NO. COA17-607 FOURTEENTH DISTRICT

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NNN Durham Office Portfolio 1, LLC, James Osmond; NNN Durham Office Portfolio 2, LLC; James Sun Yu Lam; NNN Durham Office Portfolio 3, LLC Gary F. Turtle; NNN Durham Office Portfolio 4, LLC; Sherry L. Turtle; NNN Durham Office Portfolio 5, LLC; Gregory R. Maloney; NNN Durham Office Portfolio 6, LLC; Sharon I. Maloney; NNN Durham Office Portfolio 7, LLC; Ray Miller, Trustee; Patricia M. Miller, Trustee; NNN Durham Office Portfolio 9, LLC; PCL Property, LLC; NNN Durham Office Portfolio 10, LLC; Frances H. Kieffer, Trustee; NNN Durham Office Portfolio 11, LLC; Frank A. Norman, Jr.; NNN Durham Office Portfolio 12, LLC, St. Kitts Investments, LLC; NNN Durham Office Portfolio 13, LLC Blackwelder, Fannie B.; NNN Durham Office Portfolio 14, LLC; Barbara L. Davidson, Trustee; NNN Durham Office Portfolio 15 LLC; Frederick J. Hornbacher, Trustee; NNN Durham Office Portfolio 16, LLC; Roberta MacGregor Masson, Trustee; NNN Durham Office Portfolio 17, LLC; William B. Wachter II, Trustee; NNN Durham Office Portfolio 18, LLC; Susan B. Wachter, Trustee; NNN Durham Office Portfolio 19, LLC; Pell/Cruz Investments, Inc.; NNN Durham Office Portfolio 20, LLC; Jack R. Brown; NNN Durham Office Portfolio 21, LLC, Patricia A. Brown; NNN Durham Office Portfolio 22, LLC; Jack D. LaFlesch, Trustee; NNN Durham Office Portfolio 24 LLC; Muriel Sample, Successor Trustee;	)	From Durham County 10CVS4392

James K. Merrill, Successor Trustee; NNN Durham Office Portfolio 26, LLC; C.G.B.M.T Enterprises, Inc.; NNN Durham Office Portfolio 27, LLC; Susan E. Wagner; NNN Durham Office Portfolio 28, LLC; Federic J. Van Dis; NNN Durham Office Portfolio 29, LLC; Lawrence A. Wattson, Trustee; Stephanie T. Wattson, Trustee; NNN Durham Office Portfolio 30, LLC; Darrin A. Smith; NNN Durham Office Portfolio 32, LLC; Kenneth Dena McLamb; NNN Durham Office Portfolio 33, LLC; Cynthia L. McLamb; NNN Durham Office Portfolio 34, LLC; Mark B. Pista; Carol E. Pista, Plaintiffs, v. Grubb & Ellis Company; Grubb & Ellis Realty Investors, LLC; Grubb & Ellis Securities, Inc.; NNN Durham Office Portfolio, LLC; and NNN Realty Advisors, Inc., Defendants.	)

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BRIEF OF *AMICI CURIAE* THE NORTH CAROLINA SECRETARY OF STATE AND THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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Plaintiffs,	)
v.	)
	)
Highwoods Realty Limited Partnership; Highwoods DLF 98/29, LLC; Highwoods DLF, LLC; Highwoods Properties, Inc.; Grubb & Ellis/Thomas Linderman Graham; and Thomas Linderman Graham, Inc.,	)
	)
Defendants.	)
	)

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BRIEF OF *AMICI CURIAE* THE NORTH CAROLINA SECRETARY OF STATE AND THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

****

TO THE HONORABLE NORTH CAROLINA COURT OF APPEALS:

The North Carolina Secretary of State, as Administrator of the North Carolina Securities Act (the "Secretary of State"), together with the North American Securities Administrators Association, Inc. ("NASAA"), pursuant to

Rule 28(i) of the North Carolina Rules of Appellate Procedure respectfully submit the following brief as *amici curiae*.

ISSUES PRESENTED

I. **WHETHER THE TRANSACTIONS INVOLVING FRACTIONAL INTERESTS FOR TENANTS-IN-COMMON OFFERED AND SOLD BY DEFENDANTS CONSTITUTED SECURITIES UNDER THE NORTH CAROLINA SECURITIES ACT, WITH SPECIFIC REFERENCE TO N.C. GEN. STAT. § 78A-2(11); AND**

II. **WHAT IS THE JURISDICTIONAL SCOPE OF THE NORTH CAROLINA SECURITIES ACT, WITH SPECIFIC REFERENCE TO N.C. GEN. STAT. § 78A-63(c).**

INTERESTS OF THE *AMICI*

1. The Secretary of State serves as the Administrator of the North Carolina Securities Act, G.S. Chapter 78A ("NCSA"). The Secretary of State accomplishes her role in part by acting in the public interest, for the protection of investors, and consistent with the purposes fairly intended by the policy and provisions of the NCSA.

2. Formed in 1919, NASAA is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. NASAA has sixty-seven members, including the securities regulators in all fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The Secretary of State, as the NCSA's Administrator, is NASAA's member representative from North Carolina.

3. NASAA's United States members administer state securities laws, commonly known as "Blue Sky Laws." *See generally* Loss, L. and Cowett, E.M., *Blue Sky Law* (Boston: Little, Brown and Co. (1958)) ("Loss and Cowett"). NASAA supports the work of its members and of 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. NASAA seeks to foster greater uniformity in state and federal securities laws. Ultimately, the mission of NASAA and its members is to protect investors, particularly retail investors, from fraud and abuse.

4. The Secretary of State and NASAA are jointly interested in this case because the lower court's Revised Order & Opinion and Final Judgment, dated 29 December 2016 (the "Order & Opinion"), from which both plaintiffs and defendants have appealed, raises fundamental questions about (i) what constitutes a "security" under the NCSA, and (ii) the scope of territorial jurisdiction under the NCSA. We have no interest in the eventual success or failure of any of the litigants' various claims underlying this dispute. However, the foundational jurisdiction issues raised in this case directly implicate the Secretary of State's ability to administer and police the NCSA and, potentially, the ability of other NASAA members to do likewise.

STATEMENT OF THE CASE AND STATEMENT OF THE FACTS

For purposes of this brief, *Amici* assume as correct and adopt the Statement of the Case and Statement of the Facts presented by plaintiffs.

ARGUMENT

I. THE TRANSACTIONS INVOLVING FRACTIONAL INTERESTS FOR TENANTS-IN-COMMON OFFERED AND SOLD BY DEFENDANTS IN THIS DISPUTE WERE SECURITIES UNDER THE NCSA.

The trial court's Order and Opinion reviewed the defendants' claim that the TICs were not securities and concluded, "the exercise of control by the [tenants-in-common] after the collapse of the Business Plan is inadequate to prevent their investment from qualifying as a securities transaction." Order & Opinion at ¶ 133. *Amici* agree with the Order & Opinion's general analysis of this issue, but *Amici* encourage this court to reach the ultimate question (left open by the trial court) and hold that the TICs *were* securities under the NCSA. *See* N.C. Gen. Stat. § 78A-2(11) (2016).

N.C. Gen. Stat. § 78A-2(11) defines a security by reference to various financial instruments, one of which is an "investment contract." As the NCSA's Administrator, the Secretary of State has promulgated a related rule, N.C. Admin. Code tit. 18, r. 06A.1104(8) (2016), which defines an "investment contract" to include any "investment in a common enterprise with the expectation of profit to be derived through the essential managerial efforts of someone other than the investor." This definition parallels the United States Supreme Court's widely-followed "investment contract" test from *SEC v. W.J. Howey*, 328 U.S. 293 (1946), and *Howey* is the appropriate lens for this case. *See Saw Plastic, LLC, v. Sturrus*, No. 15-cvs-10068, 2017 WL 3686515, at *5-7 (N.C. Sup. Ct. Aug. 25, 2017).

Here the TICs were securities because they constituted an investment in a common real estate enterprise with an expectation of profit to be derived from the

defendants' management thereof. Indeed, it is well-settled that TICs are securities. Several courts have previously considered this question, and all of them agreed that TICs are securities. *See Securities v. Sunwest Mgmt.*, No. 09-CV-6056-HO, 2009 U.S. Dist. LEXIS 114917, at *15-16 (D. Or. Dec. 9, 2009); *Redding v. McCarter*, 2012 MT 144, 365 Mont. 316, 328 (2012); *Mathews v. Cassidy Turley Md., Inc.*, 435 Md. 584, 608-09, 80 A.3d 269, 283 (2013). Construing the NCSA similarly would keep the NCSA uniform with the law in these other jurisdictions and satisfy the General Assembly's intent to protect the investing public and North Carolina's capital markets. Accordingly, the transactions entered into between the plaintiffs and defendants demand the regulatory oversight and protections afforded by the NCSA.

II. PLAINTIFFS INSIDE AND OUTSIDE NORTH CAROLINA HAVE STANDING TO BRING CLAIMS UNDER THE NCSA WHERE THEY CAN SHOW THAT AN OFFER OR SALE OF A SECURITY HAS "ORIGINATES FROM" THIS STATE. THE PROPER TEST FOR WHETHER AN OFFER OR SALE OF A SECURITY HAS ORIGINATED FROM NORTH CAROLINA IS WHETHER ANY PORTION OF THE SELLING PROCESS HAS OCCURRED IN-STATE OR IF THERE IS A TERRITORIAL NEXUS BETWEEN THE OFFER OR SALE AND THIS STATE.

Although the Order & Opinion reasonably analyzed the issue of whether TICs constitute securities, it failed to properly analyze whether plaintiffs in this case – particularly the out-of-state plaintiffs – can pursue claims under the NCSA.

Specifically, the Order & Opinion held that only plaintiffs who actually received or accepted an offer *in North Carolina* can bring claims. *See* Order & Opinion at ¶ 143. This was legal error, and the Opinion & Order should be reversed on this point. Specifically, the trial court erred by not considering *any* of the relevant precedents that have construed whether an extraterritorial offer or sale nonetheless "originates from" a given state. The NCSA's proper construction necessitates lineal review.

As early as 1905, the General Assembly had enacted legislation to regulate investment opportunities after unscrupulous promoters defrauded investors. *See generally* Revisal 1905, chapter 100, section 4805, as amended. This law required licensure with the State before certain companies could offer for sale or sell by agent certain stocks, bonds or other obligations. *Id.* They also provided penalty for any person acting as an insurance agent or broker without license. *See generally* Revisal 1905, chapter 100, section 3484.

Problems continued with the offer or sale of investment opportunities, nationally and in North Carolina. In 1911 several states responded by enacting the first Blue Sky Law statutes. Generally, Blue Sky Laws operate similarly among the states and in relation to federal securities law. Blue Sky Laws have components for registration of securities and persons involved in the sale thereof. They have a

separate component for enforcement of registration and of fraud and other prohibited practices.

In 1913 North Carolina enacted its own Blue Sky Law. *See* Gregory's Supplement, sec. 4805a, subsec. 1 (ch. 156, Laws 1913). The Supreme Court of North Carolina upheld North Carolina's law as a valid exercise of the State's police power. *See State v. Agey,* 171 N.C. 831, 88 S.E. 726 (1916). The *Agey* court stated, "[t]he intent of the statute is to protect our people, under the police power, from fraud and imposition by irresponsible nonresident parties." *Id.,* 171 N.C. at 833, 88 S.E. at 728; *see generally* Public Laws of North Carolina, 1925, ch. 190, p. 415, entitled "An act to provide laws governing the sale of stocks, bonds and other securities in the State of North Carolina" and *see also Smith v. Fidelity & Deposit Co.*, 191 N.C. 643, 132 S.E. 792 (1926).

A more recent milestone in North Carolina's regulation of securities arrived in 1973. That year the General Assembly repealed prior Chapter 78 and created a new Chapter 78. *See* Session Laws 1973-1380, effective 01 Apr. 1975. The General Assembly enacted the new Chapter 78, which subsequently became Chapter 78A, to essentially incorporate North Carolina's pre-existing Blue Sky Law and significantly adopt the model statute under the Uniform Securities Act of 1956. *See* Nat'l Conference of Comm'rs on Unif. State Laws 1956 ("USA 1956"). N.C. Gen. Stat. § 78A-64 (2016) establishes the NCSA's statutory policy by

stating "[The NCSA] shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this Chapter with the related federal regulation."

For the NCSA, the General Assembly continued the common Blue Sky Law approach. Related to enforcement, the NCSA provides for administrative, civil, and criminal redress. The NCSA authorizes the N.C. Department of the Secretary of State to enforce violations under all three; private parties also may bring civil actions. For government and private plaintiffs, the elements of proof substantially overlap. *See* N.C. Gen. Stat. §§ 78A-8, 78A-24, 78A-36, 78A-56, and 78A-57 (2016).

N.C. Gen. Stat. § 78A-2(8)b. (2016) defines an "offer" or "offer to sell" a security as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value." *Id.* Subpart (8)a. defines "sale" or "sell" as meaning "every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value." *Id.*

The NCSA adds N.C. Gen. Stat. § 78A-63 (2016) ("Section 78A-63") as a territorial limitation to jurisdiction. Section 78A-63's first structural component includes subsections (a) through (e). These subsections establish rules associated with an "offer" or "sale." Following these subsections, subsections (f) and (g)

relate to substituted service and appointment of the Secretary of State as agent of service, which evidence the General Assembly's intent to apply the NCSA to residents and non-residents. *See* Loss and Cowett at 407 (stating language similar to subsection (g) "has been closely modeled on the type of nonresident motorist statute whose constitutionality was sustained in *Hess v. Pawlowski*, 274 U. S. 352 (1927)").

Construing the NCSA's territorial jurisdiction component requires deconstructing subsections (a) through (f). Each subsection addresses a related concept. Subsection (a) states that the NCSA applies "to persons who sell or offer to sell when (i) an offer to sell is made in this State, or (ii) an offer to buy is made and accepted in this State." Subsection (b) states the NCSA similarly applies "to persons who buy or offer to buy when (i) an offer to buy is made in this State, or (ii) an offer to sell is made and accepted in this State."

Section 78A-63 then refines these concepts further through subsections (c) and (d). Subsections (c) and (d) are most easily understood when compared side-by-side (emphasis added) as follows.

Section 78A-63(c) – Sales		Section 78A-63(d) – Purchases
For the purpose of this section, an offer to sell or to buy is made in this State,		For the purpose of this section, an offer to buy or to sell is accepted in this State

whether or not either party is then present in this State, when the offer (i) ***originates from this State*** or (ii) is directed by the offeror to this State and received at the place to which it is directed (or at any post office in this State in the case of a mailed offer).		when acceptance (i) is communicated to the offeror in this State and (ii) has not previously been communicated to the offeror, orally, or in writing, outside this State; and acceptance is communicated to the offeror in this State, ***whether or not either party is then present in this State*** when the offeree directs it to the offeror in this State reasonably believing the offeror to be in this State and it is received at the place to which it is directed (or at any post office in this State in the case of a mailed acceptance).

These subsections are not explained further in the NCSA. However, these provisions are patterned off the USA 1956. Commentary to the USA 1956 states, "[i]t is quite clear that a person may violate the law of a given state, even criminally, without ever being within the state or performing within the state every

act necessary to complete the offense. *Strassheim v. Daily*, 221 U. S. 280 (1911)." *See* Loss and Cowett at 404.

Statutory construction occurs against the backdrop of financial fraud frequently involving complex and sophisticated securities transactions. Regulatory enforcement must keep pace with legitimate and illegitimate strategies to raise capital. Securities transactions involving real estate have long been fraudsters' instrument of choice. In 2011, NASAA listed distressed real estate among the "Top Investor Traps and Threats." NASAA, "Con Artists Find Profit in Get-Rich Schemes Tied to Economic Uncertainty," http://www.nasaa.org/3809/con-artists-find-profit-in-get-rich-schemes-tied-to-economic-uncertainty/ (last visited 03 Aug. 2017).

All state securities laws contain a territorial jurisdiction component. Thirty-three states – including North Carolina, through Section 78A-63 – have adopted the "originates from" language contained in the USA 1956 and the Uniform Securities Act of 2002 (a substantially similar, subsequent model securities act). For the remaining seventeen states, their statutes either expressly require a territorial nexus (such as Arizona's statute, which confers jurisdiction over transactions "within or from this state," Ariz. Rev. Stat. Ann. § 44-1991 (2016), or courts infer a territorial jurisdiction requirement under state law (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 apply securities statutes extraterritorially because they recognize that states have a legitimate interest in maintaining the integrity of their markets and "preventing the state from being used as a base of operations for crooks marauding outside the state." *Id.* at 881.

The NCSA and other states' criminal enforcement exemplify hallmarks of concurrent jurisdiction. If an illegal act transpires over several states, each state may 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 constitute double jeopardy, because each state is a separate sovereign. *Heath v. Alabama*, 474 U.S. 82, 88 (1985). Each state accordingly may protect its own interests. *Simms Inv. Co. v. E.F. Hutton & Co.*, 699 F. Supp. 543, 545 (M.D.N.C. 1988). Blue sky laws such as the NCSA also must be liberally construed. *State ex rel. Mays v. Ridenhour*, 248 Kan. 919, 811 P.2d 1220, 1230 (1991). As a public welfare statute, investors find protection from defrauders' avarice and from disparate sophistication in complex transactions. *See generally, State v. Nagel*, 279 N.W.2d 911, 915 (S.D. 1979).

Few courts have construed the "originates from" standard for territorial jurisdiction contained in subsection (c) and in the uniform securities acts. *See Nuveen Premium Income Mun. Fund 4, Inc. v. Morgan Keegan & Co.*, 200 F. Supp. 2d 1313, 1318 (W.D. Okla. 2002). Prior to 2017, courts that had examined this issue did so under either of two approaches. First, in 1983, an Oklahoma state

court concluded that an out-of-state offer "originates from" the state if "any portion of the selling process" occurred in-state. *Newsome v. Diamond Oil Producers*, CCH Blue Sky L. Rptr. Decisions, ¶ 71,869 (Dist. Ct. 14th Jud. Dist. Okla. 1983) (the "*Newsome* test"). Two federal district courts subsequently approved of this approach. *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 but unpublished opinion that also approved of the *Newsome* test). A competing 1985 case, though, held that an out-of-state offer originates from a state if there is a "territorial nexus" between the extraterritorial offer or sale and the originating state. *See Lintz v. Carey Manor Ltd.*, 613 F. Supp. 543, 550 (W.D. Va. 1985) (the "*Lintz* test"). And several courts subsequently followed this approach. *See Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., Nos. 15-1872-cv(L), 15-1874-cv(CON), 2017 U.S. App. LEXIS 18803, at *12-13 (2d Cir. Sep. 28, 2017); 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); and *Nuveen*, 200 F. Supp. 2d at 1318.

Although the "*Newsome* test" and "*Lintz* test" framed their analyses differently, they ultimately addressed the underlying jurisdictional question in essentially the same ways: both tests ask whether an out-of-state offer or sale can be traced back to relevant conduct in the state.

In March 2017 – *i.e.*, subsequent to the Order & Opinion in this case – the Court of Appeals of Kansas was faced with a question indistinguishable from the question presented here. Specifically, the Kansas appellate court analyzed whether Kansas had territorial jurisdiction over out-of-state offers and sales of real estate investment interests. *See State v. Lundberg*, 53 Kan. App. 2d 721, 391 P.3d 49 (2017). Reviewing the *Newsome* test and the *Lintz* test, the Kansas court first unified these two approaches into a single test, holding: "a sale or offer to sell a security originates in Kansas if any portion of the selling process has occurred here or if there is some territorial nexus between the offer and the State of Kansas." *Id.* at 731. The court then analyzed the facts in light of this test, concluding that Kansas did have territorial jurisdiction over the subject matter at issue. Relevant facts leading the *Lundberg* court's conclusion were the defendants' substantial business operations in the state, that documents had been signed in Kansas and contracts were to be governed by Kansas law, and that offering materials were faxed from Kansas outside the state. *See id.*

The trial court below erred by failing to consider *any* of these relevant precedents – the *Newsome* test, the *Lintz* test, or *Lundberg's* unification of these tests – in its Order & Opinion. *Amici* posit that *Lundberg* provides the appropriate test for this court to apply when assessing territorial jurisdiction under N.C. Gen. Stat. § 78A-63(c) and, thus, that an out-of-state offer or sale of a security

"originates from" North Carolina if any portion of the selling process has occurred here or if there is a territorial nexus between the extraterritorial transaction and this state. By adopting this standard, this court will keep North Carolina law uniform with the law of all other jurisdictions, which have considered this important question.

CONCLUSION

For the reasons discussed herein, this court should hold that the TICs here were securities under the NCSA. However, this court should find that the Order & Opinion erred in its analysis of Section 78A-63 when it barred certain out-of-state plaintiffs from potentially pursuing claims under the NCSA. If the Order & Opinion were to stand on this point, the General Assembly's intent of safeguarding the integrity of North Carolina's securities markets would be subverted. What is more, the Order & Opinion's legal error could impede the enforcement efforts of the Secretary of State and, potentially, the efforts of other state securities regulators.

Respectfully submitted this the 16th day of OCTOBER, 2017.

/s/ ELECTRONICALLY SIGNED

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CERTIFICATE OF COMPLIANCE

Pursuant to N.C. R. App. P. 28(j), the undersigned certifies that this *amici curiae* brief contains no more than 3,750 words as reported by the word-processing software excluding portions of the brief that do not count against the number of words allowed by this rule.

This the 16th day of OCTOBER, 2017.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that today the foregoing BRIEF OF *AMICI CURIAE* THE NORTH CAROLINA SECRETARY OF STATE AND THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., pursuant to N.C. R. App. P. 26, has been filed electronically to the electronic-filing site and service has been accomplished electronically by use of the correct and current e-mail address for each attorney of record as follows:

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