IN THE SUPREME COURT

STATE OF NORTH DAKOTA

State of North Dakota,

Plaintiff and Appellee,

v.

Bruce A. Hager,

Defendant and Appellant.

SUPREME COURT NO. 20100090

DIST. CT. NO. 09-05-K-2261

BRIEF OF *AMICUS CURIAE*, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., IN SUPPORT OF PLAINTIFF AND APPELLEE STATE OF NORTH DAKOTA AND AFFIRMANCE

APPEAL FROM AN ORDER DATED MARCH 12, 2010,
OF THE DISTRICT COURT, CASS COUNTY
THE HONORABLE WICKHAM CORWIN PRESIDING

Gary R. Wolberg (ND ID#03355)
Petra H. Mandigo-Hulm (ND ID#06059)
CROWLEY FLECK PLLP
400 E. Broadway, Suite 600
P.O. Box 2798
Bismarck, ND 58502-2798
(701) 223-6585

Joseph Brady, Deputy General Counsel (admitted *pro hac vice)*
North American Securities Administrators Association, Inc.
750 First Street, NE Suite 1140
Washington, DC 20002
202-737-0900

Attorneys for *Amicus Curiae*

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

STATEMENT OF INTEREST

The North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in connection with the offer and sale of securities.

NASAA and its members have a substantial interest in the outcome of this appeal for several reasons. First, the lower court's ruling was correct and should be upheld. Appellant Bruce A. Hager ("Hager") committed repeated violations of the North Dakota Securities Act over an extended period of time. He continued his pattern of illegal behavior and violated his probation by acting as an unregistered securities agent. Hager's violations typify the activities the state securities laws were designed to police and prevent.

Next, if the lower court's ruling is reversed, it will have a far-reaching impact by undermining investor protection in North Dakota, and potentially elsewhere. The National Securities Market Improvement Act, Pub. L. No. 144-290, 110 Stat. 3416 (1996), ("NSMIA") limits states' securities registration requirements; however, NSMIA does not limit the ability of states to regulate the persons through whom securities offerings are made. A ruling misinterpreting the reach of NSMIA and limiting a state's authority to register or license persons selling securities will stand well outside the mainstream of state securities law, will make successful criminal prosecution of securities law violations much more difficult, and will accordingly weaken the deterrent effect vital

to state securities regulation. As a result, in a very real sense, the citizens of North Dakota will be more vulnerable to fraud and abuse in the offer and sale of securities.

A decision misinterpreting the reach of NSMIA would set a bad precedent that may influence courts in other states that have not yet been called upon to decide the issues presented here. Such an effect in other jurisdictions will erode investor protection. An attempt to stretch the reach of NSMIA beyond legitimate boundaries in order to evade the reach of state law should be rejected.

Third, NASAA and its members are committed to oppose efforts to erode state regulatory authority resulting from a misinterpretation of Congress's preemption provisions. State regulators in the areas of securities, banking, and insurance all play a vital role in protecting the public. Although Congress can, and does, set limits on the scope of state regulation, those limits must be fairly interpreted and applied in accordance with Congressional intent and the important benefits that state regulators offer to the investing public. In this case, for example, Congress has exempted bona fide private offerings under Securities and Exchange Commission Regulation D, Rule 506, 17 C.F.R. 230.506 from state registration, but it plainly did not intend that exemption to apply to the individuals who are paid for offering these securities to investors. Hager's attempt to stretch federal preemption beyond legitimate boundaries, in order to insulate his activities from state regulation, should be rejected. By siding against these claims, NASAA seeks to uphold respect for the congressionally recognized authority of state regulators over individuals who offer securities to the investing public.

STATEMENT OF THE CASE

In 2007, Hager was charged with violating the North Dakota Securities Act and ultimately pleaded guilty to acting as an unregistered agent and selling unregistered securities. As part of his sentence, Hager was placed on supervised probation and in 2008 the State filed a petition to revoke his probation. The basis for the revocation petition included possession of a firearm and ammunition and acting as an unregistered agent in violation of the North Dakota securities laws. Following a trial, the District Court found that Hager had in fact engaged in activities that required registration as an agent and his failure to do so constituted a violation of the North Securities Dakota Act. As a result of his violation, the District Court revoked Hager's probation. Hager now appeals the District Court's finding that he violated his probation by acting as an unregistered securities agent.

ARGUMENT AND AUTHORITIES

I. Hager Violated An Enforceable State Statute Requiring Registration As A Statutory Agent Of An Issuer.

The District Court correctly found that Hager was engaged in the offer and sale of securities in North Dakota and should have been registered with the state securities regulator, the North Dakota Department of Securities. The District Court also correctly ruled that the authority of the state to require the registration of Hager has not been preempted by federal law. As will be discussed more fully below, NSMIA instituted a number of changes to the manner in which securities regulation is conducted in the United States. Among the changes that resulted from the passage of NSMIA was the preemption of certain state securities laws, primarily in the area of the regulation of securities offerings. However, except in one very limited instance inapplicable to the

facts in this dispute, NSMIA did not preempt or otherwise restrict state authority to require the registration of persons engaged in offering and selling securities.[1]

A. Hager was engaged in the offer and sale of securities in North Dakota and was, therefore, required to register as an agent.

The North Dakota Securities Act ("North Dakota Act"), N.D.C.C. §§ 10-04-01 *et seq.* expressly provides that it is unlawful to transact business in the state as a securities agent without either being registered or exempt from registration. N.D.C.C. § 10-04-10(2). The definition of "agent" contained in the North Dakota Act includes individuals who represent issuers in "effecting or attempting to effect purchases or sales of securities." N.D.C.C. § 10-04-02(1). Therefore, individuals who represent issuers in attempting to effect transactions in securities must be registered unless otherwise exempt. One such exemption is contained in N.D.C.C. § 10-04-10(2)(c) which states as follows:

> An individual who represents an issuer that effects transactions solely in federal covered securities of the issuer, but an individual who effects transactions in a federal covered security under section 18(b)(3) or 18(b)(4)(D) of the Sections Act of 1933 is not exempt if the individual is compensated in connection with the agent's participation by the payment of commissions or other remuneration based, directly or indirectly on transactions in those securities.

When claiming an exemption, the burden of proof is on the individual claiming the exemption. N.D.C.C. § 10-04-19(1); *State v. Goetz*, 312 N.W.2d 1, 9-10 (N.D. 1981). Further, because the securities acts are remedial in nature, exemptions or exclusions should be narrowly construed. *See*, *Moses v. Carnahan*, 186 S.W.3d 889 (Mo. Ct. App. 2006) (Exceptions to state securities act registration requirements for securities should be

[1] Section 15(h) of the 1934 Securities Exchange Act, 15 USC 78 (h), provides a safe harbor for associated persons of a broker or dealer who execute a small number of transactions for a client who is temporarily in a state in which the associated person is not registered. This provision applies only to associated persons of brokers or dealers and not agents of issuers.

strictly construed); *Womack v. Georgia,* 507 S.E.2d 425, 427 (Ga. 1998) (Holding that "exemptions from registration are to be strictly construed in favor of investors"); and, *Gordon v. Drews*, 595 S.E. 2d 864 (S.C. Ct. App. 2004) (Securities laws are remedial in nature and, therefore, should be liberally construed to protect investors).

The language in N.D.C.C. § 10-04-10(2)(c) provides an exemption from registration for agents who represent issuers engaged in the offer and sale of securities in compliance with Section 18(b)(4)(D) of the Securities Act of 1933, 15 U.S.C. 77r. However, if an agent is compensated in connection with those transactions then the exemption is not applicable. This exemption is not unique to North Dakota. The language in the exemption is identical to Section 402(b)(5) of the 2002 Uniform Securities Act. UNF. SEC. ACT § 402(b)(5) (2002). Furthermore, numerous other states have adopted this statutory provision as well. *See*, GA. CODE ANN. §10-5-31(b)(5) (2009); HAW. REV. STAT. §485A-402 (b)(5) (2009); IDAHO CODE §30-14-402(b)(5) (2004); IND. CODE §23-19-4-2(b)(5) (2009); IOWA CODE §502-402(2)(e) (2005); KAN. STAT. ANN. §17-12a402(b)(5) (2005); ME. REV. STAT. ANN. tit. 32, §16402(2)(E) (2005); MICH. COMP. LAWS §451.2402(2)(e) (2009); MINN. STAT. §80A.57 (2009); MISS. CODE ANN. §75-71-402(b)(5) (2009); MO. REV. STAT. §409-004.402(b)(5) (2009); OKLA. STAT. tit. 71, §1-402(B)(5) (2004); S.C. CODE ANN. §35-1-402(b)(5) (2009); S.D. CODIFIED LAWS §47-31B-402(b)(5) (2004); VT. STAT. ANN. tit. 9, §5402(b)(5) (2009); and, WIS. STAT. §551.402(2)(e) (2009).

Where a state has based its law on a uniform act, it is appropriate for the courts of that state to consult the history of the uniform act for interpretive guidance. "When the legislature enacts provisions of a uniform or model act without significant alteration, it

may be generally presumed to have adopted the expressed intention of the drafters of that uniform or model act." *Heirs of Ellis v. Estate of Ellis*, 71 S.W. 3d 705, 713 (Tenn. 2002).

The official comments to Section 402(b)(5) of the 2002 Uniform Securities Act explain that an agent could receive a salary and conventional benefits as an executive of the issuer and still fall within the exemption, unless the agent is also being compensated directly or indirectly for participation in the offer and sale of the issuer's securities. Official Comments to UNF. SEC. ACT § 402(b)(5) (2002). In other words, if an individual is involved in the executive management of the issuer, earns a salary, and is also engaged in the offer and sale of the issuer's securities, but is not compensated either directly or indirectly for participating in those sales-related activities, registration as an agent or the issuer *may* not be required. That is not the case here.

In a case involving the same category of securities as those offered and sold by Hager and a similar state registration exemption, a federal district court ruled that the defendants violated state law including the failure by one defendant to register as an agent of the issuer. *Myers v. OTR Media, Inc.*, 2008 WL 695357 (W.D. Ky. 2008). In *Myers*, the plaintiff alleged the defendants violated state law by selling unregistered securities, by using unregistered agents, and by making material misrepresentations in the sale of securities. *Id* at 1. The defendants argued that they were exempt from the registration requirements because the securities were "covered securities" under federal law and that one of the defendants was employed by the issuer. *Id* at 2.

In evaluating whether the plaintiff was entitled to summary judgment on the claim alleging the sale of securities by an unregistered agent, the court pointed out that the state

securities laws contained an exemption from registration for agents who represent issuers in the sale of covered securities. However, the court noted that in order to qualify for the exemption an agent is prohibited from being compensated for offering or selling securities. *Id* at 2-3. The court concluded that regardless of the fact that the securities were covered securities, the state securities laws mandated registration of an agent of the issuer when the agent receives compensation for his role in offering and selling securities. *Id* at 3.

In the case at hand, the District Court explained in great detail the types of activities performed by Hager on behalf of the issuer, RAHFCO Management Group, LLC ("RAHFCO"). The Court pointed to the existence of a contract between Hager and RAHFCO requiring Hager to market RAHFCO's securities to customers and potential customers and to submit a marketing plan to RAHFCO's board. Amended Memorandum Opinion and Order at 4, *State v. Hager*, No. 09-05-K-02261 (March 12, 2010). The District Court explained that evidence submitted at trial revealed that Hager maintained lists of prospects including sales calls that Hager wanted to "handle personally." Amended Memorandum Opinion and Order at 4. Clearly Hager was engaged in representing an issuer in effecting or attempting to effect transactions in securities. He was, therefore, an agent as defined in N.D.C.C. § 10-04-02(1) and required to register with the state or comply with an exemption from registration. N.D.C.C. § 10-04-10.

The District Court held that Hager received compensation in the form of draws from RAHFCO in addition to being paid rent for office space. The court further held that the record was "devoid" of any facts that would demonstrate that the draws Hager received were paid for anything other than his marketing and sales activities. Amended

Memorandum Opinion and Order at 8. The court found correctly that Hager received payments for his solicitation and sales activities on behalf of the issuer and was therefore prohibited from relying on the exemption in N.D.C.C. § 10-04-10(2)(c).

The burden of proof was on Hager to demonstrate that he was entitled to an exemption from registration. The record clearly demonstrates that Hager was paid for his services in offering and selling RAHFCO's securities to the residents of North Dakota. He was, therefore, not entitled to the exemption and was required to register as an agent under the state securities laws. His failure to do so constituted a violation of the North Dakota Act.

B. The plain language of NSMIA makes it clear that Congress did not preempt the important state function of registering persons who offer or sell securities.

The regulation of securities by the states preceded federal regulation by more than twenty years with the passage of a securities statute in Kansas in 1911. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION, 329 (5th ed. 2006). Other state legislatures began enacting laws regulating securities transactions in the early twentieth century, and today every state has adopted a securities act. ALAN R. PALMITER, SECURITIES REGULATION §1.4 (2d ed. 2002). As this Court pointed out in *State v. Goetz*, 312 N.W.2d 1 (N.D. 1981), the North Dakota securities law is a framework for "protecting investors and the public." *Id* at 5. An integral part of this framework is the regulation of individuals who engage in offering and selling securities and Congress recognized the important role states play in this regard when it considered the applicable provisions of NSMIA. The plain, unambiguous language of NSMIA does not preempt state authority to regulate the people who offer and sell securities, but rather state registration authority over certain types of securities.

The starting point in this analysis is the language of the statute itself. *American Bar Assoc. v. Fed. Trade Comm'n*, 430 F.3d 457, 467 (D.C. Cir. 2005), citing *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). "It is a universally recognized rule of statutory construction that a court should look first to the language of the statute to determine the legislative purpose." *SEC v. Ambassador Church,* 679 F.2d 608, 611 (6th Cir. 1982). "Where the statutory language provides a clear answer, the analysis ends there." *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999); *Simon v. Simon*, 2006 ND 29, ¶ 12, 709 N.W.2d 4 ("The primary objective in interpreting a statute is to determine the intent of the legislature by first looking at the language of the statute.")

The Capital Markets Improvement Act of 1996, a part of NSMIA, amended Section 18 of the Securities Act of 1933, 15 U.S.C. 77a, *et seq.*, to eliminate the necessity of registering certain securities with state regulators. It provides that under specified conditions, state laws requiring registration of securities are preempted. The scope of that preemption is delineated in terms of "covered securities." The language used by Congress in fashioning these exemptions is as follows.

> (a) Scope of Exemption -Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof -
> (1) requiring, or with respect to, registration or qualification of **securities**, or registration or qualification of **securities transactions**, shall directly or indirectly apply to a **security** that--
> (A) is a covered **security**; or
> (B) will be a covered **security** upon completion of the transaction

15 U.S.C. § 77r(a)(1)(A)-(B) (emphasis added).

The plain language of the statute clearly states that if, and only if, a security falls

into the category of a "covered security," it is exempt from registration at the state level and states are preempted from reviewing such offerings or requiring the filing of any documents beyond what is filed with the Securities and Exchange Commission. The statute does not address the registration requirements of individuals offering or selling securities. The statue makes it clear that it was not Congress's goal to broadly preempt state securities law and more particularly the states' authority to impose registration requirements on individuals offering and selling securities.[2]

As a threshold matter, any party claiming preemption bears the burden of overcoming the assumption that a federal law does not supersede the historic police powers of the states. *Vanguard Forex, Ltd. v. Arizona Corp. Comm'n*, 79 P.3d 86, 92 (Ariz. Ct. App. 2003) (Commodity Exchange Act does not preempt authority of state securities regulator to take enforcement action against off-exchange foreign currency trader (citing *Ray v. Atlantic Richfield Co.*, 735 U.S. 151, 157 (1978)).

The Supreme Court has recognized three types of preemption: *express preemption*, where Congress has explicitly defined the extent to which its enactments preempt state law; *field preemption*, where state law is preempted because it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively; and *conflict preemption*, where state law is preempted to the extent that it actually conflicts with federal law. The Supreme Court has found conflict preemption where it is impossible for a private party to comply with both state and federal requirements, or

[2]Any doubt as to the limit of the preemption imposed by NSMIA can be resolved through a review of the statute's legislative history. The House report explains "that the limitations on State law established by Section 18 apply to State law registration and regulation of securities offerings, and do not affect existing State laws governing broker-dealers, including broker-dealer sales practices." H.R. REP. NO.104-622, at 3896 (1996), *reprinted in* 1996 U.S.C.C.A.N. 3877.

where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *English v. Gen. Elec. Co.*, 496 U.S. 72, 78-79 (1990) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (other citations omitted). None of the three established forms of preemption apply in this case.

NSMIA contains no express preemptive provision with regard to state registration of securities firms or individuals, nor does it reflect a congressional intent to occupy the entire field of securities regulation. The third form of preemption, conflict preemption, is also absent in this case, because nothing in the state's registration statute prevented Hager from complying with federal law.

Clearly, the states' authority to register persons engaged in the offer and sale of securities was not preempted by NSMIA. The states are free to enact registration provisions, as well as provide for exemptions from registration. The District Court was correct in its analysis that NSMIA did not preempt the states' authority to register persons either through express provisions or otherwise. Therefore, the controlling law on this matter is that of the state of North Dakota, and upon examination of the applicable provisions and the facts of this case, there can be no doubt that Hager was required to register as an agent for RAHFCO.

II. Hager's Argument That He Is An Issuer, And Thereby Exempt From Registration, Is An Errant Attempt To Stretch NSMIA Beyond Its Plain Language In Order To Evade The Provisions Of The North Dakota Securities Act.

Hager has argued that as an "owner" of the issuer he is in fact the issuer and is thereby exempt from the registration requirements of the North Dakota Act. First, Hager is not the issuer. Second, as noted above, the applicable federal exemption from NSMIA applies only to securities offerings, and not to individuals who are conducting offers or

sales. It would not matter if instead of 1 percent Hager owned 100 percent of the issuer and was responsible for making every management decision for the partnership, the provisions of NSMIA would not afford him the relief he claims. His reliance on NSMIA is simply misplaced.

The presumption against preemption of a state's police powers can only be overcome upon a showing that preemption was the "clear and manifest purpose of Congress." *Zuri-Invest AG v. Natwest Finance, Inc.*, 177 F.Supp.2d 189, 192 (S.D.N.Y. 2001). The United States Supreme Court has instructed that remedial legislation such as the securities statutes should be broadly construed to effectuate their purpose. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Medtronic, Inc. v. Lohr*, 518 U.S. 470 (1996) (quoting *Rice v. Santa Fe Elevator Corp.* 331 U.S. 218 (1947)). Hager's argument that an inapplicable federal statute preempts the states' longstanding and well-established authority to impose registration requirements on persons involved in securities transactions falls well short of the "clear and manifest" standard required for such an argument.

The applicable state provision, N.D.C.C. § 10-04-10(2)(c), provides a limited registration exemption for agents who represent issuers in securities transactions. The District Court explained that, pursuant to this provision, it would assume that individuals who are involved in the issuer's internal executive management structure would not be required to register. Amended Memorandum Opinion and Order at 7. The District Court's assumption is similar to the comments contained in the 2002 Uniform Securities Act. However, involvement in the senior management of the issuer alone is not a determinative factor pursuant to the North Dakota statute or the model act provision. The

exemptive provision excuses registration where an individual represents the issuer in transactions involving the federally covered securities of the issuer, if the individual in turn is not compensated in connection with his or her role in these transactions. In Hager's case, he loses on both fronts.

By virtue of his agreement with RAHFCO, Hager owned 1 percent of the membership units of the issuer. However, aside from this very minimal stake in the issuer, the District Court found no evidence that Hager's activities on behalf of RAHFCO ever extended beyond marketing and selling securities. Furthermore, the filing required by both state and federal law for securities offered under Section 18(b)(4)(D), commonly referred to as the Form D, does not identify Hager as an executive at RAHFCO. The Form D contains a section requiring an issuer to identify each promoter of the issuer; each beneficial owner with the power to dispose of 10 percent or more of a class of equity securities of the issuer; each corporate general managing partner; and, each general and managing partner. Hager is not listed for any of these positions on the Form D filed with the North Dakota Securities Department on February 19, 2008. As determined by the District Court, there was simply no proof that Hager served as an executive at RAHFCO.

Hager's management status with the issuer aside, the record is clear that Hager's primary job was selling RAHFCO's securities. He was paid for his role in locating prospects and assisting them in taking the steps necessary to make their investment. In short, he received compensation as a result of his role in offering and selling securities and was, therefore, required to register with the State.

If the Court concludes that as a result of Hager's minimal ownership, he was not required to register, the Court will establish a loophole that will allow individuals to evade North Dakota's registration requirements and undermine the limited nature of the uniform exemption. If Hager's theory were to prevail, individuals with problematic regulatory histories could enter into arrangements with issuers whereby they "own" a fractional interest in the issuer and claim that they are exempt from registration. They would thereby bypass the review process that might otherwise disqualify them from selling securities to North Dakota residents. Issuers could hire legions of agents, enter agreements similar to the one at bar, and completely bypass the agent registration requirements. These are the various abuses the statute was designed to prevent.

Hager attempted to construct an arrangement whereby he could avoid registration with the state. This was necessary because Hager knew that with his regulatory background the North Dakota Securities Department would deny his application to register.[3] Looking at the reality of the relationship between Hager and RAHFCO, this Court must conclude that Hager was in fact an agent of the issuer engaged in the offer and sales of securities and was compensated for these activities. As a result, Hager was required to register with the State and his failure to do so constituted a violation of the North Dakota Act.

[3] Pursuant to N.D.C.C. § 10-04-10(6), the North Dakota Securities Commissioner can refuse an application for agent registration on the grounds of a finding that the applicant has been guilty of any act or omission which would constitute a sufficient ground for revocation of registration under N.D. C.C. § 10-04-11. The list includes N.D.C.C. § 10-04-11(a)-failed to comply with any provisions of the Securities Act; (g)-criminal conviction with direct bearing on person's ability to serve the public; (j)- subject of an order suspending association with member of self regulator organization. All of these would be applicable to Hager.

CONCLUSION

For the foregoing reasons, NASAA urges this Court to affirm the District Court's ruling in all respects.

Respectfully submitted,

Joseph Brady
Deputy General Counsel
North American Securities Administrators Associations, Inc.
750 First Street, N.E., Suite 1140
Washington, D.C. 20002

Crowley Fleck PLLP
400 East Broadway, Suite 600
P.O. Box 2798
Bismarck, ND 58502-2798

Gary R. Wolberg (ID#03355)
Petra H. Mandigo Hulm (ID#06059)

Attorneys for *Amicus Curiae*

CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing brief was mailed by U.S. Mail, postage prepaid, on the 2nd day of July 2010, to the following:

Steven M. Light
2700 12th Avenue S. #A
Fargo, North Dakota 58103

Daniel J. Frisk
2700 12th Avenue S. #A
Fargo, North Dakota 58103

Arly Richau
6710 N Scottsdale Road #210
Scottsdale, Arizona 85253

Cherie L. Clark
Cass County State's Attorney's Office
Post Office Box 2806
Fargo, North Dakota 58108

Michael F. Daley
Special Assistant Attorney General
600 East Boulevard Avenue
State Capitol – 5th Floor
Bismarck, ND 58505-0510

Gary R. Wolberg (# 03355)
Petra H. Mandigo-Hulm (#06059)