2013

Texas Annual Survey: Securities Regulation

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SECURITIES REGULATION

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SECURITIES regulation deals primarily with the laws preventing and providing remedies for fraud in the sale of stocks and bonds. Texas has two major statutes to combat securities fraud: The Texas Securities Act (TSA) and the Texas Stock Fraud Act (TSFA).[1] Since the legislature modeled the fraud provisions of the TSA on the federal statutes,[2] Texas courts use federal decisions under the federal statutes to interpret the TSA's similar language.[3] This Article, therefore, includes the Fifth Circuit cases involving state law and securities fraud under federal law. The author does not intend for this Article to exhaust all aspects of securities regulation but rather to update the Texas-based securities practitioner on new developments of interest.

I. COVERAGE OF THE SECURITIES ACTS

The definitions (especially those relating to what constitutes a security or a stock and the persons liable) as well as federal preclusion of state securities fraud actions determine the fraudulent transactions subject to the state's securities acts. Texas courts have begun to consider whether equity interests in limited liability companies (LLCs) are securities under the TSA and constitute stock under the TSFA. Texas courts were also confronted with some interesting secondary liability situations. The Fifth Circuit determined that the Securities Litigation Uniform Standards Act (SLUSA)[4] did not preclude a class action under the TSA for fraud in connection with the sale of certificates of deposits.

A. THE STOCK AND SECURITY DEFINITIONS FOR LLC EQUITY INTERESTS

The TSA applies to "securities." For many questionable contracts, most courts follow the Fifth Circuit's economic-realities-of-the-parties'-rela-

1. *See* TEX. REV. CIV. STAT. ANN. art. 581-1 (West 2012); TEX. BUS. & COM. CODE ANN. § 27.01 (West 2012). The TSFA is embedded in a statute that also covers real estate fraud, so many of the cases dealing with TSFA's statutory fraud deal with real estate. *See* TEX. BUS. & COM. CODE ANN. § 27.01.

2. *See* TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (West 2010) (comment to 1977 amendment).

3. *See, e.g.*, Highland Capital Mgmt., L.P. v. Ryder Scott Co., No. 01-10-00362-CV, 2012 WL 1136607 (Tex. App.—Houston [1st Dist.] Apr. 5, 2012), *withdrawn*, 402 S.W.3d 719, 741 (Tex. App.—Houston [1st Dist.] 2012, no pet.) (discussed below, *see infra* notes 27–45 and accompanying text); Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 102 n.13 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

4. *See* 15 U.S.C. § 78bb(f)(1)(A) (2012).

tionship test[5] with respect to investment contracts—defined as "securities"[6]—to determine whether the investor was passive (relied on the promoter to achieve a profit), in which case the interest is a security, or active (participated in management), in which case the interest is not a security.[7] In *Affco Investments 2001, L.L.C. v. Proskauer Rose, L.L.P.*,[8] the Fifth Circuit applied this test to an equity interest in an LLC for the federal securities laws. *Affco Investments* involved the sale of a hedged tax shelter scheme marketed by an accounting firm on the basis of legal opinions by unnamed national law firms and with one leg of the hedge in the LLC purchased by the investors. The Internal Revenue Service (IRS) subsequently disallowed the scheme's tax benefits. Before the investors filed their tax returns, the IRS issued notices of certain prohibited transactions. One of the national law firms issued an opinion, requested by the investors, that the scheme did not resemble the prohibited transactions. Consequently, the investors did not avail themselves of tax reporting procedures that would have enabled them to qualify for amnesty on the scheme. Suffering losses in back taxes, interest, and penalties, the investors sued the law firm for violation of the Racketeering Influenced and Corrupt Organizations Act (RICO)[9] and federal securities laws, as well as secondary liability (both aider and abettor liability and control person liability) under the TSA.[10] The trial court dismissed the RICO claim because it was barred by the Private Securities Litigation Reform Act (PSLRA)[11] and the securities claims for failure to sufficiently plead reliance and scienter, and the trial court also refused to exercise supplemental jurisdiction over the TSA claims.[12] The Fifth Circuit affirmed.[13]

With respect to the "securities" issue, the PSLRA bars civil RICO claims based on fraud in the purchase or sale of securities.[14] The investors claimed that the LLC equity interests did not constitute securities. However, the investors, many of who were the only members of the respective LLC, did not manage the LLC but had agreements with various invest-

5. *See* Williamson v. Tucker, 645 F.2d 404, 418, 422–23 (5th Cir. 1981) (determining that a passive partnership interest was an investment contract and hence a security).

6. *See* 15 U.S.C. § 77b(a)(1).

7. *See* United States v. Leonard, 529 F.3d 83, 91 (2nd Cir. 2008) (finding that the LLC interests in the case were securities).

8. Affco Invs. 2001, L.L.C. v. Proskauer Rose, L.L.P., 625 F.3d 185, 191 (5th Cir. 2010).

9. 18 U.S.C. §§ 1962(a), 1964(c) (2012).

10. The investors also sued the accounting firm under Rule 10b-5 and obtained a settlement. *See Affco Invs. 2001, L.L.C.*, 625 F.3d at 189; 17 C.F.R. § 240.10b-5 (2012).

The investors also sued the law firm under the Texas Deceptive Trade Practices Act (TDTPA). *See* Brief of Proskauer Rose LLP in Support of Motion to Dismiss First Amended Complaint at 21, Affco Invs., LLC v. Proskauer Rose, LLP, 625 F.3d 185 (5th Cir. 2010) (No. 09-20734), 2009 WL 954785; *see also* George Lee Flint, Jr., *Securities Regulation*, 59 SMU L. REV. 1541, 1555 n.94 (2006) (discussing the applicability of the TDTPA to investment advice). Although the TDTPA applies to most services, there is an exception for professional services. *See* TEX. BUS. & COM. CODE ANN. § 17.49(c) (West 2012).

11. 15 U.S.C. §§ 77z-1, 78u-4.

12. *Affco Invs. 2001, L.L.C.*, 625 F.3d at 189.

13. *Id.* at 196.

14. *See* 18 U.S.C. § 1964(c).

ment and brokerage firms for that management. So, under the Fifth Circuit's economic-realities-of-the-parties'-relationship test and its previous finding that tax benefits are "profit" for determining the presence of an investment contract,[15] the investors were passive. Consequently, these LLC equity interests constituted "investment contracts," defined as "securities."[16] The reliance and scienter issues in *Affco Investments* are discussed below.[17]

In contrast to the TSA, the TSFA applies to "stock" in a corporation or a joint stock company, not a "security."[18] An LLC is not a corporation[19] or a joint stock company.[20] However, the equity interest may take the form of stock. The principal parties in *Allen v. Devon Energy Holdings, LLC*,[21] an opinion discussed below,[22] did not raise this issue, although the LLC did mention the issue in a footnote to its brief.[23] Accordingly, the Houston First District Court of Appeals, without addressing the applicability of the TSFA, applied the TSFA to the equity interest in the LLC involved in the opinion.

B. Persons Liable

The ease of becoming judgment proof in Texas with liberal exemptions from execution of judgment makes secondary liability very important. The Texas statutes provide for several vicarious liability theories, including aiding and abetting liability and control person liability. Since federal securities law does not allow a private investor to recover against aiders and abettors,[24] aiding and abetting has become a significant aspect of state securities law. The elements of an aider and abettor claim under the TSA are: (1) a primary violation, (2) the aider's general awareness of the violation, (3) the aider's substantial assistance, and (4) the aider acted

15. *See* Long v. Shultz Cattle Co., 881 F.2d 129, 132 n.2 (5th Cir. 1989) (discussing an action involving a cattle feeding program).

16. *Affco Invs. 2001, L.L.C.*, 625 F.3d at 189–91.

17. *See infra* notes 141–45 and accompanying text. To uphold summary judgment for the fraud claim, the court need only find one element missing. Since the Fifth Circuit found reliance missing, it did not consider the scienter pleading.

18. *See* Tex. Bus. & Com. Code Ann. § 27.01(a) (West 2012) ("involving real estate or stock in a corporation or joint stock company").

19. *Compare* Tex. Bus. Orgs. Code Ann. § 1.002(14) (West 2012) (defining a corporation), *with id.* § 1.002(46) (defining a limited liability company).

20. *Compare* Flint v. Culbertson, 319 S.W.2d 690, 693–94 (Tex. 1958) (holding owners of a joint stock company jointly and severally liable for the debts of the company), *with* Tex. Bus. Orgs. Code Ann. § 101.114 (stating that owners of a limited liability company are not liable for the debts of the company).

21. Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.).

22. *See infra* notes 98–137 and accompanying text.

23. *See* Brief for Appellee Devon Energy Production Co., L.P. at 15 n.5, Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.) (No. 01-09-00643-CV), 2010 WL 780953 (asserting that Appellant has no standing to sue under the TSFA).

24. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 175–76 (1994).

with intent or reckless disregard of the truth.[25] The second TSA secondary liability principle deals with persons in control of the primary violator. Control person liability under the TSA has two elements: the controlling person had (1) actual power over the controlled person and (2) the power to control the specific action that gave rise to the primary violation.[26] Of the three appellate opinions dealing with secondary liability, two used both the aiding and abetting principles as well as control person principles to hold a perpetrator liable.

1. Aider and Abettor Liability of Subsequent Investors

The investors in the first opinion, *Highland Capital Management, L.P. v. Ryder Scott Co.*,[27] purchased the issuer's publicly registered unsecured senior notes from 1999 to 2000 and again in 2002 based on representations of the issuer's oil and gas reserves contained in its prospectus and in subsequent annual reports to the Securities and Exchange Commission (SEC). The reports were based on information prepared by one of the aiders and abettors, a petroleum engineering firm, without following SEC rules for calculating those reserves.[28] The senior notes prohibited senior secured indebtedness greater than 30% of the reserves. In 2001, the issuer sold secured notes to the second aider and abettor, an independent oil and gas producer. In late 2002, the petroleum engineering firm revised the reserves downward, the issuer became no longer able to pay the interest on the senior notes, and the investors forced an involuntary liquidation bankruptcy proceeding under which they recovered less than two cents on the dollar.[29] To recoup their losses, the investors sued the petroleum engineering firm for producing fraudulent reserve estimates and the holder of the secured notes for knowing of the fraud and causing the investors' loss, all as aiders and abettors of the bankrupt issuer's fraud.[30]

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25. *See* Darocy v. Abildtrup, 345 S.W.3d 129, 138–39 (Tex. App.—Dallas 2011, no pet.) (discussed below, *see infra* notes 46–50 and accompanying text); *see also* TEX. REV. CIV. STAT. ANN. art. 581-33, § F(2) (West 2012); Sterling Trust Co. v. Adderley, 168 S.W.3d 835, 841–42 (Tex. 2005) (adding the general awareness element); Flint, *supra* note 10, at 1550–53 (discussing *Sterling Trust Co.*).

26. *See* Abbott v. Equity Group, Inc., 2 F.3d 613, 620 (5th Cir. 1993) (laying out the two-pronged test for federal securities law). Texas follows federal law in interpreting this provision of the TSA.

27. Highland Capital Mgmt., L.P. v. Ryder Scott Co., No. 01-10-00362-CV, 2012 WL 1136607 (Tex. App.—Houston [1st Dist.] Apr. 5, 2012), *withdrawn*, 402 S.W.3d 719 (Tex. App.—Houston [1st Dist.] 2012, no pet.). The investors also alleged common law fraud, negligent misrepresentation, conspiracy, and aiding and abetting fraud. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 723.

28. The rule limits unproven reserves to those drilling units offsetting productive units reasonably certain of production when drilled. *See* 17 C.F.R. § 210.4-10(a)(31)(i) (2012).

29. For bankruptcy proceedings of the issuer, *see In re* Seven Seas Petroleum, Inc., 522 F.3d 575 (5th Cir. 2008) (where an independent oil producer, as a secured creditor, attempted to have an investor's state claims discharged in bankruptcy).

30. In the federal court system, the Fifth Circuit takes a dim view of secured debt holders who use their position to gain at the expense of the less secured. *See In re* E. A. Fretz Co., 565 F.2d 366, 369–71 (5th Cir. 1978) (where the court favored a second secured party when the first secured party bought up unsecured debt at a deep discount, raising such unsecured debt to first secured status to the second secured party's detriment).

The trial court granted a no-ground summary judgment.[31] The appellate court affirmed in part and reversed and remanded in part.[32]

To support the defensive summary judgment, the Houston First District Court of Appeals in *Highland Capital Management* only needed to find one of the elements of the investor' case nullified.[33] The independent oil producer successfully focused on the element of its awareness of the violation, relying on affidavits of its chief financial officer, executive vice president of exploration, and a director shared with the issuer, each of whom was properly coached[34] to swear that they had no knowledge of any of the mistakes or irregularities in the reserve report from the petroleum engineering firm. The investors' first piece of controverting evidence consisted of a deposition of the chief financial officer indicating the absence of a due diligence effort in creating the reserve report prior to purchasing the secured notes, and an affidavit of a registered petroleum engineer, an examination of which would have shown it violated SEC rules and used improper engineering techniques (because it used gravity segregation with counterflow without years of continuous production). The investors' second piece of controverting evidence was the common director of both the issuer (when it discovered a massive gas cap that would severely reduce reserves) and later of the aider and abettor. The investors provided no evidence that the issuer's board discussed the matter or that the director was privy to such discussions. Unfortunately for the investors, the Texas Supreme Court has ruled that the general awareness requirement under the TSA is subjective, not objective (should have known),[35] so the investors' controverting evidence failed to defeat summary judgment with respect to the independent oil producer.[36]

The interesting aspect of the opinion lay in the investors' attempt to expand aider and abettor liability through the general awareness principle. Other opinions indicate that lending money to a fraudster, enabling the fraudster to hide or perpetuate the fraudster's scheme, amounts to aiding and abetting.[37] The *Highland Capital Management* investors tried to expand this to "should have known." Fortunately, the court of appeals preserved the defense to an aiding and abetting claim when the innocent

31. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 725–26.

32. *Id.* at 748.

33. *See* Cathey v. Booth, 900 S.W.2d 339, 341 (Tex. 1995).

34. The Texas Supreme Court's test for the admissibility of a self-serving affidavit in support of summary judgment requires that the affidavit "is clear, positive, direct, otherwise credible, free from contradictions and inconsistencies, and could have been readily controverted" by opposing evidence. *See* Trico Techs. Corp. v. Montiel, 949 S.W.2d 308, 310 (Tex. 1997).

35. *See* Sterling Trust Co. v. Adderley, 168 S.W.3d 835, 841–42 (Tex. 2005); *see also* Flint, *supra* note 10, at 1550–53 (discussing *Sterling Trust Co.*).

36. Highland Capital Mgmt., L.P. v. Ryder Scott Co., 402 S.W.3d 719, 738–39 (Tex. App.—Houston [1st Dist.] 2012, no pet.).

37. *See* Goldstein v. Mortenson, 113 S.W.3d 769, 777 (Tex. App.—Austin 2003, no pet.) (where a broker aided the acquisition of a loan to cover known losses between investors' reported funds and funds available); *see also* K & S P'ship v. Continental Bank, N.A., 952 F.2d 971, 977 (8th Cir. 1991).

subsequent investor did not actually know of the fraudulent scheme.[38]

2. *Aider and Abettor Liability of a Petroleum Report Preparer*

The *Highland Capital Management* investors claimed the petroleum engineering firm aided both the public brokers who sold the bonds to the investors and the issuer in perpetrating the fraud. With respect to the brokers, the petroleum engineering firm focused on whether unidentified persons could be "sellers" for aiding and abetting liability purposes since selling requires privity.[39] Although the TSA does not define "sellers," and no Texas case has dealt with the issue, the appellate court ruled that "sellers" include brokers since the comments to the TSA say the term "sellers" includes brokers,[40] and federal law, followed by Texas courts in interpreting the TSA, similarly includes brokers within the term "sellers."[41] With respect to the issuer, the petroleum engineering firm asserted that it did not render substantial assistance since cautionary language in the prospectus rendered the issuer's misstatements immaterial, and that it did not act recklessly since it believed its reserve report complied with SEC requirements and industry standards. The first assertion failed to support summary judgment because the prospectus intermingled the cautionary language with misstatements regarding following SEC rules and industry standards. The intermingled statements raised a fact issue concerning whether the cautionary language would satisfy the test for immateriality, namely negating the capacity of the misleading statement on oil reserves to influence a reasonable investor.[42] The second assertion also failed since the trial court erroneously excluded a copy of the SEC rules as hearsay. The rules might have refuted the petroleum engineering firm's contention that it believed it had followed the SEC rules. Accordingly, the investors still had the TSA claims for aiding and abetting against the petroleum engineering firm.[43]

The disturbing aspect of the *Highland Capital Management* case concerns the inability of the SEC, in examining the registration statement for the public sale of the unsecured notes, to fathom a petroleum report prepared contrary to its rules. The upshot of that inability means an investor needs to do its own due diligence (which these investors claimed would have revealed the problem) even for a public offering. It is no wonder that Congress now permits the selling of securities through private placements with advertising to accredited investors and through registered

38. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 738–39.

39. *See* Frank v. Bear, Stearns & Co., 11 S.W.3d 380, 383 (Tex. App.—Houston [14th Dist.] 2000, pet. denied).

40. *See* TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (West 2012) (comment to 1977 amendment).

41. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 741–42; *see also* Pinter v. Dahl, 486 U.S. 622, 646–47 (1988).

42. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 745; *see also* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097–98 (1991).

43. *Highland Capital Mgmt., L.P.*, 402 S.W.3d at 748.

brokers or funded portals to small investors.[44] There is no difference in the reliability of the information contained in a registered transaction and an unregistered transaction. The small investor will become ever more dependent on state law fraud remedies.[45]

3. *Aiding and Abetting and Control Person Liability for an Issuer's Secretary/Treasurer/Director*

The second aider and abettor opinion, *Darocy v. Abildtrup*,[46] involved an oil and gas scam.[47] The scammers organized a corporation to sell and promote four oil and gas joint ventures, raised $8 million, and spent $2.3 million of that investment on Louisiana casinos, gentlemen's clubs, jewel-

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44. *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, §§ 201 (adding 15 U.S.C. § 77d(b) (2012) and directing the SEC to amend 17 C.F.R. §§ 230.502(c), 230.506 (2012) to allow general advertising in sales to accredited investors), 302 (adding a new exemption for sales by registered brokers and registered funded portals in the aggregate annual amount less than $1 million to small investors provided the investment is no more than the greater of $2,000 or 5% of the annual income or net assets for investors with annual income or net assets less than $100,000 and no more than 10% for investors with more than $100,000), 126 Stat. 306 (2012).

45. Protection by state registration will be unavailable because Congress preempted state registration for sales to small investors under the new exemption. *See id.* § 305 (amending 15 U.S.C. § 77r(b) to provide that the new exemption is a covered security exempt from state registration).

46. Darocy v. Abildtrup, 345 S.W.3d 129, 132–35 (Tex. App.—Dallas 2011, no pet.).

47. Regulatory bodies are gravely concerned about oil and gas scams. *See, e.g.*, Press Release, Tex. State Sec. Board, State Sec. Regulator Warns Against Slippery Oil Deals Oil Patch Scams Remain Favored Ploy to Fleece Investors (Jan. 11, 2007) (describing schemes of out of state limited partnerships selling to other state's residents to reduce the likelihood of discovery of the absence of substance and high pressure boiler room and internet sales; recommending an informational procedure for prospective investors to follow to reduce the possibility of being scammed). The SEC also has a warning to investors dealing with oil and gas scams. *See Oil and Gas Scams: Common Red Flags and Steps You Can Take to Protect Yourself*, SEC http://www.sec.gov/investor/pubs/oilandgasscams.htm (last visited July 22, 2012) (pointing out the red flags of (1) sales pitches focused on highly publicized news, (2) "can't miss" wells, (3) unsolicited materials, (4) limited opportunities, (5) high rates of return, and (6) tips or secrets; recommending that prospective investors (1) ask questions and check out the answers, (2) contact state oil and gas regulatory agencies [for Texas, the railroad commission], (3) research the company, and (4) know the sales person).

The Texas State Securities Board criminally prosecutes oil and gas scammers. *See* Hays v. State, 370 S.W.3d 775 (Tex. App.—Texarkana 2012, no pet.); *see also* Press Release, Tex. State Sec. Bd., North Texas Man Sentenced to 25 Years in Oil Field Scam (Apr. 26, 2011), *available at* http://www.ssb.state.tx.us/News/Press_Release/04-26.11_press.php). In *Hays*, the scammers sold two drilling joint ventures to investors, raised $2.5 million from 40 investors, drilled no wells, and spent only $400,000 on legitimate drilling expenses, spending the rest on personal expenses and salaries. *Hays*, 370 S.W.3d at 777–80. For the first well, the scammers hired a drilling company that sent equipment but left when it was not paid the down payment. For the second well, the scammers failed to inform the investors that funds invested by previous investors were spent on non-drilling activities and that the scammers had breached the contract with the drilling company by non-payment. *See* TEX. REV. CIV. STAT. ANN. art. 581-29C, §§ (3), (4)(C) (West 2012) (stating that it is a first degree felony to omit material information in the sale of a security if the amount involves more than $100,000). The defendant, the first of five scammers tried, challenged the sufficiency of the evidence. For the omitted breached contract and the omitted use of funds, investor testimony that it would have affected their investment decision (which supported materiality and the defendant's statements), leading the investors to believe drilling was imminent, failure to return investor calls, and outbursts on investor questioning supported the conviction.

ers, cleaners, and retail stores not normally associated with business supplies (including liquor stores). When the receiver took over the selling corporation, only one well was completed and another drilled. The oil and gas leases ultimately expired due to lack of operations and the entire investment was lost. The investors sued the corporation, its former chief executive officer (both of whom settled for a total of $12 million plus $0.75 million in legal fees), and the corporation's secretary/treasurer/director as an aider and abettor and a control person under the TSA. The secretary/treasurer/director had opened the issuer's bank account, was one of two people needed to sign checks over $1,000, was responsible for the IRS Forms K-1 for the investors, which he never delivered when requested, and fielded supplier inquiries about payables and wasteful spending. The trial court entered a judgment against the secretary for $1.5 million.[48] The Dallas Court of Appeals affirmed.[49]

Conceding the primary violation by the issuer, the secretary/treasurer/director challenged the sufficiency of the judgment, contending he was nothing more than a marketing and salesperson and assumed the title of secretary/treasurer/director in name only. With respect to the four elements of aider and abettor liability, the concession proved the primary violation, the supplier inquiries proved general awareness, control of the bank accounts proved substantial assistance, and failure to respond to investor inquiries proved intent to deceive.[50]

In addition to suing the secretary/treasurer/director of the issuer with aiding and abetting liability, the *Darocy* investors also sued the officer as a control person. Because the officer conceded the primary liability of his corporation with respect to control person liability, the court of appeals applied the federal two-prong test for "control" because Texas courts generally use federal principles to interpret the TSA.[51] That test requires exercised control of general operations and the power to control the specific transaction, and both elements were satisfied by the secretary/treasurer/director's actions on behalf of the corporation.[52]

4. *Aider and Abettor and Control Person Liability of a Brokerage Firm for its Employee*

The disgruntled investor in *Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc.*[53] had purchased stock from a brokerage firm employee in companies owned by the employee outside of his brokerage firm's busi-

48. *Darocy*, 345 S.W.3d at 136.
49. *Id.* at 139.
50. *Id.* at 138–39.
51. *See, e.g.*, Highland Capital Mgmt., L.P. v. Ryder Scott Co., 402 S.W.3d 719, 741 (Tex. App.—Houston [1st Dist.] 2012, no pet.).
52. *See* Abbott v. Equity Group, Inc., 2 F.3d 613, 620 (5th Cir. 1993).
53. Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc., No. 03-09-00566-CV, 2011 WL 2769838 (Tex. App.—Austin July 12, 2011, no pet.) (opinion by C.J. Jones), *appeal abated*, 2011 WL 4424291 (Tex. App.—Austin Sept. 23, 2011, no pet.) (pending settlement in related case). The author served with C.J. J. Woodfin Jones as a director of the University of Texas Law School's Legal Research Board in 1975.

ness. The investor was not a client of the brokerage firm. The brokerage firm's employee manual included a policy, consistent with brokerage association rules, that employees could not engage in outside securities transactions without the brokerage firm's permission. The omissions to induce the investor into the business included failure to disclose that the employee was not registered with the Texas State Securities Board (Board), was subject to consumer-protection litigation brought by the Texas Attorney General, and attempted to resell the same stock to others. The investor sued the brokerage firm, among others, for damages and rescission. Discovery revealed a reprimand letter from the brokerage firm to the employee regarding his failure to accurately report his outside activities but foregoing further discipline because the employee had decided to sell the outside interests. Depositions similarly revealed that the employee's superiors only knew that the sale would or had occurred. The brokerage firm moved for summary judgment, which the trial court granted and severed from the suits against the others.[54] The Austin Court of Appeals affirmed in part, and reversed and remanded in part.[55]

With respect to the aider and abettor claim, the *Fernea* court focused on the general awareness element. The evidence of knowledge of the sale failed to satisfy the general awareness requirement since the brokerage firm lacked any knowledge of the violation of omitting disclosure of various information.[56]

With respect to control person liability, the *Fernea* court focused on the power to control the specific action. The brokerage firm argued that it did not have the power to control the employee outside of the brokerage

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The other issues involved in the opinion dealt with negligence in supervising the employee, negligence for allowing an employee to violate internal policies of the brokerage firm, and violation of several National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) rules. For the securities regulation matter of an implied cause of action for violation of NASD and NYSE rules, the court quickly affirmed the dismissal because the overwhelming case law rejects the inference of a private cause of action for such a violation. *Id.* at *3–5.

The violated rules were NASD rules 3030 and 3040, and NYSE rule 346. *See* Appellant's Brief at 11–13, Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc., No. 03-09-00566-CV, 2011 WL 2769838 (Tex. App.—Austin July 12, 2011, no pet.), *appeal abated*, 2011 WL 4424291 (Tex. App.—Austin Sept. 23, 2011, no pet.), 2010 WL 1604894, at *11–16. NASD rule 3030 requires the employee to give written notice to the brokerage firm of outside business activities, while rule 3040 requires the employee to give written notice to the brokerage firm of outside securities transactions and its compensation after which the brokerage firm disapproves or approves and supervises. *See* NASD Manual, Rule 3020, 3040. NYSE rule 346 similarly requires the employee to give written notice to the brokerage firm and receive written approval before engaging in outside business activities. *See, e.g.*, *Richard Foerster Reynolds, Former Registered Representative*, Hearing Board Decision 09-NYSE-04, 2009 WL 961140 (Mar. 10, 2009). These rules have subsequently been supplanted. *See* NYSE Regulation, Exchange Act Release No. 34-64131 (Mar. 28, 2011); NASD Regulation, Exchange Act Release No. 34-62762 (Aug. 23, 2010).

54. *Fernea*, 2011 WL 2769838, at *1. On February 11, 2011, the investor obtained a judgment for $1.6 million against the employee. *See* Chuck Lindell, *Jury Awards $1.6 Million in Business Fraud Suit*, AUSTIN-AM. STATESMAN (Feb. 11, 2011, 9:22 PM), www.statesman.com/news/business/jury-awards-16-million-in-business-fraud-suit/nRXWh/.

55. *Fernea*, 2011 WL 2769838, at *18.

56. *Id.* at *13–15.

firm's business. The *Fernea* court determined this was a fact issue not conclusively proven for summary judgment.[57] One method of control is by contract,[58] and the employee manual provision relating to outside securities transactions was a contractual obligation of the employee's employment.[59]

In 2005, the Texas Supreme Court limited aider and abettor liability by adding a general awareness of the violation requirement that necessitates actual subjective knowledge, not objective should-have-known knowledge.[60] The corresponding element for control person liability is an affirmative defense that the control person neither knew nor, through reasonable care, could know of the facts of the violation[61]—a less protective requirement that changes the burden of proof and does not require a subjective standard. The *Fernea* court went on to make a few gratuitous remarks about the control person's affirmative defense, which was not asserted by the brokerage firm for summary judgment.[62] The *Fernea* court suggested that the lack of written notice required under the firm's employment policy would not suffice. The impact of the *Fernea* case is an increase in control person liability[63] merely because the brokerage firm has an employee policy concerning outside activities that the employee is free to breach at any time. Brokerage firms, absent a method of detecting employees likely to breach the employment policy, will remain exposed to control liability under the TSA until the Texas Supreme Court similarly reins in this expansion. Control person liability was designed for control of artificial entities, not free-will individuals. That is the reason vicarious liability in tort law requires an employee's tortious action to benefit the employer, which was clearly absent for the broker in the opinion.

C. Preclusion of the TSA for Fraud in Connection with Uncovered Securities

The SLUSA precludes[64] state law for class actions of over fifty investors for misrepresentation or omission of a material fact in connection

57. *Id.* at *16.

58. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33 cmt. (West 2012) (comment to 1977 amendment).

59. *Fernea*, 2011 WL 2769838, at *17.

60. *See* Sterling Trust Co. v. Adderley, 168 S.W.3d 835, 841–42 (Tex. 2005) (adding the general awareness element); *see also* George Lee Flint, Jr., *Securities Regulation*, 57 SMU L. Rev. 1207, 1210–11 (2004) (discussing *Sterling Trust Co.*).

61. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33F, § (1).

62. *See* Appellee's Brief at 24, Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc., 2011 WL 2769838 (Tex. App.—Austin July 12, 2011, no pet.), *appeal abated*, 2011 WL 4424291 (Tex. App.—Austin Sept. 23, 2011, no pet.), 2010 WL 2278493, at *24.

63. Prior brokerage cases dealing with errant employees found no control person liability. *See* Barnes v. SWS Fin. Servs., Inc., 97 S.W.3d 759, 764-65 (Tex. App.—Dallas 2003, no pet.); *see also* Hauser v. Farrell, 14 F.3d 1338, 1342–43 (9th Cir. 1994).

64. The Fifth Circuit prefers to refer to the SLUSA preemption as preclusion on the basis of a meaningless distinction, *see* Roland v. Green, 675 F.3d 503, 507 n.1 (5th Cir. 2012) (referencing two United States Supreme Court cases: one referring to preemption and the other preclusion, because the SLUSA allegedly does not replace the precluded

with a sale or purchase of "covered securities," thereby narrowing the scope of the TSA and TSFA.[65] In *Roland v. Green*, the victims of a multi-million dollar Ponzi scheme had purchased certificates of deposit (CDs) from an offshore bank with assets invested in a diversified portfolio of marketable securities.[66] The victims brought a class action in federal court against the bank's insurance brokers for misrepresentations of material facts and, along with the bank's lawyers who prevented the SEC from uncovering the Ponzi scheme, for aiding and abetting, all under the TSA. The trial court noted that the CDs were not "covered securities" because they were not registered or traded on a national exchange.[67] In the absence of any Fifth Circuit precedent, the trial court adopted the Eleventh Circuit's induced and depend principle, determining that the "in connection with the purchase or sale of covered securities" requirement was satisfied and dismissed the victims's TSA lawsuits.[68] The CDs backed by covered securities induced the victims to purchase, and the victims sold covered securities to raise money for the purchase of CDs.[69] The Fifth Circuit reversed and remanded.[70]

The Fifth Circuit noted that Congress designed the SLUSA to prevent states from imposing their litigation costs and risks on nationally traded securities,[71] yet preserved state regulation and the right of individuals to bring suit.[72] Similarly, the United States Supreme Court has indicated by its "coincide" requirement for determining "in connection with a covered security" under the SLUSA that Congress intended a broad interpretation but not so broad as to include every common law fraud that happens to involve a covered security.[73] With respect to the preclusion issue, the Fifth Circuit, in a muddled opinion, struggled to determine some rule that would strike a balance between these two poles. The Fifth Circuit noted that six of its sister circuit courts had developed rules but rejected five of these rules as too narrow and incapable of precluding numerous state class action situations that Congress designed the SLUSA to prevent.[74]

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state law), a distinction the Fifth Circuit realizes is meaningless. *See id.* at 520 (replaced by federal law).

65. *See* 15 U.S.C. § 78bb(f)(1)(A) (2012).

66. *Roland*, 675 F.3d at 503. The victims also brought a claim for civil conspiracy. The federal courts consolidated these cases with others brought under the Louisiana securities act. *See id.* at 509.

67. *See* 15 U.S.C. § 77r(b).

68. *Roland*, 675 F.3d at 510.

69. *See* Brief of Appellants Samuel Troice, et al. at 3–4, Roland v. Green, 675 F.3d 503 (5th Cir. 2012) (Nos. 11-10932, 11-11031, 11-11048), 2011 WL 6073714.

70. *Roland*, 675 F.3d at 524.

71. *See* H.R. REP. NO. 105-803, at 1, 15 (1998); 144 CONG. REC. S4,799 (daily ed. May 13, 1998) (statement of Sen. Joe Lieberman); 144 CONG. REC. H10,780 (daily ed. Oct. 13, 1998) (statement of Rep. Anna Eshoo).

72. *See* S. REP. NO. 105-182, at 1, 8 (1998).

73. *See* SEC v. Zandford, 535 U.S. 813, 819–20 (2002).

74. The Eleventh and Second Circuits use an "induced" test, which was rejected here as too narrow by adding a causation requirement. *See Roland*, 675 F.3d at 519 (citing Romano v. Kazacos, 609 F.3d 512, 522 (2d Cir. 2010); Instituto De Prevision Militar v. Merrill Lynch, 546 F.3d 1340, 1349 (11th Cir. 2008) (adding also a "depend" test)). The Sixth Circuit uses a "depend on" test, which too was rejected as too narrow. *See id.* at 513 (citing

The Fifth Circuit adopted the Ninth Circuit's test requiring the fraud and sale of covered securities to be more than tangentially related.[75] Applying this test to the sale of the nonregistered CDs by the insurance brokers, the Fifth Circuit found that the misrepresentation of a backing by covered securities was only one of eight misrepresentations made and therefore could not be more than tangentially related.[76] Similarly, sales of marketable securities by some investors to buy the CDs from the insurance brokers were only tangentially related because they could have raised money by other means.[77] With respect to the aiding and abetting of the law firm, its obstruction fraud also was not more than tangentially related.[78]

II. THE STATE SECURITIES BOARD'S ACTIONS AGAINST SCAMS

The TSA created a regulatory body, the State Securities Board (Board), to handle the registrations required by the TSA, as well as to serve as an enforcement mechanism.[79] One of the major goals of the Board is to stop investment scams, including those involving financial fraud.[80]

The legislature amended the TSA to increase penalties, especially for financial fraud on the elderly.[81] The legislature's act amended the TSA section for Board assessment of administrative fines,[82] adding an offense for intentional or reckless material aiding of a violator, doubling the penalty to $20,000 per violation, and adding an additional penalty of $250,000 if the violator defrauded a person of age sixty-five or older. The act also amended the TSA section providing for penal sanctions[83] to redefine the penalties to be consistent with the penal code: it replaced the $5,000 fine

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Segal v. Fifth Third Bank, N.A., 581 F.3d 305, 310 (6th Cir. 2009)). The Eighth and Seventh Circuits use the Supreme Court's "coincide" test with no useful explanations, which was rejected as too narrow. *See id.* at 514 (citing Siepel v. Bank of Am., N.A., 526 F.3d 1122, 1127 (8th Cir. 2008); Gavin v. AT&T Corp., 464 F.3d 634, 639 (7th Cir. 2006) (where the court applied "involving," but more than "but for")).

75. *See* Madden v. Cowen & Co., 576 F.3d 957, 966 (9th Cir. 2009); *see also Roland*, 675 F.3d at 519–20 (adopting the *Madden* test).

76. *Roland*, 675 F.3d at 522.

77. *Id.* at 523.

78. *Id.* at 511–24.

79. *See* TEX. REV. CIV. STAT. ANN. art. 581-1 (West 2012).

80. *See, e.g.*, Press Release, Tex. State Sec. Bd., Inv. Fraud 'Spiraling Out of Control' and Older Texans Are Favorite Targets, Sec. Comm'r Warns AARP Members (Nov. 30, 2010); Press Release, Tex. State Sec. Bd., State Sec. Regulators Lead Fight Against Elder Invest. Fraud and Abuse (June 15, 2010) (launching programs to educate medical professionals about identifying seniors vulnerable to financial abuse); *see also*, Press Release, Tex. State Sec. Bd., Top 10 Investor Traps: How Con Artists Target Investors Rattled by Econ., Volatile Mkts. (Aug. 23, 2011) (listing various senior fraud schemes, many of which involve complex investment scams promising inflated returns).

81. *See* Act of Apr. 27, 2011, 82nd Leg., R.S., ch. 523, 2011 Tex. Gen. Laws 1298 (amending TEX. REV. CIV. STAT. ANN. art. 581-23-1, 581-29, 581-32 (West 2012)).

82. TEX. REV. CIV. STAT. ANN. art. 581-23-1.

83. *Id.* art. 581-29

and ten-year sentences with a third-degree felony;[84] it replaced the $5,000 fine and two-year sentences with a state jail felony;[85] it extended the offenses to include investment advice; it provided that offenses involving less than $10,000 were third-degree felonies, offenses involving $10,000 to $100,000 were second-degree felonies,[86] and offenses involving more than $100,000 were first-degree felonies;[87] and it provided for penalty enhancement under the penal code for repeat offenders.[88] Finally, the act amended the TSA section for injunctions, restitution, and civil penalties by adding clarifying language for injunctions during the commission of the crime, a disgorgement remedy that included profit through subsequent sale for any TSA violation, and a $250,000 penalty for elder financial fraud.[89] The fines were increased to enable the Board to protect investors from Wall Street firms and others who regard the Texas fines as merely a cost of doing business, to facilitate the Board's enforcement actions against those not otherwise deterred, and to provide extra protection for the retirement funds of senior citizens lacking in-home family members to offer advice or urge caution.[90]

The legislature also changed the prospective termination date of the Board from 2013 to 2015 under the Sunset Law[91] to help the Sunset Commission by grouping reviews by agency and subject matter.[92]

III. SECURITIES FRAUD

One of the major reasons legislatures passed securities acts was to facilitate investors' actions to recover their moneys through a simplified fraud action that removed the most difficult elements to prove in a common law fraud action, namely scienter and privity. These securities acts generally apply only to the primary market, so when investors purchase in the secondary market their actions reintroduce these obstacles. Moreover, Congress added additional burdens to the secondary market securities fraud action through the PSLRA.[93]

84. This provision doubled the dollar penalty. *See* TEX. PENAL CODE ANN. § 12.34 (West 2012) (stating that a third degree felony penalty includes a fine up to $10,000 and a jail term between two and ten years).

85. This provision also doubled the dollar penalty. *See id.* § 12.35 (stating that a state jail felony penalty includes a fine up to $10,000 and a jail term between 180 days and two years).

86. *See id.* § 12.33 (stating that a second degree felony penalty includes a fine up to $10,000 and a jail term between two and twenty years).

87. *See id.* § 12.32 (stating that a first degree felony penalty includes a fine up to $10,000 and a jail term between five and ninety-nine years).

88. *See id.* § 12.42 (raising the degree of the felony for prior felony convictions).

89. TEX. REV. CIV. STAT. ANN. art. 581-32 (West 2012).

90. *See* House Pensions, Invs., and Fin. Servs. Comm., Bill Analysis, Tex. H.B. 2342, 82nd Leg., R.S. (2011) (also noting that the legislature last updated civil fines in 1995 and criminal penalties in 1991).

91. *See* Act of Apr. 13, 2011, 82nd Leg., R.S., ch. 1232, 2011 Tex. Gen. Laws 3278 (amending TEX. REV. CIV. STAT. ANN. art. 581-32).

92. *See* House State Affairs Comm., Bill Analysis, Tex. H.B. 2249, 82nd Leg., R.S. (2011) (the House version of the Senate's S.B. 652).

93. *See* 15 U.S.C. § 78u-4(b) (2012).

A. Legislative Action to Protect Fraud Victims

To assist investor fraud actions, the legislature added a new provision to the TSA to stay enforcement of a foreign country judgment involving a contract for sale of a security or investment that imposes an indemnification or liquidated damage clause on a Texas resident.[94] Within thirty days of attempting to domesticate a foreign country judgment against a Texas resident,[95] the resident may apply for a stay to allow the Texas court to determine de novo whether the enforcer of the judgment violated the TSA or the Deceptive Trade Practices Act.[96] The finding of a violation would provide a court with sufficient grounds for nonrecognition of the foreign judgment. The reason for the TSA addition is that some investment scams involve Ponzi schemes operated in foreign countries.[97] When Texas investors have tried to recover their moneys in these foreign countries, the fraudsters counter-sue them on the basis of an indemnification clause or liquidated damage clause contained in the sales or investment contract.

IV. COURT DECISIONS UNDER THE TEXAS ACTS

One appellate opinion involved a number of interesting issues under both the TSFA and TSA. The case involved a defrauded seller rather than the more typical defrauded buyer. The appellate court applied general fraud principles to the two acts, such as the distinction between opinion and misstatements and the efficacy of releases and disclaimers, while others related to calculation of damages and the commencement of the statute of limitations under the TSA. In the opinion, *Allen v. Devon Energy Holdings, LLC*,[98] the greedy investor, upset over surrendering his interest in an oil and gas LLC through a redemption two years prior (net-

94. *See* Act of Apr. 19, 2011, 82nd Leg., R.S., ch. 346, 2011 Tex. Gen. Laws 967 (adding Tex. Rev. Civ. Stat. Ann. art. 581-33-2).

95. *See* Tex. Civ. Prac. & Rem. Code Ann. § 36.001 (West 2012) (Texas version of the Uniform Foreign Money-Judgment Recognition Act). This act only applies to money judgments. *See, e.g.*, Sanchez v. Palau, 317 S.W.3d 780, 786 (Tex. App.—Houston [1st Dist.] 2010, pet. denied) (refusing to enforce a Mexican divorce decree under the act). Judgments to enforce indemnity agreements and liquidated damages most likely would be money judgments.

96. For the applicability of the TDTPA to investment advice, *see* Flint, *supra* note 10, at 1555 n.94.

97. *See* House Judiciary and Civil Jurisprudence Comm., Bill Analysis, Tex. H.B. 3174, 82nd Leg., R.S. (2011). The author has been unable to find a single concern for this problem in the published records of the Texas State Securities Board, the North American Securities Administrators Association, the SEC, or in state and federal appellate opinions. The bill could be a disguised special bill, proposed by the Representative from Plano, with the only hearing witnesses being a Plano ophthalmologist and his lawyer who are suing an Anguilla LLC and its agents in an oil and gas scam for violations of the TSFA and TDTPA. *See* Crithfield v. Boothe, 343 S.W.3d 274, 279–81 (Tex. App.—Dallas 2011, no pet.) (Dr. William A. Boothe and lawyer Brian Lauten); Second Amended Brief for Appellant at 33 (TSFA by co-plaintiffs), 34 (TDTPA by Boothe), Crithfield v. Booth, 343 S.W.3d 274 (Tex. App.—Dallas 2011, no pet.) (No. 05-10-00789-CV), 2010 WL 4774746.

98. Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 365–68 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.). The investor also alleged breaches of fiduciary duty and shareholder oppression claims.

ting $8 million on an investment of $700 plus providing $34,300 as collateral for a loan) and thereby missing a further twenty-fold increase when a second LLC bought out the first LLC two years after the redemption. The investor sued the second LLC and the former manager of the first LLC, a former law partner of the investor, alleging, among other causes of action, violations of both the TSFA and TSA. The investor based his securities law claims on nine misstatements made by the former manager in a letter (received six months before the redemption occurred)[99] concerning the intent to make a redemption offer that allegedly fraudulently induced the investor to participate in the redemption. The investor believed that the value had increased by 50% during the redemption's six-month delay and that the offeror was committing securities fraud by not updating the value. After a limited discovery, the trial court granted the second LLC and former manager's summary judgment motion without specifying any grounds (but the motion did specify three grounds for the TSFA claim and three for the TSA claim).[100] The Houston First District Court of Appeals affirmed in part, and reversed and remanded in part.[101] Since the standard to support a defensive summary judgment is that the movant must negate at least one element of the plaintiff's cause of action or prove conclusively an affirmative defense for each cause of action,[102] the appellate court delved into examining each element and the asserted affirmative defenses.

A. Opinions and Future Event Statements as Actionable Under the TSFA and TSA

The first element of a fraud action is an actionable statement of material fact. In a lengthy but enlightening section of its opinion, the appellate court revealed exceptions to generally non-actionable statements. The *Allen* appellate court, citing common law fraud opinions mingled with a few

99. Federal securities laws generally require current (or within a certain period) information for the transactions. *See, e.g.*, 15 U.S.C. § 77aa (2012) (stating that under Schedule A, a balance sheet must be provided within ninety days of the filing of the registration statement); 17 C.F.R. § 240.14a-9(a) (2011) (stating that a proxy solicitation at the time of solicitation is required to correct prior misleading communications).

100. *Allen*, 367 S.W.3d at 366; *see also* Appellant's Brief at 13, Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.) (No. 01-09-00643-CV), 2009 WL 3847853 (stating that the asserted claims under the TSA and TSFA are barred because no actionable misrepresentations were made and there were no recoverable damages; claims under the TSFA are barred by releases, by absence of justifiable reliance, and by disclaimers of reliance; and claims under the TSA are barred by investors' knowledge of the misstatements and the statute of limitations).

101. *Allen*, 367 S.W.3d at 412.

102. *See* Cathey v. Booth, 900 S.W.2d 339, 341 (Tex. 1995).

TSFA[103] and TSA[104] opinions, determined that six of the eight alleged misstatements were actionable.[105] Generally, opinion statements are non-actionable unless the speaker knows it is false, has superior knowledge and knows the investor is relying on the speaker's superior knowledge, or the opinion is so intertwined with other misstatements of fact that the whole amounts to a false statement of fact.[106] Similarly, opinion statements concerning future events are generally non-actionable unless they deal with predictions in which the speaker purports to have special knowledge of facts that will occur or exist in the future, or they promise future performance and the speaker has no intention of performing (with the speaker having the burden of proof of the intent to perform).[107] The *Allen* appellate court found that three of the statements were statements of fact, while the other three fell within the exceptions for non-actionable opinion statements: one of which was an opinion so mingled with fact to be a misrepresented fact, and two dealing with future performance without the speaker's proof of the intent to perform.[108]

B. Profit Disgorgement Damages Under the TSFA and Income Damages Under the TSA

Another necessary element of a fraud action deals with the presence of calculable damages. The TSFA provides a remedy for "actual damages."[109] The *Allen* redemption offeror asserted that these damages for contractual inducement were too speculative under contract law.[110] In the

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103. The only difference between the TSFA and common law fraud is that under the TSFA the investor need not prove scienter (knowledge or recklessness). *See In re* Enron Corp. Sec. Derivative & "ERISA" Litig., 623 F. Supp. 2d 798, 807–08 (S.D. Tex. 2009); Jericho Graphics Corp. v. Haynes, No. 01-03-00987-CV, 2004 WL 2538677, at *3 (Tex. App.—Houston [1st Dist.] Nov. 10, 2004, no pet.).

104. *See* Tex. Capital Sec., Inc. v. Sandefer, 58 S.W.3d 760, 776 (Tex. App.—Houston [1st Dist.] 2001, pet. denied) (applying the general opinion rule to dealer puffing under the TSA); Paull v. Capital Res. Mgmt., Inc., 987 S.W.2d 214, 218–19 (Tex. App.—Austin 1999, pet. denied) (applying exceptions to the general opinion rule to the TSA, citing common law fraud cases).

105. *Allen*, 637 S.W.3d at 376.

106. *Id.* at 370 (citing Transp. Ins. Co. v. Faircloth, 898 S.W.2d 269, 276–77 (Tex. 1995) (fraud under Deceptive Trade Practices Act and Insurance Code)).

107. *Id.* (citing Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 48 (Tex. 1998) (common law fraud); Trenholm v. Ratcliff, 646 S.W.2d 927, 930 (Tex. 1983) (common law fraud)).

108. *Id.* at 369–76.

109. *See* Tex. Bus. & Com. Code Ann. § 27.01(b) (West 2011). Before 1983, the TSFA provision contained a definition of actual damages: "The measure of actual damages is the difference between the value of the real estate or stock as represented or promised, and its actual value in the condition in which it is delivered at the time of the contract." *See* Act of 1983, 68th Leg., R.S., ch. 949, § 1, 1983 Tex. Gen. Laws 5208 (current version at Tex. Bus. & Com. Code Ann. § 27.01(b)–(c)) (deleting the definition and adding a section for exemplary damages). The deletion clearly indicates legislative desire to expand the types of damages recoverable as "actual damages." *See id.*

110. *See* Reardon v. LightPath Techs., Inc., 183 S.W.3d 429, 441–42 (Tex. App.—Houston [14th Dist.] 2005, pet. denied) (rejecting the highest intermediate value theory of damages for the equitable recessionary remedy in a securities fraud action under the TSA and TSFA in the absence of evidence for recessionary damages); *see also* Flint, *supra* note 10, at 1553–54.

absence of a statutory definition of "actual damages," courts have looked to common law fraud actions for the types of recoverable damages under the TSFA, which include the equitable remedy of profit disgorgement.[111] Therefore, the redemption offeror has yet to foreclose all possible damages.[112]

In contrast to the TSFA's actual damages, the TSA specifies damages for a defrauded seller of a security.[113] The redemption offeror claimed that these damages were limited to the value of the security at the time of the sale. This position overlooks the addition to that value resulting from income the buyer received on the shares in the interim. The *Allen* appellate court, however, rejected the greedy investor's contention that "income" under the TSA damage provision included the redemption offeror's proceeds on a subsequent sale and limited the statutory term "income" to include dividends and other issuer distributions on the shares.[114] Once again, the redemption offeror failed to deal with all possible damages.[115]

C. The Impact of a Fraud Belief on Justifiable Reliance Under the TSFA and the Affirmative Defense of Knowledge Under the TSA

Another necessary element of a TSFA claim, but not a TSA claim, is justifiable reliance on the misstatement or omission.[116] The *Allen* redemption offeror contended that the investor's reliance was not justified since the investor believed the value had increased by 50% during the redemption's six-month delay, and the offeror was committing securities fraud by not updating the value. Two of the six actionable misstatements concerned, among other things, the value of the LLC. For that aspect of the two misstatements, the investor's belief defeated justifiable reliance.[117] The investor's belief, however, did not relate to the "future prospects" aspect of those two misstatements, nor to the other four actionable misstatements, and so it could not defeat justifiable reliance.[118]

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111. *See* ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 876 n.3 (Tex. 2010) (lost profits recoverable under both common law and statutory fraud [TSFA]).

112. *Allen*, 367 S.W.3d at 405–10.

113. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33D, § (4) (West 2011) ("In damages, a seller shall recover (a) the value of the security at the time of sale plus the amount of any income the buyer received on the security, less (b) the consideration paid the seller for the security plus interest thereon at the legal rate from the date of payment to the seller.").

114. *Allen*, 367 S.W.3d at 410–11.

115. *Id.*

116. *See* Coldwell Banker Whiteside Assocs. v. Ryan Equity Partners, Ltd., 181 S.W.3d 879, 888 (Tex. App.—Dallas 2006, no pet.) (real estate statutory fraud); TCA Bldg. Co. v. Entech, Inc., 86 S.W.3d 667, 674 (Tex. App.—Austin 2002, no pet.) (real estate statutory fraud). The burden of proof for justifiable reliance under the TSFA is less than that for reasonable reliance under the common law. *See In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 540 F. Supp. 2d 759, 772 (S.D. Tex. 2007). The TSA does not require reliance. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33B; Summers v. WellTech, Inc., 935 S.W.2d 228, 234 (Tex. App.—Houston [1st Dist.] 1996, no writ).

117. *Allen*, 367 S.W.3d at 387–88.

118. *Id.* at 386–88.

In contrast to the TSFA's justifiable reliance requirement, the TSA instead provides an affirmative defense that "the seller knew of the untruth or omission."[119] The *Allen* court determined that the investor's belief that the value was changing and that the offeror was committing fraud had the same impact under the TSA as the TSFA.[120] The knowledge foreclosed a fraud action on the two value misstatements but had no impact on the other four misstatements since they did not involve the value.[121]

D. The Impact of Contractual Releases of Liability Under the TSFA

One TSFA defense raised by the *Allen* redemption offeror concerned the release clauses contained in the redemption agreement—one was a general release from all liability (except breach of contract) contained in a Finality Clause, and one was a release relating to any claim arising from the determination of the value of the redeemed interest contained in an Independent Investigation Clause. Decisions under the statutory fraud act for real estate, contained in the same statute as the TSFA, provide that enforceable releases must "'clearly . . . waive fraudulent inducement claims' or 'disclaim[ ] reliance on [the] specific matter[ ] in dispute.'"[122] Since the redemption releases did not clearly mention fraudulent inducement claims, this defense could not support summary judgment on the TSFA claim.[123]

E. The Impact of Contractual Reliance Disclaimers Under the TSFA

A second TSFA defense of the *Allen* redemption offeror depicted the release clauses contained in the redemption agreement as reliance disclaimers. Under the TSFA, an investor's disclaimer of reliance might preclude a future claim that the contract was fraudulently induced under a five-factor test.[124] The necessary factor is the presence of a clear and unequivocal disclaimer. The Finality Clause failed this test since it made no reference to reliance or fraudulent inducement, nor did it disavow oral representations.[125] The Independent Investigation Clause partially failed this test.[126] This clause implied reliance by inviting the investor to ask

119. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33B.
120. *Allen*, 367 S.W.3d at 400.
121. *Id.* at 399–400.
122. *Id.* at 368 (quoting Schlumberger Tech. Corp. v. Swanson, 959 S.W.2d 171, 178 (Tex. 1997) (oil and gas)).
123. *Id.* at 368–69. The *Allen* court did not address whether the TSA voids the release clauses with respect to a claim under the TSA. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33L (provisions waiving compliance with the TSA are void).
124. *See Schlumberger Tech Corp.*, 959 S.W.2d at 179–80 (a clear and unequivocal disclaimer), *clarified in* Forest Oil Corp. v. McAllen, 268 S.W.3d 51, 60 (Tex. 2008) (adding the following four extrinsic factors: whether (1) the terms were negotiated, (2) the complaining party was representation by counsel, (3) the parties dealt with each other at arm's length, and (4) the parties were knowledgeable in business matters).
125. *Allen*, 367 S.W.3d at 379.
126. *Id.* at 379–80.

questions and lacked any language that the investor relied exclusively on his own investigation.[127] But the clause did satisfy the test for disclaiming reliance on misrepresentations related to the value of the LLC at the time of redemption.[128] Two of the six actionable misstatements concerned, among other things, the value of the LLC. For that aspect of the two misstatements, the Independent Investigation Clause was clear and unequivocal.[129] The other four actionable misstatements did not concern the value of the LLC.[130]

To determine whether the disclaimer of reliance precludes a fraudulent inducement action under the TSFA for the two value misstatements, the *Allen* court investigated the remaining four factors of the five-factor test. The current case only satisfied two of the remaining factors (representation by counsel and sophistication in business matters) but not the other two factors (negotiated terms and dealing at arm's length). Although the *Allen* court had previously determined that not all of the factors need to be satisfied for enforcement of the disclaimer,[131] the court of appeals felt that the two missing factors in the current case mandated non-enforcement of the reliance disclaimer; they both related to an investor's ability to alter the disclaimer's terms and thereby voluntarily relinquish the fraud claim.[132]

One less ingenuous Houston law firm depicts the *Allen* opinion as merely a matter of improper drafting on behalf of the redemption offeror.[133] That firm recommends express disclaimers and express releases as well as the avoidance of boilerplate looking provisions. Such a suggestion implies that it is legally permissible to commit fraud provided the fraudster properly gets the victim to disclaim and release all claims. The *Allen* court makes it clear that these disclaimers and waivers failed not only because they were incomplete, but because there was an absence of arm's-length negotiating ability.[134] Similarly, one could expect a subsequent court to determine that a properly drafted disclaimer or release lacked the victim's knowledgeable, voluntary consent when provided.

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127. *Id.*

128. *Id.* at 380.

129. *Id.* at 381.

130. *Id.* at 376–82.

131. *Id.* at 384 (citing Atl. Lloyds Ins. Co. v. Butler, 137 S.W.3d 199, 216–17 (Tex. App.—Houston [1st Dist.] 2004, pet. denied) (settlement agreement disclaimer enforced in absence of sophistication)).

132. *Id.* at 382–86.

133. See Wilson Chu & Larry Glasgow, M&A Nugget-Palooza, available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&ved=0CC0QFjAA&url=http%3A%2F%2Fwww.acc.com%2Fchapters%2Fsocal%2Fupload%2FM-and-A-Nugget-Palooza_Jan-2012_KL-Gates.pdf&ei=TCr8UbzAB6aSyAGfroGQAQ&usg=AFQjCNFgyd8Pn6m2Uva-j_CeisRpcbPb4g&sig2=UPrQUSurga2MoqEBrlOFXA&bvm=bv.50165853,d.aWc.

134. *Allen*, 367 S.W.3d at 385.

F. Commencement of the Statute of Limitations Under the TSA

The third defense raised by the redemption offeror involved the statute of limitations under the TSA. The TSA requires an investor to bring a lawsuit within three years of the discovery of fraud or when the discovery should have been made, or within five years of the sale.[135] The *Allen* court used the plain meaning rule to determine that the three year portion of the limitation could begin prior to the sale.[136] In other words, the limitations period runs from discovery of the fraud, but the investor is only allowed a potential two-year period to make that discovery, and if the investor does discover the fraud prior to the sale, the investor provides the fraudster with knowledge as an affirmative defense. So for the surviving four misstatements, and the future prospects of the two value misstatements, the *Allen* court investigated whether the investor should have discovered the fraud from Texas Railroad Commission records, a Morgan-Stanley Barnett Shale report, a Raymond James email, a Goldman Sachs meeting preview, the DrillingInfo.com website, and news stories in the *Fort Worth Star Telegram*. Since the redemption offeror failed to point out any information in these public records that would inform the investor of the fraud, the *Allen* court determined that the offeror had not satisfied the limitations defense.[137]

V. COURT DECISIONS UNDER THE FEDERAL ACTS

The fraud provisions of the TSA are modeled on the federal statutes. Therefore, in interpreting the TSA's similar language, Texas courts look to federal decisions under the federal statutes, and there is an interest in Fifth Circuit securities law fraud opinions.[138]

A. Reliance in the Absence of Name Attribution

Since the United States Supreme Court does not permit aiding and abetting lawsuits under Rule 10b-5 to hold secondary individuals liable,[139] aggrieved investors must find such persons liable for primary liability—that is, claimants must prove all of the elements for a fraud action under Rule 10b-5.[140] The Fifth Circuit in *Affco Investments*, discussed

135. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33H, § 3 (West 2012).

136. *Allen*, 367 S.W.3d at 403. The analogous federal statute of limitations is even clearer, providing a one-year limitation from discovery or when discovery should have been made, but "[i]n no event . . . more than three years." 15 U.S.C. § 77m (2012).

137. *Allen*, 367 S.W.3d at 401–05.

138. *See supra* notes 2–3 and accompanying text.

139. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 177–78 (1994); 17 C.F.R. § 240.10b-5 (2012).

140. The six elements are: "(1) a material misrepresentation or omission . . . ; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance . . . ; (5) economic loss; and (6) loss causation." Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008); *see also* George Lee Flint, Jr., *Securities Regulation*, 62 SMU L. Rev. 1435, 1458–59 (2009) (discussing *Stoneridge*'s impact on Texas decisions).

above,[141] considered the liability of a law firm described by an accounting firm in its marketing of a tax shelter as one of several national law firms that had analyzed and approved the tax strategy.[142] The issue for the Fifth Circuit was whether it could find the law firm primarily liable without name attribution of its deceptive conduct before the investor invested. The court observed that the United States Supreme Court rejected scheme liability for secondary actors because in the absence of knowledge—actual or presumed—of the secondary actor's deceptive acts at the time of purchase, the investor has no reliance.[143] Hence, the Fifth Circuit concluded that without explicit attribution the investors had not properly plead the reliance element of their case.[144] The court upheld the dismissal of the Rule 10b-5 action.[145]

B. Rebutting Fraud-on-the-Market Presumption at Class Certification

Congress passed the PSLRA[146] to discourage extortive securities litigation. This includes filing class action lawsuits for securities fraud whenever a significant change in the issuer's price is followed by abuse of the discovery process to impose such burdensome costs as to make it more economical for the victimized issuers to settle.[147] Of the funds so extorted from victimized issuers, 40% to 60% go unclaimed since many small investors—like the author—are aware that they will receive no more than pennies on the dollar, and thus fail to file claims, while the extorting lawyers take up to 35%.[148] These lawsuits fail to serve as a deterrent since managers rarely pay; directors and officers insurance, paid for by current shareholders, picks up the tab. To lessen the extortive impact of class certification and to bring the implied cause of action under Rule 10b-5 more in line with its purpose of protecting investors,[149] the Fifth Circuit imposed a requirement for class certification of finding "loss causation" before allowing substitution of fraud-on-the-market theory's rebuttable

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141. *See supra* notes 8–17 and accompanying text.

142. Affco Invs. 2001, L.L.C. v. Proskauer Rose, L.L.P., 625 F.3d 185, 187–89 (5th Cir. 2010).

143. *See Stoneridge Inv. Partners, LLC*, 552 U.S. at 159.

144. *Affco Invs. 2001, L.L.C.*, 625 F.3d at 195.

145. *Id.*

146. *See* 15 U.S.C. § 78u-4 (2012).

147. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 731. For the fate of one such extorter, *see generally* Patrick Dillon & Carl M. Cannon, Circle of Greed: The Spectacular Rise and Fall of the Lawyer Who Brought Corporate America to Its Knees 451 (2010) (William Shannon Lerach of the Milberg Weiss law firm was sentenced to two years in jail in 2007 for illegal payments to plaintiffs and was disbarred in 2009.).

148. *See* Hal Scott & Leslie N. Silverman, *The Alternative to Shareholder Class Actions*, Wall St. J. (Apr. 1, 2012, 5:48 PM), http://online.wsj.com/article/SB10001424052702303816504577312373860495762.html.

149. *See* 15 U.S.C. § 78j (2012) (authorizing SEC fraud rulemaking only for "the public interest or for the protection of investors").

presumption for the reliance element in a cause of action.[150]

The United States Supreme Court has partially stymied the Fifth Circuit's approach but has pointed out how to achieve the Fifth Circuit's desired result. In *Erica P. John Fund, Inc. v. Halliburton Co.*,[151] the Supreme Court reversed a Fifth Circuit opinion interposing the "loss causation" requirement to deny a class certification.[152] The lawyer-extorters, on behalf of their client, went after the issuer under Rule 10b-5[153] in a class action for three alleged misstatements. The elements of a Rule 10b-5 cause of action are: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) loss causation; and (6) economic loss.[154] To form a class, the court must find the questions of fact to be predominately common amongst the class members.[155] In order to avoid placing an insurmountable evidentiary burden on the client, the fraud-on-the-market presumption (that the available public material information on the issuer determines the issuer's stock price in the open market on which all investors rely) satisfies the commonality of the reliance element by creating a rebuttable presumption upon a showing that the issuer made public misstatements, those misstatements were material, the issuer's shares are traded in an efficient market, and the client traded shares between the time of the misstatement and the corrective disclosure.[156] To lessen the extortive force of class certification, the Fifth Circuit, in the past, has refused to find materiality for the fraud-on-the-market presumption unless the investors showed the corrective statement adversely impacted the issuer's price (that is, loss causation) at the class certification stage.[157] The district court found no such impact, denied class certification, and the Fifth Circuit affirmed.

The Supreme Court, after noting that the other circuits were not as

150. *See* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 265 (5th Cir. 2007); *see also* George Lee Flint, Jr., *Securities Regulation*, 61 SMU L. REV. 1107, 1128–29 (2008) (discussing *Oscar Private Equity Investments*).

151. Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2183 (2011).

152. *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 597 F.3d 330, 335 (5th Cir. 2010); *see also* George Lee Flint, Jr., *Securities Regulation*, 64 SMU L. REV. 535, 550–53 (2011) (discussing *Archdiocese of Milwaukee*).

153. *See* 17 C.F.R. § 240.10b-5 (2012).

154. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005).

155. *See* FED. R. CIV. P. 23(b)(3).

156. *See* Basic Inc. v. Levinson, 485 U.S. 224, 241–42 (definition), 245 (reason), 248 n.27 (elements) (1988); Greenberg v. Crossroads Sys., Inc., 364 F.3d 657, 661 (5th Cir. 2004); *see also* George Lee Flint, Jr., *Securities Regulation*, 58 SMU L. REV. 1135, 1156–57 (2005) (discussing *Greenberg*).

157. *See* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 267 (5th Cir. 2007); *see also* Fener v. Operating Eng'rs Const. Indus. and Miscellaneous Pension Fund (LOCAL 66), 579 F.3d 401, 407 (5th Cir. 2009); Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221, 228 (5th Cir. 2009) (per curiam); Lormand v. US Unwired, Inc., 565 F.3d 228, 260–61 (5th Cir. 2009); George Lee Flint, Jr., *Securities Regulation*, 63 SMU L. REV. 795, 812–15 (2010) (discussing *Fener*, *Alaska Electrical Pension Fund*, and *Lormand*); Flint, *supra* note 150, at 1128 (discussing *Oscar Private Equity Investments*).

keen as the Fifth Circuit to protect current investors,[158] observed that the fraud-on-the-market theory related to reliance, and the time at which the investors entered into the securities transaction was when the investor closed the securities transaction while "loss causation" involved a later time.[159] Hence, to impose a "loss causation" requirement for the rebuttable presumption, replacing reliance, made no sense and was inconsistent with earlier Supreme Court opinions on the fraud-on-the-market theory. The lawyer-extorters, however, also requested that the Supreme Court limit the evidence rebutting the rebuttable presumption to the time of trial.[160] The Supreme Court left that issue open. "To the extent [the issuer] preserved any further arguments against class certification," the Fifth Circuit could address them on remand.[161]

The issue of rebutting the presumption at the class certification stage is presently before the Fifth Circuit, after a cursory remand to the district court[162] and the district court's certification of the class.[163] The circuits are split over the issue, with one case presently on appeal to the United States Supreme Court.[164] The Fifth Circuit's case may yet be derailed over the issue of whether the issuer's submitted evidence related to the

158. Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2184 (2011) (noting that the Second, Third, and Seventh Circuits have rejected the "loss causation" requirement); *see In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 636–37 (3d Cir. 2011); Schleicher v. Wendt, 618 F.3d 679, 687 (7th Cir. 2010); *In re* Salomon Analyst Metromedia Litig., 544 F.3d 474, 483 (2d Cir. 2008), *abrogated by* Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013).

159. *Erica P. John Fund, Inc.*, 131 S. Ct. at 2186.

160. *See* Petition for a Writ of Certiorari at 29–31, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) (No. 09-1403), 2010 WL 2007735 (citing Basic Inc. v. Levinson, 485 U.S. 224, 248 n.29 (1988)) (claiming that the Supreme Court's decision authorizing the fraud-on-the-market theory required such a procedure); *see also* Transcript of Oral Argument at 6, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011) (No. 09-1403), 2010 WL 2007735, *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-1403.pdf (Mr. Boies statement supported by the *Basic Inc.* footnote, along with J. Alito's observation that the footnote is dicta made at a time when the courts allowed conditional classes).

161. *Erica P. John Fund, Inc.*, 131 S. Ct. at 2187.

162. *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 647 F.3d 533 (5th Cir. 2011) (per curiam) (reversing the district court and remanding).

163. *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02-CV-1152-M, 2012 WL 565997, at *3 (N.D. Tex. Jan. 27, 2012) (also denying the issuer any ability to supplement the record as untimely, despite using an incorrect principle when making that record), *aff'd sub nom.* Erica P. John Fund, Inc. v. Halliburton Co., 718 F.3d 423 (5th Cir. 2013).

164. *See In re* DVI, Inc. Sec. Litig., 639 F.3d 623, 638 (3d Cir. 2011) ("[W]e believe rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage."); *In re* Salomon Analyst Metromedia Litig., 544 F.3d 474, 484 (2d Cir. 2008) ("[Issuers are] allowed to rebut the presumption, prior to class certification, by showing, for example, the absence of a price impact . . . ."); *contra* Conn. Ret. Plans & Trust Funds v. Amgen Inc., 660 F.3d 1170, 1177 (9th Cir. 2011) ("[W]e hold that plaintiffs need not *prove* materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage."), *aff'd*, 133 S. Ct. 1184 (2013); Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010) ("Defendants say that, before certifying a class, a court must determine whether false statements materially affected the price. But whether statements were false, or whether the effects were large enough to be called material, are questions on the merits.").

time of securities transaction or whether the issuer preserved the rebuttal ability.[165] Therefore, the Supreme Court may settle the issue before the Fifth Circuit acts on the key issue.

VI. CONCLUSION

During this Survey period, Texas courts after *Affco Investments* began to consider whether equity interests in LLCs are subject to the TSA and TSFA. These courts also dealt with several cases involving summary judgments obtained by aiders and abettors. They generally found fact issues to preserve the fraud lawsuits, fortunately rejecting the attempt in *Highland Capital Management* to convert the TSA's objective awareness to subjective awareness, and the ridiculous non-control claims of an officer in *Darocy*; but in *Fernea*, the court of appeals disturbingly allowed control liability for an employee's acts outside of employment. In *Roland*, the Fifth Circuit joined the Ninth Circuit in imposing a "more than tangentially related" test before applying the SLUSA preclusion of state securities laws. A Texas court in *Allen* determined that the TSA's statute of limitations may start before the transaction occurs and that damages do not include subsequent profit made by the fraudster.

The Fifth Circuit is still engaged in its campaign to protect investors from extortive lawsuits, failing in its attempt in *Erica P. John Fund* to impose "loss causation" at the class certification stage but possibly preserving the ability to rebut the fraud-on-the-market presumption at that time. The problem is that the federal securities statutes are for the protection of all investors, while the courts have interpreted the implied Rule 10b-5 action to compensate only a limited class of investors. The result is the transfer of wealth from one group of investors to another group with a substantial amount going to the latter group's greedy lawyers. The focus of Securities Acts should be similar to that of Employee Retirement Income Security Act (ERISA) plans.[166] How should one member, here an

165. *Compare* Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Plaintiff's Motion to Certify Class at 14, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (June 6, 2011) (No. 09-1403), 2012 WL 560072 (discussing the district court's failure to address the issue of rebuttal when issuer presented ample evidence that the alleged misrepresentation did not distort the price), *with* Plaintiffs' Response to Defendants' Petition for Permission to Appeal the District Court's January 27, 2012 Order Granting Lead Plaintiff's Motion to Certify Class at 14, Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (June 6, 2011) (No. 09-1403), 2012 WL 560989 ("Defendants have provided no reasonable explanation for their failure to introduce rebuttal evidence and make rebuttal arguments, at least as an alternative basis for opposing class certification . . . ."); *see also* Motion to Leave to Appeal under Fed. R. Civ. P. 23(f) at 3, Erica P. John Fund, Inc. v. Halliburton Co. (N.D. Tex. Jan. 27, 2012) (No. 12-90007) (Dennis, J., dissenting) ("Although this argument has been available . . . the defendants chose not to raise it before the district court when the class certification proceedings were being held in this case . . . .").

166. ERISA similarly has a provision that the plan be operated for the benefit of all employees. *See* 29 U.S.C. § 1104(a)(1)(A) (2012) (also referred to as ERISA § 404(a)(1)(A)); 26 U.S.C. § 401(a) (2012) (providing introductory language). There are no extracontractual damages paid from the plan, *see* Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 144 (1985), and for insurance protection of fiduciaries, not bought by the plan,

investor, be compensated when that compensation reduces the wealth of other investors, namely those investors remaining with the issuer or newly invested? The focus should also be on deterring the aberrant behavior of some members of management. Hence, rather than steal from the remaining investors to compensate the lucky investors and their lawyers, the court should force the culpable members of management to forgo a portion of their wealth.

recourse must be allowed against the fiduciary for breach of fiduciary duty. *See* 29 U.S.C. § 1110 (also referred to as ERISA § 410(a)–(b)).