contribution (shall be) as in cases of contract.'" (Emphasis added). See also *South Western Oklahoma Development Authority v. Sullivan Engine Works, Inc.*, 1996 OK 9, 910 P.2d 1052, 1059 (remanding case involving determination of material aider liability to jury); *Bane v. Anderson, Bryant & Co.*, 1989 OK 140, 786 P.2d 1230, 1235-1237 (discussing variety of issues relating to the jury's determinations regarding material aider liability). Thus, the determination of whether defendants materially aided or participated in the sale is clearly a legal issue and the right to jury trial attaches.

2. ***Does the ODS's demand for civil penalty provide Defendants the right to a jury trial?***

As noted by ODS, “the Oklahoma Supreme Court has endorsed the use of federal securities cases to interpret this state’s uniform securities laws.” *See ODS Brief*, pp. 2-3, *citing State ex rel. Day v. Southwest Mineral Energy, Inc.*, 1980 OK 118, 617 P.2d 1334, 1339. Thus, while acknowledging the differences between the Oklahoma and U.S. Constitutional provisions regarding the right to a jury trial, Defendants have provided the Court with federal securities cases holding the right to a jury trial for civil penalties in the securities context. *See Securities Exchange Commission v. Lipson*, 278 F.3d 656, 662 (7th Cir. 2002) (holding SEC’s claims for civil penalties, along with certain equitable relief, entitled the defendant to a jury trial, although the Court would determine the amount of the civil penalty); *Securities Exchange Commission v. Kopsky*, 537 F.Supp.2d 1023, 1026 (E.D. Mo. 2008).⁴

In opposition, ODS offers only a single Vermont Supreme Court case, which discusses an environmental penalty rather than anything remotely related to the

⁴ ODS cites to *S.E.C. v. Petrofunds, Inc.*, 420 F.Supp. 958 (S.D.N.Y. 1976) for the proposition that “fraud cases brought by the SEC, in its enforcement capacity to protect the public interest, are considered equitable in nature.” *See ODS Brief*, p. 2. However, *Petrofunds*, 420 F.Supp. at 959, was limited to a question of whether a party is entitled to a jury trial where the government was seeking “an accounting for, and concomitant disgorgement of, illegal profits.” *See also ODS Brief*, pp. 4-5, *quoting S.E.C. v. Commonwealth Chemical Securities*, 574 F.2d 90 (2nd Cir. 1978) (specifically noting that it was “an SEC action for injunction and disgorgement”). Defendants agree such relief is equitable, as opposed to the civil penalties sought here and in the S.E.C. cases discussed above. Moreover, *Petrofunds* and *Commonwealth* do not involve the legal determination of material aiding/participating liability present here.

securities industry, in support of its contention that the civil penalties in this case do not provide a right to jury trial. See *Vermont v. Irving Oil Corporation*, 955 A.2d 1098 (Vt. 2008).⁵ The Vermont Supreme Court predicated its determination in part on the fact that Vermont state law treated civil penalties in the environmental law context as remedial in nature and intended to reimburse government litigations costs. *Id.* at 1107.

Oklahoma, however, has a long history of cases that seek to determine if a statute is penal based on “whether its purpose is to afford a private remedy to a person wrongfully injured by the wrongful act, or for the benefit of the state to punish an offense against the state.” *Fuller v. Sight ‘n Sound Appliance Centers, Inc.*, 1999 OK CIV APP 53, 982 P.2d 528, 530; see also *Tulsa Ready-Mix Concrete Co. v. McMichael Concrete Co.*, 1972 OK 53, 495 P.2d 1279; *Culbertson v. McCann*, 1983 OK 57, 664 P.2d 338. These cases acknowledge that a statute may have both remedial and penal components. *Id.* But here, “[a]s evidenced by the Legislature’s use of the terms ‘civil penalty’...to some extent at least, the Act must be considered penal.” *Fuller*, 982 P.2d at 530. Clearly, to the extent that the state (and not an individual plaintiff) is expressly seeking a statutorily defined “civil penalty,” Oklahoma courts consider that penalty to be an “action for the benefit of the state to punish an offense against the state.” Similarly, the federal court, in *Kopsky*, 537

⁵ ODS makes no effort to address the distinctions between the Vermont and Oklahoma constitutional provisions (although they both do provide language to the effect that legal actions provide for jury trials).

F.Supp.2d at 1026, recognized that “civil penalties imposed as a fine rather than mere disgorgement are unquestionably legal remedies for which there is a Seventh Amendment right to a jury trial.” Thus, the Vermont holding is contrary to both Oklahoma and federal authority case has no persuasive authority here. Defendants are entitled to jury trial on the civil penalty claims.

3. *Must these legal issues be submitted to a jury or are they incidental to the equitable issues?*

As noted above, “[W]hen an equity cause of action and law claim are involved in one suit, the trial court at its discretion may submit the equity case to the jury, but it is its duty to submit the law case to the jury for determination.” *Amcana*, 855 P.2d at 559.⁶ However, the parties agree that there is an exception to the rule where “the equitable issues are paramount or the legal issues incidental to or dependent upon the equitable issues.” *Id.* In such circumstances, the court should examine the “nature of the issues...and not alone by the form in which the action is brought or by the prayer for relief.” *Id.*

⁶ While ODS agrees that an action can include both legal and equitable claims, ODS inconsistently appears to contend that any ODS action can be an equitable matter because, in the context of minority shareholder litigation, “the Supreme Court has determined that where a plaintiff states a cause of action where no wrong has affected him directly, it can be an equitable matter.” See *ODS Brief*, p. 3, citing *Steinway v. Griffith Consolidated Theatres, Inc.*, 1954 OK 156, 273 P.2d 872 and *Neff v. Barber*, 162 N.W. 667 (Wis. 1917). Defendants can see no logical connection for applying the holdings of minority shareholder actions to between a securities enforcement action. The entities and claims are wholly distinct. Moreover, *Neff* relies on the principle that “in an action in equity all the issues, whether legal or equitable, are triable by the court.” *Id.* at 668. This holding is expressly contrary to Oklahoma law, discussed above, which generally provides that legal issues must be tried by a jury except when they are “incidental” to the equitable issues.

This is not a case where the legal issue – whether Defendants materially aided or participated in the sales transactions – is incidental to the equitable issue regarding Ms. Schubert’s restitution owed to investors. Rather, the legal determination regarding joint and several liability is the only issue which allows for any potential liability on the part of Defendants. Moreover, ODS purports that it is seeking civil penalties in the amount of \$120,000. It then trivializes this amount by comparing it to its equitable claim which it suggests totals in the millions, although Defendants have yet to see documentation which would support such a claim. Despite ODS’s contention, there is nothing incidental about \$120,000 – it is twelve times the minimum amount necessary for the right to a jury trial to attach in the first instance.⁷

In addition, this litigation also involves the claims of the Intervenors, which are undisputedly legal issues (as they are seeking actual and punitive damages). *See Intervenors’ Petition*, pp. 22-23. Indeed, the Intervenors have agreed that a jury is appropriate, and Defendants have paid the statutory jury fee. While seeking damages rather than equitable relief, the Intervenors are attempting to impose material aider/participant liability on Defendants, just as ODS has intended to do. *See ODS Petition*, p. 59 and *Intervenors’ Petition*, pp. 21-23. Consequently, a jury will be deciding precisely the same legal issue – whether Defendants materially aided or participated in the sales transaction – with regard to the Intervenors’ claims that ODS must prove to establish liability against Defendants under its legal theory. Thus,

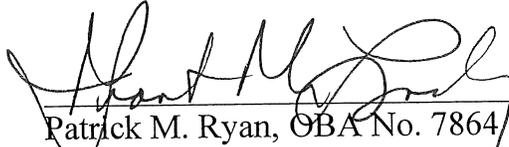
⁷ \$120,000 is also more than all but three of the seventy-four Short Investors (excluding the Intervenors) are claiming as outstanding losses. Clearly, these individuals find amounts less than \$120,000 to be significant.

ODS's contention that the legal issues are incidental cannot prevail. Moreover, as a practical matter, it can only serve judicial economy to have the jury deciding the issue rather than having two finders-of-fact, considering the identical issue with potentially different and inconsistent results.

CONCLUSION

There are three potential outcomes here. First, the Court may choose, in an exercise of its discretion, to submit all issues to a jury. Second, the Court may submit the legal issues to the jury while retaining discretion over the equitable issues, so long as the Court and jury verdicts are consistent (*i.e.*, the Court could only impose restitution, which requires a determination of material aider/participator status, if the jury determined Defendants did materially aid/participate when considering the Intervenors' claim and the civil penalties sought by ODS). Third, as ODS would argue, the Court may determine that it has no duty to submit the law case to the jury for determination the legal issues because the legal issues are incidental to the equitable issues, and deny Defendants a jury trial. If there is any question whatsoever regarding their right to a jury trial, the Court should err on the side of caution and exercise its discretion to grant the right rather than risking the denial of a constitutional right. Wherefore, Defendants respectfully request that the Court submit all of ODS's claims to the jury for a determination on the merits.

Respectfully submitted,



Patrick M. Ryan, OBA No. 7864

Daniel G. Webber, Jr., OBA No. 16332

Matthew C. Kane, OBA No. 19502

Grant M. Lucky, OBA No. 17398

RYAN WHALEY COLDIRON SHANDY PC

900 Robinson Renaissance

119 North Robinson

Oklahoma City, Oklahoma 73102

Telephone: (405) 239-6040

Facsimile: (405) 239-6766

***ATTORNEYS FOR DEFENDANTS
FARMERS & MERCHANTS BANK,
FARMERS & MERCHANTS
BANCSHARES, INC., JOHN V.
ANDERSON and JOHN TOM
ANDERSON***

CERTIFICATE OF SERVICE

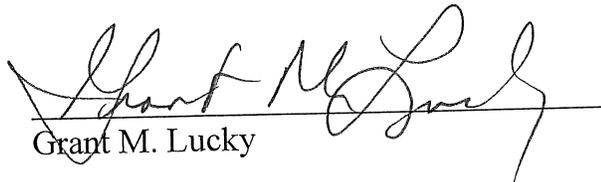
I hereby certify that on this 20th day of April, 2009, a true and correct copy of the above and foregoing instrument was mailed, via U.S. Mail, first-class, postage prepaid, to the following attorneys of record:

Melanie Hall
Amanda Cornmesser
Gerri Stuckey
Oklahoma Department of Securities
120 North Robinson Avenue, Suite 860
Oklahoma City, OK 73102

Ann L. Hoover
5611 S.W. Barrington Ct. S., Suite 100
Topeka, KS 66614-2489

Joseph H. Bocoock
Spencer F. Smith
Lauren E. Barghols
McAfee & Taft
A Professional Corporation
Tenth Floor, Two Leadership Square
211 N. Robinson Avenue
Oklahoma City, OK 73102-7102

Kurtis J. Ward
Law Offices of Kurtis J. Ward
East Wharf Plaza
9225 Lake Hefner Pkwy., Suite 101
Oklahoma City, OK 73120


Grant M. Lucky