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IN THE FIFTH DISTRICT COURT OF APPEAL
STATE OF FLORIDA

CASE NO. 5D15-4272

J.P. MORGAN SECURITIES LLC, MADHUKAR NAMBURI,
and ESTEBAN SCHRECK,

Appellants,

v.

GEVERAN INVESTMENTS LIMITED,

Appellee.

BRIEF OF AMICUS CURIAE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF APPELLANTS J.P. MORGAN SECURITIES LLC, MADHUKAR NAMBURI, AND ESTEBAN SCHRECK

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INTEREST OF AMICUS CURIAE, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. Its mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. It regularly files amicus briefs in cases raising issues of vital concern to securities industry participants in both federal and state courts.

This appeal will address two issues that are important to SIFMA's members. First, whether a placement agent, such as appellant J.P. Morgan Securities LLC, may be subjected to liability under Section 517.211 of the Florida Securities and Investor Protection Act ("FSIPA")—which provides, *inter alia*, for a cause of action for rescission damages for violations of Section 517.301 of FSIPA—without evidence that it acted with scienter or negligence as to the alleged misrepresentation or omission at issue. Second, whether individual employees of a placement agent, such as Madhukar Namburi and Esteban Schreck,[1] may be held personally liable under Section 517.211(2) of FSIPA.

[1] Collectively, defendants/appellants J.P. Morgan Securities LLC, Mr. Namburi, and Mr. Schreck will be referred to as "J.P. Morgan."

SIFMA provides this brief to assist this Court in its consideration of these two issues by bringing to the Court's attention the collective experience of its members regarding how these common issues would affect financial advisors, lenders, and underwriters engaging in securities transactions in Florida.

SUMMARY OF THE ARGUMENT

Appellee Geveran Investments Limited ("Geveran") seeks to impose a system of strict vicarious liability in Florida that is unprecedented among the current national landscape of blue sky regulation. As it stands, of the forty-nine states other than Florida, at least *forty-eight* provide protections against liability for defendants through inclusion of explicit culpability requirements, the availability of affirmative defenses, or the lack of a private right of action, and the only remaining state, Illinois, also likely has a culpability requirement. These protections are vital to the integrity of the financial markets.

At its base, FSIPA is an antifraud statute that was enacted to protect the public from fraudulent practices in the Florida securities market. In light of FSIPA's goal to prohibit fraudulent conduct, and in line with nearly every other state's blue sky law, Florida courts have held that FSIPA requires some showing of a defendant's culpability. Yet, Geveran's proffered interpretation of FSIPA would hold a defendant liable without any showing of knowledge, scienter, or even negligence by that party. Such a rigid interpretation of FSIPA would impose, by

far, the most expansive scope of liability on defendants out of all of the state blue sky statutes. Contrary to the plain language of the statute, strict liability would reach even junior employees of an agent of an issuer, such as Mr. Schreck, for the entirety of the judgment (here, over $36 million). The Florida legislature could not have intended such a result.

Geveran's interpretation of FSIPA further could discourage secondary participants from engaging in securities transactions in Florida. Accordingly, in support of the position of J.P. Morgan, SIFMA respectfully requests that the Court vacate the judgment as to J.P. Morgan and remand for further proceedings, including dismissal of the FSIPA claims against Mr. Namburi and Mr. Schreck.

ARGUMENT

I. GEVERAN'S INTERPRETATION OF FSIPA IS INCONSISTENT WITH THE STATUTORY FRAMEWORK IN THE OVERWHELMING MAJORITY OF OTHER STATES

The blue sky laws in *forty-eight* states: (i) include explicit culpability requirements; (ii) include statutorily-created affirmative defenses, such as that a defendant did not know, and in the exercise of reasonable care, could not have known of the misrepresentation or omission; or (iii) have no private right of

action.[2] Appendix A to this brief provides a survey of the relevant culpability standard in each state's blue sky law.

While Section 517.301 of FSIPA does not include an explicit culpability requirement, it is an antifraud statute that was enacted to "protect the public from fraudulent and deceptive practices in the securities market." *Rudd v. State*, 386 So. 2d 1216, 1218 (Fla. 5th DCA 1980). Given this context, and consistent with nearly every other state, Florida courts have held that FSIPA requires some showing of a defendant's culpability. Some courts have held that negligence is the relevant standard under FSIPA,[3] while others have found that the statute requires proof of scienter (*i.e.*, recklessness or intent).[4]

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[2] *See infra* pp. 5-8. Other than Florida, the only remaining state is Illinois, which does not provide an explicit culpability requirement or statutorily-created affirmative defense. Nonetheless, Illinois courts have explicitly likened the Illinois blue sky statute to Section 17 of the Securities Act of 1933, which requires negligence, even though the Illinois Supreme Court has not made a final determination as to whether a lesser mental state than scienter is applicable. *See infra* note 11.

[3] *See*, *e.g.*, *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1046 (11th Cir. 1987) (holding liability under FSIPA "is satisfied by a showing of mere negligence," rather than reckless disregard); *Arnold v. McFall*, 839 F. Supp. 2d 1281, 1286 (S.D. Fla. 2011) (same); *First Union Brokerage v. Milos*, 717 F. Supp. 1519, 1524 (S.D. Fla. 1989) (same).

[4] *See*, *e.g.*, *Barnett v. Blane*, 2013 WL 1001963, at *2 (S.D. Fla. Mar. 13, 2013) (plaintiff must establish "scienter or reckless disregard"); *Tucker v. Mariani*, 655 So. 2d 221, 225 (Fla. 1st DCA 1995) (same); *Whigham v. Muehl*, 500 So. 2d 1374, 1380 (Fla. 1st DCA 1987) ("[S]ection 517.301 action for fraud must be predicated

Despite this backdrop, Geveran seeks to make Florida the *only state* that would not provide defendants protections against liability in the form of affirmative defenses or culpability requirements. Should the Court agree with Geveran's interpretation of FSIPA as a strict liability statute, Florida's statutory scheme would be inconsistent with that present in every other state.

Specifically, forty-seven out of fifty states, along with the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands, provide for critical statutory defenses to shield secondary actors from liability.[5] These statutory defenses include either a good faith or due diligence defense—*i.e.*, that the defendant did not know, and in the exercise of reasonable care, could not have

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upon a misrepresentation that relates to *a specific material fact that is untrue and known to be so*.") (emphasis added and citation omitted).

[5] Many of these states have modeled their blue sky statutes, at least in part, after one of the three versions of the Uniform Securities Act—the Uniform Securities Acts of 1956, 1985, and 2002 (collectively, the "Uniform Securities Act"). *See*, *e.g.*, Ala. Code § 8-6-19; Ark. Code Ann. § 23-42-106; Colo. Rev. Stat. § 11-51-604; Del. Code. Ann. tit. 6 § 7323; Mass. Gen. Laws ch. 110A, § 410; Minn. Stat.§ 80A.76; N.M. Stat. Ann. § 58-13C-509; Utah Code Ann. § 61-1-22; Wis. Stat. § 551.509. As one commentator has stated, "[p]roviding for a reasonable care defense operates to establish a statutory standard for liability applicable to secondary actors. It has always been a part of the Uniform [Securities] Act with regard to the liability of 'non-sellers.'" Robert N. Rapp, Blue Sky Regulation, ch. 13, § 13.03. Further, "[w]here the focus is on secondary liability, or the violation alleged is fraud, a culpability standard clearly makes sense." *Id.*, ch. 15, § 15.03[4].

known of the misrepresentation or omission at issue[6]—or an explicit culpability requirement that the plaintiff prove that the defendant acted with negligence or wrongful intent.[7] For example, the Texas blue sky statute provides for an

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[6] **Thirty-seven states**, in addition to the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands, include good faith or due diligence defenses in their securities laws for both primary and secondary violators. *See*, *e.g.*, Ark. Code Ann. § 23-42-106(a)(1)(B), (d)(1); Cal. Corp. Code §§ 25401, 25501, 25504; Ind. Code § 23-19-5-9(a), (d)(4); Ky. Rev. Stat. § 292.480(1), (4); Neb. Rev. Stat. § 8-1118(1), (3). An additional **six states** include a statutory good faith or due diligence defense solely for secondary actors. *See* Alaska Stat. § 45.55.930(c); Mont. Code Ann. § 30-10-307(2); N.J. Rev. Stat. § 49:3-71(b)(1), (d); N.D. Cent. Code § 10-04-17(6)(c); Or. Rev. Stat. § 59.137(1); Wash. Rev. Code § 21.20.430(3). Many of these six states, however, provide for a culpability requirement for primary violators by means of statute or case law. *See*, *e.g.*, N.J. Stat. § 49:3-71(b)(1) (providing that a plaintiff must prove the seller "knew of the untruth or omission and intended to deceive"); *State ex rel. Oregon State Treasurer v. Marsh & McLennan Companies Inc.*, 346 P.3d 504, 512-14 (Or. Ct. App. 2015) (holding that plaintiff must prove scienter for primary actors under Oregon's blue sky law).

[7] **Three states** provide statutory good faith or due diligence defenses solely for primary actors while also providing for a statutory culpability requirement for secondary actors. *See* Ariz. Rev. Stat. §§ 44-1991, 44-2003; Colo. Rev. Stat. §§ 11-51-501(1)(b), 11-51-604(5) (requiring knowledge); Tex. Civ. Stat. Ann. art. 581-33A(2), F(2) (requiring "intent to deceive or defraud with reckless disregard for the truth or the law"). In addition to providing due diligence defenses for both primary and secondary violators, California's state blue sky law also provides an intent requirement for any actor, beyond those explicitly enumerated, who materially aids in a violation. *See* Cal. Corp. Code §§ 25504, 25504.1. As noted by one commentator, "[l]iability for materially aiding the commission of a violation fairly implies some element of awareness or intent." Robert N. Rapp, Blue Sky Regulation, ch. 15, § 15.03[2][c]. Moreover, while **one state**, Ohio, does not provide for affirmative defenses, its blue sky law requires plaintiffs to prove a primary violator acted with knowledge before liability can be imposed on either a primary or secondary actor. *See* Ohio Rev. Code §§ 1707.44(b)(4), 1707.43.

affirmative defense for primary actors who show either "(a) the buyer knew of the untruth or omission,"[8] or "(b) he (the offeror or seller) did not know, and in the exercise of reasonable care could not have known, of the untruth or omission." Tex. Civ. Stat. Ann. art. 581-33A(2).[9] At the same time, the Texas statute requires plaintiffs to prove that secondary violators acted with culpability, or wrongful intent, in order to prevail on a state securities fraud claim. *See* Tex. Civ. Stat. Ann. art. 581-33F(2) (imposing joint and several liability on those who "directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aid[] a seller").

Of the three remaining states, New York has no private right of action at all under its state securities fraud statute,[10] and in Illinois—the final state other than Florida—where the blue sky laws are not fully developed, the Illinois Supreme Court has left open "whether a lesser mental state [than scienter] is applicable."

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[8] Like Texas, many states have additional statutory provisions that explicitly shield primary actors from liability when the purchaser cannot establish that it did "not know[] of the untruth or omission." *See*, *e.g.*, Ala. Code § 8-6-19(a)(2); Colo. Rev. Stat. § 11-51-604(4); Conn. Gen. Stat. § 36b-29(a)(2); Mass. Gen. Laws ch. 110A, § 410(a)(2); Neb. Rev. Stat. § 8-1118(1); 7 R.I. Gen. Laws § 7-11-605(b)(1); Utah Code Ann. § 61-1-22(3).

[9] *See also* Unif. Sec. Act of 1956, § 410(a), (c); Unif. Sec. Act of 1985, § 605(b)(1)-(2), (d); Unif. Sec. Act of 2002, § 509(g)(1)-(4).

[10] *See CPC Int'l Inc. v. McKesson Corp.*, 514 N.E.2d 116, 118 (N.Y. 1987).

People v. Whitlow, 433 N.E.2d 629, 634 (Ill. 1982).[11] The Illinois statute also may include a reliance requirement.[12]

Thus, Geveran's proffered interpretation of FSIPA as a strict liability statute contradicts the blue sky statutes and interpretative case law of every state in the United States—including Florida. Such an interpretation also would be out of line with the federal regime. For example, Section 12(a)(2) of the Securities Act of 1933 explicitly provides for exclusions to liability where a plaintiff had knowledge of the misrepresentation or omission, or the defendant did not know, and in the exercise of reasonable care, could not have known of the alleged misrepresentation or omission. 15 U.S.C. § 77l(a)(2). Similarly, Section 18 of the Securities Exchange Act of 1934 expressly provides for the affirmative defenses of good faith and a plaintiff's knowledge of the alleged misrepresentation or omission. 15

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[11] As noted above, Illinois courts have explicitly likened the Illinois blue sky statute to Section 17 of the Securities Act of 1933, which requires negligence. *See S.E.C. v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012) (finding that a violation of Sections 17(a)(2) or 17(a)(3) requires negligence); *Foster v. Alex*, 572 N.E.2d 1242, 1244-45 (Ill. App. Ct. 5th Dist. 1991) ("The provisions of section 12(G) of the Illinois Securities Act were patterned after [S]ection 17 of the Federal Securities Act of 1933," and "Sections 12(F) and 12(G) of the Illinois Act correspond to [S]ections 17(a)(2) and (a)(3) of the Federal Securities Act.").

[12] *See Foster*, 572 N.E.2d at 1245-46; *see also Elipas v. Jedynak*, 2011 WL 1706059, at *11 (N.D. Ill. May 5, 2011) (citing *Foster*, 572 N.E.2d at 1245-46). Reliance also is an element of FSIPA and is addressed by the briefs of appellants and other amici curiae.

U.S.C. § 78r(a). *See also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding a cause of action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder does not lie "in the absence of any allegation of 'scienter' intent to deceive, manipulate, or defraud").

II. GEVERAN'S INTERPRETATION OF FSIPA § 517.211 DEPARTS FROM THE EXPRESS LANGUAGE OF THE STATUTE AND WOULD UNREASONABLY IMPOSE LIABILITY ON SECONDARY ACTORS

A. Imposing Liability on Employees of an Agent of the Seller is Inconsistent with the Express Language of FSIPA § 517.211

FSIPA § 517.211 expressly imposes joint and several liability only on specific categories of persons—"[e]ach person making the sale and every director, officer, partner, or agent of or for the seller, if the director, officer, partner, or agent has personally participated or aided in making the sale." Thus, the categories of the seller's employees who may be liable under FSIPA—directors, officers, and partners—are explicitly limited to those who have significant managerial authority and, importantly, some degree of control over the seller's actions.

While FSIPA also reaches "agents" of the seller, it does not reach the directors, officers, or partners of such agents—much less junior employees of agents. Indeed, it would make little sense and defy the plain language of the statute to impose liability on junior employees of a seller's agent, while shielding all but the most high-ranking employees of the seller itself. In the transaction at issue here, for example, J.P. Morgan Securities LLC served as placement agent for

Lighting Science Group Corporation ("LSG"), while Mr. Namburi and Mr. Schreck were merely employees of J.P. Morgan Securities LLC.

Geveran argues, contrary to the express language of Section 517.211 of FSIPA, that any person participating on the seller's side of the transaction, including employees of an agent of the seller, should automatically become an agent of the seller and thus subject to strict liability for the full amount of any judgment (here, over $36 million). "Personally participating" or "aiding" in the sale, however, is different from being an agent of the seller. Under FSIPA, not only must the defendant be an agent of the seller, but that agent also must have personally participated or aided in making the sale.[13] These are two *separate* requirements for liability under the statute. *See* FSIPA § 517.211.

Florida courts apply common-law agency principles to determine whether an actor is an "agent" under FSIPA. *See Arthur Young & Co. v. Mariner Corp.,* 630 So. 2d 1199, 1204 (Fla. 4th DCA 1994). Under these principles, a plaintiff must show: "(1) acknowledgment by the principal that the agent will act for it, (2) the agent's acceptance of the undertaking, and (3) control by the principal over the actions of the agent." *Rubin v. Gabay*, 979 So. 2d 988, 990 (Fla. 4th DCA 2008)

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[13] "Participat[ion]" requires a defendant to "personally induce[] the investors to purchase the securities or investments." *See Clement v. Lipson*, 999 So. 2d 1072, 1076 (Fla. 5th DCA 2008). The defendant must take "an active part in influencing the [plaintiff] to purchase." *Sorenson v. Elrod*, 286 F.2d 72, 74 (5th Cir. 1960).

(citation and internal quotation marks omitted).[14] Being an employee of an agent that personally participated in the sale is therefore insufficient to qualify the employee as an agent of the seller.

Geveran's reading of FSIPA would effectively impose liability on all actors who "personally participated" on the seller's side of the transaction, rendering the legislature's inclusion of "agent[s]" of a seller superfluous—not to mention every other enumerated category of persons specified in the statute. Such an interpretation "improperly blur[s] the distinction" established by the legislature with the clear intent to limit the scope of liability to specific groups of people. *Hawkins v. Ford Motor Co.*, 748 So. 2d 993, 1000 (Fla. 1999) (Florida courts must avoid "interpretations that render statutory provisions superfluous").

Here, J.P. Morgan Securities LLC may have been an agent of LSG, but that does not automatically render the employees of J.P. Morgan Securities LLC, such as Mr. Namburi and Mr. Schreck, agents of LSG. To be covered as an agent under Section 517.211 of FSIPA, a defendant must be in a direct agency relationship with the seller, which Mr. Namburi and Mr. Schreck were not. Neither was a party to the engagement letter between LSG and J.P. Morgan Securities LLC, and neither

[14] *See also Virgilio v. Ryland Grp., Inc.*, 680 F.3d 1329, 1336 (11th Cir. 2012); *E & H Cruises, Ltd. v. Baker*, 88 So. 3d 291, 295 (Fla. 3d DCA 2012).

agreed to act as an agent of LSG. [*See* R. 20139-44].[15] Thus, under the plain language of Section 517.211 of FSIPA, they cannot be held liable as agents of LSG, whether or not they participated in the sale to Geveran.

B. Imposing Liability on Employees of an Agent of the Seller Under FSIPA § 517.211 is Unreasonable and Inconsistent with the Statutory Framework of Other State Blue Sky Laws

To broadly extend liability to employees of an agent of the seller is even more unreasonable where the statute does not provide for any affirmative defenses against liability. Indeed, imposing liability on secondary actors without any sort of culpability requirement or affirmative defenses would render FSIPA an extreme anomaly among state blue sky laws. *See supra* pp. 3-9. Here, it would impose tens of millions of dollars in joint and several liability on individual employees of the seller's agent—including junior employees such as Mr. Schreck who had no managerial authority over the agent, much less the seller—even if such employees did nothing wrong and acted at all times with due care. Such a result is at odds with virtually every other state blue sky law.

For instance, the Uniform Securities Act—the model for most of the state blue sky laws—extends liability to a wider range of actors than FSIPA, but importantly provides affirmative defenses to all those who might be held liable

[15] Citations to "R." refer to the record on appeal.

under the Act. Unlike FSIPA, Section 410(c) of the Uniform Securities Act of 1956 extends liability to "[e]very person who directly or indirectly controls" a primary violator, in addition to others such as principals, officers, directors, or those holding similar positions or functions. Most states that have statutes based upon the Uniform Securities Act impose secondary liability on these so-called "control persons" of a primary violator. These individuals are responsible for establishing the policies of a company and ensuring general compliance with them, and are "presumed to be so closely connected with a seller that they owe a duty of care to the buyer to prevent violations of the state securities law." Robert N. Rapp, Blue Sky Regulation, ch. 15, § 15.03[2][b]. However, these blue sky statutes provide additional protections, such as a due diligence defense, even where liability is imposed on control persons. *See*, *e.g.*, N.C. Gen. Stat. § 78A-56(c)(1) (North Carolina provides for joint and several liability for "[e]very person who directly or indirectly controls a person liable" unless they "sustain the burden of proof that the person did not know, and in the exercise of reasonable care could not have known, of the existence of facts by reason of which liability is alleged to exist").

In addition to "control persons," the Uniform Securities Act extends secondary liability to every employee of the seller and every broker-dealer or agent "who materially aids in the conduct giving rise to the liability." Unif. Sec. Act of

1956 § 410(c). However, even these individuals—for example, a junior employee of the seller—have the affirmative defense of showing that they did not know, and in the exercise of reasonable care could not have known, of the existence of facts by reason of which liability is alleged to exist. *Id.*[16]

Similarly, most states that extend secondary liability to "any person" who "participates" or "materially aids" in the transaction at least provide for a due diligence defense. *See*, *e.g.*, Or. Rev. Stat. §§ 59.115, 59.137; Okla. Stat. tit. 71, § 1-509G. Other states require more, such as that the persons acted with intent, *see*, *e.g.*, Cal. Corp. Code § 25504.1, or with some other form of scienter, *see*, *e.g.*, Tex. Rev. Civ. Stat. Ann. art. 581-33(F)(2).

Geveran's interpretation of FSIPA departs from virtually every other state's blue sky law and, if adopted, would render Florida an anomaly by unfairly imposing liability on even junior employees of the seller's agent without providing for any defenses. There is no indication that the Florida legislature intended to impose such a draconian result.

[16] FSIPA further does not include "broker-dealer" as a category of persons who may be liable under Section 517.211. Nevertheless, even states that do impose liability on broker-dealers provide for a due diligence defense. *See*, *e.g.*, Cal. Corp. Code § 25504.

III. GEVERAN'S INTERPRETATION OF FSIPA MAY DISCOURAGE PARTICIPATION IN SECURITIES TRANSACTIONS IN FLORIDA

Securities laws and, in particular, civil liability against primary and secondary participants for securities fraud, play a key role in protecting both investors and the integrity of the financial markets. However, Geveran's interpretation of FSIPA goes beyond both of these goals. If FSIPA is transformed into a strict liability statute without any limitations on liability, as suggested by Geveran, it could hamper the ability of financial advisors, lenders, and underwriters to engage in securities transactions in Florida relative to other states. Indeed, even acting diligently to ensure that documents prepared in connection with an issuance of securities are accurate may be insufficient to avoid liability. These transaction costs further may be imposed even where the secondary participant's responsibilities, as set forth in the relevant transactional agreements, explicitly do not include investigating and verifying the accuracy of financial statements provided by the seller.

The illogical nature of Geveran's interpretation of FSIPA is even more pronounced given that a purchaser's knowledge of the misrepresentation or omission would not be an affirmative defense available to *any* defendant. FSIPA was enacted to protect the public from fraudulent practices in the securities market, and not as a form of statutory insurance available to investors against a deal that does not perform as anticipated. Geveran's broad interpretation of FSIPA should

not be countenanced, and the Court should take guidance from the statutory framework of blue sky laws across the nation, as well as simple logic and common sense, to impose reasonable safeguards against liability under FSIPA. Otherwise, the availability of potentially less risky alternatives in *nearly every other state* could leave the Florida financial industry at a competitive disadvantage.

CONCLUSION

For all of the foregoing reasons, SIFMA respectfully requests that the Court grant J.P. Morgan's request for the Court to reverse the trial court's order granting Geveran's motion for partial summary judgment and remand with instructions to dismiss the FSIPA claims asserted against the individually named defendants.

Dated: September 12, 2016 Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that, on September 12, 2016, a true and correct copy of the foregoing was e-filed with this Court and sent via email transmission to all counsel in the below service list:

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I hereby certify that this brief was prepared in Times New Roman, 14-point font, in compliance with Rule 9.210(a)(2) of the Florida Rules of Appellate Procedure.

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