No. 02-658

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

NUVEEN PREMIUM INCOME MUNICIPAL FUND 4, INC.
and STRONG MUNICIPAL BOND FUND,
Plaintiffs-Appellees

v.

MORGAN KEEGAN & COMPANY, INC.,
Defendant-Appellant

On Appeal From The United States District Court
For the Western District of Oklahoma
Civil Action No. 00-935-W
Honorable Joe Heaton

BRIEF OF THE BOND MARKET ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-APPELLANT AND IN SUPPORT OF REVERSAL

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DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, The Bond Market Association certifies that it is a non-profit trade association. It has no parent corporation, and no publicly held corporation owns 10 percent or more of its stock.

STATEMENT OF INTEREST

The Bond Market Association ("TBMA") respectfully submits this brief as *amicus curiae* in support of Appellant-Defendant Morgan Keegan & Company, Inc.[1] TBMA represents securities firms and banks that underwrite, trade, and sell fixed-income securities in the U.S. and international markets. TBMA's members deal in a wide variety of public and private fixed-income securities. TBMA's member firms collectively represent in excess of 95 percent of the initial distribution and secondary market trading of municipal bonds, corporate bonds, mortgage and other asset-backed securities, and other fixed-income securities. Among other activities, TBMA provides a market perspective to courts and policymakers on securities legislation, regulation, and litigation and undertakes numerous industry initiatives to improve industry practices and market efficiency.[2]

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[1] TBMA is simultaneously filing a motion for leave to file this *amicus* brief.

[2] TBMA has filed *amicus* briefs in other cases concerning regulation of the country's bond markets, including *Harris Trust and Savings Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238 (2000), *Dunn v. CFTC*, 519 U.S. 465 (1997), *De Kwiatkowski v. Bear, Sterns and Co., Inc.*, 306 F.3d 1293 (2d Cir. 2002), and the

TBMA has a particular interest in maintaining the clarity and predictability of legal and regulatory obligations faced by its members and affecting the efficient operation of the bond market. TBMA believes that the district court's decision in this case – which applied Oklahoma law modeled on the Uniform Securities Act to securities sales taking place outside that state – has the potential to unsettle longstanding industry understandings about when a particular state's securities laws apply to a sale of securities. The district court adopted an amorphous, multi-factor test that is without legal basis and inherently increases legal uncertainty to a degree that threatens to harm bond market participants – both TBMA members and investors.

TBMA seeks to address a single issue that has potentially broad implications for the predictable and efficient operation of the debt (and equity) capital markets: the circumstances that make a state law modeled on the Uniform Securities Act apply to an offer to sell securities. The Uniform Securities Act ("Uniform Act"), which Oklahoma adopted, was designed to provide uniformity and predictability for market participants. According to Professor Loss, drafter of the Uniform Act, the statute's goal was to make "certain that nobody who is acting in good faith and is properly advised will be entrapped by having a law apply other than the law or laws he has satisfied." Louis Loss, *The Conflict of Laws and the Blue Sky Laws*, 71 Harv. L. Rev. 209, 251 (1957). In this case, a straightforward

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Orange County bankruptcy litigation (CV-95-0037 CD Cal.). More information about TBMA may be found on its website: http://www.bondmarkets.com.

reading of the Oklahoma Securities Act, Okla. Stat. Ann. tit. 71, § 1 et seq. ("Act" or "Oklahoma Act") provides the needed certainty. The Act applies when an "offer to sell" is "made in" Oklahoma or "directed" to the state. What matters is the location of the transaction at issue, not whether a party to that transaction had some connection to Oklahoma. Here, it appears undisputed that the relevant sales offers were made from Morgan Keegan's offices in Tennessee to buyers in Illinois and Wisconsin. Accordingly, those states' laws, not Oklahoma's, should apply to the transaction.

BACKGROUND

The facts set out in the record that are relevant to the issue TBMA wishes to address are relatively simple. In 1998, the Oklahoma County Finance Authority planned to issue revenue bonds in order to raise approximately $40 million for the renovation of low-income housing complexes. *See* Aplt. App. at 1294. T. Kenny & Company, Inc. entered into a contract with the Authority to serve as the underwriter for the bond issue. *See id.* at 3597.

Morgan Keegan is a regional broker-dealer based in Tennessee. *See id.* at 1294. It became interested in purchasing some of the bonds from T. Kenny and dispatched a securities analyst named Neill Conkling to Oklahoma for a day-long trip to see the housing projects and evaluate the bond issue. *See id.* at 3065, 3082. Conkling returned to Tennessee and prepared a research report on the bonds. *See id.* at 1578. Morgan Keegan also received a copy of the Preliminary

Official Statement and additional due diligence material from T. Kenny. *See id.* at 1870, 3357.

Based on review of this information, Morgan Keegan placed an advance order with T. Kenny for $25 million of the bonds. *See id.* at 2769. When the bonds were issued, Morgan Keegan completed its purchase of bonds from T. Kenny and assumed full market and counterparty risk in the position it held. *See id.* Morgan Keegan then began selling a portion of these bonds in the secondary market from its offices in Tennessee. Among its sales were two to sophisticated institutional investors: a $10 million sale to plaintiff Nuveen in Illinois and a $5 million sale to plaintiff Strong in Wisconsin. *See id.* at 1294-95.

Nuveen and Strong received copies of Conkling's research report before purchasing the bonds. *See id.* at 1295. They later claimed that the report included material misstatements of fact and subsequently filed suit against Morgan Keegan, asserting a number of claims, including some for violations of the Oklahoma Act.

Before trial, Morgan Keegan sought to dismiss the Oklahoma Securities Act claims against it, pointing out that the Act applied only to "sales" or "offers to sell" "made in" Oklahoma, Act § 413, and that the relevant "sales" and "offers" in this case had been made in Tennessee. The district court denied the motion. *See Nuveen Premium Income Municipal Fund 4, Inc. v. Morgan Keegan & Co., Inc.*, 200 F. Supp. 2d 1313 (2002). In its view, the relevant inquiry was whether there existed "[s]ome nexus between the 'sale' . . . and the state." *Id.* at 1318. The court then concluded that plaintiffs had sufficiently alleged such a "nexus." *Id.* In particular, the court pointed to three specific allegations: (i) that Conkling had been involved in the drafting of "some or all of the offering documents"; (ii) that he had made a research trip to Oklahoma; and (iii) "the timing and circumstances of the offer." *Id.* Additionally, the court stated that "other factors," which it did not name, had entered into its conclusion. *Id.*

At the close of evidence, Morgan Keegan moved for judgment as a matter of law on the Oklahoma Securities Act claim. Finding the motion to present a "close legal questio[n]" because the facts of the case "presen[t] circumstances that may well be at the outer limits of the scope of the Oklahoma act," the court denied the motion. *See* Aplt. App. at 3940.

The court then yielded to the jury the question of the Act's applicability to Morgan Keegan's bond sales. *See id.* at 1297. Specifically, the court instructed: "If you find that Morgan Keegan's offer to sell these bonds 'originated in Oklahoma,' either due to Morgan Keegan's relationship to Oklahoma as a seller or by reasons of finding that it is an 'underwriter,' then you must proceed to consider whether plaintiffs have established the other elements necessary to recover from it for a violation of the Oklahoma Securities Act." *See id.* at 1300. The jury was not asked on the verdict form to state whether it found the Oklahoma Act applicable because it deemed Morgan Keegan an "underwriter" or whether it instead relied on the firm's "relationship to Oklahoma." *See id.* at

1322. Instead, it was simply asked to state whether Morgan Keegan was liable under the Act, a question it answered in the affirmative. *See id.*

SUMMARY OF ARGUMENT

The district court's extraordinary rule contradicts the plain meaning and purpose of the Oklahoma Act and the Uniform Securities Act on which it is based, while also threatening to introduce potentially significant legal uncertainty into the capital-raising process – exactly the opposite of the intent of the Act's drafters. A transaction-specific rule that focuses on where the seller makes or originates a specific offer, in contrast, is the best and most natural reading of the Act's text and fulfills its purpose of ensuring certainty surrounding the sales of securities.

This case is first and foremost about statutory construction. The principal issue is not whether Morgan Keegan had sufficient contacts with Oklahoma such that the state could have chosen to regulate the out-of-state bond sales. The issue is instead whether Oklahoma *did* choose to regulate them. The answer to that question is clearly no. In essence, the Oklahoma Securities Act applies when the buyer or seller (or seller's agent) in a particular transaction is present in the state when the transaction is negotiated or completed. The Act's language and purpose establish a simple geographic test to determine its applicability to particular offers to sell securities, and that test was not satisfied in this case. The seller made an offer to sell from Tennessee. Neither its pretransaction due diligence in Oklahoma, nor its indirect contacts with the state pursuant to its *purchase* of the securities from the underwriter is relevant to where its offer to sell originated or was made. *See infra*, Section I.

Even if there were any doubt on this question, however, it should be resolved against extra-territorial application of Oklahoma's statute. Such an attempt by the state to extend its jurisdiction to transactions with only attenuated connections to its territory and residents would press hard against the limits of both the dormant Commerce and Due Process Clauses of the Constitution. Because the Court can avoid the constitutional inquiry by adopting a reasonably available interpretation of the statute, indeed the best and most natural interpretation, it must do so. *See infra*, Section II.

Confirming that the Oklahoma Act and its Uniform Securities Act counterpart focus on where a discrete offer to sell securities is made or originates also fulfills the Act's primary purpose of providing certainty and predictability to capital markets transactions. The drafters of the Act sought to ensure that sellers know with certainty the scope of their obligations and potential liability, including registration obligations, which a transaction-based interpretation of the Act provides. The district court's rule, in contrast, creates a high degree of uncertainty whenever a seller of securities undertakes due diligence in a place different from where it makes or directs an offer of sale or may be brought within the "other factors" left undefined by the district court. By infusing the securities sales process with uncertainty and creating a disincentive for the production of market-protecting due diligence information, the district court's rule would have potentially significant and unfortunate consequences for maintaining a robust, efficient, and effective market for capital. *See infra*, Section III.

ARGUMENT

I. The Oklahoma Securities Act Does Not Apply to Transactions Where, as Here, the Buyer and Seller Are Outside the State.

A. The Act Covers Only Offers to Sell "Made in" Oklahoma.

"As in all cases involving statutory construction," the "starting point" for determining the Oklahoma Act's applicability "must be the language employed" by the legislature, for courts "assume that the legislative purpose is expressed by the ordinary meaning of the words used." *United States ex rel. Holmes v. Consumer Insur. Group*, 318 F.3d 1199, 1208 (10th Cir. 2003) (quoting *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982)). "Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Id.* (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

Section 413 of the Oklahoma Securities Act,[3] which governs the "[s]cope of the act," states that it applies to "persons who sell or offer to sell when: (1) *an offer to sell is made in this state*; or (2) an offer to buy is made and accepted in this state." (emphasis added). Subsection (c) of this provision provides that

[3] Section 413 of the Oklahoma Act is closely modeled on the corresponding provision of the Uniform Securities Act. *See* Unif. Securities Act § 414 (amended 1958), 7C U.L.A. 316 (2000).

"[f]or the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer: (1) originates from this state; or (2) 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)." The Act further defines "offer to sell" as an "attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value." Act, § 2(t)(2).

For purposes of Section 413, what matters under the Act is clearly the location of buyer and seller when they communicate with each other regarding an offer to sell, not the provenance of the securities, the location of the issuer, or the actions of other market participants. When a particular "offer to sell . . . is made" in Oklahoma in this geographic sense, the seller may be liable for misstatements it makes to effect *that* sale. *See id.* § 413(a) (cross-referencing § 408 (civil liability provision)).[4] Courts have uniformly rejected plaintiffs' attempts to invoke a state's Blue Sky law simply because the securities are those of an entity located in, or incorporated in, that state. *See, e.g.*, *Singer v. Magnavox Co.*, 380 A. 2d 969, 981 (Del. 1977), *overruled on other grounds by Weinberger v. UOP, Inc.*, 457 A. 2d 701 (Del. 1983); *Allen v. Oakbrook Secs. Corp.*, 763 So. 2d 1099, 1101 (Fla. App. 1999) (per curiam). A Tennessee broker's offer to sell the securities of an

[4] The prospect of civil liability is not the only consequence that flows from a determination that a particular sales transaction took place in Oklahoma. The finding also triggers other aspects of the state's securities regulatory regime. For example, broker-dealers conducting such transactions must register with the Oklahoma Securities Commission, *see* Act § 413(a) (citing *id.* § 201(a)), and the securities sold must be registered with the State, *see id.* § 413(a) (citing *id.* § 301).

Oklahoma-based issuer is not an offer "made" in Oklahoma any more than a Colorado grocery store's offer to sell a Hershey bar is "made" in Pennsylvania.

Section 413 includes a carefully tailored supplement to its definitional provisions that both reinforces the authority of the seller's state to regulate the seller's transaction and addresses a specific factual scenario quite different from that presented by this case. Section 413(c) states: "For the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer . . . originates from this state." An offer "originates from" Oklahoma if it is transmitted from there, *i.e.* when the offeror makes its "attempt or offer to dispose of, or solicitation of an offer to buy," Act § 2(t)(2), from the state. The phrase, "whether or not either party is then present in this state," does not change this commonsense reading but instead makes clear that an offer "originates from" Oklahoma even if the party transmitting it from the state is merely an agent.[5] This interpretation is confirmed by the leading commentator on the Blue Sky laws, who writes that this provision was intended to prevent an agent from escaping state jurisdiction by claiming that his principal was not

[5] This interpretation is reinforced by other uses of "originates" in the 1985 version of the Uniform Act. Section 801(h) of the Uniform Act states that "a radio or television program or other electronic transmission is considered as having *originated* in this State if either the broadcast studio or the originating source of transmission is located in this State." 7C U.L.A. 96 (amended 1988) (emphasis added). The emphasis is on physical transmission of the signal, not, for example, the production history of the programming. In the same way, the emphasis in Section 413 of the Oklahoma Act is on the physical transmission of the offer, not activities preceding it.

"present in this state," *see* 12 Joseph C. Long, *Blue Sky Law* § 4:36 (2002), not to expand the concept of where an offer is made.

The commentary for the Uniform Securities Act provision corresponding to Section 413 of the Oklahoma Act confirms this reading. The commentary states that:

> an offer which originates in State S and is directed to State B is made in both states. Hence, the statute of State B applies under § 414(c)(2) in the hypothetical case. . . . By the same token, the statute of State S also applies to the offer under § 414(c)(1), on the theory that State S should not be used as a base of operations for defrauding persons in other states.

Unif. Securities Act § 414 comment. (amended 1958), 7C U.L.A. 316 (2000). As this explanation demonstrates, the drafters' use of the word "originates" was simply meant to render unassailable the authority of the seller's state to regulate the seller's activities, whether the seller was acting on behalf of itself as principal or on behalf of someone else as an agent.

B. The Purposes Underlying the Securities Act and Its "Scope" Provision Confirm Their Inapplicability to Out-Of-State Transactions.

According to its principal drafter, the Uniform Securities Act's choice of law provision was intended to be "as explicit as possible" so that it could "be made certain that nobody who is acting in good faith and is properly advised will be entrapped by having a law apply other than the law or laws he has satisfied." Louis Loss, *The Conflict of Laws and the Blue Sky Laws*, 71 Harv. L. Rev. 209, 251 (1957). That goal is well-served by a simple rule making applicable the laws of the states where buyer and seller are when they complete a sale. The goal of predictability is completely subverted, however, by the district court's multi-factor approach, which makes it very difficult to predict with any confidence what law will apply to any given transaction. *See infra*, Section III.

The simple rule permitting the state laws of both buyer and seller (but no other) to govern a securities transaction is also consistent with the state interests the Uniform Act's choice of law provision was meant to advance. First, and most obviously, a state has an interest in protecting its citizens from becoming the victims of securities fraud. Accordingly, the Oklahoma Act, like the other statutes modeled on the Uniform Act, is triggered any time "an offer to sell . . . is directed by the offeror to this state." Act § 413(c). Oklahoma's citizens are therefore protected from misleading offers to sell, whether they come from Tulsa or Tucson. *See, e.g.*, Long, § 4:2 n. 1 (collecting cases). The drafters recognized that a state has a second interest in regulating securities transactions: the need to prevent its territory from becoming a "base of operations" for fraudulent securities sales and thus sullying the reputation of its legitimate businesses. Unif. Securities Act § 414 comment; *see also Newsome v. Diamond Oil Producers, Inc.*, [1982-1984 Decisions] Blue Sky L. Rep. (CCH) ¶ 71,869 (Okla. Dist. Ct. 1983) ("the public interest in preventing this state from becoming a 'springboard' for unscrupulous securities promoters deserves strong consideration"); Long, § 4:25 (discussing poor reputation that Oklahoma developed in the early 1970s as situs for "boiler room" sales of suspect oil and gas leases). Accordingly, the Oklahoma Act regulates "offers to sell" "made in" Oklahoma, whether the buyer is in the state or not.

Neither state interest recognized by the Act is served by the district court's rule. The out-of-state buyer does not need Oklahoma's protection: its own state's Blue Sky law will provide it a cause of action if it is defrauded. Likewise, Oklahoma does not need to police the out-of-state seller's misstatements; the Blue Sky laws of the seller's state will ensure that it does not become a "base of operations" for fraud.

C. Morgan Keegan's Sales From Tennessee to Plaintiffs in Illinois and Wisconsin Are Not Covered by the Act.

Applying these principles to this case, it becomes evident that the relevant "offers to sell" in this case were not "made in" Oklahoma. They were made in Tennessee, Wisconsin, and Illinois. Morgan Keegan bought the securities of an Oklahoma issuer from its underwriter in Denver. Morgan Keegan then sold the securities from its offices in Tennessee to buyers in Wisconsin and Illinois. Oklahoma was not used as a base of operations for these transactions or as a platform from which Morgan Keegan made its alleged misstatements.

This analysis is unaltered by the fact that Conkling traveled to Oklahoma to research the bond issue before Morgan Keegan placed its order. The trip was irrelevant to the location of Morgan Keegan's later "offer to sell" to plaintiffs. Plaintiffs do not allege, for example, that Conkling telephoned them from Oklahoma to solicit their purchase. The fact that information gathered on this trip went into Conkling's research report has nothing to do with the location of the buyer or seller when the offer to sell securities was made to Nuveen and Strong.

The Act's language and purpose also attaches no relevance to the timing of the transaction – another factor cited by the district court. As is made clear by the Act's terms, the inquiry here is geographic, not temporal. Whether Morgan Keegan held the bonds for five minutes or five years, Oklahoma law would not apply to the sales it made from its offices in Tennessee. Similarly, Morgan Keegan's purchase of the bonds soon after T. Kenny acquired them does not establish in any regard that Oklahoma was the site of the subsequent and independent offer to sell made to Nuveen and Strong.

Finally, the Act also provides no basis for the district court's instructions that allowed the jury to apply the Act if it found Morgan Keegan to be an "underwriter."[6] The Act's text provides no basis to conclude that it applies to underwriters any more than to other sellers of securities. Whether the Act applies to any seller depends on where that seller makes an "offer to sell." Indeed, the Act in other sections does impose certain additional or different obligations on parties as an "underwriter." *See, e.g.*, Act § 304.1(b)(4); *id.* § 306. In contrast, Section 413 makes no such reference to "underwriter," which confirms the irrelevance of the underwriter status for purposes of applying that section. *See Rodriguez v.*

[6] TBMA takes no position on whether Morgan Keegan is properly considered an "underwriter" under the Oklahoma Act because it views the question as irrelevant to the Act's applicability to the transactions at issue here.

United States, 480 U.S. 522, 525 (1987) (per curiam) (where a legislature "includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that [it] acts intentionally and purposely in the disparate inclusion or exclusion." (internal quotations omitted)); *Joseph v. Wiles*, 223 F.3d 1155, 1161 (10th Cir. 2000).[7]

II. The Doctrine of Constitutional Doubt Compels the Conclusion That the Oklahoma Act Does Not Apply to Morgan Keegan's Out-of-State Sales.

As shown above, the Oklahoma Securities Act by its terms excludes plaintiffs' claims. Even if there were any doubt on the question, however, this Court should resolve it against the extra-territorial application of the statute sought by plaintiffs because adopting plaintiffs' reading would raise substantial constitutional questions under both the dormant Commerce Clause and the Due Process Clause. *See Erznoznik v. City of Jacksonville*, 422 U.S. 205, 216 (1975) (court can and should avoid deciding a constitutional question if the statute is

[7] Finally, nothing regarding the preparation or distribution of the Official Statement ("OS") tied Morgan Keegan's offer to Oklahoma. Mandatory distribution of the OS pursuant to Municipal Securities Rulemaking Board Rule G-32 does not constitute an offer to sell originating in the place where the OS was prepared. Indeed, many parties must distribute the OS to purchasers, *see id.*, and the OS is in any event often distributed, as evidently occurred here, well after the "offer to sell" is accepted by the purchaser. In addition, no evidence suggests that Morgan Keegan distributed the OS from Oklahoma even if the official statement were deemed part of the "offer" for purposes of the Oklahoma Act. Liability in Oklahoma could not in any event be based only on involvement in drafting the OS. *See* Long, § 4:2 n. 16. *Compare Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1433, 1460-61 (S.D. Cal. 1988) (California Blue Sky law inapplicable to sales made out-of-state notwithstanding defendants' involvement in preparing offering documents for California issuer) *with Rosenthal v. Dean Witter Reynolds, Inc.*, 908 P.2d 1095, 1104-05 & n. 14 (Co. 1995) (Colorado Blue Sky law applicable to out-of-state seller that engaged in "conspiracy" with Colorado issuer to issue fraudulent Official Statement from the state).

"readily subject to a narrowing construction"); *Frisby v. Schultz*, 487 U.S. 474, 483 (1988) (citing "well-established principle that statutes will be interpreted to avoid constitutional difficulties"); *Phelps v. Hamilton*, 59 F.3d 1058, 1070 (10th Cir. 1995). Because a reasonable interpretation – in fact, a superior one – that avoids those constitutional questions is available, the Court should adopt it.

A. Dormant Commerce Clause

The dormant Commerce Clause prohibits states from regulating "commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989) (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-643 (1982) (plurality opinion)). Put another way, "[t]he critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Id.* Oklahoma therefore cannot police securities transactions taking place between residents of Tennessee, Wisconsin, and Illinois.

In fact, the Supreme Court expressly premised its rejection of a dormant Commerce Clause challenge to Ohio's Blue Sky law on that statute's disclaimer of any aspiration to regulate transactions taking place elsewhere. Because the Act's requirements "apply to dispositions of securities *within* the state," the Court said, they were a proper exercise of Ohio's police power over conduct within its borders. *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 557 (1917) (emphasis in original). As a plurality of the Court later put it, the "rationale for upholding blue-sky laws was that they only regulated transactions occurring within the regulating States." *Edgar*, 457 U.S. at 641.

If a state's Blue Sky law did not provide such a limitation, the dormant Commerce Clause would. The Arizona Court of Appeals reached this conclusion in *Arizona Corp. Comm'n v. Media Prods., Inc.*, which held that Arizona could not constitutionally regulate an initial public offering conducted by an out-of-state underwriter and directed toward out-of-state buyers. *See* 763 P.2d 527, 531 (1988). That was so even though the stock sold was that of an Arizona-based company, "the terms of the sale were formed" in the state; the underwriter and issuer had a "best efforts," rather than a "firm" underwriting contract; and the stock certificates were issued in Arizona in the names of the buyers solicited by the underwriter. *See id.* at 528, 529-30; *see also id.* at 534 (Corcoran, J., dissenting). Despite these connections between the sales and Arizona, the court concluded that their regulation by the state would constitute "an improper interference with interstate commerce." *Id.* at 531.[8] Here too, the Oklahoma connections to the relevant transactions are too attenuated to permit Oklahoma regulation of them.[9]

Even were Oklahoma regulation of out-of-state securities transactions found to have only an "indirect" effect on interstate commerce, the lack of state

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[8] Professor Long concludes that the Arizona court's constitutional analysis was "correct," but could have been avoided by employing the doctrine of constitutional doubt to construe the Arizona statute as inapplicable to the transactions. Long, § 4:2.

[9] Neill Conkling's visit to Oklahoma for purposes of research is an even more attenuated connection than the activities found insufficient to justify state jurisdiction in *Arizona Corp. Comm'n.*

interest in regulating those transactions, *see supra* p. 13, and the resulting harm to capital markets, *see infra* Part III, would cause the Act to run afoul of the Commerce Clause. *See Healy*, 491 U.S. at 337 n.14; *Mesa Petroleum Co. v. Cities Serv. Co.*, 715 F.2d 1425, 1429 (10th Cir. 1983); *Arizona Corp. Comm'n*, 763 P.2d at 533.

B. Due Process Clause

For similar reasons related to appropriate statutory interpretation, the Due Process Clause would disfavor a rule that allowed Oklahoma to regulate a securities transaction taking place among out-of-state parties based only on the insignificant Oklahoma contacts to the transaction asserted by plaintiffs. The Supreme Court has emphasized "the due process principle that a state is without power to exercise 'extraterritorial jurisdiction,' that is, to regulate and control activities wholly beyond its boundaries." *Watson v. Employers Liability Assurance Corp.*, 348 U.S. 66 (1954); *see also Allstate Insur. Co. v. Hague*, 449 U.S. 302, 310-11 (1981) (plurality opinion) ("[I]f a State has only an insignificant contact with the parties and the occurrence or transaction, application of its law is unconstitutional.").

In *Home Insurance Co. v. Dick*, for example, the Court concluded that a Texas court could not apply Texas law to an insurance coverage dispute that arose outside the state. 281 U.S. 397 (1930). Because "[a]ll in relation to the making of the contracts of reinsurance were done [in Mexico] or in New York . . .[,] Texas was . . . without power to affect the terms of contracts so made." *Id.* at

408. Likewise, the Eleventh Circuit recently invalidated a Florida statute requiring insurers to disclose information about transactions that took place outside the state. *See Gerling Global Reinsurance Corp. of Amer. v. Gallagher*, 267 F.3d 1228 (11th Cir. 2001). The court concluded that the reporting requirements violated Due Process because "as a practical matter . . . [they] seek to regulate . . . a subject matter . . . with no jurisdictionally-significant relationship to Florida." *Id.* at 1238.

In sum, the substantial constitutional questions presented by the dormant Commerce and Due Process Clauses can and should be avoided by construing the Oklahoma Act in accord with its terms as inapplicable to these out-of-state transactions.

III. The District Court's Rule Threatens the Certainty Necessary to an Efficient Capital Market.

Another reason to adopt a clear, transaction-based rule rather than the District Court's open-ended standard is that the District Court's reasoning would, if upheld, threaten to materially undermine the certainty that is essential to the efficient operation of the capital markets and particularly the secondary bond market. The implications of the district court's rule are potentially very broad because the court interpreted a statute that closely follows the Uniform Securities Act, and thus created a published precedent that may apply to a wide range of obligations over many participants in equity and debt securities transactions.

Laws should establish a clear, predictable framework that enables parties to understand their legal obligations and liabilities and to conform their actions accordingly. Just as it is desirable to have "'a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some assurance as to *where* that conduct will and will not render them liable to suit,'" *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 471-72 (1985) (quoting *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980) (emphasis added)), so too is it important to have a clear test to allow potential defendants to know what law governs liability for their primary conduct. A test that makes liability depend upon the specific actions within a party's control provides "clear notice" of the standard it must meet, "and [the party] can act to alleviate the risk of burdensome litigation by procuring insurance, passing the expected costs on to customers, or, if the risks are too great, severing its connections with the State." *World-Wide Volkswagen Corp.*, 444 U.S. at 297.

Clear legal rules are particularly important for capital markets, which "demand[] certainty and predictability." *Central Bank v. First Interstate Bank*, 511 U.S. 164, 188 (1994) (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). Raising capital depends on parties' ability to assess and assume risk. Where risk increases, capital will become more expensive or cannot be raised at all. When market participants are subjected to increased risk, as for secondary market participants under the district court's rule, they will pay less or charge more for the risks they take in purchasing and selling securities – to the extent that they do not decline to participate in particular transactions altogether. Capital becomes more expensive, harming issuers and, ultimately, consumers and investors, as well as parties subjected to increased uncertainty and liability. With these considerations in mind, the drafters of the Uniform Securities Act sought to craft a rule regarding the law applicable to offers to sell securities that was “as explicit as possible” so that it could “be made certain that nobody who is acting in good faith and is properly advised will be entrapped by having a law apply other than the law or laws he has satisfied.” Louis Loss, *The Conflict of Laws and the Blue Sky Laws*, 71 Harv. L. Rev. 209, 251 (1957); *see also* 12 Joseph C. Long, *Blue Sky Law* § 4:1 (2002) (goal of Uniform Act was to “bring some order to the chaos” in pre-Act choice of law decisions).

The district court’s interpretation of the Act threatens to create considerably greater uncertainty regarding the sources and extent of liability than would a straightforward application of the Uniform Securities Act and its Oklahoma counterpart. Under the language and structure of those Acts, the relevant states’ law is determined by where the particular, specific offer to sell a security is made or originates. *See supra* Section I. Any seller of a security controls the origin and destination of its offers to purchasers and thus can know with a high degree of certainty which laws apply to a particular transaction. *See Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226-27 (10th Cir. 1996) (“In addition to being consistent with the language of the statute, this rule . . . provides more guidance . . . .”).

Under the district court’s novel approach, however, it is impossible for the seller to determine with certainty which law applies. Liability potentially arises from the travels and investigations of its employees, the actions of the underwriter if the vendor has obtained the securities near the issue date, or "other factors" that will only be determined retrospectively in an unknown forum to be chosen by a potential plaintiff.

The degree of uncertainty created by the district court's interpretation is potentially far broader than the facts of this case immediately suggest. First, the Act applies broadly to all initial equity and debt offerings, not just municipal bond offerings. *See* Oklahoma Act § 413 (Act applies to all "offers to sell" securities); *id.* § 2(t)(2); *id.* § 2(v). Second, the Oklahoma statutory provisions at issue are derived directly from the Uniform Securities Act, which has been implemented in relevant part in 39 states, plus the District of Columbia and Puerto Rico. *See* 7C U.L.A. 1, 7 (Supp. 2002) (collecting statutes). Affirming the decision below could lead to adoption of equally vague standards under those laws as well.

The district court's legal rule also creates considerable uncertainty by conflating different sellers' actions and different offers. The district court appears to attribute to Morgan Keegan the activities of the issuer and, apparently, T. Kenny. *See Nuveen Premium Income Municipal Fund 4, Inc. v. Morgan Keegan & Co., Inc.*, 200 F. Supp. 2d 1313, 1318 (2002). It did so notwithstanding that when Morgan Keegan purchased $25 million worth of the bonds from T. Kenny, it bore the full risk of owning them pending any resale. Morgan Keegan then separately resold the bonds to Nuveen and Strong through independent offers that originated in Tennessee. No evidence established that Morgan Keegan acted at the direction of, or had any contractual relationship with, the issuer, or that it was acting as an agent for T. Kenny; and the district court did not rely on these grounds. Yet if, as here, a seller of securities can be subject to a state's law based on offers made or activities undertaken by other parties, including actions related to other offers, that seller has no basis for determining what law will apply to its own actions and offers to sell securities.

The district court's interpretation of the Act has especially negative implications for the management of risk by participants in the capital markets because it blurs the distinction between sellers in privity with issuers and other, secondary market participants. This distinction, which has legal importance in a variety of contexts, follows industry practices and is essential to allowing parties to assess and manage risks associated with raising capital. An agreement with an issuer (either an equity underwriting agreement or a bond purchase agreement) both defines obligations related to the purchase of securities from the issuer and permits the financial intermediary to manage those and other risks, including risks arising from subsequent sales. Those risks are typically managed through provisions addressing when the purchaser will assume market risk and, in some cases, through indemnities provided by the issuer, as well as through the due diligence process undertaken to reduce the risks associated with its production of an offering document. *See, e.g.*, Charles J. Johnson, Jr. and Joseph McLaughlin, *Corporate Finance and the Securities Laws* 78-102 (2d ed. 1997). Morgan Keegan in this case did not have any contract with the issuer, much less an underwriting agreement that defined its obligations and indemnified the firm. Rather, Morgan Keegan had an agreement only with the underwriter, T. Kenny, which was limited to an obligation to purchase the bonds when and if issued. Market participants that cannot manage risk effectively will either exit the market or pass on additional costs to other parties, reducing the market's overall efficiency.

Other implications of the district court's expansive definitions of the underwriter's role and the scope of an offer to sell may be equally harmful to the efficient operation of the nation's bond markets. The district court emphasized the timing of Morgan Keegan's purchase of securities from T. Kenny and offers to Nuveen and Strong, which followed soon after the issue of securities. But this practice is the industry norm for initial sales of equity or debt securities from an underwriter to participants in the secondary market. *See* Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 70 (4th ed. 2001) (dealers typically enlisted by underwriter in advance of issuance "to ensure a rapid sale of the offering"). Many of those purchasers that support the offer by placing orders, such as Morgan Keegan, do so with the intention of reselling those securities, often as soon as possible for all or some of the purchased securities. *See id.* (quick sales necessary to prevent issue from becoming "sticky"). This initial support is vital to raising capital, and a rule that imposes liability based on early resales provides an unusually heavy disincentive to the purchases in an offering that are necessary to capital raisings. The disincentive created by the district court's rule would also undermine underwriters' efforts to make the initial distribution as fair, transparent, and orderly as possible.

An especially unfortunate implication of the district court's interpretation of the Act is that it imposes liability based on market-protecting activities such as undertaking additional due diligence. Here, the district court found the Oklahoma statute to apply in large measure because Morgan Keegan's research analyst visited the project's premises to gather information to support research regarding the securities. Had the analyst simply relied on the Official Statement or issued no report, Oklahoma law would very likely not have been found to apply. The district court's rule creates a marked disincentive for secondary market participants who would otherwise produce valuable analysis that clearly benefits the capital markets. *See* 15 David A. Lipton, *Broker-Dealer Regulation* § 3:17 (2002) (research reports "help to insure an informed investing public and thereby enhance the efficiency of the securities markets").

In sum, the uncertainty inherent in the district court's rule threatens to increase the risks and costs imposed on market intermediaries as they assist issuers to raise capital and investors to purchase securities. This result, in turn, threatens the liquidity, effectiveness and efficiency of capital markets and could result in increased costs being imposed on investors and issuers. In contrast, the transaction-based rule that provides the requisite certainty is also the one directly and clearly supported by the language and purpose of the Oklahoma Securities Act.

CONCLUSION

For these reasons, TBMA respectfully asks that the Court adopt a clear, transaction-based rule governing where an offer "is made" for purposes of the Oklahoma Securities Act. Pursuant to such a rule, the judgments of the district court under the Oklahoma Securities Act should be reversed and the plaintiffs' claims under that Act should be dismissed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

As required by Fed. R. App. P. 32(a)(7)(C), I certify that this brief is proportionally spaced and contains 6902 words.

I relied on my word processor to obtain the count and it is: Microsoft Word 97.

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Joseph R. Palmore