

**IN THE DISTRICT COURT OF SHAWNEE COUNTY, KANSAS
CIVIL COURT DIVISION**

THOMAS EDWARD BLUMER, on behalf of)
himself and all others similarly situated,)
)
Plaintiff,)
)
v.)
)
STATE OF KANSAS,)
)
Defendant.)
_____)

Case No. 2019-CV-000720

FIRST AMENDED CLASS ACTION PETITION

Plaintiff Thomas Edward Blumer (“Plaintiff”), for his First Amended Class Action Petition against Defendant State of Kansas, states and alleges as follows:

1. This is a putative class action lawsuit concerning unlawful fees paid into and unlawful sweeps from the Securities Fee Fund (the “Fund”) pursuant to K.S.A. 17-12a601.
2. Plaintiff seeks certification of a class pursuant to K.S.A. 60-223 and requests declaratory relief in accordance with K.S.A. 60-1701 *et seq.* and injunctive relief in accordance with K.S.A. 60-901 *et seq.* in the form of a finding that K.S.A. 17-12a601(a)(4) is unconstitutional and an Order that all amounts transferred under such provision be returned to affected fee payers.

The Parties, Jurisdiction and Venue

3. Plaintiff has paid and continues to pay the fees required of a registered investment adviser under Kansas Uniform Securities Act, which are accumulated by the State in the Fund pursuant to K.S.A. 17-12a601.
4. Plaintiff brings this action on behalf of himself and all others similarly situated pursuant to K.S.A. 60-223.

5. Plaintiff has standing to bring this action because as a registered representative, he has been uniquely harmed and has suffered a cognizable injury by the State of Kansas transferring monies from the Fund into the general fund, which forces the Kansas Securities Commission to impose additional assessments on the regulated industry each year.

6. The State causes this to occur without further legislative action by exercising its authority under K.S.A. 17-12a601.

7. Service of process on Defendant State of Kansas is pursuant to K.S.A. 60-304(d) and may be made by serving Kansas Attorney General Derek Schmidt, or any assistant attorney general, at Memorial Hall, Second Floor, 120 S.W. 10th Avenue, Topeka, KS 66612.

8. This Court has subject matter jurisdiction over the parties and venue is proper in Shawnee County, Kansas.

Factual Allegations

9. The Fund is administered by the Securities Commissioner of Kansas pursuant to K.S.A. 17-12a601.

10. Securities registrants pay fees into the Fund for the purported purpose of regulating their industry and ensuring all registrants are on the same regulatory footing. These fees include, for example, a filing fee when an investment adviser files an application for registration, and an additional fee when the registration is renewed.

11. Over the course of a single fiscal year, through the accumulation of these fees, the balance of the Fund easily can exceed \$10,000,000.00.

12. While these fees are for the purported purpose of regulating the securities industry, only a small fraction of these fees are actually used for this purpose. Instead, the bulk of the fees are transferred to the state general fund and used for general purposes.

13. The relevant statutory provisions are K.S.A. 17-12a601(a)(3)-(5) and K.S.A. 75-3170a(a) & (c). These provisions state as follows:

a. K.S.A. 17-12a601(a)(3):

The administrator shall remit all moneys received from all fees, charges, deposits or penalties which have been collected under this act or other laws of this state regulating the issuance, sale or disposal of securities or regulating dealers in this state to the state treasurer at least monthly. Upon receipt of any such remittance, the state treasurer shall deposit the entire amount thereof in the state treasury. In accordance with K.S.A. 75-3170a, and amendments thereto, 10% of each such deposit shall be credited to the state general fund and, except as provided in subsection (d), the balance shall be credited to the securities act fee fund.

b. K.S.A. 17-12a601(a)(4):

On the last day of each fiscal year, the director of accounts and reports shall transfer from the securities act fee fund to the state general fund any remaining unencumbered amount in the securities act fee fund exceeding \$50,000 so that the beginning unencumbered balance in the securities act fee fund on the first day of each fiscal year is \$50,000. All expenditures from the securities act fee fund shall be made in accordance with appropriation acts upon warrants of the director of accounts and reports issued pursuant to vouchers approved by the administrator or by a person or persons designated by the administrator.

c. K.S.A. 17-12a601(a)(5):

All amounts transferred from the securities act fee fund to the state general fund under paragraph (4) are to reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services and any other governmental services which are performed on behalf of the state agency involved by other state agencies which receive appropriations from the state general fund to provide such services.

d. K.S.A. 75-3170a(a):

The 10% credit to the state general fund required by K.S.A. 1-204, 9-1703, 16a-2-302, 17-12a601, 17-2236, 20-1a02, 20-1a03, 31-133a, 31-134, 36-512, 44-324, 44-926, 47-820, 49-420, 55-155, 55-176, 55-609, 55-711, 55-901, 58-2011, 58-3074, 58-4107, 65-6b10, 65-1718, 65-1817a, 65-1951, 65-2011, 65-2855, 65-2911, 65-4024b, 65-5413, 65-5513, 65-6910, 65-7210, 65-7309, 66-1,155, 66-1503, 74-715, 74-1108, 74-1405, 74-1503, 74-1609, 74-2704, 74-3903, 74-50,188, 74-5805, 74-6708, 74-7009, 74-7506, 75-1119b, 75-1308, 75-1514, 84-9-801, and amendments thereto, is to

reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services, and any and all other state governmental services, which are performed

e. K.S.A. 75-3170a(c):

Notwithstanding any provision of any statute referred to in or amended by this act or referred to in subsection (a), whenever in any fiscal year such 10% credit to the state general fund in relation to any particular fee fund is \$100,000, in that fiscal year the 10% credit no longer shall apply to moneys received from sources applicable to such fee fund and for the remainder of such year the full 100% so received shall be credited to such fee fund.

14. The net effect of these provisions is to cause the Kansas Securities Commission to pay twice and sometimes three times for the same services, and to substantially overpay for what those services actually cost.

15. Each month, 10% of the Fund is credited the general fund, “to reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services, and any and all other state governmental services, which are performed on behalf of the state agency involved by other state agencies which receive appropriations from the state general fund to provide such services.” K.S.A. 17-12a601(a)(3); K.S.A. 75-3170a(c). This continues until the total of these monthly sweeps reaches \$100,000.00. K.S.A. 75-3170a(c).

16. The \$100,000 credit is more than sufficient to reimburse the state for the limited services it provides to the Kansas Securities Commissioner in a given year. *See Hammes Depo.*, 58:2-18.

17. Moreover, beyond this \$100,000, the state separately bills the Kansas Securities Commissioner for some services, such as maintenance on the state campus, that should be covered by the \$100,000 credit. *See Deposition of Lynn Hammes (“Hammes Depo.”)* 61:16-62:16, 65:19-66:17.

18. The state double-charges the Kansas Securities Commissioner for these services. *See Hammes Depo.* 65:19-66:17.

19. Because the money to pay these bills comes from Securities Fund, the state is ultimately is double-charging fee payors like Plaintiff. *See Hammes Depo.* 66:13-17.

20. The cost of the services provided by the State to the Office of the Kansas Securities Commissioner is generally around \$7,000-\$10,000 per year.

21. This \$7,000-\$10,000 and the annual budget of the Office of the Kansas Securities Commissioner represents the sum total of the amount that it costs the State to regulate the State's securities markets.

22. The \$100,000 credit discussed above gives the state *ten times* more than it needs. *See Deposition of Steve Wassom ("Wassom Depo.")* 46:23-47:17, 69:16-22.

23. Then, in addition to the \$100,000 credit, on the last day of the fiscal year, any remaining balance in the Fund in excess of \$50,000.00 is transferred to the general fund "to reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services and any other governmental services which are performed on behalf of the state agency involved by other state agencies which receive appropriations from the state general fund to provide such services." K.S.A. 17-12a601(a)(4) & (5).

24. The current State Budget Director conceded that the \$100,000 credit and the year-end fee sweep constituted a double payment for the same services. *See Deposition of Larry Campbell ("Campbell Depo.")* 66:9-70:14.

25. There is no doubt the State of Kansas can sweep money from the Fund to pay for the services referenced in K.S.A. 75-3170a(c) and K.S.A. 17-12a601(5), the State makes no effort to reconcile the actual cost of these services with the amounts transferred from the Fund.

Instead, it simply transfers all amounts over \$50,000.00. This results in the State transferring approximately four times the amount necessary to operate the entire office on an annual basis.

26. The sweeps from the Fund under K.S.A. 17-12a601(a)(4) far exceed any amounts due to the State for reimbursement for general services.

27. At the end of fiscal year 2016, the amount of the sweep totaled \$11,643,189. *See Hammes Depo.* 84:25-85:11.

28. The 2016 sweep amount is approximately four times what is needed to operate the the entire Office of the Kansas Securities Commissioner in 2016.

29. The 2016 sweep amount is more than **1,000 times** what is needed to reimburse the State for general services it provides to the Office of the Kansas Securities Commissioner on an annual basis.

30. At the end of fiscal year 2017, the amount of the sweep totaled \$13,400,866. *See Hammes Depo.*, 86:10-24.

31. The 2017 sweep amount is approximately four times what is needed to operate the the entire Office of the Kansas Securities Commissioner in 2017.

32. The 2017 sweep amount is more than **1,000 times** what is needed to reimburse the State for general services it provides to the Office of the Kansas Securities Commissioner on an annual basis.

33. At the end of fiscal year 2018, the estimated amount of the sweep totaled \$13,600,000. *See Hammes Depo.*, 92:13-93:20.

34. The 2018 sweep amount is approximately four times what is needed to operate the the entire Office of the Kansas Securities Commissioner in 2018.

35. The 2018 sweep amount is more than *1,000 times* what is needed to reimburse the State for general services it provides to the Office of the Kansas Securities Commissioner on an annual basis.

36. These statutory sweeps violate Article 11 of the Kansas Constitution which governs the State's taxation. Section 5 of Article 11 provides: "No tax shall be levied except in pursuance of a law, which shall distinctly state the object of the same; to which object only such tax shall be applied." Kan. Const. Art. XI, § 5. These sweeps result in the fees being an unlawful tax on Plaintiff and other fee-paying participants in the Kansas securities industry, with these taxes used for general purposes and not for any specified purpose.

37. Moreover, because the fees required under K.S.A. 17-12a410(3) and K.A.R. 81-14-2 are paid by persons and entities engaged in interstate commerce and are grossly excessive in comparison to the purported purpose for which they are collected, the fee sweeps also violate the commerce clause and the Fourteenth Amendment of the United States Constitution. This is the very situation described by the Kansas Supreme Court in *Panhandle Eastern Pip Line Co. v. Fadely*, 183 Kan. 803 (1958), where "the income derived from the fees collected so far exceeds the expenses of regulation as to impugn the good faith of the law." *Id.* at 807 (citing *Great Northern Ry. v. Washington*, 300 U.S. 154, 160-61 (1937)).

38. The current State Budget Director agreed that Kansas is charging securities fee payors much more than it takes to regulate the industry. *See Campbell Depo.* 81:6-13.

39. Because the the income derived from the fees collected by the Office of the Kansas Securities Commissioner each year so far exceeds the expenses of regulation, the fees themselves are excessive and, therefore, unconstitutional and illegal.

40. If the Fund were not drained of these fees at the end of the fiscal year, Plaintiff and other fee-paying participants in the securities industry in Kansas would not be required to continue paying fees at the levels presently required.

41. These sweeps force the Kansas Securities Commission to impose additional assessments on Plaintiff and the regulated industry as whole.

Class Action Allegations

42. Pursuant to K.S.A. 60-223, Plaintiff brings this action on behalf of himself and (a) all persons and entities that have paid fees under the Kansas Uniform Securities Act within the applicable statute of limitations period; and (b) all persons and entities that are required to pay fees under K.S.A. 17-12a410 on a going-forward basis. Excluded from the class are all judicial officers presiding over this or any related case. The class definition also excludes all employees of the State of Kansas. Plaintiff reserves the right to modify this class definition as discovery or other case circumstances warrant.

43. Although the exact number of class members is presently unknown, Plaintiff alleges that the class will number in the thousands, as it encompasses all issuers, broker-dealers, agents, investment advisers and investment adviser representatives currently registered in the State of Kansas.

44. There are questions of law and/or fact common to the Plaintiff and the class members, including whether the State's statutory-authorized sweeps of the Fund violate Article 11 of the Kansas Constitution, the Commerce Clause and the Fourteenth Amendment of the United States Constitution.

45. Plaintiff's claims are typical of the claims of absent class members in that Plaintiff, like all the absent class members, paid fees under K.S.A. 17-12a410 within the

applicable statute of limitations period and is required to pay fees under K.S.A. 17-12a410 on a going-forward basis.

46. Plaintiff is a member of the class he seeks to represent.

47. Plaintiff is an adequate class representative in that, as a member of the class, his interests are aligned with those of the class.

48. There are no individual conflicts that would prevent Plaintiff from adequately representing the class.

49. Plaintiff has retained competent counsel experienced in class action litigation.

50. Class certification is proper because common questions of fact and law predominate over questions that may affect only individual members of the class.

51. A class action presents a superior form of adjudication over individual litigation.

52. The costs of litigating this action against the State, in comparison to the recovery or relief sought, would make individual litigation impracticable. In addition, forcing individual litigation would risk the result of inconsistent rulings.

53. This class action is manageable. The proposed class represents an identifiable community that can be readily identified, and the relief sought is one that can be overseen by this Court.

Cause of Action

54. Plaintiff realleges and incorporates by reference all the preceding paragraphs.

55. The Fund is a statutory fee fund administered by the Securities Commissioner of Kansas.

56. Plaintiff and other members of the putative class are required to pay into the Fund under K.S.A. 17-12a410(3) and K.A.R. 81-14-2.

57. The stated purpose of the Fund is “to reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services, and any and all other state governmental services, which are performed on behalf of the state agency involved by other state agencies which receive appropriations from the state general fund to provide such services.”

58. The fees collected by the Fund on an annual basis are grossly disproportionate to the amount required to fulfill the stated purpose of the Fund. Through statutory sweeps, the State utilizes the bulk of these fees for the State’s general operations and not to regulate and supervise the Kansas securities industry.

59. As shown in the most-recent budget for the Kansas Securities Commission attached hereto as Exhibit A, the actual cost of operations in fiscal 2018 was approximately \$2.5 million, while the amounts budgeted for fiscal years 2019 and 2020 were approximately \$3.1 million and \$3.2 million respectively. In comparison, as shown in the excerpt attached hereto as Exhibit B, the State transferred approximately \$14 million from the Fund to the general fund in 2018 and expects to transfer \$13.3 million in 2019 and 2020 respectively.

60. But for these statutory sweeps, Plaintiff and other members of the putative class would not have been required and would not be required in the future to pay fees at the levels specified in K.S.A. 17-12a410(3) and K.A.R. 81-14-2.

61. The statutory sweeps forced and continue to force the Kansas Securities Commission to impose additional assessments on Plaintiff and other putative class members.

62. The fee payment provision (K.S.A. 17-12a410(3)) and the statutory sweep provisions (K.S.A. 17-12a601(a)(3)-(5)) collectively are being used by the State as a general revenue raising measure rather than a valid exercise of the State’s police power.

63. For the reasons stated herein, the statutory fees violate and continue to violate Article 11 of the Kansas Constitution, the commerce clause and the Fourteenth Amendment of the United States Constitution and 42 U.S.C. § 1983.

64. For the reasons stated herein, the statutory fee sweeps violated and continue to violate Article 11 of the Kansas Constitution, the commerce clause and the Fourteenth Amendment of the United States Constitution and 42 U.S.C. § 1983.

65. Unless the Court grants the relief requested, Plaintiff and other members of the putative will continue to be subjected to what amounts to an unconstitutional tax.

Prayer for Relief

WHEREFORE, Plaintiff prays for relief as follows:

- A. Pursuant to K.S.A. 60-223, an Order certifying this case for class action treatment;
- B. Pursuant to K.S.A. 60-1701 *et seq.*, a declaration that the statutory sweeps described herein are unconstitutional and void;
- C. Pursuant to K.S.A. 60-901 *et seq.*, injunctive relief to stop future sweeping of the Securities Fee Fund and over-collection of fees;
- D. A judgment in favor of class members for all monies paid by the class in fiscal years 2016 through the present over and above the amounts actually expended for regulatory operations;
- E. An award of the reasonable costs and attorney's fees incurred in bringing this action;
- F. An award of prejudgment interest; and
- G. For such other and further relief as the Court deems just and proper.

Jury Demand

Plaintiff requests a trial by jury on any issues so triable.

Respectfully submitted,

BARTLE & MARCUS, LLC

By: /s/ Matthew V. Bartle

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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on the 27th day of October, 2020, I electronically filed the foregoing with the Clerk of the Court via e-filing with all parties being electronically notified by the e-Flex filing system and an electronic notice and additional electronic mail copy sent to the following:

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/s/ Matthew V. Bartle

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Insurance Department
Securities Regulation

	FY 2018 Actual	FY 2019 Base Budget	FY 2019 Gov. Rec.	FY 2020 Base Budget	FY 2020 Gov. Rec.
Expenditures by Object					
Salaries & Wages	2,049,254	2,425,907	2,425,907	2,664,983	2,664,983
Contractual Services	392,133	569,562	569,562	453,126	453,126
Commodities	11,644	12,634	12,634	12,899	12,899
Capital Outlay	5,038	25,004	25,004	22,729	22,729
Debt Service	--	--	--	--	--
Subtotal: State Operations	\$2,458,069	\$3,033,107	\$3,033,107	\$3,153,737	\$3,153,737
Aid to Local Governments	--	--	--	--	--
Other Assistance	82,250	62,500	62,500	62,500	62,500
Subtotal: Operating Expenditures	\$2,540,319	\$3,095,607	\$3,095,607	\$3,216,237	\$3,216,237
Capital Improvements	--	--	--	--	--
Total Reportable Expenditures	\$2,540,319	\$3,095,607	\$3,095,607	\$3,216,237	\$3,216,237
Non-expense Items	--	--	--	--	--
Total Expenditures by Object	\$2,540,319	\$3,095,607	\$3,095,607	\$3,216,237	\$3,216,237
Expenditures by Fund					
State General Fund	--	--	--	--	--
Water Plan	--	--	--	--	--
EDIF	--	--	--	--	--
Children's Initiatives Fund	--	--	--	--	--
Building Funds	--	--	--	--	--
Other Funds	2,540,319	3,095,607	3,095,607	3,216,237	3,216,237
Total Expenditures by Fund	\$2,540,319	\$3,095,607	\$3,095,607	\$3,216,237	\$3,216,237
FTE Positions	26.53	25.80	25.80	28.00	28.00
Non-FTE Unclassified Permanent	--	--	--	--	--
Total Positions	26.53	25.80	25.80	28.00	28.00

Performance Measures	FY 2017 Actual	FY 2018 Actual	FY 2019 Estimate	FY 2020 Estimate
Amount of securities offerings registered (in billions)	\$83.7	\$73.2	\$75.0	\$80.0
Number of broker-dealers and investment adviser examinations that corrected noncompliance	50	71	80	89
Number of enforcement and compliance cases opened	41	80	90	96

and is responsible for defending the legal interests of the State of Kansas in all actions and proceedings, civil and criminal. Key responsibilities of the office include enforcement of the state's Consumer Protection, Charitable Solicitations, Charitable Trust, and False Claims Acts. The agency also houses the Office of the Inspector General, which provides oversight and accountability of the state Medicaid program, the MediKan program, and the Children's Health Insurance Program. Coordination of the Crime Victims Compensation Board and the Child Death Review Board are also major agency responsibilities.

A revised budget of \$28.8 million is recommended for FY 2019 and includes \$7.0 million from the State General Fund. Revisions to the approved budget include \$4.0 million in additional funds to pay wrongful conviction claims as a result of the passage of HB 2579 during the 2018 Legislative Session.

For FY 2020, the Governor recommends a budget for the Attorney General totaling \$27.2 million, including \$6.5 million from the State General Fund. A transfer of \$600,000 from the State General Fund to the Medicaid Fraud Prosecution Revolving Fund is recommended in both fiscal years to meet a 25.0 percent federal Medicaid grant matching requirement which funds the Medicaid Fraud and Abuse Unit. The recommendation will support 125.60 FTE and 35.56 non-FTE unclassified permanent positions in both fiscal years.

Insurance Department

The mission of the Insurance Department is to protect the insurance consumers and investors of Kansas and to serve the public interest through the supervision, control, and regulation of persons and organizations transacting the business of insurance and issuing securities in the state, and to promote integrity and full disclosure in financial services. This mission is accomplished by assuring fair, affordable, accessible, and competitive insurance and securities markets and fostering capital formation. For FY 2019 and FY 2020, the Governor recommends expenditures totaling \$32.3 million and \$32.8 million, respectively. These recommendations will finance 127.63 FTE positions in FY 2019 and 129.63 FTE positions in FY 2020.

In prior fiscal years, the Insurance Department transferred the excess balance in the Insurance

Department Service Regulation Fund to the State General Fund. The Insurance Department will transfer \$8.3 million in FY 2019 from the Insurance Department Service Regulation Fund to the State General Fund. However, no such transfers are recommended in FY 2020. By statute, the Securities Act Fee Fund is swept at the end of the fiscal year so that any amount over \$50,000 is transferred to the State General Fund. The agency estimates that it will transfer a total of \$13.3 million from the Securities Act Fee Fund to the State General Fund in FY 2019, which is a decrease of \$720,765 from the transfer amount approved by the 2018 Legislature. For FY 2020, the agency will transfer \$13.3 million from the Securities Act Fee Fund to the State General Fund.

The Office of the Securities Commissioner merged with the Insurance Department at the beginning of FY 2018. The State General Fund transfer totals above include estimated efficiency savings from the merger totaling \$500,000 in FY 2019 (\$250,000 from the Insurance Department Service Regulation Fund and \$250,000 from the Securities Act Fee Fund). The bill authorizing the merger also requires the Insurance Department to transfer \$400,000 to Attorney General's Fraud and Abuse Criminal Prosecution Fund beginning in FY 2018, including \$200,000 each from the Securities Act Fee Fund and the Insurance Department Service Regulation Fund.

Secretary of State

The mission of the Office of the Secretary of State is to serve as the custodian of official government documents for the State of Kansas. The primary duties of the office are to register corporations doing business in the state; supervise and provide assistance to local election officers in all elections; oversee the Help America Vote Act; and administer the State Uniform Commercial Code. The Secretary of State also appoints notaries public, maintains a registry of trademarks, and supervises the engrossing of all legislative acts and compilation of *The Session Laws of Kansas*.

For FY 2019, the agency was approved to spend \$8.9 million, which includes a base amount of \$4.5 million from fee and federal funds approved by the 2018 Legislature and nearly \$4.4 million from a federal Help America Vote Act Election Security Grant. For FY 2020, the agency plans to spend \$3.9 million from fee