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SECURITIES REGULATION

*George Lee Flint, Jr**

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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 what is referred to here as the Texas Stock Fraud Act (TSFA).[1] Although this article includes Fifth Circuit cases under federal law, the author attempts to limit the material to that involving state law, only touching federal securities law when necessary. The author does not intend this article to exhaust all aspects of securities regulation but rather to update the Texas-based securities practitioner with new developments of interest.

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1. *See* TEX. REV. CIV. STAT. ANN. art. 581 (West 2011); TEX. BUS. & COM. CODE ANN. § 27.01 (West 2011). TSFA is included in a statute also covering real estate fraud; so many of the cases dealing with TSFA's statutory fraud deal with real estate. *See* § 27.01.

I. ORGANIZATION OF THE STATE SECURITIES BOARD

The TSA created a regulatory body, the Texas State Securities Board ("Board"), to handle the registrations required by the TSA as well as to serve as an enforcement mechanism.[2] One of the Board's major goals aims at stopping investment scams preying on the elderly, especially those with inadequate knowledge or mental capabilities to perceive the scam.[3] These efforts led to conviction of the "free lunch" seminar scammer.[4]

The fraudster in *Head v. State*,[5] allegedly a certified senior advisor, estate planner, and wealth transfer practitioner with a team of professionals, advertised seminars including a complimentary lunch or dinner in newspapers aimed at seniors.[6] The fraudster originally sold trusts and annuities to his senior clients, but after hiring a lawyer and observing a joint venture purchasing distressed assets, the fraudster decided to form a corporation with his lawyer to invest in distressed assets with moneys of his senior clients. The private placement memorandum[7] prepared for the corporation indicated contributions would be invested in distressed assets. The selling agent told the senior clients their money would be invested in credit card debt and foreclosed homes. Numerous senior clients

2. *See* TEX. REV. CIV. STAT. arts. 581–82 (West Supp. 2010).

3. *See, e.g.*, Press Release, Tex State Sec. Bd., State Securities Regulators Lead Fight Against Elder Investment Fraud and Abuse (June 15, 2010), *available at* http://www.ssb.state.tx.us/News/Press_Release/06-15-10_press.php. (launching programs to educate medical professionals about identifying seniors vulnerable to financial abuse); Press Release, Tex. State Sec. Bd., List of Texas "Top 10" Investment Scams, Schemes, and Scandals Issued by Texas Securities Commissioner (Jan. 14, 2004), *available at* http:/www.ssb.state.tx.us/News/Press_Release/prl-14-04.pdf. (listing senior fraud, by targeting seniors with complex investment scams promising inflated returns, as second on the list).

4. *See, e.g.*, Office of Compliance Inspections and Examinations, Sec. and Exch. Comm., et al., Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars, (Sept. 2007) (joint examination by the SEC, the North American Securities Administrators Association, and the Financial Industry Regulatory Authority regarding "free lunch" seminars aimed at selling financial products, often to seniors, with a free meal as enticement, revealing potentially misleading sales materials and potential suitability issues relating to the products discussed at the seminars), *available at* http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

5. 299 S.W.3d 414 (Tex. App.—Houston [14th Dist.] 2009, pet. ref'd). This article omits the issues on misapplication of fiduciary property, jury charge, continuance, and effectiveness of assistance of counsel.

6. *Id.* at 420.

7. The TSA provides an exemption from registration of securities for sale without any public solicitation or advertisements. *See* TEX. REV. CIV. STAT. ANN. art. 581-5(I) (West 2010). The Board's rule under this exemption requires sales to well-informed investors–a requirement sellers can satisfy by delivering a private placement memorandum prior to the sale. *See* 7 TEX. ADMIN. CODE § 109.13(a)(1) (2010) (Tex. State Sec. Bd., Banking and Securities) ("The term 'well-informed' could be satisfied through the dissemination of printed material to each purchaser prior to his or her purchase, which by a fair and factual presentation discloses the plan of business, the history, and the financial statements of the issuer, including material facts necessary in order that the statements made in the light of circumstances under which they are made, not be misleading."). Since the selling agent did not deliver the private placement memorandum before the investment sale and it contained serious omissions of material facts, see *Head*, 299 S.W.3d at 427–30, the Board sanctioned the promoters for selling unregistered securities. *See In re* Head, et al., No. ENF-04-CDO-1552, 2004 WL 179864, at *2 (Tex. State Sec. Bd. Jan. 21, 2004) (selling unregistered securities).

cashed in retirement funds and annuities to invest in the corporation and incurred substantial surrender penalties.[8] It became apparent early on that the corporation lacked sufficient funds to invest in distressed assets, so the fraudster invested these funds in the lawyer's personal injury litigation making loans to himself and his lawyer. The selling agent never disclosed to his senior clients the loans to the fraudster and lawyer, that the lawyer filed a previous bankruptcy, that the Board issued a cease and desist order for later,[9] and that the fraudster filed for bankruptcy and consented to a judgment for violating the Iowa Consumer Fraud Act. The senior clients invested more than $3.7 million, of which only $450,000 was left when the corporation entered receivership. Indicted in Galveston by the district attorney for securities fraud,[10] a jury convicted the fraudster and sentenced him to thirty-two years confinement and a $10,000 fine.[11]

The securities law issue for the appellate court was whether the evidence was sufficient for conviction.[12] The district attorney charged the fraudster in the disjunctive, with one misrepresentation about investing moneys in distressed assets and six omissions concerning the two bankruptcies, the Iowa judgment, the Board's cease and desist orders, the loans to the fraudster and lawyer, and the other uses of money. Because the charge was in the disjunctive, the court of appeals only needed to consider the evidence to support one charge.[13] The court of appeals selected the failure to disclose the investments in other than distressed assets.[14] The fraudster contended the private placement memorandum had clear boilerplate language stating the corporation could invest the moneys in any asset. But four investors testified at trial they never saw a

8. *Head*, 299 S.W.3d at 421.

9. *See In re Head*, 2004 WL 17984, at *2 (selling unregistered securities when not registered as a dealer); *see also In re* Nat'l CD Brokers, No. CDO-1540, 2003 WL 22279544, at *2–3 (Tex. State Sec. Bd. Sept. 23, 2003) (emergency cease and desist order for similar offenses).

10. *See* TEX. REV. CIV. STAT. ANN. art. 581-29(C) (West 2010) ("In connection with the sale, offering for sale or delivery of, the purchase, offer to purchase, invitation of offers to purchase, invitations of offers to sell, or dealing in any other manner in any security or securities, whether or not the transaction or security is exempt under Section 5 or 6 of this Act, directly or indirectly: . . . (3) knowingly make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . (4) . . . is guilty of a felony and upon conviction shall be . . . (c) imprisoned for life or for not less than 5 or more than 99 years and fined not more than $10,000, if the amount involved is $100,000 or more.").

11. *Head*, 299 S.W.3d. at 419. The trial court in another proceeding also convicted the attorney. *See* Press Release, Tex. State Sec. Bd., Former Texas Lawyer Admits to Defrauding the Elderly Sentenced to Confinement in State Prison (Oct. 10, 2007), *available at* http://www.ssb.state.tx.us/news/Pres_Release/pr_10_10_07.pdf (seven years' confinement); *see also In re* Wintford E. Verkin II, No. 07-9078 (May 23, 2007) (revoking the lawyer's law license), *available at* http://www.supreme.courts.state.tx.us/MiscDocket/07/07907800.pdf (last visited Feb. 19, 2011).

12. *Head*, 299 S.W.3d at 425.

13. *See* Martinez v. State, 129 S.W.3d 101, 106 (Tex. Crim. App. 1999) (proof on any one alternative mean is sufficient for conviction).

14. *Id.* at 445.

private placement memorandum, a fifth testified he was not allowed any time to read it until after the selling agent had left with his money, and a sixth testified the selling agent did not allow him to keep it for reading and study.[15] Thus, these investors were not alerted by the private placement memorandum concerning the use of their moneys. Lastly, the fraudster contended the selling agent told the investors that the corporation would not invest all the moneys in distressed assets. The testimony of the selling agent indicated only a seventh investor was told about investments in personal injury lawsuits, but not about the loans and other non-distressed assets. Consequently, the court of appeals affirmed the conviction.[16]

II. REGISTRATION OF MARKET OPERATORS

One underpinning of securities in state regulation is the requirement to register in the state as a seller of securities before selling securities and as an investment advisor before rendering investment advice.[17] The Board made a number of changes to dealer and agent registration as well as investment adviser and investment adviser representative registration, generally adopting the standards of the North American Securities Administrators Association (NASAA).[18] The Board created a restricted registration for investment-banking dealers by (allowing them to take a shorter examination on general securities principles without emphasis on retail sales not part of their business)[19] substituting the passing percentage for dealers on examinations specified by the NASAA for the former Texas percentage,[20] requiring supervising systems maintained by dealers and by investment advisers designed to achieve compliance with all applicable securities laws not just Texas securities laws,[21] and replacing several Texas forms with NASAA forms.[22]

The Board has authority to deny, revoke, or suspend a license granted to dealers, agents, and investment advisor representatives for any felony or misdemeanor that directly relates to their duties and responsibilities.[23] In 2009, the Texas Legislature authorized occupational licenses for potential applicants to obtain preliminary information regarding their eligibility before beginning a training program for that occupation and allowed a

15. *Id.* at 429.
16. *Id.* at 426.
17. *See* TEX. REV. CIV. STAT. ANN. arts. 581-12(A)–(B); 581-13(A) (West 2011).
18. *Adopted Rules*, Tex. State Sec. Bd., (Aug. 16, 2010), http://www.ssb.state.tx.us/Texas_Securities_Act_and_Board_Rules/Adopted_Rules/August_16_2010.php.
19. 7 TEX. ADMIN. CODE ANN. § 115.1(c)(2)(N) (West 2011) (Tex. State Sec. Bd., Banking and Securities).
20. *Id.* § 115.3(a).
21. *Id.* § 115.10(a) (dealer supervision); § 116-10 (investment adviser supervision).
22. *Id.* §§ 133.5, 133.6, 133.9, 133.11, 133.29, 133.30, 133.34 (adopting new forms without comment); *see also* 35 Tex. Reg. 2428 (2010), *adopted* 35 Tex. Reg. 7051 (2010) (repealing former forms).
23. *See* 7 TEX. ADMIN. CODE ANN. §§ 115.6(a) (for dealers and agents) & 116.6(a) (West 2011) (Tex. State Sec. Bd., Banking and Securities) (for investment advisers and investment adviser representatives).

licensing authority to charge a fee for requesting a criminal history evaluation letter.[24] The Board added a rule providing the procedure to request a criminal history evaluation letter at a fee of $100 for registration by dealers and agents and by investment advisers and investment adviser representatives.[25]

Each year there is at least one court opinion depicting a party-litigant as a legal buffoon for wasting the court's time with a frivolous lawsuit. This year's effort involved a training company whose principals at best were unaware they were rendering investment advisor services.[26] One can but wonder whether the court has so slanted a few selected facts to make the party-litigant's lawyer look incompetent or whether the lawyer so convinced his client to pursue the quixotic matter to fatten the legal bill. In *S & D Trading Academy, LLC v. AAFIS Inc.*, two principals formed a company training foreign citizens to day-trade stocks on an investment company's account in the United States stock market.[27] Training began under an oral agreement while the companies negotiated a written contract. The oral agreement between the training company and the investment company provided a one dollar fee for every thousand shares traded during a probationary six-month period and thereafter for thirty-six months. The training consisted of monitoring the trainees' live, online trading activities and providing them with market research, stock recommendations, and trading strategies at the beginning of each day, and specifying the maximum loss each trainee could sustain before requiring the trader to exit the market for that day.[28] Negotiations for the written contract collapsed and the training company sued the investment company for perceived unpaid compensation. The TSA prohibits rendering investment advice in Texas unless registered under the TSA or exempt from such registration.[29] The TSA further prohibits lawsuit under a contract violating any provision of the TSA.[30] The training company conceded its services constituted investment advice,[31] but contended the

24. *See* TEX. OCC. CODE ANN. § 53.101 (West Supp. 2010); *see also* Act of Jan. 30, 2009, 81st Leg., R.S., § 1, sec. 53D, 2009 Tex. Sess. Law Serv. 616 (West) (adding section 53D to the occupations code).

25. 7 TEX. ADMIN. CODE ANN. § 104.7(a)(1) (West 2011) (Tex. State Sec. Bd., Banking and Securities (adopting new rule without comment). The rule addition required amendments to two other rules referring to the new procedure. *See* §115.6(d) (adopting amended rule without comment) (for dealers and agents); § 116.6(d) (adopting amended rule without comment) (for investment advisers and investment adviser representatives).

26. S & D Trading Acad., LLC v. AAFIS, Inc., 336 F. App'x 443, 444 (5th Cir. 2009), *cert. denied* 130 S. Ct. 1054 (2010).

27. *Id.*

28. *Id.* at 445.

29. *See* TEX. REV. CIV. STAT. ANN. art. 581-12B (West 2011) ("a person may not, directly or through an investment adviser representative, render services as an investment adviser in this state unless the person is registered under this Act . . . or is otherwise exempt under this Act.").

30. *See* TEX. REV. CIV. STAT. ANN. art. 581-33K (West 2011) ("[n]o person who has made or engaged in the performance of any contract in violation of any provision of this Act or any rule or order or requirement hereunder . . . may base any suit on the contract").

31. *See* S & D Trading Acad., LLC v. AAFIS Inc., No. G-06-739, 2008 WL 2325167, at *1 (S.D. Tex. June 3, 2008).

training company fits the teacher exemption from registration as an investment adviser.[32] The district court dismissed the action on the basis that one SEC no-action letter concluded under an almost identical provision in the federal statute that the teacher exemption applied only to actual teachers who work for accredited and certified institutions or schools of higher learning.[33] The district court assessed the investment company's legal costs against the training company, stating had the training company sought out competent legal advice before entering into the transaction, it would have been advised to register.[34]

The securities law issue for the Fifth Circuit was the interpretation of TSA's exemption from investment adviser registration for teachers.[35] The training company asserted that a federal administrative decision under federal law did not constitute precedential authority for a court interpreting the TSA. Instead, the training company concluded the court should follow Texas law requiring courts to give terms, not otherwise defined, their ordinary meaning.[36] For a teacher, that was one who teaches. Because Texas state courts have not rendered decisions on the definition of investment adviser, the Fifth Circuit proceeded as any Texas state court would.[37] Recognizing a future Texas court could define the term "investment adviser" differently, the Fifth Circuit noted that in interpreting the TSA both Texas state courts and the Fifth Circuit have previously used federal decisions interpreting federal securities laws, due to similarities between the securities laws of both jurisdictions.[38] The Fifth Circuit noted the federal Investment Adviser Act contains a virtually identical investment adviser definition.[39] The Fifth Circuit noted that federal

32. *See id.*; TEX. REV. CIV. STAT. ANN. art. 581-4N(2) (West 2011).

33. *See S & D Trading Acad.*, 2008 WL 2325167, at *1 (citing Joseph P. Canouse, SEC No-Action Letter, 1977 WL 10657 (May 26, 1977)).

34. *S & D Trading Acad.*, 336 F. App'x at 444–45; *see also S & D Trading Acad.*, 2008 WL 2325167, at *1 (consult attorney).

35. *S & D Trading Acad.*, 336 F. App'x at 447.

36. *Id.*; TEX. GOV'T. CODE ANN. § 311.011(a)–(b) (West Supp. 2010) ("Words and phrases shall be read in context and construed according to the rules of grammar and common usage. . . . Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly."); *see also* Guitar Holding Co., v. Hudspeth Cnty. Underground Water Conservation Dist. No. 1, 263 S.W.3d 910, 915 (Tex. 2008) (terms "not otherwise defined are typically given their ordinary meaning").

37. *S & D Trading Acad.*, 336 F. App'x at 447.

38. *Id.*; *see, e.g.*, Herrmann Holdings Ltd. v. Lucent Techs., Inc., 302 F.3d 552, 563 (5th Cir. 2002) (interpreting the TSA's fraud provision); Star Supply Co. v. Jones, 665 S.W.2d 194, 196 (Tex. App.—San Antonio 1984, no writ) (defining "securities"); *see also* Searsy v. Commercial Trading Corp., 560 S.W.2d 637, 639-41 (Tex. 1977) (using federal law to define "investment contract" and "evidence of indebtedness" as securities); George Lee Flint, Jr., *Securities Regulation*, 56 SMU L. REV. 1995, 2017 (2003) (discussing *Herrmann Holdings Ltd*); *accord* TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (West 2011) (portions of the TSA are based on federal securities laws).

39. *S & D Trading Acad.*, 336 F. App'x at 447. *Compare* TEX. REV. CIV. STAT. ANN. art. 581-4N (West 2010) (an investment adviser is "a person who, for compensation, engages in the business of advising another, either directly or through publications or writings, with respect to the value of securities or to the advisability of investing in, purchasing, or selling securities or a person who, for compensation and as part of a regular business,

courts, although not bound by the SEC no-action letters which bind only the SEC and subject of the letter, may consider them persuasive authority when interpreting a federal provision.[40] The Fifth Circuit then examined several SEC no-action letters noting the SEC found the teacher exemption to registration unavailable for teaching individuals how to invest in the stock market, one-day seminars on opportunities currently available in securities markets, stock market school, and college courses in stock market strategy because they were not offered by accredited educational institutions.[41] The Fifth Circuit found these no-action letters persuasive and the teacher exemption from registration of investment advisers unavailable because the training company was unaccredited, the principals were not professional teachers, and the training was not academic in nature.[42] Therefore, the Fifth Circuit affirmed.[43]

For those that do not find SEC no-action letters persuasive, note the Texas statutory interpretation rule requires courts to construe accordingly words with technical meanings, "whether by legislative definition or *otherwise*."[44] The teacher exemption to registration for investor advisers is one such technical term. The federal Investment Adviser Act created the term "investment adviser" including the teacher exemption in 1940,[45] the SEC no-action letters gave the term and its teacher exemption a technical meaning in the 1970s,[46] and the Texas Legislature added the federal language to the TSA in 2000[47] knowing that technical meaning.

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issues or adopts analyses or a report concerning securities . . . . The term does not include . . . . 2) a lawyer, accountant, engineer, teacher, or geologist whose performance of the services is solely incidental to the practice of the person's profession.") *with* 15 U.S.C. § 80b-2(a)(11) (2010) (an investment adviser is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include . . . (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession.").

40. *S & D Trading Acad.*, 336 F. App'x at 448; *see, e.g.*, Allaire Corp. v. Okumus, 433 F.3d 248, 254 (2d Cir. 2006) (finding the no-action letter persuasive); *accord* Gryl ex rel. Shire Pharm. Grp. PLC v. Shire Pharm. Grp. PLC, 298 F.3d 136, 145 (2d Cir. 2002) (no-action letters are not agency rule-making nor adjudication and thus entitled to no more deference beyond their persuasive value; not finding the no-action letter persuasive).

41. *S & D Trading Acad.*, 336 F. App'x at 448–49; *see* Joseph P. Canouse Esq., SEC No-Action Letter, 1977 WL 10657 (July 15, 1977) (teaching individuals); David A. Umstead, SEC No-Action Letter, 1976 WL 12176 (Aug. 13, 1976) (one-day seminars); J.H. Rodgas, Jr., SEC No-Action Letter, 1974 WL 10941 (Sept. 7, 1974) (stock market school); Frank T. Hines, SEC No-Action Letter, 1972 WL 8250 (Aug. 21, 1972) (unaccredited college course).

42. *S & D Trading Acad.*, LLC, 336 F. App'x at 449–50.

43. *Id.* at 453.

44. TEX. GOV'T CODE ANN. § 311.011(b) (West 2011) (emphasis added).

45. *See* 15 U.S.C. § 80b-2(a)(11)(B) (2011).

46. *See supra* note 29.

47. *See* TEX. REV. CIV. STAT. ANN. art. 581–4N (West 2011).

III. SECURITIES FRAUD

One major reason legislatures passed securities acts was to facilitate investors' actions to recover their moneys through a simplified fraud action that removed scienter and privity, the most difficult elements to prove in a common-law fraud action.[48] These securities act lawshifts generally apply only to the primary market. When investors purchase in the secondary market their actions reintroduce these obstacles. Moreover, Congress added additional burdens to secondary market securities fraud actions through the Private Securities Litigation Reform Act of 1995 (PSLRA).[49]

A. COURT DECISIONS UNDER THE TEXAS ACTS

The opinions under the TSA and TSFA raised three issues of interest concerning aiding and abetting, projections, and misrepresentations.

1. No Aiding and Abetting Liability for Failure to Whistle-Blow Absent a Duty

When investments sour, injured investors seek to recover moneys from solvent defendants, such as third parties that enable an alleged fraud perpetrator to sell securities. Because federal law severely limits aiding and abetting lawsuits by private investors against third parties under federal securities laws,[50] such actions are more common under state blue sky laws.[51] The TSA specifically allows investors to sue aiders and abettors of perpetrators in the sale or purchase of a security to those investors.[52] This year's effort by investors essentially sought to impose aider and abet-

48. George Lee Flint, Jr., *Securities Regulation*, 56 SMU L. REV. 1995, 2016 (2003).

49. *See* 15 U.S.C. § 78u-4(b) (2010).

50. *See* Cent. Bank of Denver v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (holding a private plaintiff cannot maintain an implied cause of action for aiding and abetting under Rule 10b-5 of the Exchange Act). The Congressional response to *Central Bank of Denver* was to amend the Exchange Act in 1995, and not the Securities Act, to permitting the SEC to bring aiding and abetting actions, *see* 15 U.S.C. § 78t(e) (2010) (in action by SEC, person providing substantial assistance to perpetrator also liable), thereby foreclosing aiding and abetting liability under the Securities Act. Recently, the Supreme Court foreclosed attempts to circumvent the ban on private aiding and abetting lawsuits by recharacterizing the action as a primary violation of Rule 10b-5 (participation in a deceptive scheme without a communication to the public). *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 161 (2008) (scheme liability extending securities liabilities beyond the securities markets to basic contracts violates the Court's precedents); *see also* George Lee Flint, Jr., *Securities Regulation*, 62 SMU L. REV. 1435, 1458–59 (2009) (discussing *Stoneridge*, a case impacting prior Texas decisions).

51. *See, e.g.*, *In re* Enron Corp. Secs., Derivative & ERISA Litigation, 540 F. Supp. 2d 759, 765 (S.D. Tex. 2007) (investment banker aiding and abetting under the TSA); Kastner v. Jenkens & Gilchrist, P.C., 231 S.W.3d 571, 579 (Tex. App.—Dallas 2007, no pet.) (attorney aiding and abetting under the TSA); *see also* Flint, *supra* note 50, at 1452; George Lee Flint, Jr., *Securities Regulation*, 61 SMU L. REV. 1107, 1119–20 (2008) (discussing *Kastner*).

52. *See* TEX. REV. CIV. STAT. ANN. art. 581-33(F)(2) (West 2011) ("A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer.").

tor liability on an accounting firm for not warning the investors of fraud committed by an issuer.[53] The issuer had engaged in a Ponzi scheme, another of the Board's top investment scams.[54]

In *Navarro v. Grant Thornton, LLP*, the Houston Court of Appeals dealt with a sale and lease-back of coin-operated payphones to investors by two corporate promoters, both using the same business model and having the principal of one promoter serving as a consultant to the other promoter.[55] The business model called for the promoter to sell payphones to distributors who would resell them to the investors for a profit, and the investors would then lease the payphones back to the promoter for sixty months with a full refund buy-back provision on 180 days notice. At the end of the lease term, each investor could manage their payphone themselves, renew the lease for an additional sixty months, or sell the payphones back to the promoter.[56] The revenues received by the promoters from the payphone users were never enough to cover the promoters' lease payments to the investors, so the promoters used proceeds received from additional payphone sales to new investors to satisfy the lease payments to earlier investors. To prevent alerting the investors, the promoters sought a non-GAAP method to account for the sale transactions of payphones to the investors (as operating leases, thereby recognizing income from the payphone sales).[57] Both original accountants, who withdrew from preparation of audited financial statements over the issue, and defendant accountants, hired to replace the original accountants under the belief they could be persuaded to use the non-GAAP method, concluded that accountants must account for the transactions in accordance with GAAP (as capital leases, a financing revealing the losses, due to the repurchase option).[58] Within two years the promoters could no longer make their lease payments, the SEC sought civil enforcement actions against the promoters for selling unregistered securities (the sale and lease-back of the payphones amount to an investment contract or security) and committing fraud (failing to inform investors of the promoters' losses and the Ponzi scheme of paying earlier investors with moneys from new investors), one promoter went into receivership, and the other

53. Navarro v. Grant Thornton, LLP, 316 S.W.3d 715, 717 (Tex. App.—Houston [14th Dist.] 2010, no pet.).

54. *See* Press Release, Tex. State Sec. Bd., List of Texas "Top 10" Investment Scams, Schemes, and Scandals Issued by Texas Securities Commissioner (Jan. 14, 2004) (listing Ponzi Schemes, using moneys from new investors to pay returns to old investors, as first on the list).

55. *Navarro*, 316 S.W.3d at 717. This article omits the issue on the statute of limitations for conspiracy to defraud.

56. *See* Brief for Appellant, Navarro v. Grant Thornton, LLP, 316 S.W. 3d 715 (Tex. App—Houston [14th Dist.] 2010, no pet.) (No. 14-08-00482-CV), 2009 WL 1225582 at *3.

57. *See id.* at *7 (promoter feared investor panic because it owed more money on the 180-day buy-backs than it had); *id.* at *10 (treatment as an operating lease if promoter had sold the payphones to a third party, owned no risk, and received a stream of fees for providing services).

58. *See id.* at *10 n.18.

into bankruptcy.[59] Texas investors sued the solvent accounting firm three years later for violating securities laws under the TSA as an aider and abettor of the promoters (not registering securities and omitting material information in the sales materials).[60] The trial court granted summary judgment for the accounting firm.[61]

The securities law issue for the court of appeals involved whether the aider and abettor had rendered substantial assistance to the perpetrator, one element of the cause of action.[62] With respect to whistle-blowing failures to disclose to regulators or investors issues relating to a Ponzi scheme and siphoning of funds by the principal of one promoter,[63] the court of appeals concluded that a court, in the absence of a duty to disclose neither asserted or briefed by the investors, could not consider failures to whistle-blow in determining if the accountant firm substantially assisted the perpetrator.[64] With respect to other omissions and misstatements made to regulators relating to the inability to continue as a "going concern,"[65] there was no evidence that the accountant interacted with the

59. *Navarro*, 316 S.W.3d at 718; *see* SEC v. Edwards, 540 U.S. 389, 392 (2004) (describing the payphone scheme as a classic investment contract); *id.* at 397 (not telling investors that the promoter failed to make a profit, lost money on the payphones, and depended on funds from new investors to sustain operations constituted fraud).

60. *Navarro*, 316 S.W.3d at 718; *see* TEX. REV. CIV. STAT. ANN. arts. 581-33(A)(1) (unregistered securities) & 33(A)(2) (West 2010) (omission of material information). Additionally, the Board sanctioned a Texas seller of the payphone investment contracts. *See In re* Todd Robert Fecht, No. CDO-1457, 2002 WL 927153 at *1 (Tex. State Sec. Bd. Apr. 24, 2002) (cease and desist order for selling ETS Payphones, Inc. Equipment Lease Program without registering as a dealer).

61. *Navarro*, 316 S.W.3d at 718.

62. *Id.* at 720. The elements in a cause of action for aider and abettor liability under the TSA are: (1) a primary violation of the TSA by the perpetrator, (2) the aider's general awareness of the violation, (3) the aider's substantial assistance in the violation, and (4) the aider's intent to deceive or reckless disregard of the truth or law. *See* Ins. Co. of N. Am. v. Morris, 981 S.W.2d 667, 675 (Tex. 1998) (approving a jury instruction that added an awareness element to the other three elements obvious from the statute); *see also* Frank v. Bear, Stearns & Co., 11 S.W.3d 380, 384 (Tex. App.—Houston [14th Dist.] 2000, pet. denied) (listing the four elements).

63. *Navarro*, 316 S.W.3d at 721 (investors alleged the accounting firm failed to disclose that the business model was a Ponzi scheme, there was a relationship between the promoters and one of their principals, this principal received moneys on each sale of payphones and siphoned investor funds to other corporations, and there was an investigation by the Pennsylvania Securities Commission).

64. Noting there was some evidence that accountants had a duty to their client (in this case the perpetrator) to disclose the fraud, the court of appeals bolstered its opinion with two cases interpreting New York common law fiduciary law, albeit in the securities context. *Id.* at 721–22 (citing Eurycleia Partners, LP v. Seward & Kissel, LLP, 910 N.E.2d 976, 981 (N.Y. 2009); Stanfield Offshore Leveraged Assets, Ltd. V. Metro. Life Ins. Co., 883 N.Y.S.2d 486, 489–90 (N.Y. App. Div. 2009)).

65. *Id.* at 722 (failures to include a "Going Concern" paragraph in the promoters' audited and compiled financial statements); *id.* at 724–25 (alleging the following omissions and misstatements before the Pennsylvania Securities Commission: (1) notes to one promoter's compiled GAAP statements prepared by the accountant indicated the operating loss does not reflect an inability to continue as a going concern, (2) a draft letter of promoter's chief financial officer to the Pennsylvania Securities Commission claimed the accountant would issue an audited financial statement opinion without qualification, and (3) the accountant proposed to retroactively restructure to remove liabilities from that promoter's GAAP financial statements but that was not done; also alleging the following

investors, that the investors heard about the accountant from the sellers, or that the investors received the accountant-prepared financial statements. Consequently, the court of appeals concluded that no reasonable jury member could find the accountant rendered substantial assistance and affirmed the trial court.[66]

Aiders and abettors can obtain little comfort from the *Navarro* opinion. The failure of the court of appeals to craft a safe-harbor rule suggests that this appellate court prefers to follow a fact laden case-by-case approach in determining substantial assistance. The appellee-accountant asserted the accountant's mere performance of routine professional work cannot amount to substantial assistance.[67] This thought appears nowhere in the *Navarro* opinion. With respect to the absence of a duty, the SEC once had this problem for misappropriators of inside information that it solved by alleging a duty to the employer in the next case.[68] Moreover, the statutory trend imposes some whistle-blowing obligations. The Sarbanes-Oxley Act requires the SEC to issue rules requiring attorneys to report evidence regarding a material violation of securities laws or breach of fiduciary duty to the issuer's chief legal counsel or to an appropriate committee of the issuer's board of directors.[69] The recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act goes further and provides financial incentives of 10% to 30% of the SEC's sanction to individuals who report securities and accounting fraud to the SEC, pursuant to the SEC's rules, if it leads to sanctions in excess of one million dollars.[70] Furthermore, the appellate court's finding an absence of contact between the investors and aider and abettor, including a communication about the aider and abettor by the securities's sellers, suggests substantial assistance could arise when sellers use the aider and abettor's

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omissions and misstatements before the SEC: (1) accountant stated the promoter's GAAP financial statements depicted a worse financial condition than it actually was, (2) accountants were unable to make a determination whether the promoter needed to keep selling payphones to meet obligations).

66. *Id.* at 728.

67. *See* Brief for Appellee & Cross-Appellant at B, Navarro v. Grant Thornton, LLP, 316 S.W. 3d 715 (Tex. App.—Houston [14th Dist.] 2010, no pet.) (No. 14-08-00482-CV), 2008 WL 6491768, at *9. Before 1994, when federal courts allowed aiding and abetting lawsuits by private investors under federal law, the Fifth Circuit's awareness/intent test required clear proof of intent to violate securities laws by an aider if the aider was involved in daily grist mill activities but allowed a possible inference of knowledge for unusual activities. *See* Ins. Co. of N. Am. v. Dealy, 911 F.2d 1096, 1101 (5th Cir. 1990); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 97 (5th Cir. 1975).

68. For failure to allege a duty, see Chiarella v. United States, 445 U.S. 222, 235 (1980). For duty to the employer alleged, see SEC v. Materia, 745 F.2d 197, 203 (2d Cir. 1984).

69. *See* 15 U.S.C. § 7245 (2011); *see also* 17 C.F.R. § 205.3(b) (2011) (rule requiring attorneys that practice before the SEC to report evidence of a material violation). Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act (Sarbanes-Oxley) of 2002 § 307.

70. *See* Dodd-Frank Wall Street Return and Consumer Protection Act (Dodd-Frank) of 2010 § 87u-6(b)(1) (2011); *see also* Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Security Exchange Act release No. 63237, 75 Fed. Reg. 70.488 (Nov. 17, 2010).

firm documents or reputation as approving the investment. When known by the aider and abettor, a duty to disclose might arise.

2. *No Liability for Projections of Future Performance not Worded as Guarantees*

Federal courts also deal with securities fraud lawsuits brought under the TSA or the TSFA when coupled with a federal action. In the first of such cases, *Arkoma Basin Project Limited Partnership v. West Fork Energy Company LLC*, the Fifth Circuit dealt with an action under both the TSA and federal securities laws (Rule 10b-5),[71] namely a breach of duty to conduct natural gas production operations in a good and workmanlike manner.[72] Frequently, contract lawsuits also involve securities, here an undivided interest in oil and gas rights.[73] An operating company originally owned the natural gas leases. The promoters, in order to purchase the natural gas leases, formed a limited liability company, entered into negotiations with an energy company to purchase a fifty percent working interest in the leases, and prepared a business plan for the energy company outlining a first-year development plan to reconnect shut-in wells and drill additional wells, with projections of the production volume and generated revenues. When negotiations with the energy company failed, two brokers assisting the sale[74] formed a limited partnership, created a prospectus from the business plan by altering some of its data, and recruited twelve limited partners. The limited liability company and limited partnership, both Texas residents,[75] entered into a purchase agreement with the operating company to acquire the natural gas leases. As part of the purchase agreement, the limited partnership and operating company entered into a joint operating agreement. Neither the purchase agreement nor operating agreement mentioned the business plan. A subsequent natural gas boom resulted in shortages of personnel and equipment, leading to higher operating costs. The operating company was only able to complete the first phase of the business plan and sought additional funds from a hedge fund. Negotiations for additional funds

71. *See* 17 C.F.R. § 240.10b-5 (2010).

72. Arkoma Basin Project LP v. W. Fork Energy Co., 384 F. App'x 375, 379 (5th Cir. 2010). This article omits the issues on evidence, jury influence, and legal fees.

73. *See* TEX. REV. CIV. STAT. ANN. art. 581-4A (West 2011) ("The term 'security' . . . shall include . . . any instrument representing any interest in or under an oil, gas or mining lease, fee or title . . . . "); *see also* 15 U.S.C. § 77b(a)(1) (2011) ("the term 'security' means. . .fractional undivided interest in oil, gas, or other mineral rights . . . .").

74. *See* Brief for Appellant at *7; Arkoma Basin Project LP v. W. Fork Energy Co., 384 F. App'x 375 (5th Cir. 2010) (No. 09-40011), 2009 WL 6621745 at *7; *see also Arkoma Basin Project LP*, 384 F. App'x at 377 (describing one broker as a co-crafter of the business plan).

75. *See* Brief for Appellant, Arkoma Basin Project LP at *13 n.3; *see also West Fork Energy Company, LLC*, CORPORATION WIKI, http://www.corporationwiki.com/Texas/Fort-Worth/West-fork-energy-company-l-l-c/38610410.aspx (last visited Feb. 21, 2011) (filed in Texas July 14, 2003); *Arkoma Basin Limited Partnership*, CORPORATION WIKI, http://www.corporationwiki.com/Texas/Dallas/arkoma-basin-project-limited-partnership136671878.aspx (last visited Feb. 21, 2011) (filed in Texas Sept. 21, 2004).

failed when the limited partnership refused to sign a letter of intent with the hedge fund and instead brought suit under the TSA and federal law against the promoters, the operating company, and the limited liability company for breach of contract and securities fraud. At the conclusion of the limited partnership's case in chief, the district court granted summary judgment on the grounds that the limited partnership provided no evidence of reliance on the misrepresentations contained in the business plan.[76] The Fifth Circuit affirmed but on different grounds.[77]

The securities law issue for the Fifth Circuit was whether the alleged misstatement was actionable under the TSA and federal securities laws for the facts elicited by the limited partnership.[78] The misstatement was using the projections from the business plan to entice investors to invest with no intent to take the necessary steps to achieve those projections.[79] The Fifth Circuit examined the materiality and scienter elements of the cause of action,[80] rather than focus on reliance because the TSA does not require reliance for an action against the seller.[81] The TSA also does not require scienter[82] except for an untrue promise of future performance.[83] With respect to materiality, the Fifth Circuit noted projections of future performance are not actionable unless accompanied by language of guarantee,[84] which the projections in the business plan did not have. With respect to scienter, the Fifth Circuit noted promises of future perform-

76. *See* Brief for Appellant at *7, Arkoma Basin Project LP v. W. Fork Energy Co., 384 F. App'x 375 (5th Cir. 2010) (No. 09-40011), 2009 WL 6621745 at *13 (there can be no reliance on the business plan drafted by the promoters because the business plan was materially altered and changed; the district court also doubted the TSA and federal securities laws applied because there was no security, just a purchase contract).

77. *Arkoma Basin Project*, 384 F. App'x at 383.

78. *Id.* at 380.

79. *Id.*

80. *Id.* For the TSA the investor needs to prove (1) the promoter offered or sold a security, (2) the promoter made an untrue statement or omission of a material fact, and (3) the untrue statement or omission is the means by which the sale of the security was made. *See* TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (West 2010) ("A person who offers or sells a security . . . by means of an untrue statement of a material fact or an omission to state a material fact . . . is liable to the person buying the security from him . . . ").

81. *See, e.g.*, Weatherly v. Deloitte & Touche, 905 S.W.2d 642, 648–49 (Tex. App.—Houston [14th Dist.] 1995, writ dism'd w.o.j.); *see also* Granader v. McBee, 23 F.3d 120, 123 (5th Cir. 1994). Perhaps the reliance requirement has been replaced by "by means of," requiring proof that the misstatement or omission (1) related to the security sold and (2) induced the purchase. *See* Pitman v. Lightfoot, 937 S.W.2d 496, 531 (Tex. App.—San Antonio 1996, writ denied); Nicholas v. Crocker, 687 S.W.2d 365, 368 (Tex. App.—Tyler 1984, writ ref'd n.r.e.); *see also* Calpetco 1981 v. Marshall Exploration, Inc., 989 F.2d 1408, 1419 n.24 (5th Cir. 1993).

82. *See, e.g.*, Dorsey v. Portfolio Equities, Inc., 540 F.3d 333, 343–44 (5th Cir. 2008); *see also* George Lee Flint, Jr., *Securities Regulation*, 56 SMU L. REV. 1995, 2005 (2003) (discussing *Dorsey*). The TSA makes the absence of scienter a defense with burden of proof on the seller. *See* TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (West 2011) (unless the "person . . . liable . . . sustains the burden of proof that [he] did not know . . . of the untruth or omission.").

83. *See* Herrmann Holdings Ltd. v. Lucent Techs. Inc., 302 F.3d 552, 563–64 (5th Cir. 2002); *see also* Flint, *supra* note 82, at 2017 (discussing *Herrmann Holdings Ltd*).

84. *Arkoma Basin Project*, 384 F. App'x at 380. For interpretations of the TSA's provision for a fraud remedy, Texas courts are advised to use federal law because it is so similar. TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (West 2011) (portions of the TSA are

ance required proof the promoter had no intention of performing when making the misrepresentation.[85] Because the promoters actually completed the first phase of the projections and made serious efforts to complete the second phase, that required intent was absent. Similarly, the federal action under Rule 10b-5[86] requires the same two elements of materiality and scienter.[87]

The *Arkoma Basin Project Limited Partnership* case would appear to be another opinion that depicts a party-litigant as a legal buffoon for wasting the court's time with a frivolous lawsuit. But this time the slanting of a few selected facts to make the party-litigant's lawyer look incompetent may be aimed at disguising the weak law clerking of the district court. The district court had the right idea that there was no cause of action, but was unable to provide a reason with respect to the TSA. The Fifth Circuit continued the cover-up by not publishing the opinion in the Federal Reporter and not emphasizing the district court's reasoning. Such action, however, merely suggests that the bar is not well versed in the differences between the TSA and federal securities acts.

3. *Repurchase or Substitute Language in Prospectus Defeats a Misrepresentation*

In the second Fifth Circuit action involving both state and federal claims, *Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC*[88] encountered a fraud action against a bank for selling mortgage-backed securities under the TSA, TSFA, and federal securities laws. The bank purchased residential mortgages, placed them in trusts, and had the trusts issue securities (trust interests) to an investor pursuant to prospectuses and supplemental prospectuses. The supplemental prospectuses and the representation and warranty agreements referenced in the supplemental prospectuses contained representations and warranties by the bank for each mortgage loan not thirty days or more delinquent since origination of the loan. Both the supplemental prospectuses and the referenced representation and warranty agreements also contained statements to the effect that the sole remedy for a breach of any such representation and warranty was that the bank would repurchase the delinquent mortgage or replace it with a non-delinquent mortgage.[89] After discovering several

based on federal securities laws). That federal law provides the guarantee rule. *See* ABC Arbitrage Plaintiffs Grp. v. Tchuruk, 291 F.3d 336, 359 (5th Cir. 2002).

85. *See Herrmann Holdings Ltd.*, 302 F.3d at 563 (interpreting the TSA); *see also* Flint, *supra* note 82, at 2017 (discussing *Herrmann Holdings Ltd*).

86. *See* 17 C.F.R. § 240.10b-5 (2010).

87. *Arkoma Basin Project*, 384 F. App'x at 380. For Rule 10b-5 the investor needs to prove (1) a material misstatement or omission, (2) scienter, (3) a connection with a purchase or sale of securities, (4) reliance, (5) loss causation, and (6) economic loss. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005).

88. 594 F.3d 383 (5th Cir. 2010) (opinion by C.J. Jones). The author served with Edith Jones on the University of Texas Law School's Law Review in 1975. This article omits the issue on jurisdiction.

89. *Id.* at 389.

delinquent mortgages violating the representation and warranty, the investor brought suit against the bank for material misrepresentations under the TSA, TSFA, and federal Securities Act.[90] The district court granted a motion to dismiss for failure to state a claim on the ground that all actions required a material misrepresentation and there was no alleged misrepresentation, much less a material one.[91] The Fifth Circuit affirmed.[92]

The first securities law issue for the Fifth Circuit in *Lone Star Fund* was whether there was a misrepresentation.[93] The investor contended the representation and warranty constituted misrepresentation.[94] The Fifth Circuit, however, determined that when reading misrepresentations all language in the prospectus and accompanying documents should be read together.[95] Reading the representation and warranty along with the repurchase or substitute provision changes the nature of the statement to one guaranteeing the mortgage loans will be compliant or will be made compliant. Hence, there was no misrepresentation.[96] The second issue was whether the repurchase or substitute provision amounted to a waiver of the right to sue under the securities laws, which both the TSA and federal securities laws prohibit.[97] The Fifth Circuit viewed the repurchase or substitute provision not as a waiver, but as changing the nature of the bank's representation.[98]

Through *Lone Star Fund V (U.S.), L.P.*, the Fifth Circuit created another use for cautionary information. The general use defeats the materiality requirement of a fraud action under the idea that no reasonable

90. *See* 15 U.S.C. § 77k(a) (2006) (misrepresentation in a registration statement); 15 U.S.C. § 771(a)(2) (2006) (misrepresentations in a prospectus); 15 U.S.C. § 770 (2006) (liability of controlling persons).

91. Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC, No. 3:08-CV-0261-L, 2008 WL 4449508, at *11 (N.D. Tex. Sept. 30, 2008).

92. *Lone Star Fund V (U.S.), L.P.*, 594 F.3d at 390.

93. *Id.*

94. Appellant's Brief, Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC, 594 F.3d 383 (5th Cir. 2010) (No. 08-11038), 2009 WL 6445739 at *36–38. The repurchase or substitution language related to remedies under 15 U.S.C. § 77k(e) and TEX. REV. CIV. STAT. ANN. art. 581-33D, not the misrepresentation. *Id.* at *37.

95. The Fifth Circuit cited an insurance contract interpretation case. *See Lone Star Fund V (U.S.), L.P.*, 594 F.3d at 389–90 (citing Transitional Learning Cmty. at Galveston, Inc., v. U.S. Office of Pers. Mgmt., 220 F.3d 427, 431 (5th Cir. 2000)). It is unclear this is correct when different sorts of contracts have different interpretation rules. *See, e.g.*, George Lee Flint, Jr., *ERISA: Reformulating the Federal Common Law for Plan Interpretation*, 32 SAN DIEGO L. REV. 955, 996–1009 (1995) (noting ERISA plans don't use the interpretation rules for collective bargaining agreements nor the interpretation rules for insurance contracts). One bankruptcy court in the Fifth Circuit, however, recently applied a modified version of the rule proposed in *Lone Star Fund V (U.S.), L.P.* for the TSA when it held a court reads a statement in context along with the cautionary language when the statement is not buried in information designed to obscure; *see In re* Perry, 404 B.R. 196, 216 (S.D. Tex. 2009); *see also* George Lee Flint, Jr., *Securities Regulation*, 63 SMU L. REV. 795, 803–05 (2010) (discussing *Perry*).

96. *Lone Star Fund V (U.S.), L.P.*, 594 F.3d at 389.

97. *Id.* at 390; *see* 15 U.S.C. § 77n (2009); TEX. REV. CIV. STAT. ANN. art. 581-33L (West 2011).

98. *Lone Star Fund V (U.S.), L.P.*, 594 F.3d at 387–90.

person attaches much significance to the misrepresentation in light of the cautionary material when making the decision to purchase.[99] Now, such language in the Fifth Circuit might also negate a misrepresentation.[100]

B. Court Decisions Under the Federal Acts

Because the fraud provisions of the TSA are modeled on federal statutes, there is an interest in Fifth Circuit securities law opinions.[101] Originally, this meant that Texas courts interpreting the TSA's similar language looked to federal decisions under the federal statutes.[102] But more recently, litigants and judges tend to graft federal concepts onto the TSA even when the language is not similar.[103]

1. Loss Causation as a Prerequisite to the Fraud-on-the-Market Presumption

Congress passed the Private Securities Litigation Reform Act (PSLRA) of 1995[104] to discourage extortive securities litigation. This includes filing class lawsuits for securities fraud whenever a significant change in the issuer's price occurred followed by abuse of the discovery process imposing burdensome costs, making it more economical for the victimized issuers to settle.[105] This year's effort to protect investors from lawyers extorting investor's corporate value involved the Fifth Circuit's requirement for class certification of finding "loss causation" before allowing substitution of fraud-on-the-market theory's rebuttable presumption for the reliance element in a cause of action.[106]

In *The Archdiocese of Milwaukee Supporting Fund, Inc., v. Halliburton Co.*, the plaintiffs went after an issuer under Rule 10b-5 in a class action for alleged misstatements in three categories: (1) statements concerning

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99. *See In re Perry*, 404 B.R. at 216 (applying it to the TSA); Kapps v. Torch Offshore, Inc., 379 F.3d 207, 214 (5th Cir. 2004) (discussing federal securities act for misrepresentation in a registration statement); Olkey v. Hyperion 1999 Term Trust, Inc., 98 F.3d 2, 5 (2d Cir. 1996); *see also* Flint, *supra* note 95, at 803–05 (2010) (discussing *Perry*).

100. *Lone Star Fund V (U.S.), L.P.*, 594 F.3d at 388.

101. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33 cmt. (West 2010) (Comment to 1977 Amendment).

102. *See, e.g.*, Anglo-Dutch Petroleum Int'l, Inc. v. Haskel, 193 S.W.3d 87, 103 n.13 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

103. *See In re* Enron Corporation Securities, Derivative and "ERISA" Litigation 623 F. Supp. 2d 798, 814–16 (S.D. Tex. 2009) (failed attempt to graft federal "loss causation" onto the TSA); Dorsey v. Portfolio Equities, Inc., 540 F.3d 333, 338 (5th Cir. 2008) (applying federal rules to pleading fraud with particularity to the TSA and TSFA); *see also* George Lee Flint, Jr., *Securities Regulation*, 56 SMU L. Rev. 1995, 2005 (2003) (discussing *Dorsey*).

104. *See* 15 U.S.C. § 78u-4 (2009).

105. *See* H.R. Rep. No. 104–369, at 31 (1995) (Conf. Rep.) *reprinted in* 1995 U.S.C.C.A.N. 730. For the fate of one such prominent extorter, *see generally* Patrick Dillon and Carl Cannon, Circle of Greed: the Spectacular Rise and Fall of the Lawyer who Brought Corporate America to its Knees 452 (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 later disbarred in 2009).

106. *See* Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 264–65 (5th Cir. 2007); *see also* George Lee Flint, Jr., *Securities Regulation*, 61 SMU L. Rev. 1107, 1128 (2008) (discussing *Oscar*).

the issuer's exposure (arising from a former spun-off subsidiary of a merger partner) to asbestos litigation and the stated reserves for that litigation, (2) statements about the issuer's benefits from that merger, and (3) improperly recording cost-overruns in fixed-price construction contracts as revenue by deeming the cost-overruns as probable of collection.[107] The elements of a Rule 10b-5 cause of action are material misrepresentation (or omission), scienter, connection with purchase or sale of a security, reliance, loss causation, and economic loss.[108] To form a class the court must find questions of fact to be predominately common amongst the class members.[109] To avoid placing an insurmountable evidentiary burden on the client, the fraud-on-the-market presumption (that available public material information on an 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 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 misstatement and corrective disclosure.[110] To lessen the extortive impact of class certification, the Fifth Circuit will not find materiality unless the client shows the corrective statement adversely impacted the issuer's price (that is, loss causation), even at the class certification stage.[111] Finding no causal connection between the alleged misstatements and the corrective statements, the district court denied the client's motion for class certification.[112] The Fifth Circuit affirmed, thwarting a major opportunity for an extortion scheme that would arise upon class certification.[113]

The securities law issue for the Fifth Circuit in *Archdiocese* concerned whether the client had satisfied the materiality (loss causation) requirement for class certification.[114] The idea behind the fraud-on-the-market theory is that a false statement causes an inflated issuer stock price. So in the Fifth Circuit, loss causation for class certification has two requirements: the client shows materiality of a false statement by (1) connecting the falsehood to a corrective statement and (2) showing that misstate-

107. 597 F.3d 330, 334 (5th Cir. 2010), *vacated and remanded* by Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011).

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

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

110. *See* Basic Inc. v. Levinson, 485 U.S. 224, 241–42, 245, 248 n.27 (1988) (definition, reasons, and elements of fraud-on-the-market); 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*).

111. *Oscar Private Equity Invs.*, 487 F.3d at 266–67; *see* Fener v. Operating Eng'rs Constr. Indus. & Misc. Pension Fund, 579 F.3d 401, 406 (5th Cir. 2009); Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221, 227–28 (5th Cir. 2009); Lormand v. US Unwired, Inc., 565 F.3d 228, 260–61 (5th Cir. 2009); George Lee Flint, Jr., *Securities Regulation*, 61 SMU L. REV. 1107, 1128–29 (2008) (discussing *Oscar*); George Lee Flint, Jr., *Securities Regulation*, 63 SMU L. REV. 785, 809–15 (2010) (discussing *Fener*, *Alaska Electrical Pension Fund*, and *Lormand*).

112. *The Archdiocese of Milwaukee Supporting Fund, Inc.*, 597 F.3d at 334.

113. *Id.*

114. *Id.* at 335.

ment, and not some other event, most likely caused the resulting price change.[115] With respect to asbestos litigation, the client failed the first requirement.[116] The client produced various post-class period issuer press releases and SEC filings that sequentially increased reserves for asbestos-related liability. The client did not produce any prior misstatement concerning the asbestos reserves, instead relying on some inference that these statements must correct something. The first reported statement provided financial assistance to the pre-merger spun-off subsidiary covering the former subsidiary's asbestos liabilities; the latter ones reported additional recent judgments. These statements merely indicated to the Fifth Circuit that the issuer was properly keeping the market abreast of developments.[117] An issuer is allowed to be proven wrong with respect to its estimates.[118] With respect to the merger benefits, the client failed to satisfy the second requirement.[119] The alleged misstatements made early in the class-period specified the expected savings while the corrective statements (one from the issuer and one from analysts), also made early in the class-period, reduced earnings estimates. The corrective statements contained two other pieces of negative news (the decline in offshore construction business and reduced spending levels by energy industry customers) besides the less than expected profits from the merger partner. The Fifth Circuit requires expert testimony and analytical research for multiple negative news to determine amount of loss, if any, caused by the corrective statement.[120] The client's expert witness failed to statistically or econometrically analyze three different pieces of information. Moreover, the expert witness relied solely on news commentary and analysts, a practice the Fifth Circuit rejects as merely well-informed speculation.[121] With respect to the improper accounting, the client failed to satisfy the first requirement.[122] The issuer made two corrective press releases late in the class period. Both press releases related to restructuring and restructuring charges, with no mention of fixed price contracts, unapproved claims, or method of revenue recognition. The client's expert witness could not match these corrective statements with any prior issuer misstatement.[123]

115. Greenburg v. Crossroads Sys., Inc., 364 F.3d at 666 (plaintiff must prove "(1) that the negative 'truthful' information causing the decrease in price is related to an allegedly false, non-confirmatory positive statement made earlier and (2) that it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline."); *see* George Lee Flint, Jr., *Securities Regulation*, 58 SMU L. REV. 1135, 1156–57 (2005) (discussing *Greenberg*).

116. *The Archdiocese of Milwaukee Supporting Fund, Inc.*, 597 F.3d at 340–41.

117. *Id.* at 341.

118. *Id.* at 343–44.

119. *Id.* at 341.

120. *See* Fener, 579 F.3d at 410–11; *see also* George Lee Flint, Jr., *Securities Regulation*, 63 SMU L. REV. 785, 814–15 (2010) (discussing *Fener*).

121. *See Oscar Private Equity Invs.*, 487 F.3d at 271; *see also* George Lee Flint, Jr., *Securities Regulation*, 61 SMU L. REV. 1107, 1128 (2008) (discussing *Oscar*).

122. *The Archdioese of Milwaukee Supporting Fund, Inc.*, 597 F.3d at 342.

123. *Id.* at 339–44.

The plaintiffs were so angered by the result that they suggested the Fifth Circuit's requirement showing loss causation at the class certification stage violated the Supreme Court's placement of the burden of proof to rebut fraud-on-the-market.[124] But the plaintiff does have the burden of proof for loss causation as an element in a cause of action for securities fraud and for materiality (shown by the loss causation) as prerequisite of the fraud-on-the-market presumption.[125] The plaintiffs' counsel also claimed that other circuits rejected the Fifth Circuit approach.[126] The Seventh Circuit did reject the Fifth Circuit approach.[127] The Second Circuit, however, adopted a middle position by holding an issuer may rebut the fraud-on-the-market presumption before class certification.[128] The plaintiffs appealed to the Supreme Court and the Supreme Court requested the acting Solicitor General to file a brief expressing the views of the United States on this issue.[129]

2. *Duty of Large Minority Shareholder for Misappropriation of Inside Information*

While Congress reined in class actions for securities fraud by private investors, the SEC remains a viable option for prosecuting securities fraud violations under rules against insider trading.[130] Yet some refuse to recognize the legal principles upon which those rules are based. For over two centuries in the United States, there has been a duty to disclose unless the means of acquiring the information are equally accessible to both parties.[131]

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124. *Id.* at 334 n.2; *see* Basic v. Levinson, 485 U.S. 224, 248 (1988).

125. *Archdiocese of Milwaukee Supporting Fund, Inc.*, 597 F.3d at 335.

126. Appellant's Brief, *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. 2010) (No. 08-11195), 2009 WL 6445755, at *32–34. The appellant listed a few district court cases that rejected the Fifth Circuit approach. *Id.; see In Re* HealthSouth Corp. Sec. Litig., 257 F.R.D. 260, 283 (N.D. Ala. 2009) ("[T]he *Oscar* case has never been followed in the Eleventh Circuit and this court will not be the first to adopt it."); *In re* LDK Solar Sec. Litig., 255 F.R.D. 519, 530 (N.D. Cal. 2009) ("*Oscar* placed the Fifth Circuit in a minority-indeed, apparently solitary-stance amount the circuits . . . "); Lapin v. Goldman Sachs & Co., 254 F.R.D. 168, 186 (S.D.N.Y. 2008) ("The Court . . . finds that *Oscar* should be rejected as a misreading of *Basic*."); *In re* Nature's Sunshine Prods. Inc. Sec. Litig., 251 F.R.D. 656, 665 (D. Utah 2008) ("[T]he Fifth Circuit's decision in *Oscar* appears to be in conflict with Supreme Court and Tenth Circuit precedent which warn against determining the merits at the class certification stage."); Ross v. Abercrombie & Fitch Co., No. 2:05-CV-0819, 2008 WL 4059873, at *3 (S.D. Ohio 2008) ("No other Court of Appeals, and no district court outside the Fifth Circuit, appears to have followed *Oscar*."); Darquea v. Jarden Corp., No. 06-Civ. 722 (CLB), 2008 WL 622811, at *4 (S.D.N.Y. 2008) (*Oscar* "is limited to the Fifth Circuit."); *In re* Micron Techs. Inc., Sec. Litig., 247 F.R.D. 627, 634 (D. Idaho 2007) ("It is unlikely that [*Oscar*] would be adopted in this Circuit because it misreads *Basic*.").

127. Schleicher v. Wendt, 618 F.3d 679, 685–87 (7th Cir. 2010).

128. *In re* Salomon Analyst Metromedia Lit., 544 F.3d 474, 485–86 (2d Cir. 2010).

129. Erica P. John Fund, Inc., fka Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 131 S. Ct. 856 (2010) (proceedings and orders), *available at* http://www.supremecourt.gov/search.aspx?FileName=/Docketfiles/09-1403.htm.

130. *See* 17 C.F.R. §§ 10b5-1 & 10b5-2 (2010).

131. *Cf.* Laidlaw v. Organ, 15 U.S. 178, 194 (1817) (C.J. Marshall) (sale of tobacco within one hour after peace treaty was posted by handbill ending British blockade of New

This year's effort by the SEC to protect investors from large minority shareholders too rich to abide by the laws involved the misappropriation theory of insider trading by a shareholder owning six percent of the issuer.[132] The complaint in *SEC v. Cuban* stated the issuer decided to raise capital through a private investment of public equity offering (sale of public shares to private investors at a discount to the market price).[133] The issuer's investment banker recommended the issuer's chief executive officer contact the large minority shareholder, Cuban, to invite him to participate in the offering. Before conveying this information to Cuban, the investment banker told the chief executive officer to instruct Cuban to keep the information confidential. Cuban did not like such offerings, stating, "[N]ow I'm screwed. I can't sell." The CEO's report to the issuer's board indicated Cuban would sell his shares, although not until announcing the offering, but he also asked to see the terms and conditions arranged so he could decide whether to participate in the offering.[134] The chief executive officer emailed Cuban to contact the investment banker if he wanted more details. Cuban contacted the investment banker and learned of the magnitude of the offering's discount. Immediately after contacting the investment banker, Cuban sold all his shares to the issuer. A second email from the chief executive officer to the board indicated that after contact with the chief executive officer and underwriter, Cuban would not invest in the offering and would sell his shares, only after the offering.[135] Upon the announcement of the offering, the issuer's stock price declined eight percent the next day and thirty-nine percent over the next week. The SEC filed a lawsuit against Cuban for violation of the securities laws in order to obtain an "injunction against future violations of the securities laws, disgorgement of losses avoided, prejudgment interest, and imposition of a civil monetary penalty."[136] On a motion to dismiss for failure to state a claim, the district court determined the Supreme Court required not only a confidentiality agreement, but also an agreement not to trade.[137] In granting the motion, the district court concluded that Cuban's "I can't sell" statement did

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Orleans did not give rise to the duty of buyer, who saw handbill, to inform seller because the information was accessible to both parties).

132. SEC v. Cuban, 620 F.3d 551, 555 (5th Cir. 2010). The Exchange Act deems shareholders with more than ten percent ownership as insiders. *See* 15 U.S.C.A. § 78p(a)(1) (2006).

133. Complaint at 11, SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 3-08CV2050-D), 2008 WL 4901149.

134. *Id.* at 15.

135. *Id.* at 20.

136. SEC v. Cuban, 634 F. Supp. 2d 713, 718 (N.D. Tex 2009); *see* 15 U.S.C. § 78u-1(A)(3) (2006) (up to treble damages in an SEC action for insider trading); 15 U.S.C. § 77q(a)-(b) (2006) (fraud in the sale of a security); 15 U.S.C. § 7j (2006) (manipulation and deceptive devices in contravention of rules); 17 C.F.R. § 240.10b-5 (2010) (fraud in connection with the sale or purchase of a security).

137. *Cuban*, 634 F. Supp. 2d at 725–26; *see* United States v. O'Hagan, 521 U.S. 642, 654, 655 (1977) (stating "[d]eception through nondisclosure is central to the [misappropriation] theory of liability . . . " and "[b]ecause the deception essential to the misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses to

not amount to an agreement not to sell and dismissed the chief executive officer's emails as unilateral expectations not based on the other party's agreement.[138] The Fifth Circuit vacated and remanded.[139]

The securities law issue addressed by the Fifth Circuit dealt with the interpretation of the complaint; the court did not agree that the complaint only alleged a confidentiality agreement.[140] Before making the "I can't sell" statement, Cuban requested the terms and conditions of the offering. He misled the chief executive officer as to the timing of his sale to obtain a confidential look at the offering terms for his own benefit. Pursuant to that deceptive request, the chief executive officer sent the contact information. Only after Cuban reached out to obtain the offering's pricing, following his statement of understanding he could not sell, did he sell his shares. Hence, it was plausible that each party understood, if only implicitly, that the issuer would release the pricing information for the purpose of Cuban's evaluation to participate in the offering and that Cuban could not use that information for his own personal benefit.[141]

The securities issue avoided by the Fifth Circuit's reading of the petition concerned statutory authorization for Rule 10b5-2(b), which applies misappropriation of non-public information in cases when a trader agreed to maintain the information in confidence only.[142] Because the district court concluded Cuban agreed to keep the information confidential and yet traded (a violation of Rule 10b5-2(b)(1)) and had determined that misappropriation theory under Supreme Court jurisprudence requires deception, it determined that Rule 10b5-2 exceeded the SEC's authority under Section 10b of the Exchange Act the rule described no deception under its interpretation of the law.[143] The Fifth Circuit's dodge of the Rule 10b5-2 vitality may mean the rule still has some force in the Fifth Circuit.[144]

The Fifth Circuit also suggested two other theories besides the misappropriation theory, where Cuban may have violated insider trading

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the source that he plans to trade on the nonpublic information, there is no 'deceptive device.'. . . .").

138. *Cuban*, 634 F. Supp. 2d at 727–28.

139. *Cuban*, 620 F.3d at 556–58.

140. *Id.* at 552.

141. *Id.* at 557.

142. 17 C.F.R. § 240.10b5-2 (2010).

143. *Cuban*, 634 F.3d at 730–31; *see* 15 U.S.C. § 78j(b) (2006). This was the result sought by certain misguided law professors. *See* Amended Brief of Amici Curiae in Support of Defendant's Motion to Dismiss, SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 3:08-CV-02050(SAF)), 2009 WL 1257407 at *1 (expressing the belief that misappropriation only applies to fiduciary relationships); *see also* Brief of Amici Curiae Law Professors in Support of Defendant-Appellee, SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010) (No. 09-10996), 2010 WL 3576550 at *5-6 (decrying the SEC's effort to expand misappropriation theory and suggesting courts should leave confidence breaches as breach of contracts to state law). To the district court's credit, it rejected the fiduciary approach and recognized that breach of a contract could supply the necessary deception. *See Cuban*, 634 F.3d at 724.

144. *Cf. Cuban*, 620 F.3d at 558, n.40 ("nor must we reach the validity of Rule 10b5-2(b)(1).").

rules.[145] First, Cuban's reading of the complaint—that he had an exclusive license to trade on the material non-public information—suggests tipper/tippee liability.[146] Tipper/tippee liability only requires an insider to have breached his or her duty to shareholders by disclosing the non-public information to the tippee when the tippee knows or should have known there was a breach.[147] The tipper's breach occurs when the tipper receives a benefit from the disclosure.[148] A reputational benefit translating into future earnings constitutes that benefit.[149] If the facts show the chief executive officer knowingly gave Cuban material non-public information and arranged so he could trade on it, a court might infer the chief executive officer did so for a personal benefit: the good will from a wealthy investor.[150] Second, Cuban's deception itself may provide liability without resort to misappropriation theory.[151] The Second Circuit found an options trader liable under Rule 10b-5 without requiring a breach of fiduciary duty when the trader affirmatively misrepresented himself in order to gain access to nonpublic information used in his options trading.[152] Such misrepresentation is an deceptive act.[153]

Cuban's defense to the SEC's attempts to protect investors is to harass the SEC. A month after the filing of the SEC's complaint in Dallas, Cuban requested much documentation under the Freedom of Information Act,[154] including documents concerning the SEC's internal investigations of the SEC lawyers filing the complaint and the trading of SEC personnel in the issuer's stock.[155] Failing to rapidly obtain the information due to the SEC's policy of responding on a first come basis, and the volume and complexity of the documents requested, Cuban filed an action against the SEC in Washington, D.C. to compel production of the information.[156] The second stage of the harassment involved Cuban seeking legal fees from the SEC for prosecutorial misconduct in its pre-suit investigation

145. *Id.* at 557.
146. *Id.* at 557, n.38.
147. *Id.* at 554 (citing Dirks v. SEC, 463 U.S. 646, 660 (1983)).
148. *Id.* (citing *Dirks*, 463 U.S. at 663).
149. *See Dirks*, 463 U.S. at 663–64.
150. *See* SEC v. Yun, 327 F.3d 1263, 1277 (11th Cir. 2003).
151. *See Cuban*, 620 F.3d at 557.
152. *See* SEC v. Dorozhko, 574 F.3d 42, 49–50 (2d Cir. 2009).
153. *Id.* at 51.
154. *See* 5 U.S.C. § 552 (2006).
155. *Compare* Complaint, SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 3-08CV2050D), 2008 WL 4901149 at *1 (listing SEC attorneys as Aderton, Chaudoin, Freistad, Kaplan, O'Rourke, and Riewe) *with* Complaint for Declaratory and Injunctive Relief, Cuban v. SEC, 2010 WL 3777844 (D.D.C.) (No. 109-CV-00996), 2009 WL 1619336 at *1 (describing Freedom of Information Act requests for information including applications for award of bounty in his case, trading transactions by SEC employees in certain issuers' stock, and any internal investigation of SEC personnel Aderton, Chaudoin, Freistad, Kaplan, O'Rourke, and Riewe).
156. Cuban v. SEC, 2010 WL 3777844, at *3 (D.D.C.); *see* Declaration of Margaret Celia Winter at 155, Cuban v. SEC, 2010 WL 3777844 (No. 109CV00996), 2010 WL 94337 (stating that request for documentation won't reach first position for three years and will then require six months because processing the documents will be particularly time consuming.)

motivated by a bias against Cuban, evidenced among other actions by e-mails sent between SEC officials mocking him and repeated questioning of key witnesses in the case.[157] With such lawsuit harassment pending, Cuban's own lawyers will soon separate him from his ill-gotten gains.

IV. CONCLUSION

The securities law opinions under Texas law during this Survey period can be divided into two groups. The first grouping deals with various fraudulent schemes targeted by the Board. The "free lunch" scam aimed at senior investors surfaced in *Head v. State*.[158] The scammer lost the appeal of his conviction for failure to inform investors, because the evidence clearly confirmed that failure.[159] In *Navarro v. Grant Thornton, LLP* investors failed in their aiding and abettor lawsuit against the accountants.[160] Absent contact between the accountants and investors, the accountants have no duty to whistle-blow to regulators or investors. Incompetent lawyers, or lawyers who convinced their clients to pay for half-baked arguments, constitute the second grouping. In *S & D Trading Academy, LLC v. AAFIS Inc.*, an unregistered investment advisor failed to collect unpaid fees because it did not fit the teacher exception to registration for investment advisers for its day-trading instruction.[161] The investment advisor was not an accredited institution of higher learning and the instructors were not professional teachers. In *Arkoma Basin Project Limited Partnership v. West Fork Energy Company LLC*, natural gas producers escaped liability for failing to meet certain projections, although they satisfied the early stages of their projections.[162] There is no materiality for securities fraud for projected future performance unless worded as guarantees.[163] In *Lone Star Fund V (U.S.), L.P. v. Barclays Bank PLC*, a bank did not misrepresent the quality of mortgages in mortgage backed securities when it stated in the offering materials that it would repurchase the offending mortgages or substitute qualifying mortgages, and did so when requested.[164]

Under the federal securities laws, the Fifth Circuit dealt with loss causation and misappropriation theory. In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, the Fifth Circuit confirmed its requirement of a class-action plaintiff's showing of loss causation at the class certification stage before the plaintiff can use the fraud-on-the-mar-

157. SEC v. Cuban, No. 3:08-CV-2050-D, 2009 WL 4544178, at *1 (N.D. Tex. Dec. 4, 2009); *see* 28 U.S.C. § 2421(b) (2006); *see also* Perales v. Casillas, 950 F.2d 1066, 1071 (5th Cir. 1992) (*citing* F.D. Rich Co. v. United States ex rel Indus. Lumber Co., 417 U.S. 116 (1974) (stating that fees will be awarded if the party acted "in bad faith, vexatiously, wantonly, or for oppressive reasons")).

158. 299 S.W.3d 414 (Tex. App.—Houston [14th] 2009, pet. ref'd).

159. *Id.* at 430.

160. 316 S.W.3d 715, 717 (Tex. App.—Houston [14th Dist.] 2010, no pet.).

161. 336 F. App'x 443, 445 (5th Cir. 2009), *cert. denied* 130 S. Ct. 1054 (2010).

162. 384 F. App'x 375, 380–81 (5th Cir. 2010).

163. *Id.* at 380.

164. 594 F.3d 383, 390 (5th Cir. 2010).

ket rebuttable presumption.[165] Because the Seventh Circuit rejected this approach and the Second Circuit places the burden of proof on the defendant, this case will continue to foster interest. In *SEC v. Cuban*, the Fifth Circuit reinstated an insider trading case by determining the complaint did allege sufficiently that the tippee misled the tipper in order to misappropriate the confidential information used in trading.[166] Because the tippee has inaugurated an all-out war against the SEC, this case will also engender future interest.

165. 597 F.3d 330, 344 (5th Cir. 2010), *vacated and remanded* by Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011).

166. 620 F.3d 551, 557 (5th Cir. 2010).