

IN THE DISTRICT COURT OF OKLAHOMA COUNTY  
STATE OF OKLAHOMA

FILED IN THE DISTRICT COURT  
OKLAHOMA COUNTY, OKLA.

OKLAHOMA DEPARTMENT OF SECURITIES )  
*ex rel.* Irving L. Faught, Administrator, )  
 )  
Plaintiff, )  
 )  
vs. )  
 )  
FARMERS & MERCHANTS BANK, et al. )  
 )  
Defendants. )

JUL 20 2006

PATRICIA PRESLEY, COURT CLERK  
by \_\_\_\_\_  
Deputy

Case No. CJ-2006-3311  
Honorable Patricia G. Parrish

**DEFENDANTS' REPLY TO PLAINTIFF'S RESPONSE TO DEFENDANT'S  
MOTION TO DISMISS AND BRIEF IN SUPPORT**

Defendants Farmers & Merchants Bank ("FMB"), Farmers & Merchants Bancshares ("Bancshares"), John V. Anderson and John Tom Anderson (collectively referred to as "Defendants"), through this reply, continue to assert that a civil enforcement action cannot be brought against Defendants by the Oklahoma Department of Securities ("ODS") for: (1) purported aiding and abetting arising before the current Oklahoma Securities Act went into effect on July 1, 2004; and (2) restitution under either version of the statutory civil enforcement scheme.

**ARGUMENT AND AUTHORITIES**

**I. ODS' Waiver Argument**

Despite ODS' representations to the contrary, neither Defendants' motion for extension nor the agreed order cited to 12 O.S. § 2012(b) as authority for an extension; rather, they reflected a general extension of time, after which Defendants would *answer or otherwise plead pursuant to 12 O.S. § 2012*. This situation would be different if Defendants had acted unilaterally, but that is not what happened here. ODS clearly understood that

Defendants were seeking to “answer or otherwise plead” after having an opportunity to evaluate the case and agreed to the extension, signing the agreed order. To now contend Defendants should not have an opportunity to answer or file a motion to dismiss is disingenuous.

## **II. Standard of Review**

Defendants believe they have appropriately stated the standard of review in this situation. Regardless, even under ODS’ interpretation, relief is not possible “under any set of facts that could be established consistent with the allegations” brought by ODS.

## **III. Administrator’s Authority**

Defendants have not sought a carte blanche dismissal. Rather, Defendants seek to limit ODS’ claim in time and scope pursuant to the express provisions of the Oklahoma Securities Act, which both provide for the existence of ODS and define its scope. Clearly, both the old and new Securities Acts unambiguously provide for both “civil enforcement” and “civil liabilities” actions. The civil liabilities provision provides *only* the “purchaser” or “seller” with actionable rights. *See* 71 O.S. § 408; *see also* 71 O.S. § 1-509. Oklahoma case law expressly states that while “[t]he determination of legislative intent controls judicial statutory interpretation...it is unnecessary to apply rules of construction to discern Legislative intent if the will is clearly expressed.” *In re Estate of Flowers*, 1993 OK 19, 848 P.2d 1146, 1151 (applying plain language of the statute).<sup>1</sup> Thus 71 O.S. § 408 and § 1-509 clearly provide that only the purchaser or seller may bring the action.

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<sup>1</sup> ODS cites to *State v. Diacide Distributors, Inc.*, 561 N.W.2d 369 (Iowa 1997), for its position. The Iowa decision is non-authoritative and contrary to clear Oklahoma law on statutory construction. Further, the Iowa Legislature still found the need to clarify its statutory scheme even after *Diacide*. *See Laws of the 1999 Regular Session of the 78<sup>th</sup> General Assembly of the State of Iowa*, Ch. 166, § 6 (attached as Exh. “1”).

Even if the court looks beyond that statute itself, the construction of the act in its entirety supports the plain language reading, with distinct statutes for distinct schemes to enforce the Act. The Administrator has enumerated powers—he can bring administrative sanctions under 71 O.S. § 406 and enforcement actions in court under 71 O.S. § 406.1. As this is the basis for his authority, these provisions alone set out his authority, and any actions outside the statutory authority are *ultra vires*. As previously discussed, only the purchaser or seller can bring suit under the civil liability provision. Reading the statute as it is written does not render any portion meaningless. Purchasers and sellers maintain an opportunity to seek joint and several liability in a damages action.

ODS relies on *S.E.C. v. Wong*, 252 F.Supp. 608 (D.P.R. 1966), a case which holds that the S.E.C. can enforce 10(b) (15 U.S.C. § 78j) without being a “victim.” This is only logical, as 10(b) does not require a “victim.” Wong was seeking to impose the judicially created elements of a private right of action on the S.E.C. Such is not the case here, where the statutory scheme explicitly defines both the private right of action and the enforcement mechanism available to ODS. Contrary to ODS’ position, *Wong* supports the position that civil liability and enforcement actions should remain distinct.

Assuming *arguendo* that ODS is permitted to act under 71 O.S. § 408 or § 1-509, in filling the shoes of the investors, it must then accept both the positive and negative aspects of taking on such a role. For instance, 71 O.S. § 408 provides (1) a statute of limitations, (2) a right of contribution and (3) potentially a jury trial, assuming ODS continues to seek what are truly damages (amounts in excess of funds, if any, Defendants actually received), rather than equitable remedies. In short, ODS cannot select to bring an action under a civil enforcement

scheme while obtaining the benefits (and not the corresponding limitations) of a civil liability action.

#### IV. Restitution

Defendants' "*narrow* definition of restitution," as ODS describes it, is in fact the general rule provided by the Oklahoma Supreme Court, quoting from the *first* section of the *Restatement of Restitution*. See *Stites v. DUIT Constr. Co., Inc.* 1995 OK 69, 903 P.2d 293, 301, n. 28. Moreover, in a seminal discussion of restitution (on which *Stites* relies), the Oklahoma Supreme Court espoused the following:

The unifying theme of various restitutionary tools is the *prevention of unjust enrichment*...restitution will be available whenever one has received a benefit to which another is justly entitled. The remedy in restitution rests on the ancient principles of disgorgement. Beneath the cloak of restitution lies the dagger that compels the conscious wrongdoer to disgorge his gains...Disgorgement is said to occur when a defendant is made to cough up what he got, *neither more nor less*.

*Warren v. Century Bank Corporation, Inc.*, 1987 OK 14, 741 P.2d 846, 851 (emphasis added internal quotation marks and footnotes omitted).<sup>2</sup>

In *Lapkin v. Garland Bloodworth, Inc.*, 2001 OK CIV APP 29, 23 P.3d 958, 983, the Oklahoma Court of Civil Appeals reversed a trial court decision holding an attorney jointly and severely liable where he had only been enriched by one-third of the entire amount owed. After noting that the remedy sounded in equity, the Court of Civil Appeals held: "It is inequitable to hold [the defendant] liable for restitution of the full [amount] when [he] was

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<sup>2</sup> ODS cites to *State ex rel. Day v. Southwest Mineral Energy, Inc.*, 1980 OK 118, 617 P.2d 1334, a case permitting disgorgement under 71 O.S. 406.1, as "further support for Plaintiff's position" although it is not clear from the Response what position Plaintiff is referring to. It in no way discusses an attempt by ODS to bring a civil enforcement action for "restitution" based solely on aider and abettor liability. What the case does confirm is that the Administrator seeks *equitable* remedies, *Id.* at 1337-1338 and Plaintiff's Response, p. 12, and thus the "narrow" *equitable* definition of restitution is the correct definition under these circumstances.

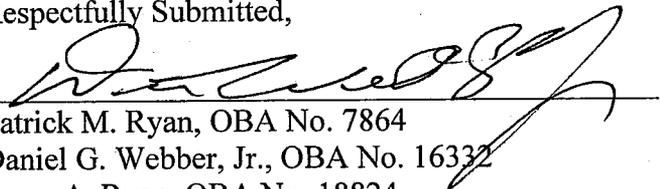
only unjustly enriched in the amount of [one third of the total].” Thus the case confirms that unjust enrichment is the key, and that such unjust enrichment determines the individual defendant’s extent of liability.

While the cases and other authority cited by Defendants clearly establish the proper understanding of restitution in general circumstances, ODS can cite only to bar disciplinary proceedings, where the Court begins its discussion of restitution by expressly limiting it in scope to “*bar disciplinary cases*.” *State ex rel. Oklahoma Bar Assn. v. Leigh*, 1996 OK 37, 914 P.2d 661, 668. In addition, its quote from Black’s Law Dictionary ODS conveniently omits a key citation—*State v. Barnett*, 110 Vt. 221, 3 A.2d 521, 525, 526 (1939)—revealing the source of this particular definition sounds in criminal law, something not present here. Additionally, it should be noted that ODS has not offered a single Oklahoma case (or a case from any other jurisdiction) permitting restitution based on aider and abettor liability. This is simply because restitution is an equitable remedy, and thus must be equitable reflecting restitution only of monies wrongfully held by the individual defendant.

### CONCLUSION

For the reasons set forth above, Defendants respectfully request the Court grant their Motion to Dismiss and dismiss all aspects of the ODS claim (1) arising before July 1, 2004, based on acts or omissions prior to that date, as 71 O.S. § 406.1 does not provide a civil enforcement mechanism against those “materially aiding” in the securities violation; or (2) relying on the civil liability scheme (71 O.S. §§ 1-509 and/or 408), as this case has been brought pursuant to a civil enforcement mechanism. Further, Defendants request an order stating that restitution is not an available remedy against Defendants for any part of the ODS claim.

Respectfully Submitted,



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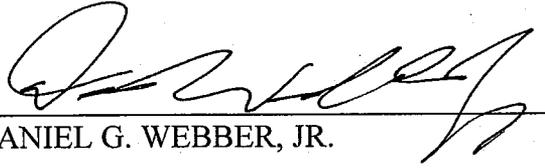
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**CERTIFICATE OF SERVICE**

I hereby certify that on this 20<sup>th</sup> day of July 2006, a true and correct copy of the above and foregoing instrument was mailed, via U.S. First Class Mail, postage prepaid, to the following counsel of record:

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DANIEL G. WEBBER, JR.

**LAWS OF THE 1999 REGULAR SESSION  
OF THE SEVENTY-EIGHTH  
GENERAL ASSEMBLY OF THE STATE OF IOWA**



**CHAPTER 166**

**ENTITIES AND SUBJECT MATTER REGULATED BY  
INSURANCE DIVISION**

*S.F. 406 Bill History*

AN ACT relating to entities and subject matter under the regulatory authority of the insurance division, including securities, business opportunities, funeral merchandise, funeral services, cemeteries, cemetery merchandise and residential service contracts, providing for fees, and establishing penalties.

*Be It Enacted by the General Assembly of the State of Iowa:*

Section 1. Section 502.202, subsection 12, paragraph b, unnumbered paragraph 1, Code 1999, is amended to read as follows:

A mutual or cooperative organization, including a cooperative association organized in good faith under and for any of the purposes enumerated in chapters 497, 498, ~~and 499~~, and 501 that deals in commodities or supplies goods or services in transactions primarily with and for the benefit of its members, if:

Sec. 2. Section 502.302, subsection 3, Code 1999, is amended to read as follows:

3. Every applicant for initial or renewal registration as a broker-dealer or investment adviser shall pay a filing fee of two hundred dollars. Every applicant for initial or renewal registration as an agent or investment adviser representative shall pay a filing fee of thirty dollars. However, an investment adviser representative is not required to pay a filing fee, if the investment adviser is a sole proprietorship or the substantial equivalent and the investment adviser representative is the same individual as the investment adviser. A filing fee is not refundable. Every person acting as a federal covered adviser in this state, except with respect to federal covered advisers whose only clients are those described in section 502.301, subsection 3, paragraph "b", shall pay an initial and renewal notice filing fee of one hundred dollars.

Sec. 3. Section 502.304, subsection 5, Code 1999, is amended to read as follows:

5. Withdrawal from registration as a broker-dealer, agent, investment adviser, or investment adviser representative becomes effective thirty days after receipt of an application to withdraw or within such shorter period of time as the administrator may by order determine, unless a proceeding to deny, suspend, or revoke a registration is pending when the application is filed or a proceeding to deny, suspend, or revoke a registration, or to impose conditions upon the withdrawal is instituted within thirty days after the application is filed. If a proceeding is pending or instituted, withdrawal becomes effective

at such time and upon such conditions as the administrator by order determines. If no proceeding is pending or instituted and withdrawal automatically becomes effective, the administrator may nevertheless institute a revocation or suspension proceeding under subsection 1, ~~paragraph "b"~~, within one year after withdrawal became effective and enter a revocation or suspension order as of the last date on which registration was effective.

Sec. 4. Section 502.304, Code 1999, is amended by adding the following new subsection:

NEW SUBSECTION.5A. A person who directly or indirectly controls a broker-dealer or agent is subject to the same sanctions applicable to an applicant or registrant under this section, unless the person proves that the person did not know, and was not grossly negligent in failing to know, of the existence of facts by reason of which the liability is alleged to exist.

Sec. 5. Section 502.305, Code 1999, is amended to read as follows:

#### 502.305 EXAMINATION OF INVESTMENT ADVISER REPRESENTATIVE AND EXEMPTION FROM EXAMINATION.

The administrator may adopt rules requiring the passage of an examination by an individual who is required to be registered under this chapter as an investment adviser representative. However, a person who is registered as an investment adviser representative between January 1, 1999, and December 31, ~~2000~~ 1999, shall not be required to pass an examination for as long as the person maintains a continuous registration.

Sec. 6. Section 502.503, subsection 1, Code 1999, is amended to read as follows:

1. Affiliates of a person liable under section 502.401, 502.501, 502.502, or 502.502A, or 502.604, partners, principal executive officers or directors of such person, persons occupying a similar status or performing similar functions for such person, persons (whether employees of such person or otherwise) who materially aid and abet in the act or transaction constituting the violation, and broker-dealers or agents who materially aid and abet in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person, unless one of the following applies:

a. With respect to section 502.501, section 502.502, subsections 1 and 5, or section 502.502A, ~~any a~~ person liable ~~hereunder~~ under this subsection proves that the person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist; ~~and~~ .

b. With respect to section 502.401, section 502.502, subsections 2 and 3, and section 502.604 ~~any a~~ person liable ~~hereunder~~ under this subsection proves that the person did not know, and was not grossly negligent in failing to know, of the existence of the facts by reason of which the liability is alleged to exist.

Sec. 7. Section 502.504, Code 1999, is amended by adding the following new subsection:

NEW SUBSECTION.7. This section shall not apply to actions filed by the administrator pursuant to section 502.604.

Sec. 8. Section 502.604, subsection 2, Code 1999, is amended to read as follows:

2. Bring an action in the district court to enjoin the act or practice and to enforce compliance with this chapter or a rule or order adopted or issued pursuant to this chapter. Upon a proper showing, the court may do all of the following:

a. Grant a permanent or temporary injunction, restraining order, ~~or asset freeze, accounting, writ of attachment, writ of general or special execution, writ of mandamus shall be granted and a~~, or other equitable or ancillary relief.

b. Appoint a receiver or conservator ~~may be appointed~~ for the defendant or the defendant's assets. ~~In addition, upon a proper showing by the administrator, the court may enter an order of~~

c. Order the administrator to take charge and control of a party's property, including but not limited to managing rents and profits, collecting debts, and acquiring and disposing of property.

d. Order the rescission, restitution, or disgorgement directed at any person who has engaged in an act constituting a violation of this chapter, or a rule or order adopted or issued pursuant to this chapter, ~~and may order~~.

e. Order the payment of prejudgment and postjudgment interest.

PARAGRAPH DIVIDED. The administrator shall not be required to post a bond.

Sec. 9. Section 523A.5, subsection 2, Code 1999, is amended by adding the following new paragraph:

NEW PARAGRAPH. e. "Prepaid contract" means a written contract or other agreement executed by a seller in which the seller promises to deliver merchandise or services upon the future death of a person named or implied in the agreement.

Sec. 10. Section 523A.6, Code 1999, is amended to read as follows:

#### 523A.6 COMPLIANCE WITH OTHER LAWS.

The seller of a prepaid contract for the purchase of funeral services or funeral merchandise shall comply with chapter 555A ~~with respect to all contracts that are subject to regulation under this chapter~~. A ~~failure~~ person failing to comply with chapter 555A is subject to the remedies and penalties provided in that chapter.

Sec. 11. Section 523B.2, subsection 10, paragraph a, subparagraph (9), Code 1999, is amended to read as follows:

(9) The seller does not have a minimum net worth of ~~twenty-five~~ fifty thousand dollars, as determined in accordance with generally accepted accounting principles. A seller may submit a surety bond in lieu of the net worth requirement. The administrator may by rule or order increase the amount of the net worth or bond for the protection of purchasers and may require the seller to file reports of all sales in this state to determine the appropriate amount of the net worth requirement. The surety bond shall be for the period of the registration, issued by a surety company authorized to do business in this state and for the benefit of any purchaser.

Sec. 12. Section 523C.6, Code 1999, is amended to read as follows:

## 523C.6 NET WORTH REQUIREMENT.

A service company that has issued or renewed in the aggregate one thousand or less residential service contracts during the preceding calendar year shall maintain a minimum net worth of forty thousand dollars, and the minimum net worth to be maintained shall be increased by an additional twenty thousand dollars for each additional five hundred contracts or fraction thereof issued or renewed, up to a maximum required net worth of four hundred thousand dollars. At least twenty thousand dollars of net worth shall consist of paid-in capital.

~~For purposes of this chapter, "net worth" means the excess of all assets over all liabilities including required reserves computed in accordance with generally accepted accounting principles. At least twenty thousand dollars of net worth shall consist of paid-in capital.~~

Sec. 13. Section 523C.8, Code 1999, is amended to read as follows:

## 523C.8 REBATES AND COMMISSIONS.

1. Except as provided in subsection 2, a service company shall not pay a commission or any other consideration to any person as an inducement or compensation for the issuance, purchase, or acquisition of a residential service contract. However, this

2. This section does not prohibit any of the following:

a. The payment of an override commission or marketing fee to an employee or commission sales agent who is a marketing or sales representative of the service company or its parent company, subsidiary, or affiliate on the sale or marketing of a residential service contract, provided the employee or commission sales agent is not a real estate licensee sharing in or entitled to share in, or affiliated with, a company or organization which is entitled to share in any real estate commission generated by the underlying real property transaction. ~~This section also does not prohibit fees,~~

b. Fees, payments, or reimbursements for a bona fide ~~inspections~~ inspection, if an inspection of the property to be the subject of a residential service contract is required by a service company and if the inspection fee is reasonably related to the services performed.

3. The division may adopt rules identifying types of fees, payments, or reimbursements that do not constitute an inducement or compensation for the issuance, purchase, or acquisition of a residential service contract.

Sec. 14. Section 523E.1, subsection 6, Code 1999, is amended to read as follows:

6. This section does not apply to payments for merchandise delivered to the purchaser. Delivery includes storage in a warehouse ~~under the control of the seller or any other warehouse~~ or storage facility approved by the commissioner ~~when a receipt of ownership in the name of the purchaser is delivered to the purchaser, the merchandise is insured against loss, the merchandise is protected against damage, title has been transferred to the purchaser, the merchandise is appropriately identified and described in a manner that it can be distinguished from other similar items of merchandise unless this identification requirement with respect to bronze merchandise is waived by the commissioner by rule, the method of storage allows for visual audits of the merchandise, and the annual reporting requirements of section 523E.2, subsection 1, are satisfied.~~

Sec. 15. Section 523I.6, Code 1999, is amended by adding the following new subsection:

NEW SUBSECTION. 4.A cemetery shall provide services necessary for the installation or burial of vaults or other similar merchandise sold by the cemetery. This subsection shall not require the cemetery to provide for opening or closing interment or entombment space, unless an agreement executed by the cemetery expressly provides otherwise.

Approved May 24, 1999

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Updated: NOV 10 1999

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