

1992

# Utah v. Ronald A. Harry : Brief of Appellant

Utah Court of Appeals

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Jan Graham; attorney general; David Sonnenreich; assistant attorney general; attorneys for appellee. Walter F. Bugden Jr.; Bugden & Lundgren; attorney for appellant.

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**BRIEF**

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DOCKET NO. 920633

**IN THE UTAH COURT OF APPEALS**

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STATE OF UTAH,	:	
Plaintiff/Appellee,	:	
v.	:	Case No. 920633-CA
RONALD A. HARRY,	:	Priority No. 2
Defendant/Appellant.	:	

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**BRIEF OF THE APPELLANT**

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An appeal from a Judgment and Conviction entered by the Third Judicial District Court for Salt Lake County, State of Utah, the Honorable Richard H. Moffat, presiding.

WALTER F. BUGDEN, JR., #480  
BUGDEN & LUNDGREN  
257 Tower, Suite 340  
257 East 200 South - 10  
Salt Lake City, Utah 84111  
Attorney for Defendant/Appellant

JAN GRAHAM  
Utah Attorney General  
DAVID SONNENREICH  
Assistant Attorney General  
236 State Capitol  
Salt Lake City, Utah 84114  
Attorneys for Plaintiff/Appellee

**FILED**

APR 2 1993

**COURT OF APPEALS**

IN THE UTAH COURT OF APPEALS

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WALTER F. BUGDEN, JR., #480  
BUGDEN & LUNDGREN  
257 Tower, Suite 340  
257 East 200 South - 10  
Salt Lake City, Utah 84111  
Attorney for Defendant/Appellant

JAN GRAHAM  
Utah Attorney General  
DAVID SONNENREICH  
Assistant Attorney General  
236 State Capitol  
Salt Lake City, Utah 84114  
Attorneys for Plaintiff/Appellee

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### JURISDICTIONAL STATEMENT

The Utah Court of Appeals has jurisdiction in this matter pursuant to U.C.A. § 78-2a-3(2)(f) and Rule 3, Utah Rules of Appellate Procedure.

### STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Did the trial court err by overruling the Defendant's objection and permitting the State's expert witnesses to express opinions as to what constitutes materiality in a securities fraud case?

Standard of Appellate Review: While decisions to admit evidence are reviewed for "abuse of discretion", "[w]hether a piece of evidence is admissible is a question of law, and we always review questions of law under a correctness standard . . . . [I]t is possible that we might refer casually to this standard as an 'abuse of discretion' standard. In fact, it is not." State v. Ramirez, 817 P.2d 774, 781-82 n.3 (Utah 1991). State v. Clayton, 646 P.2d 723, 726 (Utah 1982).

2. Did the trial court err by failing to instruct the jury that specific intent to defraud is an element of the offense of securities fraud under U.C.A. §§ 61-1-1(2) and (3) and 61-1-21?

Standard of Appellate Review: A trial court's interpretation of statutory law is reviewed for correctness. State v. James, 819 P.2d 781, 796 (Utah 1991). State v. Clayton, 646 P.2d 723, 726 (Utah 1982); Lamb v. Bangart, 525 P.2d 602, 607-608 (Utah

1974); State v. Thurman, 203 Utah Adv.Rep. 18, 25 (Utah 1/7/93); State v. Aly, 782 P.2d 549, 550 (Utah App. 1989).

3. Did the trial court err by failing to give an instruction to the jury that the good faith of the Defendant was a complete defense to a prosecution under U.C.A. §§ 61-1-1(1), (2) and (3) and 61-1-21?

Standard of Appellate Review: A trial court's interpretation of statutory law is reviewed for correctness. State v. James, 819 P.2d 781, 796 (Utah 1991). State v. Clayton, 646 P.2d 723, 726 (Utah 1982); Lamb v. Bangart, 525 P.2d 602, 607-608 (Utah 1974); State v. Thurman, 203 Utah Adv.Rep. 18, 25 (Utah 1/7/93); State v. Aly, 782 P.2d 549, 550 (Utah App. 1989).

4. Did the Defendant receive ineffective assistance of counsel at trial?

Standard of Appellate Review: Legal correctness. "But a correctness review necessarily incorporates a review of the trial court's resolution of factual questions and the associated determination of credibility that may underlie the decision to admit. This subsidiary determination will be overturned only if clearly erroneous. Utah R.Civ.P. 52(a); Bountiful v. Riley, 784 P.2d 1174, 1175 (Utah 1989); Grayson Roper v. Finlinson, 782 P.2d 467, 470-71 (Utah 1989)." State v. Ramirez, 817 P.2d 774, 781 n.3 (Utah 1991); Mountain Fuel Supply Company v. Salt Lake City Corp., 752 P.2d 884, 887 (Utah 1988); Scharf v. BMG Corp., 700 P.2d 1068,

1070 (Utah 1985); State v. Thurman, 203 Utah Adv.Rep. 18, 25 (Utah 1/7/93).

5. Did the trial court err by failing to dismiss Count IV of the Amended Information because the facts proven at trial did not constitute a public offense?

Standard of Appellate Review: Legal correctness. Mountain Fuel Supply Company v. Salt Lake City Corp., 752 P.2d 884, 887 (Utah 1988); Scharf v. BMG Corp., 700 P.2d 1068, 1070 (Utah 1985); State v. Ramirez, 817 P.2d 774, 781 n.3 (Utah 1991); State v. Thurman, 203 Utah Adv.Rep. 18, 25 (Utah 1/7/93); State v. Eldredge, 773 P.2d 29 (Utah 1989).

6. Did the trial court err by failing to dismiss Counts II and III because the facts proven at trial did not constitute a public offense?

Standard of Appellate Review: Legal correctness. Mountain Fuel Supply Company v. Salt Lake City Corp., 752 P.2d 884, 887 (Utah 1988); Scharf v. BMG Corp., 700 P.2d 1068, 1070 (Utah 1985); State v. Ramirez, 817 P.2d 774, 781 n.3 (Utah 1991); State v. Thurman, 203 Utah Adv.Rep. 18, 25 (Utah 1/7/93).

#### STATEMENT OF THE CASE

This appeal is from a Judgment and Conviction entered against the Defendant from his convictions on four counts of Securities Fraud, in violation of U.C.A. § 61-1-21. The Judgment and Conviction was entered by the Honorable Richard H. Moffat on September 25, 1992. Defendant filed a Motion for New Trial or in

the Alternative, Motion in Arrest of Judgment on or about January 28, 1992. By Minute Entry dated May 22, 1992, the Honorable Richard H. Moffat denied the Defendant's Motion for New Trial and Motion in Arrest of Judgment. The Notice of Appeal was filed on September 25, 1992.

#### STATEMENT OF FACTS

On January 11, 1988, the Defendant became affiliated with Private Ledger Financial Services, Inc. (hereinafter "Private Ledger") as a stockbroker (Tr. 716). The Defendant had been in the brokerage business since 1975 (Tr. 1124) and had passed several examinations required in the securities industry (Tr. 703). Private Ledger mailed the Defendant a procedures manual on April 29, 1988 (Tr. 715) and received the Defendant's acknowledgement he had read its contents on May 11, 1988 (Tr. 715). In 1988, the Defendant learned about a limited partnership in undeveloped real property in the Mesa and Phoenix, Arizona, areas. The limited partnership was known as Red River Mountain. The Defendant was offered an opportunity to sell limited partnership interests in the Red River Mountain Limited Partnership by the general partner, Ross Farnsworth (Tr. 1141-1145).

For over thirteen years, the Defendant had acted as the investment broker for three clients: Seymour Issacs, Frank Brgoch, and Viri Thornton (Tr. 33, 200, 291). For many years the Defendant had been given discretion by his clients to make investments on their behalf (Tr. 206, 299, 1151). In the Defendant's professional

judgment, Red River Mountain was the type of investment suitable for Messrs. Issacs, Brgoch and Thornton based on their investment expectations and their investment history with him.

On April 11, 1988, Seymour Issacs purchased six units of Red River Mountain for a total investment of \$30,600.00. On April 29, 1988, Viri Thornton purchased three units of Red River Mountain for a total investment of \$15,300.00. On April 11, 1988, Frank Brgoch purchased six units of Red River Mountain for a total investment of \$30,600.00. Each investor was issued a certificate on or about May 9, 1988, indicating their interest was fully paid and non-assessable. However, annual payments were called due by Red River Mountain in 1989 and thereafter.

The Defendant knew that Private Ledger had not performed any due diligence on the Red River Mountain Limited Partnership. However, the Defendant's manager at Private Ledger, Craig Cannon, advised the Defendant that he had notified Private Ledger and obtained clearance for the sale of the Red River Mountain Limited Partnership (Tr. 1081, 1109). Other stockbrokers were also advised by the manager that the sales of the limited partnership had been approved by Private Ledger (Tr. 1156).

The State alleged, *inter alia*, that when the Defendant sold the limited partnership interests to his clients, he willfully made an untrue statement of a material fact to Mr. Thornton (that he had purchased units in Red River Mountain for both himself and his father and that he was "selling away") (Tr. 641-642, 644);

willfully omitted to state a material fact to Brgoch and Issacs (that they might be liable for future payments and that he was "selling away") (Tr. 831, 923). Additionally, the State contended the sale of the limited partnerships constituted securities fraud against Private Ledger because he intended to defraud Private Ledger of its percentage of the commission generated by the sale of the units of Red River Mountain to Issacs, Brgoch and Thornton.

At the trial, the State was permitted, over objection, to present the "expert" testimony of Steven Neilson, the Assistant Director of the State of Utah Division of Securities, who opined that certain facts not disclosed to investors were material omissions (Tr. 895, 900). The Defendant was convicted by a jury of all four counts of Securities Fraud.

The Defendant moved the trial court for a new trial or for an arrest of judgment on all four counts. The Defendant's Motion for New Trial and for Arrest of Judgment were both denied. This appeal followed.

#### **SUMMARY OF ARGUMENT**

1. Expert testimony on materiality under the securities law is improper. The trial court incorrectly admitted the opinion testimony of a compliance officer of the Defendant's brokerage house and the Assistant Director of the Utah State Division of Securities that certain facts allegedly omitted by the Defendant in his discussion with three investors were "material". The Court of Appeals, in the case of State v. Larsen, 828 P.2d 487 (Utah App.

1992), held that the testimony was permissible because it went to "an ultimate issue of fact." In so ruling, the Court relied on vacated case authority and misconstrued Rule 704 Utah R.Evid. which abolished the "ultimate fact" rule. The Court of Appeals' decision conflicts with securities cases holding that expert testimony on materiality is inadmissible.

2. Intent to defraud is an element of a violation of U.C.A. §§ 61-1-1 and 61-1-21. The trial court erred by ruling that intent to defraud is not an element of securities fraud under U.C.A. §§ 61-1-1 and 61-1-21. The Court of Appeals reached the same decision in State v. Larsen, supra. This interpretation collides with the interpretation of the related federal provision, Federal Rule 10b-5 ("Rule 10b-5"), 17 C.F.R. § 240.10b-5, on which Utah's act was patterned and with which Utah's law was intended to harmonize. See U.C.A. § 61-1-27. A violation of Rule 10b-5 requires such intent.

3. Good faith is a defense to securities fraud. Consistently, good faith has been interpreted to be a defense under Rule 10b-5. Utah's legislature intended U.C.A. § 61-1-1 to have the same interpretation. The trial court disagreed. The Court in State v. Larsen, supra, also disagreed. The Larsen decision permits a strict-liability conviction with possible imprisonment, as in this case, without proof of either an intent to defraud and regardless of the Defendant's good faith belief in his conduct. 828 P.2d at 495-496.



4. The Defendant received ineffective assistance of counsel.

Defense counsel failed to deliver an opening statement in this complicated securities fraud case. Additionally, defense counsel failed to introduce essential exculpatory evidence bearing upon the suitability of the three investors for the Red River Mountain Limited Partnership. Although the investors each testified that they had advised the Defendant that they were not interested in either risky investments or investments requiring future payments, their investment records with this Defendant belied those assertions. In asserting this argument, the Defendant does not suggest that the mere suitability of the investors would preclude the Defendant from being guilty of securities fraud by failing to make a material disclosure. Rather, the Defendant asserts that the investment portfolio of the three investors was relevant because the nature of their investments contradicted their assertions that they had told the Defendant of their unwillingness to be involved in an investment like Red River Mountain Limited Partnership.

Additionally, defense counsel failed to object when the State introduced evidence through the compliance officer of the Defendant's brokerage house and an attorney from the Utah Securities Division who testified, *inter alia*, that the Defendant's failure to disclose the possibility of future payments, that he was "selling away," and that his conduct was unethical and violated NASD rules, were irrelevant and immaterial to the jury's determination of whether the Defendant had violated U.C.A. §§ 61-1-1 and 61-

1-21. Whether the Defendant's conduct violated internal policies of his brokerage house, or even that the Defendant would be held in low esteem by members of his profession, should have been excluded under Rule 403, Utah R.Evid.

Defense counsel's conduct fell below an objective standard of reasonableness. Additionally, because the trial was permeated with an aura that the Defendant was an unethical stockbroker, trial counsel's cumulative errors establish a reasonable probability that but for the counsel's errors and omissions, the outcome of the trial would have been different.

5. The facts proven at trial in Count 4 do not constitute securities fraud. The State contended in Counts 1, 2, and 3 that the Defendant was guilty of securities fraud because he had failed to disclose facts which were material to an investor's investment decision. The State presented the testimony of all three investors that the Defendant had failed to disclose the possibility of future payments and had also failed to disclose that Private Ledger, his brokerage house, had not performed any due diligence regarding the Red River Mountain Limited Partnership. All three investors testified that the implicit endorsement of the sale of the limited partnership by the brokerage house was important to their decision to invest in the Red River Mountain Limited Partnership.

The State also argued that the Defendant was guilty of securities fraud with Private Ledger as the victim because of his "selling away" in Counts 1, 2, and 3. In seeking a conviction on

Count 4, the State is seeking more than the "pound of flesh" that it might be due under the facts of this case. The facts proven at trial do not establish a crime under U.C.A. § 61-1-1(3) in Count 4.

6. The facts proven at trial do not constitute a public offense in Counts 2 or 3. The sale of the security - the limited partnership - in Counts 2 and 3 does not fit within the parameters of U.C.A. § 61-1-1. No misrepresentations or omissions were made by the Defendant "in connection with" the sale or purchase of the Red River Mountain units. The Defendant had discretionary authority to make investment decisions for these investors. If there were any misrepresentations or omissions by the Defendant, they occurred at a separate time from the actual purchase of the Red River Mountain units.

#### ARGUMENT

#### POINT I

THE TRIAL COURT ERRED BY OVERRULING THE DEFENDANT'S  
OBJECTION AND PERMITTING THE STATE'S EXPERT WITNESS  
TO EXPRESS AN OPINION AS TO WHAT CONSTITUTES MATERIALITY  
IN THIS SECURITIES FRAUD CASE.

At the trial of this matter, the State called Donna Nauss, a non-lawyer, Compliance Director for Private Ledger, and Steve Neilson, the Assistant Director of the Utah Securities Division. Over the objection of defense counsel, both witnesses were permitted to opine in front of the jury what facts constituted a material omission by the Defendant in his dealings with the three investors. Ms. Nauss' testimony focused upon "selling away", i.e.,

selling a security by the stockbroker independently and without the endorsement of the brokerage house:

Q (By Mr. Sonnenreich) Assuming that a limited partnership had a series of possible future payments; which as Private Ledger's position as a compliance officer, what is Private Ledger's position on the need to disclose those future payments with regard to this paragraph?

Mr. Barber: Objection, your Honor. That's not relevant.

. . . .

Mr. Barber: Your Honor, as to the violating of the laws of the State of Utah, the question is not of this agreement.

. . . .

The Court: The objection will be overruled.

Q (By Mr. Sonnenreich) Let me ask you the question again because we didn't get an answer to it. As the compliance officer, what is Private Ledger's position on whether Paragraph 2-D requires disclosure of possible future payments in a limited partnership that has no possible future payment obligations?

A (Ms. Nauss) The representative has an obligation to disclose everything about the investment, including the future payment obligations, if there are any, on the investment.

Trial Transcript, Tr. 711-718.

And later during Ms. Nauss' testimony, she was permitted to opine as follows:

Q (By Mr. Sonnenreich) Would a failure to disclose a specific thing that you're doing that was in violation of this policy, such as "selling away" -- let's do it specifically with something. Let's be narrow.

(Same questioner) Would a failure to disclose "selling away" in light of these documents be an omission that, as the compliance officer of Private Ledger, you would view as material, and material can mean significant, important? It could--

Mr. Barber: Well, that's a compound question your Honor.

Mr. Sonnenreich: Just was the definition.

The Court: Well, if she is confused, she can tell us.

The Witness: Yes, it would be an omission. A material omission. Its important for us to know, and I think that you see in the "selling away" memorandum and in the procedures manual--

Trial Transcript, Tr. 766-767.

Over the objection of defense counsel, Mr. Neilson was permitted to declare that "selling away" was illegal:

Q: Now, looking at true selling away -- we'll leave aside this other question of what happens if you have two brokerage houses. Is true selling away legal?

A: No. It is illegal.

Trial Transcript, Tr. 895.

Next, Mr. Neilson was permitted to opine that the possibility of future payments was a material issue which needed to be disclosed to an investor (Trial Transcript, Tr. 899). He was also permitted to express the opinion that the fact that a broker-dealer had not subjected an offering to a due diligence search was also a material fact which should have been disclosed to an investor (Trial Transcript, Tr. 899-900). Finally, Mr. Neilson was permitted to testify that the fact that an offering had been sold away from all brokerage houses was a material fact that should have been disclosed to a potential investor (Trial Transcript, Tr. 900).

The Court, in overruling the objection, necessarily ruled that the question of what was "material" was a question susceptible to

opinion testimony by experts under Rule 702 of Utah R.Evid. The issue of materiality about which the witnesses were testifying did not involve scientific, technical, or other specified knowledge required by Rule 702, Utah R.Evid. Among other reasons, this is so because the jury was ultimately instructed in Instruction No. 21 that: ". . . 3. A 'material fact' is a fact that a reasonable person would deem important in determining whether or not to purchase a security." Moreover, in Instruction No. 22, this Court advised the jury that: "A 'material' fact is a fact that a reasonable person in similar circumstances would deem important in making a particular decision, such as a decision to purchase or sell a security." Since the standard is that of a reasonable man, Ms. Nauss' and Mr. Neilson's testimony as to materiality were inappropriate and unfairly prejudicial.

Furthermore, in the elements instructions involving each count (Instructions 30 through 34), this Court instructed the jury that to find the Defendant guilty, they must find that he willfully made to an alleged victim "an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Therefore, the jury had the definition of "material fact" and understood that finding a misrepresentation or omission regarding a material fact was a required prerequisite to finding Mr. Harry guilty of securities fraud in all four Counts. With the testimony of the alleged investor-victims, and the other

testimony presented during the trial, the question of what was material or not material should have been left up to the jury, and was not so complicated that scientific, technical, or other specialized knowledge was necessary for the jury to understand the evidence or to determine the facts at issue.

The trial court concluded that it was perfectly proper to allow both Ms. Nauss and Mr. Neilson to opine, in essence, that "facts" the Defendant failed to disclose to his investors were "material." Mr. Neilson, in effect, rendered his expert opinion that the Defendant was guilty. The Defendant's Motion for a New Trial was denied by the trial court based upon this Court's decision in State v. Larsen, 828 P.2d 487 (Utah App. 1992). The Defendant submits that the Larsen Court relied on invalid case authority when it found that expert testimony was proper because it went to "an ultimate issue of fact."

1. The Larsen Court Disregarded the Correct Analysis of Federal Securities Actions Involving Expert Opinion and Relied on Vacated Case Authority

Admission of the testimony of Ms. Nauss and Mr. Neilson was error under the analysis applied in federal securities cases. Securities cases pose unique problems in defining the scope of proper expert testimony. In the first of the leading decisions, Scop v. United States, 846 F.2d 135 (2d Cir. modified on rehearing, 856 F.2d 5 (1988)), the defendant was convicted of federal securities fraud after the government introduced opinion evidence through an SEC official offered as an expert witness. Taken as a whole,

the expert opinions expressed that the defendant's actions constituted "manipulation" and "fraud" which were terms of the statute used to charge the defendant. Scop, 846 F.2d at 138. The Scop court found that the expert's use of statutory terms created an improper legal conclusion:

Had Whitten [the witness] merely testified that controlled buying and selling of the kind alleged here can create artificial price levels to lure outside investors, no sustainable objection could have been made. Instead Whitten made no attempt to couch the opinion testimony in even conclusory factual statements but drew directly on the language of the statute and accompanying regulations concerning "manipulation" and "fraud." In essence,

his opinions were legal conclusions that were highly prejudicial and went well beyond his province as an expert in securities trading.

Id. at 140.

Fear that the jury may have been misled by such testimony was heightened by the fact that statutory terms like "manipulation" and "scheme to defraud" are not self-defining, but have been the subject of diverse judicial interpretation. Id. at 140-41.

The analysis in Scop is understandable and persuasive. Like the expert opinion in Scop, Mr. Neilson's testimony improperly drew on language of the statute under which the Defendant was charged -- § 61-1-1. (Trial Transcript, Tr. 898-900); U.C.A. § 61-1-1). Mr. Neilson's opinions "were calculated to invade the province of the court to determine the applicable law and to instruct the jury as to that law." Id. at 140 citing F.A.A. v. Landy, 705 F.2d 624, 622



(2d Cir.), cert denied, 464 U.S. 895 (1983). The Larsen Court failed to address this, remarking that the expert used the legal, statutory term "material" in a "factual" way. State v. Larsen, supra, at 493. Moreover, like the statutory term "manipulation," disapproved for expert use in Scop, "materiality," an element of the offense charged here, is not a self-defining term. Id.

Other securities cases confirm the problems associated with use of "securities expert" testimony regarding legal standards. In Marx & Co., Inc. v. Diner's Club, Inc., 550 F.2d 505 (2d Cir. 1977), cert. denied, 434 U.S. 861 (1977), a "securities expert" testified concerning what he thought the contract phrase "best efforts" meant, and whether or not the defendants there had used "best efforts." Id. at 509. The expert also testified that failure to issue a registration statement within 70 days was proof that "best efforts" were not used. Id. at 510. Finding this testimony an inadmissible legal opinion concerning "reasonableness" of delay in registration, the Marx court noted that securities fraud litigation presents a special danger of abuse of expert witness testimony: "With the growth of intricate securities litigation . . . we must be especially careful not to allow trials before juries to become battles of paid advocates posing as experts on the respective sides concerning matters of domestic law." Id. at 511.

Adalman v. Baker, Watts & Co., 807 F.2d 359 (4th Cir. 1986) is another example. There, the defendants attempted to call as an

expert witness an attorney who was former counsel for the defendants. The attorney was to testify concerning whether certain omitted information was "material" to an investment decision. The court held such testimony inadmissible because the expert would in effect "testify in substantial part to the meaning and applicability of the securities laws to the transactions [at issue], giving his expert opinion on the governing law." Id. at 368.

These cases reveal that while the opinions of Nauss and Neilson were not improper just because they went to an "ultimate issue," they were improper because they are not "otherwise admissible" (Rule 704, Utah R.Evid.); they "were legal conclusions that were highly prejudicial and went well beyond his province as an expert in securities trading." Scop, 846 F.2d at 140.<sup>1</sup> Like the testimony in Marx and Adalman, the objectionable portions of Neilson's testimony "did not concern practices in the securities business on which [he] was qualified as an expert, but were rather

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<sup>1</sup>Both Marx and Adalman implicitly recognize the risk that experts in areas of law have their own ideas not only as to what the law requires, but what they think it should require. Often, as here, this line is blurred in the mind of the witness, let alone the juror's minds. These cases also recognize that testimony of legal experts in securities fraud cases presents significant conceptual problems which reach beyond securities issues. See, e.g., Adalman v. Baker, Watts & Co., 807 F.2d 359, 366 (4th Cir. 1986) ("If such experts are to testify to the meaning and applicability of securities laws, what line is to be drawn to exclude tort lawyers from offering their expert opinions to the jury as to the meaning and applicability of laws governing tort litigation. Examples of this sort could be multiplied across the gamut of litigation").

legal opinions as to the meaning of the . . . terms at issue." Marx at 509.

The Court of Appeals disregarded this authority and relied instead on language from United States v. Leuben, 812 F.2d 179 (5th Cir. 1987), which apparently unknown to the Court of Appeals, was previously vacated. See United States v. Leuben, 816 F.2d 1032, 1033 (5th Cir. 1987).<sup>2</sup> Leuben, which involved neither securities claims nor actual testimony, consists of two reported decisions; the first, (the only one the Court of Appeals cites) noted that the parties had simply assumed that the issue of materiality under 18 U.S.C. § 1001 was a question of law, while under 18 U.S.C. § 1014 it was an issue of fact. 812 F.2d at 183. Relying on that assumption, the Leuben court held that expert testimony on a "factual" issue of materiality was permissible. Id. It also held that under Rule 403 FedR.Evid., the trial court abused its discretion by permitting the government to put on expert testimony on "materiality" while prohibiting similar testimony by the defense. Id. at 184.

The second Leuben decision (overlooked by the Court of Appeals), vacated its prior assumption that "materiality" was a fact question and held that the issue correctly was one of the law. Leuben, 816 F.2d 1032, 1033 (5th Cir. 1987). Given this subsequent

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<sup>2</sup>Stating that it was "persuaded by Leuben", the Court of Appeals characterized the case as follows: "In Leuben, the Fifth Circuit held that expert opinion on materiality was admissible as being fact-oriented." State v. Larsen, 828 P.2d 487 at 493.

correction, Leuben plainly does not stand for the proposition attributed to it by the Court of Appeals. State v. Larsen, supra, at 493.

More importantly, even if the analysis of the first Leuben decision were valid, it would exclude Nauss and Neilson's testimony. The Leuben court characterized the proffered testimony as "fact-oriented" because it would have been phrased in terms of whether certain false statements would "'have the capacity to influence' a loan officer, not the legal question of whether the statements were 'material.'" Leuben, 812 F.2d at 184. Here, the responses of both Nauss and Neilson entered forbidden ground when they characterized information as "material." (Trial Transcript, Tr. 766-767, 898-900). Thus, even under Leuben, the responses of Nauss and Neilson, and the entire line of questioning viewed as a whole, fell within the range of evidence distinguished in Leuben as impermissible. Id.

## 2. The Court of Appeals Misapplied Rule 704

Rule 704 Utah R.Evid., modeled on the federal rule abolished the prohibition on opinion testimony going to an "ultimate issue of fact." Relying on Leuben, the Court of Appeals apparently read Rule 704 to mean that opinion testimony is admissible if it goes to an issue of ultimate fact because, by definition, it is not a legal conclusion. (Larsen, 828 P.2d at 493). This incorrect approach stands Rule 704 on its head.

Under Rule 704, evidence does not become admissible because it goes to an ultimate fact; rather it cannot be excluded only because it goes to an issue of ultimate fact.<sup>3</sup> Testimony going to an ultimate fact issue may be inadmissible for other reasons; e.g., where, as here, that testimony embodies a legal conclusion. Scop, 846 F.2d at 139-40.

The intent of Rule 704 is to eliminate the labelling problem created by the ultimate fact rule. (See Rule 704, Utah R.Evid. Advisory Committee Notes and Rule 704 Fed.R.Evid. Advisory Committee Notes). Yet the Court of Appeals' approach replaces one label with another. To say an issue is one of ultimate fact and not a legal opinion simply states the result and fails to clarify the basis for determination. "Materiality" in the context of a securities claim cannot be neatly labelled as a legal or a fact issue; it is a conclusion reached by applying an objective legal standard to a set of facts. Here, the analysis must focus on whether the expert improperly supplants the judge as law giver and as the jury instructor and on whether the opinions are "phrased in terms of inadequately explored legal criteria." Scop, 846 F.2d at 140.

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<sup>3</sup> "The abolition of the ultimate issue rule does not lower the bars so as to admit all opinion. . . . [Rule 403, 701 and 702] afford ample assurances against opinions which would merely tell the jury what result to reach." Marx, 550 F.2d at 511 n.17, citing Notes of Advisory Committee on Proposed Rule 704, Fed. R. Evid.

The testimony of Nauss and Neilson is not troublesome because they gave evidence of a factual predicate for materiality. The error occurred when they were permitted in effect to instruct the jury that in their opinion the Defendant failed to disclose material facts; in essence, that the Defendant was guilty. (Trial Transcript, Tr. 766-767, 899-900). This is not proper, as the Court explained in Matthews v. Ashland Chemical, Inc., 770 F.2d 1303 (5th Cir. 1985). There, the trial court excluded proffered expert testimony based on broach hypothetical questions that assumed every relevant fact that required the expert to give legal opinions on the complex personal injury case, including proximate cause. Id. at 1311. The Court affirmed, noting that the defendant was "asking his expert to tell the jury what result to reach after having been told all of the facts possibly relevant to the case." Id. at 1311. This case is no different. By admitting Nauss and Neilson's testimony, the trial court allowed the State's experts to instruct the jury on its result after rehearsing the facts of the State's case.

This error is compounded by Mr. Neilson's status as an attorney and securities regulator. The forceful impact of his ostensibly vast, specialized knowledge as an attorney in the securities area prevented subsequent correction of his improper testimony. This was explained in Specht v. Jensen, 853 F.2d 805 (10th Cir. 1988). In Specht, a 1983 Civil Rights action for unlawful search, an attorney expert-witness for the plaintiff

considered "hypothetical" circumstances which, according to the court, merely restated the plaintiffs' view of the evidence. Id. at 807. The attorney witness testified that as a constitutional expert, he believed no consent had been given and that the search violated constitutional rights. Id. at 809. The Court of Appeals reversed, finding that the witness supplanted both the trial court and jury with the "array of legal conclusions." Id. The error was not harmless:

[G]iven the pervasive nature of this testimony, we cannot conclude its admission was harmless. There is a significant difference between an attorney who states his belief of what law should govern the case and any other expert witness.

Id. at 808.

Like the attorney witness in Specht, Mr. Neilson, an attorney and securities regulator, "imbued with all the mystique inherent in the title 'expert,'" heightened the "substantial danger" that "the jury simply adopted the expert's conclusions rather than making its own decision." Id. at 809. The error of admitting his testimony could not be corrected by cross-examination, rebuttal, or instruction as the Court of Appeals suggests. Id. See also United States v. Zipkin, 729 F.2d 384 (6th Cir. 1984) (testimony by bankruptcy judge concerning his prior order and availability of interim fees not curable by cross-examination); Marx & Co., Inc. v. Diners' Club, Inc., 550 F.2d 505, 511 (2d Cir. 1977) ("[C]ompelling the

opponent to cross-examine to repair the damage is to invite disaster").

## POINT II

THE TRIAL COURT ERRED IN FAILING TO INSTRUCT THE JURY THAT SPECIFIC INTENT TO DEFRAUD IS AN ELEMENT OF THE OFFENSE OF SECURITIES FRAUD UNDER U.C.A. §§ 61-1-1(2) AND (3) AND 61-1-21.

The Amended Information in the instant case charged three different theories to prove a violation of the Securities Fraud Statute. The trial court instructed the jury that the specific intent to defraud was only an element of one of the three theories set forth in the Securities Fraud Statute. In Instruction No. 26, the Court advised the jury in part pertinent hereto, that:

In order for you to find the defendant guilty under the theory that he employed a device, scheme or artifice to defraud, the State of Utah must prove beyond a reasonable doubt that it was the defendant's specific intent to defraud some person.

However, later in the instruction, the Court noted that:

Even if you find that the defendant acted in good faith, however, you shall still convict the defendant if the State establishes beyond a reasonable doubt each element of either one of the other two theories, (1) that the defendant made an untrue statement of a material fact or omitted to state a necessary fact, or (2) that the defendant engaged in an act, practice, or course of business which operates or would operate to defraud or deceive.

Additionally, in Instruction No. 24, this Court advised the jury that with regard to the false representation or omission theory:



You are instructed that no amount of belief, honest or otherwise, by the defendant that any enterprise or business would ultimately make money for the investors excuses or justifies false representations or omissions willfully made by him. Therefore, to the extent that there exists any such belief, it does not constitute a defense to the crimes alleged in this case if you find that the defendant has engaged in willful misstatements or omissions.

The Supreme Court of Utah has ruled on numerous occasions that a jury must be instructed with regard to all the legal elements that it must find in order to convict a defendant of the crime charged, and the absence of such an instruction is reversible error as a matter of law. See State v. Laine, 618 P.2d 33 (Utah 1980). In State v. Roberts, 711 P.2d 235 (Utah 1985), the Court stated, "The general rule is that an accurate instruction upon the basic elements of an offense is essential. Failure to so instruct constitutes reversible error." Id. at 239. Thus, the failure to give an appropriate elements instruction can never be deemed harmless error. See State v. Jones, 177 Utah Adv.Rep. 3 (1/14/92). In State v. Jones, the defendant's counsel failed to object to the lack of an elements instruction on aggravated kidnapping. The Supreme Court ruled that the absence of a proper elements instruction constituted clear error and required a reversal of the conviction. Id. at 4. Thus, in the instant matter, regardless of whether the Defendant's predecessor counsel objected to the foregoing instructions, the fact that the jury was not instructed

in an elements instruction that the specific intent to defraud was an element of each of the three theories set forth under U.C.A. § 61-1-1 constitutes clear error and requires the granting of a new trial.

The trial court denied the Defendant's Motion for a New Trial on this issue, again relying upon the precedent of this Court in State v. Larsen, supra. The Defendant submits that the Larsen Court erroneously failed to construe U.C.A. § 61-1-1(2) in harmony with the United States Supreme Court decisions interpreting the related federal provisions (Rule 10b-5) on which § 61-1-1 was patterned.

1. Section 61-1-1 Was Patterned After Rule 10b-5.

In 1963, the Utah Legislature adopted (with certain revisions unimportant here) the Uniform Securities Act ("Uniform Act"). This is known as the Utah Uniform Securities Act ("Utah Act"). See U.C.A. § 61-1-28. Section 101 of the Uniform Act (§ 61-1-1 of Utah's Act) was patterned after Federal Securities and Exchange Commission ("SEC") Rule X-10B-5 (Rule 10b-5). See Uniform Securities Act § 101, Official Comment, reprinted in Louis B. Loss, Commentary on the Uniform Securities Act 6 (1976). The language of the three classes of proscribed activity under § 61-1-1 and Rule 10b-5 is identical. Compare U.C.A. § 61-1-1 and 17 C.F.R.

§ 240.10b-5. Consistently, under both § 61-1-1 and Rule 10b-5, criminal penalties are set for any "willful" violation.<sup>4</sup> U.C.A. § 61-1-21; 15 U.S.C. § 78ff.

Another holding in the Larsen case was that "willfulness" and not "specific intent to defraud" is the required mental state in a criminal securities fraud prosecution under U.C.A. §§ 61-1-1 and 61-1-21 (1989). "The trial court, therefore, properly instructed the jury that the culpable mental state for the crime of securities fraud is 'willfulness' rather than specific intent as proposed by Larsen." 828 P.2d at 495.

The intent of Rule 10b-5 was derived from § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), (not § 17a of the 1933 Act), which empowered the SEC to act and which provided the standard of liability that must be imposed. 425 U.S. at 200.<sup>5</sup> Rule 10b-5 "was adopted pursuant to authority granted the Commission under § 10(b) . . . to carry into effect the will of Congress as expressed by the statute." (425 U.S. at 212-13). The

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<sup>4</sup>Mr. Harry does not challenge the trial court's instruction on "willfulness." (Instruction No. 12; Tr. 250). Willfulness is also an element of a § 61-1-1 violation. The trial court and the Larsen court erred by refusing to instruct that scienter was a separate, additional element of the offense.

<sup>5</sup>Congress fashioned standards of fault on a particularized basis under the securities laws. See Ernst & Ernst v. Hochfelder, 425 U.S. at 200. "Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the Acts must therefore rest on the language of that section." Id. Here, the sole focus of inquiry is § 10(b) under which Rule 10b-5 was promulgated. Congressional intent for other sections, such as § 17a of the 1933 Act, is thus irrelevant.

Draftsmen's Commentary to § 101 of the Uniform Act confirms that Rule 10b-5 was "the logical model" for a uniform state fraud provision because of the language disparities in existing state statutes and "because of the substantial body of judicial precedent which has been developed under the federal provisions." Louis B. Loss, Commentary on the Uniform Securities Act 7 (1976) (emphasis supplied).

This comment also reveals that the draftsmen anticipated that adopting states would construe § 101 in harmony with federal court interpretation of Rule 10b-5. A prominent commentator on Utah law (Professor Wallace Bennett) presumed that federal and state court construction of like provisions would be identical. See Wallace F. Bennett, Securities Regulation in Utah: A Recap of History and the New Uniform Act, 1963 Utah L. Rev. 216, 232 n.112 ("Similarity to the federal statute will allow for interchangeability of judicial precedence in this important area").

Utah's legislature expressed synonymous intent. Aware of the Utah Act's federal origin, Utah's legislature declared that the Act was intended not only to encourage uniformity among the states, but "to coordinate the interpretation and administration of this chapter with the related federal regulation." U.C.A. § 61-1-27 (emphasis supplied). The Utah Act should be construed to effectuate this "general purpose". Id.

In U.S. v. Danser, 26 F.R.D. 580 (D.C. Mass. 1959), affirmed in Danser v. U.S., 281 F.2d 492 (1st Cir. 1960), the eminent Judge

Wyzanski directly addressed the issue of whether specific intent to defraud is an element of federal securities fraud under the Securities Act of 1933:

"To secure a conviction under Count 10 the Government must prove beyond a reasonable doubt not merely that there was an omission, that the omission was material and that Danser knew of the omission, but also that Danser intended to defraud."

26 F.R.D. at 588 (emphasis added).

The United States Supreme Court has definitively held that a private civil action for damages will not lie under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, in the absence of a specific allegation of intent to deceive, manipulate, or defraud. In Ernst & Ernst v. Hochfelder, 425 U.S. 193 (1976), the Court held as follows:

We granted certiorari to resolve the question of whether a private cause of action for damages will lie under Sec. 10(b) and Rule 10b-5 in the absence of any allegation of "scienter" -- intent to deceive, manipulate, or defraud. 421 U.S. 909, 95 S.Ct. 1557, 43 L.Ed.2d 773 (1975). We conclude that it will not and therefore we reverse.

425 U.S. at 193 (footnotes omitted and emphasis added).

In Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977), the 10th Circuit expounded upon the decision of the United States Supreme Court in Ernst as follows:

A significant clarification has taken place in this body of law as a result of the Supreme Court's recent decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Prior to this decision

there had been a division in the circuits as to the need for proving scienter. Ernst & Ernst, supra, has settled this conflict by holding that proof of negligence is not enough in a 10b-5 action; that such an action will not lie in the absence of an allegation and proof of scienter, the same being an "intent to deceive, manipulate, or defraud."

425 U.S. 193, 96 S.Ct. at 1381 (emphasis added).

Therefore, based upon the foregoing analysis of case law and Utah statutes, Defendant submits that the State was required at trial to prove beyond a reasonable doubt that the Defendant specifically intended to defraud the investors named in Counts 1 through 3 and Private Ledger in Count 4 of the Amended Information under all three of the theories set forth in the elements Instruction Nos. 30-34. Failure to so instruct the jury deprived the Defendant of a fair trial and his rights to due process of law under both the Utah and United States Constitutes were therefore violated.

### POINT III

THE TRIAL COURT ERRED IN FAILING TO GIVE AN INSTRUCTION TO THE JURY THAT THE GOOD FAITH OF THE DEFENDANT WAS A COMPLETE DEFENSE TO A PROSECUTION UNDER U.C.A §§ 61-1-1(1), (2), (3) AND 61-1-21.

Again, the Larsen case effectively resolves this issue in favor of the State by implication. The good faith defense is the flip side of the specific intent coin. If the prosecution must prove that the Defendant acted with a specific intent to defraud the victim, then the Defendant can defend by claiming that he acted

with subjective good faith, and without an intent to defraud the victim.

Although the issue of whether the "good faith" of a defendant in a criminal securities fraud prosecution constitutes a defense has not been directly addressed by the Utah Supreme Court, the 10th Circuit Court of Appeals has directly addressed this question in numerous cases involving the federal criminal securities fraud and mail fraud statutes. In Frank v. U.S., 220 F.2d 559 (10th Cir. 1955), the defendant argued that the following jury instruction, which rejected a defense of "good faith", was erroneous:

"It is contended by the defendant vigorously that he believed the statements he made and that there was no intention upon his part to commit a fraud. However, you are instructed that if the statements made by the defendant were false and there was no basis for such statements except the hope and belief of the defendant that he could produce the oil, and that he made the statements in good faith, that contention would be no defense, because if the statements within themselves were false or based purely upon speculation and caused the investors to rely upon the statements as true, the defendant's acts would constitute an offense regardless of his good faith."

220 F.2d at 564-65 (emphasis added).

The 10th Circuit Court rejected this instruction and held as follows:

While the meaning of this instruction is not entirely clear, we are forced to conclude that it, in effect, declares that, if the jury should find that false statements were made which were relied upon by investors, an of-

fense was committed even if such statements were made in good faith.

This was an erroneous instruction.

220 F.2d at 565 (emphasis added).

In several cases subsequent to Frank, the 10th Circuit Court has consistently reaffirmed that "good faith" is a complete defense to a criminal prosecution under the federal securities fraud and mail fraud statutes. See Beck v. U.S., 305 F.2d 595 (10th Cir. 1962); Steiger v. U.S., 373 F.2d 133 (10th Cir. 1962); Sparrow v. U.S., 402 F.2d 826 (10th Cir. 1968); U.S. v. Westbo, 576 F.2d 285 (10th Cir. 1978); U.S. v. Cronic, 839 F.2d 1401 (10th Cir. 1988); and U.S. v. Alexander, 849 F.2d 1293 (10th Cir. 1988).

After reviewing its previous decisions in Beck and Steiger, that "good faith is a complete defense to a mail fraud prosecution," the 10th Circuit Court in Sparrow held as follows:

Thus the good faith of the defendant in the plan or scheme and good faith intention to carry out the promises and representations constitutes a defense which the defendant may assert in a prosecution both under the Mail Fraud Statute, 18 U.S.C. Sec. 1341, and the fraud portions of the Securities Act, 15 U.S.C. Sec. 77q(a).

402 F.2d at 828-29 (emphasis added).

Recently, in U.S. v. Cronic, supra, the 10th Circuit Court stated that: "We have long held that good faith is a complete defense to a mail fraud charge as have other circuits." (Emphasis added). 839 F.2d at 1403. The Court was merely reiterating the doctrine it had declared in 1968 that the good faith of a defendant



"in the plan or scheme and good faith intention to carry out the promises and representations" constitutes a complete defense to a securities fraud prosecution. Sparrow v. U.S., supra, at 402 F.2d 828-29.

When a defense to a criminal prosecution is raised, whether by the defendant's or the prosecution's own evidence, the prosecution has the burden to prove beyond a reasonable doubt that the defense does not apply. State v. Knoll, 712 P.2d 211 (Utah 1985) (when self-defense is raised as a defense, the prosecution has the burden to prove beyond a reasonable doubt that the killing was not in self-defense). The trial court's failure to give a good faith instruction deprived the Defendant of his most important factual defense -- that he had a good faith belief that there would be no future payments in the Red River Mountain Limited Partnership. (See Instruction 24; Tr. 262 - good faith not a defense). The trial court's refusal to submit an instruction applying good faith to all three of the State's theories denied the Defendant his right to a fair trial and due process of law under both the Utah and United States Constitutions and he is therefore entitled to a new trial on all four counts of Securities Fraud.

#### POINT IV

#### THE INTERESTS OF JUSTICE NECESSITATE GRANTING THE DEFENDANT A NEW TRIAL ON COUNTS 1, 2 AND 3 BECAUSE HE RECEIVED INEFFECTIVE ASSISTANCE OF COUNSEL.

The applicable standard in assessing an ineffective assistance of counsel claim was set forth in Strickland v. Washington, 466 U.S. 668 (1984). This case set forth a two-part standard for evaluating claims of ineffective assistance of counsel. The first prong is that "[w]hen a convicted defendant complains of the ineffectiveness of counsel's assistance, the defendant must show that counsel's representations fell below an objective standard of reasonableness." 466 U.S. at 687-688. The second prong requires that "[t]he defendant must show that there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceedings would have been different." Id. at 694.

##### 1. Trial Counsel's Representations Fell Below an Objective Standard of Reasonableness.

The first half of the Strickland v. Washington test is nothing more than a restatement of the standard of attorney competence. Thus, the inquiry must focus upon whether the counsel's advice or representation of the defendant "was within the range of competence demanded of attorneys in criminal matters." McMann v. Richardson, 397 U.S. 759, 771 (1970).

In the instant matter, the errors and omissions of trial counsel which "fall outside the wide range of professional and competent assistance" demanded of attorneys in criminal cases are

enumerated below. See, State v. Frame, 723 P.2d 401, 405 (Utah 1986):

1. Defense counsel failed to deliver an opening statement to the jury in a complicated securities fraud trial. This was not a strategic decision. Defense counsel intended to give an opening statement but failed to give one because he forgot (Tr. 956-957).

2. Based upon Mr. Thornton's testimony, the State contended in Count 1 that Mr. Thornton had no knowledge of the possibility of future payments. However, Mr. Thornton's testimony that he had no knowledge of the possibility of any future payments could have been easily and convincingly contradicted by the introduction of the signed and notarized Subscription Agreement (Tr. 467-477) as well as the initialled Suitability Questionnaire (Tr. 454-463). Trial counsel failed to introduce either the Subscription Agreement or the Suitability Questionnaire, notwithstanding that the Defendant had specifically advised him that he should impeach Mr. Thornton with the aforementioned documents. When trial counsel realized he had neglected to introduce the Subscription Agreement and the Suitability Questionnaire through Mr. Thornton, the State's witness, it was too late -- Mr. Thornton had been released and had returned to Yuma, Arizona. The State objected to the introduction of the documents through the Defendant, and as a result, these critically important documents were not presented to the jury.

3. Trial counsel failed to demonstrate Mr. Thornton's suitability for the Red River Mountain investment. Notwithstanding

Mr. Thornton's testimony, his net worth was \$1,000,000.00; his stock and bond portfolio were valued in excess of \$400,000.00; he was a partner in a trailer park development in Sandy, Utah with an approximate value of \$300,000.00 to \$400,000.00 where Mr. Thornton was subject to unlimited liability; and the \$15,000.00 investment in the Red River Mountain limited partnership represented less than two percent (2%) of Mr. Thornton's net worth and four percent (4%) of his investment portfolio. Thus, the Red River Mountain investment was well within the reasonable limits of the "prudent man" investment rule. Defendant provided his trial counsel with an outline of the foregoing points, but trial counsel failed to explore the foregoing points. (See Appendix 1, Defendant's post-trial Exhibits 5, 6 and 7).

4. Trial counsel failed to demonstrate the suitability of the Red River Mountain limited partnership for Mr. Issacs in Count 2. Mr. Issacs had a portfolio value of over \$600,000.00; he had participated in at least ten other partnerships; and a \$30,000.00 investment in the Red River Mountain limited partnership represented only five percent (5%) of his total portfolio value. Notwithstanding Mr. Issacs' testimony, the investment in the Red River Mountain limited partnership constituted reasonable diversification and satisfied the "prudent man" investment rule. Again, the Defendant provided his trial counsel with an outline of the foregoing points, but trial counsel failed to explore the foregoing points. (See Appendix 2, Defendant's post-trial Exhibits 1 and 2).

5. Trial counsel failed to demonstrate the suitability of the Red River Mountain limited partnership for Mr. Brgoch in Count 3. Mr. Brgoch had a portfolio value of over \$600,000.00; he had been a participant in at least 14 other partnerships; the \$30,000.00 investment in the Red River Mountain Investment represented only five percent (5%) of his total portfolio value. The investment in the Red River Mountain limited partnership constituted reasonable diversification and satisfied the "prudent man" investment rule. The Defendant provided his trial counsel with an outline of the foregoing points, but trial counsel failed to explore the foregoing points. (See Appendix 3, Defendant's post-trial Exhibits 3 and 4).

6. Without objection from counsel, the State was permitted to introduce the opinion of Ms. Nauss, the Private Ledger compliance officer, that the Defendant's conduct violated the internal rules and regulations of Private Ledger. Ms. Nauss based her opinions upon the Private Ledger compliance manual. However, this manual was not mailed to the Defendant until after two of the Red River Mountain sales had been consummated and was not returned by the Defendant to Private Ledger until after the final sale had been completed (Tr. 715-716). Moreover, the testimony is neither relevant nor probative on the issue of whether this Defendant violated U.C.A. §§ 61-1-1 and 61-1-21. Defendant submits that under Rule 403 this evidence should have been excluded.

Similarly, Ms. Nauss was also permitted to testify that Private Ledger could have been subjected to civil liability as a

result of the Defendant's "selling away" and failure to disclose a material fact - the possibility of future payments:

Q Now besides the fact that Private Ledger was denied a potential of some commissions; what other harm did this conduct of not notifying Private Ledger of Red River Mountain subject Private Ledger to?

A Well, if someone who made an investment in that product were hurt by making that investment, they may assume that Private Ledger had been involved in and that we were a party to that transaction, even though they didn't even know about it, and weren't asked to review it. And didn't have the opportunity to say whether or not our representative could sell it. They may assume, because the representative was licensed with the firm, that we were a party to the transaction.

Q In your experience, could that cause the risk of a lawsuit, regardless of whether you might win it in the end--the risk you have to go through in a lawsuit and other litigation, in your experience?

A Yes. It could.

Q And those, I take it, could be expensive matters for Private Ledger.

A They could be very expensive.

(Trial Transcript, Tr. 724-725).

As with the unobjected questions discussed supra, these questions had no probative value, and should have been excluded under Rule 403, Utah R.Evid. Even if this Court declines to reach the improperly preserved issue under Strickland v. Washington, supra, the Defendant submits that it was plain error under State v. Verde, 770 P.2d 116 (Utah 1989) and State v. Eldredge, 773 P.2d 29 (Utah 1989), and should therefore be reviewed under that precedent.

Finally, although trial counsel did object when the State

began to introduce testimony concerning the NASD rules and regulations, he neglected to move to strike the testimony. The NASD is a voluntary organization of securities dealers and brokers. A violation of NASD rules and regulations has no bearing upon whether this Defendant violated U.C.A. § 61-1-1. The following colloquy occurred before the jury:

Q What is that relationship [the securities regulations of the State of Utah and the NASD rules]?

A First its contained in Rule 177-6-1G. That rule refers to ethical or unethical and dishonest practices of broker-dealer agents. One of the provisions of that rule

Mr. Barber: Objection to any of the provisions your Honor. The rule is the best evidence. It is hearsay.

(Trial Transcript, Tr. 881-882).

The Defendant submits that the proper objection should have been Rule 403, Utah R.Evid., not hearsay. An expert is permitted to base his testimony upon hearsay. The NASD rules and regulations would clearly be within the scope of this witness' expertise. Accordingly, defense counsel should have been arguing that even a deviation from industry standards - as evidenced by a violation of NASD rules and regulations - had no probative value, or alternatively, that the minimal probative value was outweighed by the extraordinary prejudicial effect upon the jury. After extensive arguments with the Court, the State elected to forego this line of inquiry. However, defense counsel did not request that the testimony be stricken. As a result, the jury was left with the lingering impression that the Defendant's conduct was unethical.

Marshalling the facts in support of the trial court's denial of a motion for a new trial, it could be said that all of counsel's omissions were conscious, strategic decisions and that none of the omissions would have altered the outcome of the case. However, the Defendant submits that these omissions evidence that trial "counsel rendered a deficient performance in some demonstrable manner." State v. Verde, 770 P.2d 116, 118 (1989).

## 2. Prejudice Requirement.

The second, or prejudice requirement, under the Strickland v. Washington and State v. Verde tests focuses upon whether counsel's constitutionally ineffective performance affected the outcome of the trial process. In other words, in order to satisfy the prejudice requirement, the Defendant must show that there is a reasonable probability that but for counsel's errors and omissions, the result of the trial would have been different. As stated in Strickland, 446 U.S. at 686:

[T]he benchmark for judging any claim of ineffectiveness must be whether counsel's conduct so undermined the proper functioning of the adversarial process that the trial cannot be relied on as having produced a just result.

In the instant matter, the second part of the Strickland test has also been met. The cumulative effect of trial counsel's errors or omissions certainly undermines confidence in the jury's verdicts on Counts 1, 2 and 3. The failure to present an opening statement in a complicated securities fraud trial is remarkable. Furthermore, the failure of trial counsel to challenge the representations



of the three investors with regard to the suitability of the Red River Mountain limited partnership, in view of the fact that the Defendant had provided his counsel with a detailed outline of their investment histories which included participation in both land deals, partnerships, and long term investments falls below an objective standard of reasonableness and certainly leads one to the ineluctable conclusion that but for counsel's defective performance, a different outcome could have been reached on all three of these Counts. Finally, with respect to Count 1, the failure of trial counsel to introduce a signed and notarized Subscription Agreement which would have directly contradicted Mr. Thornton's testimony cannot be emphasized enough. Mr. Thornton's credibility was essential to the State's prosecution in Count 1. Had trial counsel introduced the signed and notarized Subscription Agreement which clearly set forth the existence of the possibility of future payments, there can be little doubt that Mr. Thornton's credibility would have been seriously impeached.

Under the standard articulated in Strickland v. Washington, the Defendant has satisfied the two-prong test. For all of these reasons, the interests of justice will best be served by granting the Defendant a new trial on Counts 1, 2 and 3.

## POINT V

### THE FACTS PROVEN AT TRIAL DO NOT CONSTITUTE A PUBLIC OFFENSE IN COUNT 4 OF THE AMENDED INFORMATION.

Justice Stewart of the Utah Supreme Court, dissenting on other grounds, stated in the Utah Supreme Court case of State v. Eldredge, 773 P.2d 29 (Utah 1989): ". . . The whole thrust of criminal procedure in the area of appellate review of criminal convictions has been to try to avoid, where possible, collateral attacks on criminal convictions. For that reason, it makes sense to address at the earliest possible stage errors which might lead to reversals. . . ." 773 P.2d at 42.

Rule 23 of the Utah Rules of Criminal Procedure reads:

At any time prior to the imposition of sentence, the court upon its own initiative may, or upon motion of a defendant shall, arrest judgment if the facts proved or admitted do not constitute a public offense, or the defendant is mentally ill, or there is other good cause for the arrest of judgment. . . .

The facts proven at trial do not constitute a public offense with regard to Count 4. The contracts and documents executed between Private Ledger and the Defendant do not constitute either a device, a representation, or a course of business, in connection with the offer, sale or purchase of any security as required under U.C.A. § 61-1-1. As Ms. Nauss admitted, the Defendant did not receive the manual prohibiting discretionary accounts at any of the relevant times to this case. Indeed, the manual was not received by the Defendant until May 3, 1988. It was not returned to Private

ledger until May 11, 1988, more than one month after the purchase of the Red River Mountain interests by all three investors (Tr. 715). The facts proven by the State may constitute a breach of contract with Private Ledger, but they do not constitute the commission of a public offense.

In State v. Burton, 800 P.2d 817 (Utah App. 1990), the Utah Court of Appeals ruled that whenever the State advances a unique or novel theory of criminal liability in what normally would be a civil business situation, the appellate courts will require the prosecution to meet the "incumbent burden of sound reasoning and persuasive authority" in order to uphold a guilty verdict." In the Burton case, the Defendant attempted to sell a home to one Waldron. The home in question was encumbered by two trust deeds, with the first trust deed containing a "due on sale" clause, barring assumption of the note obligation by any subsequent purchaser. Waldron was unable to obtain financing through the note holder with the "due on sale" clause, so he entered into a private financing agreement with Burton. Waldron was to make monthly payments to Burton, who would then make the mortgage payment to the holder of the trust deed with the "due on sale" clause. It would not be reported to the holder of the "due on sale" clause that the home had been sold to another purchaser without the bank's permission.

Although it was understood that Burton was to make the mortgage payments to the bank, it was not explicit in the agreement executed by the parties. Subsequently, Burton obtained the monthly

payments from Waldron, but failed to make those payments to the bank which resulted in the bank's ultimate foreclosure on the property. The State brought theft charges against Burton, claiming that his failure to apply the payments he had received from Waldron to the bank constituted the crime of theft.

In analyzing the case, Judge Orme stated as follows:

The state advances a unique theory of criminal liability in this case. It is quite telling that neither side has presented the court with any decision validating or precluding the criminal prosecution of what is essentially a breach of a real estate sale agreement. We are not unreceptive to novel theories of law when they are supported by firm logic and have some basis, even if tangential, in established precedent. However, the more unique the innovation, the greater will be the incumbent burden of sound reasoning and persuasive authority. Such reasoning and authority are notably absent in this case.

In that posture, we are loath to give approval to the broad construction of Section 76-6-404 (the theft statute) urged upon us by the state. Were we to do so, it is likely that memorials of commercial transactions would soon be drafted to include boilerplate language designed to impose criminal liability for interruptions in the stream of payments -- a circumstance which would normally be nothing more than a breach of contract, traditionally viewed as adequately remedied through an action of law.

800 P.2d at 819.

It can be readily seen that the facts established by the State in the instant matter might establish an actionable breach of contract by the Defendant and enforceable by Private Ledger. However, this is precisely the situation Judge Orme indicated in

State v. Burton, supra, should be handled civilly and not criminal-ly. The effort by the Attorney General's Office to bootstrap this civil breach of contract (Count 4) into a criminal prosecution must be rejected by this Court. In any event, the conduct alleged in Count 4 -- selling away -- is the same conduct alleged by the State to constitute a material omission in the sale of the securities in Counts 1, 2, and 3. Count 4 must therefore merge with the first three counts of the Information.

#### POINT VI

#### THE FACTS PROVEN AT TRIAL DO NOT CONSTITUTE A PUBLIC OFFENSE IN EITHER COUNTS 2 OR 3.

The State did not prove a violation of the Securities Fraud Statute in Counts 2 or 3 because there were no misrepresentations or omissions made "in connection with" the sale or purchase of the Red River Mountain Units. All of the transactions were executed by the Defendant before any statements which might be characterized as either misrepresentations or omissions were made by the Defendant to either Mr. Issacs or Mr. Brgoch. Both Issacs and Brgoch testified that they had delegated the authority to make investment decisions for them to the Defendant and that he had invested their money in Red River Mountain before they knew that the investment had been made. The record is clear; indeed, there is not one shred of evidence that Defendant Harry made any representation to either Issacs or Brgoch regarding Red River Mountain before he exercised his discretionary delegated authority. The Defendant's alleged

misrepresentations therefore did not occur "in connection with" the offer or sale of securities because he never made any representations to either Issacs or Brgoch regarding Red River Mountain before the sale of the security was completed.

In the absence of Utah law focusing upon the "in connection with the offer, sale or purchase" requirement of U.C.A. § 61-1-1, it is appropriate to look at the case law that has developed around similarly worded federal provisions. The language of Section 61-1-1(2) tracks closely with Section 17(b) of the Securities Exchange Act of 1933, 15 U.S.C. § 77q(a)(2), which provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --

. . . .

To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. . . .

The foregoing federal statute has been interpreted in numerous federal appellate decisions. In Braka v. Multibanch Comermet, S.A., 589 F.Supp. 802 (SDNY 1984), plaintiff/purchasers brought an action under 15 U.S.C. §77q(a) to recover money allegedly owed on two certificates of deposit and to rescind the certificates and recover damages. The district court granted defendant's motion to dismiss in part because the alleged misrepresentations and nondis-

closures of the defendant occurred after the sales to plaintiffs and therefore could not be in "in connection" with the sales of securities. "It is well established that a misrepresentation or a nondisclosure, to be actionable under §77q, must occur 'in connection' with the sale, i.e. at or before the time the buyer commits himself to the sale." Id. at 805 n.3 (emphasis added).

Resource Investors Group v. National Resource Inv. Corp., 457 F.Supp. 194 (E.D. Mich. 1978), presented a situation where one of the defendants charged with a violation of U.S.C. § 78j(b) had had no relationship with any of the parties in the lawsuit until after the plaintiff had purchased working interests in certain oil and gas wells. The district court granted defendant's motion for summary judgment because defendant "could not have participated in any fraud 'in connection with the purchase or sale of any security.'" Id. at 197 (emphasis added).

The Securities and Exchange Commission brought an action for injunctive sanctions alleging that the defendants had participated in securities law violations in connection with a merger in Securities & Exchange Comm'n v. National Student Marketing Corp., 457 F.Supp. 682 (D.D.C. 1978). In that case the court addressed the required "nexus" between the alleged misconduct and the purchase or sale of a security. The court concluded that: "Once the decision is made and the parties are irrevocably committed to the transaction, there is little justification for penalizing

alleged omissions or misstatements which occur thereafter and which have no effect on the decision." Id. at 703.

In Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co., Inc., 800 F.2d 177 (7th Cir. 1986), the investor brought an action against the securities dealer who executed transactions initiated by the investor's agent, and which resulted in losses. The Seventh Circuit concluded that there could be no violation of Section 10(b) or Rule 10b-5 when the plaintiff had transferred to its agent full authority to make investment decisions:

The Congregation made no investment decisions; it hired Mr. Newell [like Mr. Harry in the instant case] for that purpose. Mr. Newell had 'full discretion to develop and implement a prudent portfolio strategy.'

800 F.2d at 181.

In the instant matter, there was no "investment decision" to be made after the time when both Issacs and Brgoch learned of the necessity for future payments and that the investment had been made in Red River Mountain.

The Defendant might have had exposure under a different criminal statute. However, the State elected not to charge the Defendant with the offense of Unlawful Dealing with Property by a Fiduciary (U.C.A. § 76-6-513), and instead alleged a violation of the Securities Fraud Statute. The Defendant's "market transactions" with Issacs and Brgoch were not violative of U.C.A.



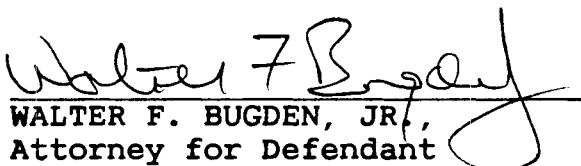
§ 61-1-1. The Defendant did not discuss the Red River Mountain investments with either Issacs or Brgoch before making the investment. Thus, there were no omissions or misrepresentations, as required by U.C.A. § 61-1-1 to "make the statements made not misleading."

The facts established by the State do not constitute the public offense of Securities Fraud, and therefore, judgment of acquittal on Counts 2 and 3 is mandated by the provisions of Rule 23 of the Utah Rules of Criminal Procedure. In the alternative, the Defendant submits that he is entitled to a new trial due to the Court's refusal to grant the Defendant's Motion for Directed Verdict at the end of the State's case. The Court's refusal in this regard had "a substantial effect upon the rights of the Defendant" and thereby constitutes a basis for the granting of a new trial under Rule 24 of the Utah Rules of Criminal Procedure.

#### CONCLUSION

For the above reasons, this Court should reverse the Defendant's convictions and remand the matter for a new trial.

DATED this 2 day of April, 1993.

  
WALTER F. BUGDEN, JR.,  
Attorney for Defendant

CERTIFICATE OF SERVICE

I hereby certify that I caused two true and correct copies of the foregoing to be mailed, by first class U.S. postage prepaid, this 2 day of April, 1993, to:

David Sonnenreich  
Assistant Attorney General  
236 State Capitol  
Salt Lake City, Utah 84114

Walter F. Engel

# APPENDIX 1

VIRL THORNTON

I. Only bought because he thought my father and I had.

A. He seems confused as to who my father is.

1. Father-Gordon Harry Grandfather-Elbert Harry

2. Believes father owned cleaners, when grandfather did.

a. Did know however that grandfather lived in Az. (Tr pg.47)(how is that?)

3. Never made any previous investments decisions as to whether or not either my father/grandfather or I had participated.

B. Suitability

1. Networth over \$1,000,000

a. Stock & bond Portfolio- over \$400,000

2. Partner in development of trailer park in Sandy, Ut. approx value of \$3-400,000. (Tr pg. 24)

a. unlimited liability

3. \$15,000 investment less than 2% of networth, 4% of investment portfolio. Well within reasonable limits of "prudent-man".

4. Red River well within parameters of preservation of principal, with growth potential, if deal was as presented.

a. Spends every winter in Arizona. Knows Arizona real estate market.

b. Has not lost any money in this partnership.

5. I told him Private Ledger not involved in offering.

a. (Tr pg.11) Did I make any representation regarding PL involvement?- "No"

b. (Tr pg.13) Can't remember whether P/L name is on door. (it is)

DEFENDANT'S  
EXHIBIT

901901580  
NO 5

page 2

- c. (Tr pg.20) Can't remember if document was bound.  
(it was)
- 6. Acknowledges signing supscription agreement.
  - a. Question as to whether he wrote in number "3" or read page 5, was never answered. (Tr pg. 62)

LIMITED PARTNERSHIP PORTFOLIO  
for  
VIRL THORNTON

PROGRAM	APPROX AMOUNT	YEAR	TYPE
Oil/Gas Exploration	10,000	1978	Oil & Gas
Enviorndyne	15,000	1979	Real Estat
Unknown	7,500	1979	Oil & Gas
Equity Oil	10,000	1980	Oil & Gas
Sandy Mobile Home Park	135,000	1981	Real Estat Develope
Unknown	10,000	1983	Oil & Gas
Centruty Prop	25,000	1984	Real Estat
Hampton Inns	50,000	1986	Hotel Dev
Red River LTD	15,000	1988	Real Estat

RESTRICTED -- SEE REVERSE

NUMBER

39

UNITS

3

RED RIVER MOUNTAIN LIMITED PARTNERSHIP

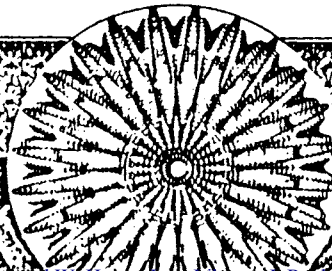
This Certifies that Viril W. Thornton, Trustee,  
Viril W. Thornton Trust is the owner of  
-----THREE----- fully paid and  
non-assessable Units of the above Limited Partnership transferable only on the books of the  
Limited Partnership by the holder hereof in person or by duly authorized Attorney upon  
surrender of this Certificate properly endorsed.

In Witness Whereof, the said Limited Partnership has caused this certificate to  
be signed by its duly authorized Partners.

Dated May 6, 1988

DEFENDANT'S  
EXHIBIT

901901580



## APPENDIX 2



IKE ISAACS

I. Suitability

- A. Portfolio value over \$600,000
- B. Participant in at least 10 other partnerships.
  - 1. Acknowledges that RR is partnership (Tr pg 85)
- C. Acknowledges an objective of some growth. (Tr pg. 72-73, 83)
- D. \$30,000 investment 5% of portfolio. Reasonable diversification.
  - 1. Could be dangerous if shown that I knew of additional payments.
  - 2. Has history of involvement with at least one other partnership with additional payments.
- E. Knows Phoenix real estate (Tr pg 80)

II. Power of Attorney

- A. Acknowledging my authority to trade for his benefit (Tr pg. 73, 74, 75, 80, 86, 93)
- B. Sonnenreich did not establish whether Isaacs thought RR a P/L deal. (Tr pg 78)
- C. Established that questions were sometime after investment was made. (Tr pg 87)
  - 1. Satisfied with answers (Tr pg 87)
- D. He was told not to make additional payments. This was not deal shown to us. (Tr pg 93)

LIMITED PARTNERSHIP PORTFOLIO  
for  
SEYMOUR (IKE) ISAACS

<u>PROGRAM</u>	<u>APPROX \$AMOUNT</u>	<u>YEAR</u>	<u>TYPE</u>
Option Spread	10,000	1975	Commodities
Premier Angus	20,000	1976	Cattle Feed
Can/Am	10,000	1977	Oil & Gas
Arlington Park	60,000 (Staged payments)	1977	Real Estate/ Susidized Hsng
Century Properties	10,000	1979	Real Estate
Utah/Ohio Oil	10,000	1980	Oil & Gas
Century Properties	40,000	1984	Real Estate
Energy Income	40,000	1984	Oil & Gas
Polaris Income	40,000	1985	Equipment Lease
Red River Ltd.	30,000	1988	Real Estate

# APPENDIX 3

FRANK BRGOCH

I. Suitability

- A. Portfolio value over \$600,000
- B. Participant in at least 14 other partnerships.
- C. \$30,000 investment 5% of portfolio. Reasonable diversification.
  - 1. Involved with at least one other partnership with additional payments.
- D. Knows Phoenix real estate market. (Tr pg 119)
- E. States he didn't want partnerships or long-term. (Tr pg 101)
  - 1. Conflicts with investment history both before and after psuedo-retirement.
- F. Acknowledges real estate is suitable investment. (Tr pg 117)
- G. Visit General Partner, acknowledged what I had told him. (Tr pg 119, 122)

II. Power of attorney

- A. Sonnenreich did not establish whether Brgoch thought RR was P/L deal. (Tr pg 101)
- B. Acknowledges my authority to trade for his benefit. (Tr pg 103, 106, 115, 118)
- C. Established that questions asked some time after initial investment. (Tr pg 110-111)
- D. Don't make additional payments, not the deal that we were shown. (Tr pg 112, 122)

LIMITED PARTNERSHIP PORTFOLIO  
for  
Frank Brgoch

<u>PROGRAM</u>	<u>APPROX \$ AMOUNT</u>	<u>YEAR</u>	<u>TYPE</u>
Option Spread	10,000	1975	Commodities
Premier Angus	20,000	1976	Cattle Feed
Energy Management	10,000	1976	Oil & Gas
Essex Towers	55,000 (Staged 1977 payments)		Real Estate/ Subsidized Hsng
Century Properties	10,000	1979	Real Estate
Can/Am	5,000	1979	Oil & Gas
Utah/Ohio Oil	10,000	1980	Oil & Gas
Unknown	10,000	1980	Real Estate
Century Properties	40,000	1984	Real Estate
Energy Income	40,000	1984	Oil Income
Polaris Income	40,000	1985	Equipment Lease
Unknown	10,000	1986	Real Estate
Unknown	7,500	1987	Oil & Gas
Red River Ltd.	30,000	1988	Real Estate

## APPENDIX 4

**61-1-1. Fraud unlawful.**

It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly to:

- (1) employ any device, scheme, or artifice to defraud;
- (2) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
- (3) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

**61-1-21. Penalties for violations — Limitation of prosecutions.**

Any person who willfully violates any provision of this chapter except Section 61-1-16, or who willfully violates any rule or order under this chapter, or who willfully violates Section 61-1-16 knowing the statement made to be false or misleading in any material respect, shall upon conviction be fined not more than \$10,000 or imprisoned not more than three years, or both. No person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order. No indictment or information may be returned or complaint filed under this chapter more than five years after the alleged violation.

**61-1-27. Construction of chapter.**

This chapter may 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.

17 C.F.R. § 240.10b-5 ("Rule 10b-5"):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

**Rule 403. Exclusion of relevant evidence on grounds of prejudice, confusion, or waste of time.**

Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.

**Rule 704, Utah Rules of Evidence:**

Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.