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No. 15-114897-A
No. 15-114898-A

IN THE COURT OF APPEALS
OF THE STATE OF KANSAS

STATE OF KANSAS,
Plaintiff-Appellant

vs.

DAVID G. LUNDBERG
MICHAEL W. ELZUFON,
Defendants-Appellees

BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, *AMICUS CURIAE* IN SUPPORT OF THE SECURITIES COMMISSIONER OF THE STATE OF KANSAS

Appeal from the District Court of Sedgwick County, Kansas
The Honorable Benjamin Burgess, Judge
District Court Case Nos. 2015 CR 0458 and 2015 CR 0459

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IDENTITY AND INTEREST OF *AMICUS CURIAE*

Formed in 1919, 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. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The Securities Commissioner ("Commissioner") of the State of Kansas, Plaintiff-Appellant in this matter, is the NASAA member representative from Kansas.

NASAA's U.S. members are responsible for administering state securities laws, commonly known as "Blue Sky Laws." *See generally* 1 LOUIS LOSS ET AL., SECURITIES REGULATION 55-251 (5th ed. 2014). NASAA supports the work of its members and the investing public by promulgating model rules, providing training opportunities, coordinating multi-state enforcement actions, and commenting on legislative and rulemaking proposals. NASAA also offers its legal analysis and policy perspective to state and federal courts as *amicus curiae* in cases involving the interpretation of state and federal securities laws. One of NASAA's goals is the fostering of greater uniformity in state and federal securities laws. The overriding mission of NASAA and its members is to protect investors, particularly retail investors, from fraud and abuse.

NASAA and its U.S. members have an interest in this case because the Commissioner's charges against Defendants-Appellees David G. Lundberg and Michael W. Elzufon (hereinafter, "Defendants") raise fundamental questions about

the scope of territorial jurisdiction under the Kansas Uniform Securities Act (the "KUSA") and, more generally, the scope of jurisdiction under other state securities statutes. Accordingly, at the request of the Commissioner and in accordance with Kansas Appellate Court Rule 6.06, NASAA has reviewed the parties' appellate briefs and related materials and conducted its own legal research to provide NASAA's analysis of the jurisdictional issue before this court.

SUMMARY OF THE ARGUMENT

The trial court committed legal error when it concluded that Kansas lacked territorial jurisdiction over this case within the meaning of KUSA § 17-12a610(c)(1). To the contrary, under either of the two tests courts have applied to evaluate whether an out-of-state securities offer "originated from" the state (referred to in this brief as the "*Newsome* test" and the "*Lintz* test"), the basic facts of this case demonstrate that Kansas does have territorial jurisdiction.

ARGUMENT AND AUTHORITIES

I. SUMMARY OF THE OPINION BELOW.

The trial court, through a November 12, 2015, oral order, granted Defendants' motion to dismiss for lack of jurisdiction. (R. VII, 1-36). The trial court based its conclusion on the parties' pleadings, a Stipulation of Facts and evidence it had adduced.

The Stipulation of Facts and the transcript of the hearing at which the trial court issued its oral order show the court accepted the following as true. Defendants were the members and sponsors, either directly or indirectly through their company Real Development Corp., of four Kansas limited liability companies (Wichita 19, LLC; 150 Main Four Ten, LLC; 150 WFA, LLC; and 150 Main, LLC). (R. II, 242-243.) These limited liability companies owned interests in real property in Kansas and had "substantial operations" in Kansas. (R. II, 243-244.) The limited liability companies prepared and issued promissory notes signed by Defendants that were offered and sold to individuals inside and outside of Kansas. (R. II, 243-244.) Offers and eventual sales of promissory notes *outside* Kansas were facilitated by the selling agents, Mr. Tacelli, Mr. Martinson and Ms. Cascione, based on information and documents provided by the Defendants. (R. II, 244; R. VII, 31, 35.) Investors in the LLCs' securities wired their investments to bank accounts in Minnesota. (R. II, 244.) The trial court concluded that Kansas lacked territorial jurisdiction over the out-of-state offers because they did not "originate from within" Kansas within the meaning of Section 12a610(c)(1) of the KUSA. Kan. Stat. Ann. § 17-12a610(c)(1). (R. VII, 35.)

II. THE KANSAS UNIFORM SECURITIES ACT, AND THE MODEL STATE UNIFORM SECUIRITIES ACTS MORE BROADLY, DO NOT SPECIFY WHEN A SECURITIES OFFER OUTSIDE KANSAS "ORIGINATES FROM WITHIN" THE STATE.

The State of Kansas, by and through criminal prosecutors or the Commissioner, can bring charges for violations of the KUSA. *See* Kan. Stat. Ann.

§ 17-12a508(c). KUSA Section 12a501 prohibits fraud in connection with the offer, sale or purchase of a security, while Section 12a301 requires offers or sales of securities in Kansas to be registered in the state or exempt from registration. *See id.* § 17-12a508(a) (citing § 17-12a501 and § 17-12a301). But there can be no violation of the KUSA unless territorial jurisdiction exists in Kansas pursuant to Section 12a610. *See id.* § 17-12a610. Territorial jurisdiction must exist for criminal prosecutions and for civil claims. *See id.*; *see also State v. Dunn*, 304 Kan. 773, 375 P.3d 332, 356 (2016).

Territorial jurisdiction can exist in several ways. Among these is where "an offer to sell or to purchase a security is made . . . , whether or not either party is then present in this state, if the offer . . . [o]riginates from within this state." *Id.* § 17-12a610(c)(1). The KUSA does not delineate when an offer does / does not "originate from within" Kansas, though, and no legislative history on the KUSA answers this question.

The KUSA was enacted in 2004. *See* H.B. 2347 (Kan. 2004). It was patterned off the Uniform Securities Act of 2002 ("2002 USA"), a model state securities statute. (The 2002 USA is available at: http://www.uniformlaws.org/shared/docs/securities/securities_final_05.pdf.) Indeed, the KUSA's jurisdictional provision was taken straight from the 2002 USA. *Compare* Kan. Stat. Ann. § 17-12a610(c)(1) *with* 2002 USA § 610(c)(1). The 2002 USA's jurisdictional provision, in turn, drew heavily from an earlier model act, the Uniform Securities Act of 1956 ("1956 USA"), which conferred jurisdiction where an offer

"originates from this state." (The 1956 USA is available at: http://www.nasaa.org/wp-content/uploads/2011/08/UniformSecuritesAct1956withcomments.pdf.) *See* Official Comments to 2002 USA § 610, 1956 USA § 414(c)(1). But none of the 2002 USA, the 1956 USA or the official commentary on either model act provides instruction as to when an extraterritorial offer should or should not be deemed to have "originated from" a state.

Thirty-three states including Kansas have adopted this "originates from" standard to confer territorial jurisdiction over offers between parties located entirely out-of-state. (These states are: Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Georgia, Idaho, Iowa, Indiana, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Utah, Vermont, West Virginia, Wisconsin and Wyoming.) For the remaining seventeen states, their statutes either expressly require a similar territorial nexus (such as Arizona's statute, which confers jurisdiction over transactions "within or from this state," Ariz. Rev. Stat. Ann. § 44-1991), or courts infer such a requirement (such as in Ohio, see *In re Nat'l Century Fin. Enters. Inv. Litig.*, 755 F. Supp. 2d 857, 875 (S.D. Ohio 2010)). Courts agree that states have a legitimate interest in regulating out-of-state offers that originate from within their borders in order to prevent fraudsters from using the state as a safe base of operations. *Id. at* 881. And, overlapping state securities laws do not present a conflict of laws question, as each state is entitled to protect

its own interests. *Simms Inv. Co. v. E.F. Hutton & Co.*, 699 F. Supp. 543, 545 (M.D.N.C. 1988).

Under criminal statutes such as the KUSA, if an illegal act transpires over several states, each state can assert jurisdiction over the entire scope of the criminal conduct. *See State v. Rimmer*, 877 N.W.2d 652, 665 (Iowa 2016). This does not violate the principle of double jeopardy because each state is a separate sovereign. *Heath v. Alabama*, 474 U.S. 82, 88 (1985). In addition, the KUSA is remedial in nature and "must be liberally construed." *State ex rel. Mays v. Ridenhour*, 248 Kan. 919, 811 P.2d 1220, 1230 (1991). This protects investors not only from the avarice of fraudsters but, potentially, from investors' own inexperience or errors of judgment. *See State v. Nagel*, 279 N.W.2d 911, 915 (S.D. 1979).

Although territorial jurisdiction is a universal requirement under state securities laws and a majority of states have, like Kansas, adopted the "originates from" standard of the 2002 USA and the 1956 USA for extraterritorial offers, there is no consensus as to how courts should evaluate this issue. *See Nuveen Premium Income Mun. Fund 4, Inc. v. Morgan Keegan & Co.*, 200 F. Supp. 2d 1313, 1318 (W.D. Okla. 2002) (stating "cases and other authorities provide little guidance as to what 'originates' means"), *vacated on other grounds*, 2005 WL 857002 (W.D. Okla. 2005). To the extent courts have examined this issue, they have come up with two different standards. First, in 1983, an Oklahoma state court concluded that an out-of-state offer "originated from" the state if "any

portion of the selling process" had occurred there. *Newsome v. Diamond Oil Producers*, CCH Blue Sky L. Rptr. Decisions ¶ 71,869 (Dist. Ct. 14th Jud. Dist. Okla. 1983) (hereinafter, the "*Newsome* test"). Two federal district courts later approved of the *Newsome* test. *See Barneby v. E.F. Hutton & Co.*, 715 F. Supp. 1512, 1540 (M.D. Fla. 1989) (and discussing *Klawans v. E.F. Hutton & Co.*, Case No. IP 83-680-C (S.D. Ind. 1983), a related unpublished opinion that also approved of *Newsome*). Separately, a second line of cases holds that an out-of-state offer originates from a state if there is a sufficient "territorial nexus" between the offer and the state. This standard was adopted by a federal district court in *Lintz v. Carey Manor Ltd.*, 613 F. Supp. 543, 550 (W.D. Va. 1985), and three subsequent state and federal courts have followed this approach. *See Cromeans v. Morgan Keegan & Co.*, 303 F.R.D. 543, 556 (W.D. Mo. 2014); *Rosenthal v. Dean Witter Reynolds, Inc.*, 908 P.2d 1095, 1105 (Colo. 1996); *Nuveen*, 200 F. Supp. 2d at 1318 (hereinafter, the *"Lintz* test").

Although the *Newsome* test and the *Lintz* test frame their analysis of the "originates from" question differently, the tests are substantially similar. Both tests ask whether out-of-state offers are traceable back to activities that had occurred in-state. The trial court in this action applied neither test – nor did it evaluate the central question underlying these two tests, namely whether the activities of the California selling agents (Mr. Tacelli, Mr. Martinson and Ms. Cascione) related back to the Defendants' sponsorship of the Kansas LLCs' securities.

III. THE TRIAL COURT MISCONSTRUED KUSA § 17-12a610(c)(1).

The trial court ruled that the out-of-state offers and sales in this case did not originate from within Kansas under KUSA Section 17-12a610(c)(1) based on the court's plain reading of the statute. (R. VII, 29, 35.) In so doing, the trial court misinterpreted important terms in securities transactions, including what it means to be an "issuer" or an "offeror."

The trial court erroneously thought an "issuer has to be a person, not an entity." (R. VII, 29.) The trial court also wrongly concluded that "Mr. Martinson, Mr. Tacelli, Miss Cascione, were the offerors," as they were the only ones actually soliciting investors. (R. VII, 35.) In the trial court's assessment, identifying these California selling agents as the "offerors" was dispositive as to whether territorial jurisdiction existed in Kansas: "It seems to me that this entire issue turns on determining who is the offeror." (R. VII, 27.) The court concluded that because the Defendants had no contact with the out-of-state purchasers, the Defendants therefore had no potential culpability in connection with the extraterritorial offers and sales. (*See* R. VII, 34, "And, like Mr. Martinson, I conclude that Mr. Tacelli is the offeror . . . when there's no contact whatsoever with any of these California investors with either of these defendants.") These conclusions misconstrue basic securities law principles.

A security "issuer" is the "person that issues or proposes to issue a security." *See* Kan. Stat. Ann. § 17-12a102(17). A "person" can be a legal entity or a natural person. *See id.* § 17-12a102(20). For closely-held corporations or

partnerships, the entity and any natural person controlling the entity will be considered issuers of the entity's securities. *See State v. Hager*, 790 N.W.2d 745, 751 (N.D. 2010), *citing United States v. Rachal*, 473 F.2d 1338, 1342 (5th Cir. 1973). In the instant case, therefore, the Kansas LLCs sponsored by the Defendants, as well as the Defendants themselves, were "issuers" of the LLCs' securities.

The term "offeror" is widely used in state and federal securities laws, though the term is not defined. Courts accept that an offeror can either be the issuer of a security, *e.g.*, *Latta v. Rainey*, 689 S.E.2d 898, 906 (N.C. Ct. App. 2010), *Anastasi v. Am. Petroleum, Inc.*, 579 F. Supp. 273, 274 (D. Colo. 1984), or, potentially, a broker-dealer or agent selling a security on behalf of an issuer, *e.g.*, *Piazza v. Kirkbride*, 785 S.E.2d 695, 712 (N.C. Ct. App. 2016), *Byrley v. Nationwide Life Ins.*, 640 N.E.2d 187, 196 (Ct. App. Ohio 1994).

The "offerors" in the instant case therefore would include the Defendants and the Kansas LLCs, as securities issuers, as well as the California selling agents (Mr. Martinson, Mr. Tacelli and Miss Cascione) who acted to offer and sell the LLCs' securities to potential investors. The trial court, by construing the California selling agents as the sole offerors here and by failing to undertake any assessment of the linkages between the California selling agents and the Defendants, committed legal error in its jurisdictional analysis. Quite to the contrary, under either the *Newsome* test or the *Lintz* test, territorial jurisdiction exists in Kansas for the out-of-state offers and sales in this case.

IV. TERRITORIAL JURISDICTION EXISTS IN KANSAS FOR THE OUT-OF-STATE SECURITIES OFFERS AND SALES IN THIS CASE UNDER EITHER THE *NEWSOME* TEST OR THE *LINTZ* TEST.

Under the *Newsome* test, an out-of-state offer or sale originates from the state if "any portion of the selling process" occurred in the state. *See Barneby*, 715 F. Supp. at 1540. Relevant facts in making this determination include whether any "preliminary steps" in the preparation and extension of the ultimate offers took place in the state asserting jurisdiction. *See id.* (quoting *Klawans*). In *Barneby*, the court found that securities offers in Florida had originated from Oklahoma where the issuer was an Oklahoma limited partnership with an Oklahoma-based general partner, the offering documents were prepared in Oklahoma and listed the general partner's Oklahoma address, and notwithstanding that investors returned their subscription agreements and payments to the defendants in New York. *Id.* at 1536-37. Analogous facts are present in this case, and a similar result should follow.

Under the *Lintz* test, territorial jurisdiction exists if there is a sufficient "territorial nexus" between the state and an out-of-state offer or sale. *See Lintz*, 613 F. Supp. at 550. Two courts after *Lintz* held that relevant facts in this analysis can include whether the issuer was located in the state and offering materials were prepared in the state, *see Rosenthal*, 908 P.2d at 1105, and whether underwriting activities occurred in the state, *see Cromeans*, 303 F.R.D. at 556. The facts that support jurisdiction here under the *Newsome* test therefore similarly support jurisdiction under the *Lintz* test.

These conclusions are consistent with the laws of other states that, unlike Kansas, do not follow the "originates from" standards of the 1956 USA or the 2002 USA. Arizona is such a state. In *Chrysler Capital*, a federal district court applying Arizona law found that a securities offer and sale outside of Arizona had occurred "within or from" the state because the issuer was incorporated in Arizona and had its principal place of business there: "Where the issuer of the securities is incorporated in and has its principal place of business in Arizona, the securities must have been offered or sold 'from' Arizona." *See Chrysler Cap. Corp. v. Cent. Power Corp*, No. 91-cv-1937, 1992 WL 163006, at *3 (S.D.N.Y. June 24, 1992).

The Defendants' appellate briefs cite several cases in support of their arguments that Kansas lacks territorial jurisdiction over the facts of this case. In particular, Defendant Lundberg argues from *In re Information Resources Corp.*, 126 N.J. Super. 42 (Sup. Ct. N.J. 1973), and Defendant Elzufon argues from *Morrison v. Nat'l Australia Bank*, 561 U.S. 247 (2010). *See* Brief of Appellee David Lundberg at 30-31, Brief of Appellee Michael Elzufon at 7-10. But neither *Information Resources* nor *Morrison* is relevant to the jurisdictional questions at issue here. First, *Information Resources* examined whether certain securities were required to be registered under New Jersey law. The case did not examine the very different (and broader) question of whether territorial jurisdiction existed in New Jersey for a potential securities fraud charge. *Morrison* too is inapposite. There, the question before the Supreme Court was whether the federal securities laws provided a cause of action for foreign plaintiffs suing American and foreign

defendants in connection with securities traded on foreign securities exchanges. *Morrison*, 561 U.S. at 250-51. While jurisdictional, this question is extremely attenuated from the question in this case. Subject-matter jurisdiction under the federal securities laws is jurisprudentially a very different issue than the scope of territorial jurisdiction under state securities laws. Furthermore, the federal securities laws have nothing like the "originates from" territorial jurisdiction standard in the uniform securities acts and KUSA Section 17-12a610(c)(1).

V. CONCLUSION.

For the reasons discussed herein, the trial court erred when it concluded that Kansas lacked territorial jurisdiction for this case under KUSA Section 17-12a610(c)(1) because the out-of-state offers and sales did not "originate from" Kansas. To the contrary, the basic facts of this case demonstrate that under either of the two tests courts have applied to evaluate this issue, Kansas does have territorial jurisdiction. Were this court to conclude otherwise, this court would deprive the state of Kansas and potential private plaintiffs of their legitimate rights to access Kansas courts and would undercut the KUSA's underlying remedial purposes.

Respectfully submitted,

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Date: November 28, 2016

CERTIFICATE OF SERVICE

I hereby certify that on November 28, 2016, I electronically filed the foregoing with the Clerk of the Appellate Courts by using the electronic filing system, which will send a notice of electronic filing to the following:

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