

IN THE DISTRICT COURT OF OKLAHOMA COUNTY
STATE OF OKLAHOMA

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.,)
)
 Intervenor.)

Case No. CJ-2006-3311

**FILED IN THE DISTRICT COURT
OKLAHOMA COUNTY, OKLA.**

AUG 13 2008
PATRICIA PRESLEY, COURT CLERK
by _____
DEPUTY

**DEFENDANTS' RESPONSE TO INTERVENORS' BRIEF ON ADMISSIBILITY
OF INVESTORS' NEGLIGENCE AND PLAINTIFF'S MEMORANDUM
CONCERNING DISCOVERY ISSUES**

COME NOW Defendants Farmer & Merchants Bank, Farmers & Merchants Bancshares, Inc., John V. Anderson and John Tom Anderson ("Defendants") and respectfully submit their *Response to Intervenor's Brief on Admissibility of Investors' Negligence ("Intervenor's Brief")* and *Plaintiff's Memorandum Concerning Discovery Issues ("Plaintiff's Brief")*. On August 13, 2007, Defendants served discovery on the Oklahoma Department of Securities ("ODS") relating to ODS's claim that Defendants materially aided Marsha Schubert's sales of securities by untrue statements of material facts and/or omissions. *See Defendants' First Set of Interrogatories and Defendants' First Request for Production*, attached as Exhibits 3 and 4 to *Defendants' Brief in Support of Outstanding Discovery Issues ("Defendants' Brief")*. Nonetheless, a year after ODS received the discovery requests, ODS

now complains that such discovery should not be permitted because it will “substantially delay the resolution of this case.” *Plaintiff’s Brief* at 1. While Defendants, like all the parties to the litigation, seek timely resolution of this litigation, discovery – which ODS could have long since provided – is necessary to prepare a defense to the claims seeking millions of dollars from Defendants. Part I of *Defendants’ Response* addresses the issues raised in *Intervenors’ Brief*; Part II responds to contentions set out in *Plaintiff’s Brief*. As set forth below, Defendants are entitled to the discovery sought as it is relevant to the subject matter of this action and/or reasonably calculated to lead to the discovery of admissible evidence. 12 O.S. § 3226(B)(1).

I. DEFENDANTS’ RESPONSE TO INTERVENORS’ BRIEF ON ADMISSIBILITY OF INVESTORS’ NEGLIGENCE

A. The Intervenors’ Brief Is Based On The Wrong Statute

The *Intervenors’ Brief* fundamentally misconstrues and misstates the basis for the Defendants’ alleged liability under Oklahoma law. The Intervenors initially state that their claims against Defendants arise “under the Oklahoma Securities Act for aiding and abetting the securities fraud scheme of Marsha Schubert.” See *Intervenors’ Brief*, p. 2. However, the Intervenors then claim that 71 O.S. § 1-501 “is the statute at issue in the current suit,” and proceed to cite a number of cases decided under state and federal case law construing statutes identically worded to 71 O.S. § 1-501. *Id.* at p. 4. The Intervenors have relied on the wrong statute, and thus their entire brief rests on an incorrect theory of liability, which, as a consequence, undermines the applicability of the arguments raised by the Intervenors.¹

¹ In addition to citing the wrong statute, the Intervenors begin their brief by stating that “[s]ecurities fraud actions are commonly brought against banking institutions.” *Brief*, p. 3. In support of that assertion, the Intervenors cite a number of cases involving banks which are based, not on state or federal securities violations, but on state common law actions of deceit

Under Oklahoma's Securities Act, *civil liability* for securities violations, including "material participant" liability, is *exclusively* found in the provisions of 71 O.S. § 1-509.² As noted in *Defendants' Brief* (p. 5), that statute expressly creates a private cause of action for any person who purchased a security from a seller "by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the purchaser not knowing the untruth or omission" 71 O.S. § 1-509(B). Section 1-509(B) also extends liability – jointly and severally with the seller – to any person "who materially aids in the conduct giving rise to liability [under 71 O.S. § 1-509(B)]." Put simply, there must be a sale by means of an untrue statement of material fact, and the Defendants must have sufficiently participated with the seller in that unlawful sales transaction. *See Defendants' Brief* at 5-6.

Importantly, if a cause of action for violating Oklahoma's securities laws is not contained in 71 O.S. § 1-509, it simply does not exist. 71 O.S. § 1-509(M) provides that, "*this act does not create a cause of action not specified in this section.*" (Emphasis added); *see also South Western Oklahoma Development Authority v. Sullivan Engine Works*, 1996 OK 9, 910 P.2d 1052 (noting that civil liability under Oklahoma's securities laws for those who materially participate or aid in an unlawful sale is exclusively found in section 408 of the Predecessor Act). Thus, for the Intervenor to suggest that § 1-501 creates civil liability for the Defendants and to cite a number of cases interpreting state and federal statutes similar to § 1-501, simply misstates the applicable law not only as to Defendants' monetary liability

and/or conspiracy. The Intervenor fails to cite a single case against a bank that is similar to the facts of this case and the relevant analysis relating to participant liability in a securities fraud case.

² Under the Predecessor Act, 71 O.S. § 408 governed civil liability and is similar to 71 O.S. § 1-509.

but also as to the proper scope of review relating to the outstanding discovery issues between the parties.

Oklahoma courts have consistently looked to federal authority in construing the Oklahoma Securities Act. *State ex rel. Day v. Southwest Mineral Energy, Inc.*, 1980 OK 118, ¶¶ 10-16, 617 P.2d 1334, 1336-37; *see also Howell v. Ballard*, 1990 OK CIV APP 92, 801 P.2d 127, 128; *Adams v. Smith*, 1986 OK CIV APP 32, 734 P.2d 843; 71 O.S. § 501. In that regard, the federal counterpart to § 1-501 is § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.³ The United States Supreme Court has expressly held that there is no private cause of action for aiding and abetting liability under Section 10(b). *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 114 S.Ct. 1439 (1994). Even more recently, the United States Supreme Court has also rejected so-called “scheme liability” under Rule 10(b), where a plaintiff attempts to sue a secondary actor in a securities

³ 71 O.S. § 1-501, “General fraud,” provides:

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, not 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.

Similarly, 17 C.F.R. § 240.10b-5, “Employment of manipulative and deceptive devices,” states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To 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 were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

transaction without any evidence that the plaintiff “had knowledge, actual or presumed, of [Defendants’ allegedly] deceptive acts during the relevant times.” *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S.Ct. 761 (2008). The Intervenor alleges in their Petition that they were not aware of Defendants’ alleged misconduct until March 23, 2005, five (5) months after Schubert’s Ponzi scheme fell apart. Thus, for Intervenor to argue that Section 1-501 of Oklahoma’s Securities Act is the relevant statute in this case is simply erroneous and contrary to applicable law.

Assuming *arguendo* (and despite the clear authority to the contrary discussed above) that the Intervenor could rely upon § 1-501 as a basis for recovery against Defendants, investor conduct would be directly relevant and discoverable. Under 10(b) (and thus § 1-501), a plaintiff must establish that in connection with the purchase or sale of a security, the defendant, with scienter, made a false representation of a material fact upon which the plaintiff justifiably relied to his or her detriment. *See Holdsworth v. Strong*, 545 F.2d 687, 694 (10th Cir. 1976). A private cause of action for damages will not lie under 10(b) or 10(b)-5 in the absence of scienter on the part of the defendant, *i.e.*, an intent to deceive, manipulate or defraud, and that liability under 10(b) and 10(b)-5 will not lie for merely negligent conduct. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); *Holdsworth v. Strong*, 545 F.2d 687 (10th Cir. 1976). In addition to establishing an intent to deceive, an investor’s justifiable reliance is also an essential linchpin of a Section 10(b) claim. *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511 (10th Cir. 1983).

To that end, an investor’s reliance upon a broker’s misstatement is never justified when the “investor’s conduct rises to the level of recklessness.” *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1032 (2nd Cir. 1993). A plaintiff is reckless if he “intentionally

refuse[s] to investigate in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow.” *Dupuy v. Dupuy*, 551 F.2d 1005, 1020 (5th Cir. 1977) (quotations and citation omitted). Stated differently, a plaintiff is reckless if he “possesses information sufficient to call [a mis]representation into question,” but nevertheless “close[s] his eyes to a known risk.” *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 530 (7th Cir. 1985) (citation omitted). Thus, “[i]f the investor knows enough so that the lie or omission still leaves him cognizant of the risk, then there is no liability.” *Id.* For these reasons, as well as the others discussed below, the Intervenors’ conduct would be relevant and discoverable for any alleged claim under 71 O.S. § 1-501.

B. Admissibility Is Not The Standard Governing Discovery

In addition to citing the incorrect standard for liability, the Intervenors have also cited the incorrect standard governing discovery. *See Intervenors’ Brief* at 1-2, 9 (discussing discovery issues in terms of “admissibility”). Discovery rules are to be given broad and liberal treatment. *Hickman v. Taylor*, 329 U.S. 495, 67 S.Ct. 385 (1947). Oklahoma’s Discovery Code allows discovery of information which will not be admissible at trial, as long as it appears “reasonably calculated to lead to the discovery of admissible evidence.” *See* 12 O.S. § 3226(B)(1). Thus, any denial of discovery that is reasonably calculated to lead to the discovery of admissible evidence would thwart the very purposes of the Oklahoma Discovery Code.

“Relevancy is broadly construed at the discovery stage of litigation and a request for discovery should be considered relevant if there is any possibility that the information sought may be relevant to the subject matter of the action.” *Flour Mills of America, Inc. v. D.F.*

Pace, 75 F.R.D. 676, 680 (W.D. Okla. 1977); see also *Centurion Industries, Inc. v. Warren Steurer and Associates*, 665 F.2d 323, 326 (10th Cir. 1981) (“relevancy is construed more broadly during discovery than at trial”). While Intervenor’s assert that evidence of the Intervenor’s investment conduct is inadmissible and/or irrelevant to this case, see *Intervenor’s Brief* at 2, 8, Oklahoma law governing the respective claims in this case clearly contemplates discovery of such information.

Defendants are requesting information regarding the Intervenor’s investment conduct that specifically relates to the discovery of relevant and admissible evidence that goes to the heart of the validity of the Intervenor’s claim, including but not limited to: (1) the date Intervenor’s were put on inquiry notice into Marsha Schubert’s purported investment program and the period in which a diligent investor should have discovered facts underlying the possible fraud;⁴ and (2) Defendants’ liability or lack thereof, which includes a corresponding inquiry into the discovery of facts regarding, among other things, the Intervenor’s decision to purchase securities from Marsha Schubert as well as the discovery of facts relating to their lack of knowledge of the untruthfulness of Schubert’s statements. See generally, *Defendants’ Brief* at 6 and Exhibits 1 and 2 thereto. Such evidence is certainly relevant and discoverable and Intervenor’s should be ordered to produce it.

The information Defendants requested from the Intervenor’s in discovery is by no means unique in securities litigation. In fact, in *any* securities related arbitration brought by

⁴ “Evidence of the possibility of fraud, rather than particular details of the fraud, is all that is required to begin the limitations period.” *Caprin v. Simon Transportation Services, Inc.*, 99 Fed.Appx. 150, 155 (10th Cir. 2004). State securities laws are intended to “protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act.” *Sterlin v. Biomune Systems*, 154 F.3d 1191, 1202 (10th Cir. 1998) (citation omitted).

a customer against a NASD (now known as "FINRA") regulated entity, the following documents, among others, must be produced by a customer:

- (1) All customer and customer-owned business federal tax returns;
- (2) All financial statements or similar statements of the customer's assets, liabilities and/or net worth;
- (3) All account statements and confirmations for accounts maintained at securities firms;
- (4) All documents showing action taken by the customer to limit losses in the transaction(s) at issue.

See Exhibit "1" attached hereto.⁵ This information is presumptively discoverable irrespective of the precise claim being brought by the customer against the securities firm or associated broker. Defendants have requested substantially similar information from the Intervenors, yet the Intervenors have refused to produce such documents. The Intervenors should not be able to profit from such an untenable stance.

C. Contributory Negligence

Intervenors concede that "Oklahoma courts have not fully analyzed the plaintiff's burden of proving securities fraud under 71 Okla. Stat. § 1-501." See *Intervenors' Brief* at 4. Once again, the relevant statutes are 71 O.S. §§ 1-509 and 408 (not § 1-501), thus negating Intervenors' subsequent arguments. However, Intervenors are correct to an extent, as Oklahoma has simply not provided any specific guidance on this issue.⁶ While other

⁵ Also available at http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p018922.pdf (last visited 8/13/08).

⁶ Intervenors rely on "*Lloyds of America, Ltd. v. Theoharous*, 2005 WL 3115329, (W.D. 2005)" as authority for their proposition that an investor has no independent duty of investigation. However, *Theoharous* is not a federal Western District case as cited by Intervenors but rather a Canadian County case authored by Judge Cunningham, properly cited as *Lloyds of America, Ltd. v. Theoharous*, No. CJ-1998-84, 2005 WL 3115329

jurisdictions reach differing conclusions, *Landry v. Thibaut*, 523 So.2d 1370 (La. App. 1988), provides significant assistance here. The Louisiana statute at issue, much as §§ 1-509 and 408, places the burden on the defendant to establish that the defendant “did not know and, in the exercise of reasonable care could not have known of untruth or omission.” *Id.* at 1379. Thus, “[u]nder the statute the standard for liability is *negligence*: the defendant must sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known of the untruth or omission.” *Id.* at 1380 (emphasis added).

Once the proper standard is acknowledged (predicated on application of the correct statute), much of Intervenor’s cited Oklahoma authority and related argument advocates application of a comparative negligence doctrine. Specifically, comparative negligence, in these circumstances, is not raised as a “defense to common law fraud or fraudulent misrepresentation claims” or “any form of conduct found to be willful and wanton or intentional.” *See Intervenor’s Brief* at 6. To the contrary, as contemplated by *Landry*, any negligence of Defendants should be weighed against that of the investors. Regardless, any discovery sought to support a contributory negligence evaluation would mirror relevant discovery necessary to ascertain, among other issues: (1) the date of discovery for each sale; (2) which sales were made in reliance upon Ms. Schubert’s misrepresentations; (3) what sales, if any, Defendants materially aided, (4) how much civil restitution is owed by Ms. Schubert; and (5) what, if any, restitution is owed by Defendants based on joint and several liability relating to specific sales by Ms. Schubert. Defendants respectfully request that the Court order the Intervenor to produce the requested information within thirty (30) days from the hearing date on the outstanding discovery issues.

(Okla. Dist. Ct. Canadian County Apr. 26, 2005). More importantly, the case simply does not address the issue of investor negligence and thus provides no assistance to Intervenor here.

II. DEFENDANTS' RESPONSE TO PLAINTIFF'S MEMORANDUM CONCERNING DISCOVERY ISSUES

ODS paints with an extraordinarily broad brush in its six pages of briefing, improperly attempting to narrow the scope of discovery while expanding the breadth of Defendants' liability. On the one hand, ODS alleges as the basis for Defendants' liability that "Defendants materially aided [Marsha Schubert's] 'Ponzi' scheme." See *Plaintiff's Brief* at 1. To support this sprawling interpretation of Defendants' potential liability, ODS relies upon the language of § 1-509 and *State ex Rel. Goettsch v. Diacide Distributors, Inc.*, 561 N.W.2d 269, 377 (Iowa 1997). Notably, § 1-509(G)(5) expressly contradicts ODS's position, as it specifically limits liability to a person who "materially aids in the conduct giving rise to the liability under subsections B through F of this section." In turn, ODS has provided that Ms. Schubert's untrue statements of material facts and/or omissions – *i.e.*, § 1-509(B) – give rise to Defendants' alleged "materially aiding" liability. See *Petition* at 58. Thus, some general assistance in Ms. Schubert's scheme is insufficient. ODS's reliance on *Diacide*, 561 N.W.2d at 377, is also clearly misplaced, as the paragraph of the opinion preceding the elements propounded by ODS expressly provides that those elements are *incorrect* because the parties "*ignored*" the appropriate standard under Iowa's uniform "material aider" statute.

Conversely, ODS absurdly contends that the Court should "deny Defendants the opportunity to depose the Short Investors as the testimony they will provide is not relevant to the determination of the merits" See *Plaintiff's Brief* at 6. As discussed below, ODS has waived any objection as to relevance and simply cannot realistically contend that Defendants should be somehow bound by prior litigation which (1) did not involve Defendants and, regardless, (2) does not provide the findings ODS must rely upon to argue

issue preclusion. Moreover, in hopes of limiting its discovery obligations, ODS again ignores a critical aspect of *Diacide* – that the state department of securities is suing on behalf of the purchasers – which is fundamentally necessary to permit this action in the first place. ODS simply cannot have it both ways.

A. ODS Has Waived Any Objection As to Relevance

Defendants served ODS with interrogatories and request for production of documents that sought, among other things, information relating to: (1) the Loser Investors' investment conduct in their transactions with Marsha Schubert; (2) the material facts and circumstances surrounding each and every allegedly unlawful sale between the Loser Investors and Marsha Schubert, including the process leading up to and/or bringing about the Loser Investors' investment decisions with Marsha Schubert and the form and content of Marsha Schubert's alleged misrepresentations to them; and (3) how Defendants materially participated and/or materially aided in any of the sales transactions between Marsha Schubert and the Loser Investors. Unlike the Intervenors, ODS did not object to a single discovery request served on them by Defendants on grounds that the information sought was irrelevant to the case. *See ODS Response to Defendants' First Set of Interrogatories and ODS Response to Defendants' First Request for Production*, attached as Exhibits 5 and 6 to *Defendants' Brief*.

However, in *Plaintiff's Brief* at 2-4, ODS now attempts to argue that Defendants' discovery requests are not relevant to the merits of the case. Defendants have already demonstrated how the requested information is relevant to this case. *See supra*. Moreover, by failing to object to Defendants' discovery request on relevancy grounds, ODS has waived the objection. *See* 12 O.S. §§ 3233(A) and 3234 (failure to timely object to discovery request results in waiver of the objection); *see also Essex Ins. Co. v. Neely*, 236 F.R.D. 287 (N.D.

W.Va. 2006) (late filed objections deemed waived); *Davidson v. Goord*, 215 F.R.D. 73, 77 (W.D. N.Y. 2003); *Drexel Heritage Furnishings, Inc. v. Furniture USA, Inc.*, 200 F.R.D. 255 (M.D. N.C. 2001) (waiver is implicit in Rule 34's requirement that objections be explicitly stated). Thus, ODS is precluded from objecting to Defendants' discovery requests on grounds of relevance.

B. ODS Cannot Use Collateral Estoppel Against Defendants

Defendants are clearly entitled to obtain discovery relating to every aspect of the claims brought against them. For instance, Defendants must be permitted to obtain discovery regarding which investors lost money and which prospered under Ms. Schubert's Ponzi scheme. However, ODS appears to be operating under the illusion that civil and criminal proceedings instituted against Marsha Schubert somehow prevent Defendants from conducting such discovery in this case. *See Plaintiff's Brief* at 2. Not surprisingly, ODS fails to cite a single case to support such a statement. To the extent that ODS argues that any guilty plea entered by Marsha Schubert in a state or federal criminal case⁷ can be used in this civil case, it is only admissible as an admission against interest. *Laughlin v. Lamar*, 1951 OK 330, ¶ 5, 237 P.2d 1015, 1016 ("judgment in a criminal prosecution may not be received in a civil action to establish the truth of the facts in which in was rendered"); *Dover v. Smith*, 1963 OK 166, 385 P.2d 287. Thus, any judgment rendered in the criminal case involving Marsha Schubert does not prove the truth of any facts asserted in this case.

Alternatively, any reliance on principles of collateral estoppel (also known as issue preclusion) is simply untenable. "Under the doctrine of issue preclusion, once a court has

⁷ ODS does not attach or cite to any evidence regarding the precise criminal charges filed against Marsha Schubert in state or federal court. Nor does ODS provide an explanation as to how the elements of any criminal charges Marsha Schubert may have pled to relate in any way to their burden of proof against Defendants in this case.

decided an issue of fact or of law necessary to its judgment, the *same* parties or their privies may not re-litigate that issue in a suit brought upon a different claim.” *Salazar v. City of Oklahoma City*, 1999 OK 20, ¶ 10, 976 P.2d 1056, 1060 (emphasis added). Moreover, the party relying upon the argument of issue preclusion “*bears the burden of establishing that the issue to be precluded was actually litigated and determined in the prior action between the parties or their privies, and that its resolution was essential to a decision in that action.*” *Id.* (Emphasis in original.)

Of course, ODS has not provided any evidence – nor can they – that Defendants were parties or privies to any case brought by ODS or any other governmental agency against Marsha Schubert. In that respect, this case is somewhat similar to the facts of *Department of Public Safety v. 1985 Chevrolet Blazer*, 1999 OK CIV APP 134, 994 P.2d 1183, wherein the Department of Public Safety (“DPS”) unsuccessfully attempted to prove its forfeiture case through the offensive use of collateral estoppel.

Specifically, DPS brought a forfeiture proceeding against a vehicle and property found therein after a passenger in the vehicle (Fritz) pled guilty to a charge of conspiracy to possess cocaine with intent to distribute. The actual owner of the vehicle – Young – was not present during the criminal offense and was not charged with a crime. ODS attempted to use Fritz’s criminal plea against Young in the forfeiture proceeding in order to demonstrate “that the Blazer and the personal property found therein were used in furtherance of the conspiracy to distribute cocaine” *Id.* at ¶ 7. The Oklahoma Court of Civil Appeals quickly rejected such an argument since Young was not a party to the criminal case and, therefore, Fritz’s plea could have not a preclusive effect on Young.

Here, ODS submits that Loser Investor information is not relevant to the merits of the case, in part, because “Marsha Schubert’s liability to the [Loser] Investors to make restitution has also been determined by the Logan County court in case no. CJ-2004-256.” However, as this Court is well aware, Defendants were not a party to that action and any issue actually litigated in that case cannot limit the scope of discovery here. Consequently, to the extent that ODS asserts that Defendants are precluded from conducting discovery based upon the principles of issue preclusion, such an assertion is legally infirm and has no application to this case.

C. **Even if Issue Preclusion were Somehow Permissible, Ms. Schubert has not been Found Guilty or Liable for the Sales and Restitution at Issue in this Litigation.**

There are three key cases (collectively, the “Schubert Cases”) which have been brought against Ms. Schubert upon which ODS may be seeking to presume the first element of “material participant” liability under § 1-509 (and thereby avoid its discovery obligations): (1) *State v. Schubert*, CF-2004-391 (Logan County) (the “State Case”); (2) *United States v. Schubert*, CR 05-078-HE (W.D. Okla.) (the “Federal Case”); and (3) *Okla. Dep’t of Securities v. Schubert*, CJ-2004-256 (Logan County) (the “Civil Case”). See respectively, Exhibits “2,” “3,” and “4” (providing relevant materials from each of the Schubert Cases). To establish liability as to Defendants, Plaintiff must show: “(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).” *Southwestern Oklahoma Development Authority v. Sullivan Engine Works, Inc.*, 1996 OK 9, 910 P.2d 1052, 1058 (emphasis added). Thus, “the liability of the seller is a prerequisite for there to be liability as to one materially participating or aiding in

the sale.” *Nikkel v. Stifel, Nicolaus & Co.*, 1975 OK 158, 542 P.2d 1305, 1307. ODS simply cannot make the requisite showing as to Ms. Schubert based on the Schubert Cases.

In the Civil Case, Ms. Schubert consented, “*without admitting or denying any violation of the Oklahoma Uniform Securities Act,*” to an injunction, predicated on her “issuance, offer and/or sale of securities in and/or from Oklahoma to investors” The Civil Case thus does not reflect any liability on Ms. Schubert’s part as to the sales at issue here. Moreover, the Civil Case, to date, has not issued an order of restitution.

In the Federal Case, the government charged Ms. Schubert with one count of money laundering relating to the use of a single check. While an element of the offense was the property transfer was derived from a securities fraud, there is no specific finding as to what that securities fraud was or if that fraud would fall into one of the § 1-509(b)-(f) categories. Moreover, while the Court did order restitution, criminal restitution is a distinct legal concept from the civil restitution at issue here. In the criminal context, “[r]estitution” means the return of property to the crime victim or payments in cash or the equivalent thereof, and payment in cash or the equivalent thereof as reparation for injury, loss of earnings, and out-of-pocket loss ordered by the court in the disposition of a criminal proceeding.” *See* 21 O.S. § 142A-1; *see also*, 18 U.S.C. §§ 3663, 3663A (discussing specific types of restitution for various losses due to criminal activity). Conversely, in the civil context, “[r]estitution is an equitable remedy that generally will be available whenever one has received a benefit to which another is justly entitled. A person who has been unjustly enriched at the expense of another is required to make restitution to the other.” *See Stites v. Duit Construction Company, Inc.*, 1995 OK 69, 903 P.2d 293, 301, fn. 28; *see also Defendants’ Motion for Partial Summary Judgment* at 13-15. As expressed by one Court, “[r]estitution in a criminal

case is the counterpart to damages in civil litigation.” See *U.S. v. Sung*, 51 F.3d 92, 94 (7th Cir. 1995). In short, an award of criminal restitution has no relationship to the civil restitution sought here.

In the State Case, the Ms. Schubert pled guilty to fourteen counts of obtaining money by false pretense. Each of the fourteen counts involved obtaining money from one of four investors by falsely promising to use the funds to purchase stock options but instead using the funds to pay prior investors and for her own benefit. Thus, assuming admission to such conduct was sufficient to show liability under § 1-509(b), such liability could only extend to those four individuals and the fourteen specific sales alleged in the information. The Court also adopted the restitution ordered in the Federal Case; thus, as criminal restitution, it is inapplicable to a determination of the civil restitution at issue here.

ODS simply cannot attempt to piecemeal a critical component of this litigation – that Ms. Schubert “[sold] a security...by means of an untrue statement of a material fact or an omission” – based on the prior actions against Ms. Schubert. None of the Schubert Cases rely upon or even reference 71 O.S. §§ 1-509 or 408. The Schubert Cases either do not contemplate any of the individual sales, or only a minimal number the sales relevant to the instant action, and thus cannot establish the sweeping liability ODS envisions. Moreover, these cases do not establish the civil restitution owed by Ms. Schubert to the Loser Investors. Clearly, ODS’s arguments regarding the scope of discovery must fail.

D. Diacide Revisited

ODS has relied extensively on *State ex rel. Goettsch v. Diacide Distributors, Inc.*, 561 N.W.2d 369 (Iowa 1997) in bringing its claims against Defendants. Such reliance, however, is far from complete. When confronted with Defendants’ discovery requests, which this

Court is now reviewing, ODS simply ignores the very case they relied upon to justify this unusual case against Defendants in the first place.

ODS has refused to obtain discovery in this case from the Loser Investors based, in part, upon its assertion that ODS does not represent the Loser Investors. *See Plaintiff's Brief* at 4-5. However, while ODS may have instituted this case in order to enforce the State's securities laws, its specific request for an order of restitution to the Loser Investors constitutes victim-specific relief. In that regard, ODS's action is no different than an action brought by a Loser Investor against Defendants based upon the same claim.

That was the precise reasoning behind the Iowa Supreme Court's decision in *Diacide* to permit the state to pursue restitution under Iowa's statutory scheme. Because the state was admittedly seeking relief on behalf of the Loser Investors, the *Diacide* Court found that it should receive the benefit of any statute that a Loser Investor could use to impose liability upon a party who materially participated in an unlawful sale to the Loser Investor. The Court stated:

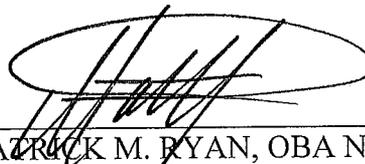
[T]he State is suing on behalf and for the benefit of the defrauded purchasers. The State must therefore have the benefit of any theory of liability available to the individual purchasers suing in their own names in the absence of any contrary legislative intent.

Id. at 375. Based upon this language, it is clear that a contrary result would have been reached by the Iowa Supreme Court if the state – like ODS here – had asserted that it was not seeking relief on behalf of the Loser Investors. ODS cannot have it both ways: they cannot claim that they are seeking restitution on behalf of and/or for the benefit of the Loser Investors in order to maintain this suit, but disclaim that fact when it comes to collecting discoverable information from the Loser Investors.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court order ODS and the Intervenors to produce the requested information, documents, and privilege log, and for such other relief as this Court finds just and equitable.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on this 13th 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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