

“Intervenors”), and submits its brief concerning the admissibility of investors’ negligence in the present case.

STATEMENT OF THE CASE AND BRIEF STATEMENT OF FACTS

This is an action brought by the Oklahoma Department of Securities (“ODS”) against Farmers & Merchants Bank, (“F&M Bank”), Farmers and Merchants Bancshares, Inc. (“Bancshares”), John V. Anderson, individually, as an officer and director of F&M Bank, and as a shareholder of Bancshares, and John Tom Anderson, individually, as an officer and director of F&M Bank, and as a shareholder of Bancshares. In this suit, the ODS seeks an order requiring F&M Bank, John V. Anderson, and John Tom Anderson to make restitution for the benefit of all investors who lost money in the fraudulent investment scheme orchestrated by Marsha Schubert.

Intervenors were investors who lost money in the same fraudulent scheme and are seeking to recover the damages caused by F&M Bank, John V. Anderson, and John Tom Anderson’s aiding and abetting Marsha Schubert’s scheme. Intervenors’ claim in this action concerns the liability of F&M Bank, John V. Anderson and John Tom Anderson under the Oklahoma Securities Act for aiding and abetting the securities fraud schemes of Marsha Schubert.

LEGAL AUTHORITY

Under 71 Okla. Stat. § 1-501:

It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly: (1) to employ a device, scheme, or artifice to defraud; (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it is made, no misleading; or (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

Securities fraud cases are commonly brought against banking institutions. *See Grubb v. FDIC*, 868 F.2d 1151 (10th Cir. 1989) (involving misrepresentations made concerning the loan portfolio in the sale of bank stock). Under most states' securities laws, a bank can be held liable for aiding and abetting a fraudulent scheme. *FDIC v. First Interstate Bank of Des Moines, N.A.*, 885 F.2d 423 (8th Cir. 1989) (court entered six million verdict against bank for aiding and abetting a fraudulent scheme of its customer); *Adam v. Mount Pleasant Bank & Trust*, 387 N.W.2d 771 (Iowa 1986) (bank's continual coverage of overdrafts in violation of legal lending limit intentionally gave customer false appearance of solvency such as to uphold verdict against bank in favor of those who dealt with customer); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. First Nat'l Bank of Little Rock*, 774 F.2d 909 (8th Cir. 1985) (bank liable for participation in check kiting scheme); *Whitney v. City Bank, N.A.*, 782 F.2d 1106 (2nd Cir. 1986) (holding that bank is liable for actual and punitive damages for aiding a breach of fiduciary duty).

The majority of courts across the country have held that a plaintiff's proportionate fault is not applicable in a suit alleging violations of securities law. *See, e.g., In re Atl. Fin. Mgmt., Inc., Sec. Litig.*, 603 F.Supp. 135 (D.Mass.1985); *McCracken v. Edward D. Jones & Co.*, 445 N.W.2d 375 (Iowa Ct.App.1989); *Duperier v. Tex. State Bank*, 28 S.W.3d 740 (Tex.App.2000); *Toothman v. Freeborn & Peters*, 80 P.3d 804, 815 -816 (Colo.App. 2002). *But see Banks v. Yokemick*, 177 F.Supp.2d 239 (S.D.N.Y.2001); *Landry v. Thibaut*, 523 So.2d 1370 (La.Ct.App.1988). Most courts that have not addressed this issue within the securities law context still recognize the longstanding common law rule that a plaintiff's fault may not reduce an intentional tortfeasor's liability. *See Prosser & Keeton, The Law of Torts* 462 (5th ed. 1984); *RESTATEMENT (SECOND) OF TORTS* §§ 481, 482 (1965). In *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1040 (7th Cir.), cert. denied, 434 U.S. 875 (1977), the Seventh Circuit Court of Appeals held that in a case alleging a violation of Securities Rule 10b-5 by the

defendants, the defendants' defense of the plaintiffs' "failure to exercise due care or diligence ... is not available in an intentional fraud case."

Although Oklahoma courts have not fully analyzed the plaintiff's burden of proving securities fraud under 71 Okla. Stat. § 1-501, courts around the country, with only one exception, have determined that an investor has no independent duty of investigation with regards to the handling of his investment. See *Lloyds of America, Ltd. v. Theoharous*, unpublished opinion, 2005 WL 3115329, (W.D. Okla. 2005); *Kelsey v. Nagy*, 410 N.E.2d 1333, 1336 (Ind. Ct. App. 1980); *Duperier v. Texas State Bank*, 28 S.W.3d 740 (Tex. App.--Corpus Christi 2000) (holding that the Texas securities statute at issue provides no defenses besides assumption of the risk and that a comparative fault defense would abrogate the protections granted by the Texas Securities Act); *McCracken v. Edward D. Jones & Co.*, 445 N.W.2d 375 (Iowa Ct. App. 1989 (Iowa Securities Act does not allow reduction of damages based upon comparative fault) *but see* Louisiana Case.

In *McCracken v. Edward D. Jones & Co.*, the Iowa Supreme Court analyzed Iowa Code § 502.401, which is identically worded to 71 Okla. Stat. § 1-501, the statute at issue in the current suit. This section states, in part, that

it is unlawful for any person, in connection with the offer, sale, or purchase of a security, directly or indirectly...[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

After determining that the brokerage service defendant violated the provisions in this code, the *McCracken* court noted that the securities laws in Iowa do not allow for the reduction of damages due to alleged fault by the plaintiff, even though the jury determined that the plaintiff should be assigned 35% of the overall liability for its damages.

The United States Supreme Court has repeatedly stressed that a “fundamental purpose” for the creation of Securities Acts, “was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. *Basic v. Levinson*, 485 U.S. 224, 235 (1988); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963); *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972). Although the Oklahoma courts have not yet specifically stated this principle, it is very likely that they will follow the rationale stated by the *McCracken* court and many other courts throughout the country which have dealt with the inapplicability of comparative/contributory negligence in the enforcement of securities statutes. *See Washington National Corp. v. Thomas*, 117 Ariz. 95, 102, 570 P.2d 1268, 1275 (Ariz. App. 1977), overruled on other grounds, *State v. Superior Court of Maricopa Co.*, 123 Ariz. 324, 599 P.2d 777 (Ariz. App. 1977), overruled on other grounds by *State v. Gunnison*, 618 P.2d 604 (Ariz. 1980) (holding that contributory negligence is not available as a defense to one who violates the securities statutes); *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (Ariz. App. 1986) (“The statutes do not require investors to act with due diligence...To the contrary, defendants have an affirmative duty not to mislead potential investors.”).

Under well-settled Oklahoma law, the comparative negligence doctrine is specifically limited to negligence causes of action—comparative negligence is completely irrelevant to the analysis of intentional and strict liability torts.¹ 23 Okla. Stat. § 13; *Kirkland v. General Motors Co.*, 1974 OK 52, ¶ 47, 521 P.2d 1353. Thus, contributory negligence is certainly not a defense

¹ “**In all actions** hereafter brought, whether arising before or after the effective date of this act, **for negligence** resulting in personal injuries or wrongful death, or injury to property, contributory negligence shall not bar a recovery, unless any negligence of the person so injured, damaged or killed, is of greater degree than any negligence of the person, firm or corporation causing such damage, or unless any negligence of the person so injured, damaged or killed, is of greater degree than the combined negligence of any persons, firms or corporations causing such damage.” (emphasis added) 23 Okla. Stat. § 13.

to common law fraud or fraudulent misrepresentation claims. The Oklahoma Supreme Court held in *Graham v. Keuchel*, 1993 OK 6, 52, 847 P.2d 342, 363, that a "jury must be instructed that...negligence...may not be considered as a defense against any form of conduct found to be willful and wanton or intentional." See Oklahoma Civil Jury Instruction 9.17; *Eastern Trading Co., v. Refco.*, 229 F.3d 617, 625 (7th Cir. 2000). The *Graham* court noted that the "apportionment of fault into percentage figures becomes impermissible once a defendant's behavior has been established as willful and wanton misconduct...'negligence' and 'willful and wanton misconduct' differ in kind." *Id.* at ¶46, at 361.

Additionally, under Oklahoma law, a defendant may not raise the affirmative defense of comparative negligence in a suit alleging statutory violations. When determining whether dram shop liability rested on statutory or common law grounds, the Oklahoma Civil Court of Appeals held that because dram shop liability "is of judicial, not statutory origin...[t]he cause of action...sounds in negligence and, therefore, comparative negligence principles govern." *Bennett v. Covergirls*, 1999 OK CIV. APP. 3, 973 P.2d 896 (Okla. Civ. App. 1999); *Brigance v. Velvet Dove Restaurant*, 1986 OK 41 at ¶24, 725 P.2d at 305 (Okla. 1986); 23 O.S.1991 § 13. Thus, the *Bennett* court implicitly held that claims alleging statutory violations are not negligence claims, and thus, any comparative negligence analysis would be improper and irrelevant. *Id.*; see also *Douglas County Bank v. United Financial*, 207 F.3d 473, 479 (8th Cir. 2000); *Little v. Gillette*, 354 N.W. 2d 147 (Neb. 1984)(quoting *Foley v. Holtry*, 61 N.W. 120, 123-124 (1894)).

Although Oklahoma law, unlike some other states' statutes², does not specifically assign strict liability to those entities which violate the Oklahoma Uniform Securities Act, the relevant sections of the Act prohibit acts of fraud or deceit, both of which are clearly involve intentional

² For example, Arizona courts impose strict liability for those who make misrepresentations and omissions in violation of its securities statutes. *Garvin v. Greenbank*, 856 F. 2d 1392, 1398 (9th Cir. 1998).

conduct. A defendant who is alleged to have committed acts of fraud or deceit under the Act cannot use any alleged negligent acts committed by the plaintiffs to the suit to decrease or eliminate the defendant's overall liability. Since investors have no duty under the Oklahoma Uniform Securities Act to investigate for misrepresentations or omissions, a defendant may not raise the defense of comparative negligence in a suit claiming violations of the Act.

In *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 552 (Ariz. App. 1986), the Arizona Court of Appeals affirmed that an appellant company had violated sections of A.R.S. § 44-1991 & § 44-1992 of Arizona's securities statutes when they implemented a sophisticated scheme to defraud investors by inflating their company's assets and by creating expectations of growth that were completely unfounded. The Defendants argued that the plaintiffs were negligent in that they failed to investigate the false representations, and that had they done so, they would have prevented the loss. *Id.* at 553. In its opinion, the court noted that the Defendants had violated the applicable statute by breaching their affirmative duty not to mislead potential investors. *Id.* The court then noted that the very nature of this affirmative duty "not only removes the burden of investigation from an investor, but places a heavy burden upon the offeror not to mislead potential investors in any way." *Id.* Thus, the issue of whether the investor was contributorily negligent was moot because the court reiterated Arizona does not recognize contributory negligence as a defense to a violation of its securities statutes. *Id.*

In *Besett v. Basnett* an often-cited Florida case regarding the related issue of fraudulent misrepresentation, the court held that the plaintiffs, buyers of land, were entitled to rely upon the truth of the seller's representation that the lot was a particular size, even though its falsity could have been discovered upon a simple investigation. *Besett v. Basnett*, 389 So. 2d 995, 998 (Fla. 1980). In its opinion, the Florida Supreme Court noted that although "one should not be

inattentive to one's business affairs, the law should not permit an inattentive person to suffer loss at the hands of a misrepresenter." *Id.* The court cited with approval § 540 of RESTATEMENT (SECOND) OF TORTS (1976) which provides that "the recipient of fraudulent misrepresentation of fact is justified in relying upon its truth, although he might have ascertained the falsity of the representation had he made an investigation."

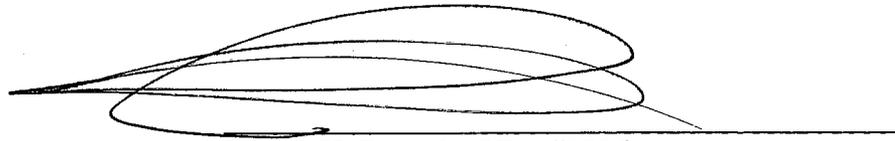
Other courts also recognize that plaintiffs should not be denied recovery for putting their trust in their fiduciaries' representations. In *Little v. Gillette*, the Nebraska Supreme Court held that the plaintiff was entitled to rely on the fraudulently optimistic statements that two realtors made to him regarding the profit potential of a business he was purchasing, holding as irrelevant the defendants' argument that the plaintiff was partially to blame for his failure to independently investigate the veracity of their representations. *Little v. Gillette*, 218 Neb. 271, 276-277, 354 N.W. 2d 147, 154 (1984); *see also Bristol v. Braidwood*, 28 Mich. 191 (Mich. 1873).

For the above-stated reasons, a purchaser of security interests has no duty to investigate a possible fraud being perpetrated upon them and need not verify a security statement's accuracy for the purposes of a comparative negligence analysis. *MidAmerica Federal Sav. and Loan Ass'n v. Shearson/American Exp., Inc.* 886 F.2d 1249, 1256 -1257 (10th Cir. 1989); *see Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522 (7th Cir. 1985)("An ordinary investor is under no duty to investigate...many people invest large sums in reliance on representations made to them"); *Currie v. Cayman Resources Corp.*, 835 F.2d 780, 783 (11th Cir.1988); *see also Junker v. Crory*, 650 F.2d 1349, 1359 (5th Cir. 1981); *Sanders v. John Nuveen & Co., Inc.*, 619 F.2d 1229 (7th Cir. 1975); *In re Olympia Brewing Co. Sec. Litig.*, 612 F.Supp. 1367 (N.D.Ill. 1985). Instead, the defendant in a suit involving alleged violations of securities laws must rely solely upon its own actions and omissions in crafting its defenses. Thus, a comparative negligence analysis would be completely irrelevant to the resolution of the claims in such a suit.

CONCLUSION

The Intervenor respectfully request the Court to consider their brief on the admissibility of the investors' negligence.

Respectfully submitted this 1st day of August 2008.



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CERTIFICATE OF SERVICE

I hereby certify that on this **1st** day of **August 2008**, a true and correct copy of the foregoing was emailed and sent via U.S. First Class Mail, postage prepaid, to the following counsel of record:

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