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Securities Regulation

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SECURITIES REGULATION

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Preventing and providing remedies for fraud in the sale of stocks and bonds are the primary focus of securities regulation laws. The two major statutes to combat securities fraud in Texas are 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 Fifth Circuit cases

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1. *See* TEX. REV. CIV. STATS. ANN. arts. 581-1 to 581–600 (West 2010 & Supp. 2017); TEX. BUS. & COM. CODE ANN. § 27.01 (West 2015).

2. *See* TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (West 2010) (Comment to 1977 Amendment); Tex. S.B. 469, 65th Leg., R.S. (1977).

3. *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.); Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 102 n.13 (Tex. App.—Houston [1st Dist.] 2006, pet. denied); *see also* George Lee Flint, Jr., *Securities Regulation*, 66 SMU L. REV. 1129, 1133–36 n.3 (2013) (discussing *Highland Capital Management*) [hereinafter Flint, *Securities Regulation* 2013]; George Lee Flint, Jr., *Securities Regulation*, 60 SMU L. REV. 1293, 1299–1302 (2007)

addressing securities fraud issues under both state and federal law. This article is not intended to exhaust all aspects of securities regulation but to update the Texas-based securities practitioner on new Texas developments that have emerged during the Survey period (December 1, 2016 to November 30, 2017).

I. COVERAGE OF THE TEXAS 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 that are subject to the state's securities acts.[4] One Texas court confronted a seller of notes of an oil trader purchasing crude oil in Iraq. The seller desired to sell the notes in Syria and Kurdistan through several misrepresentations and omissions by claiming the notes were commercial loans and not securities, and therefore not subject to the TSA.[5] The U.S. Court of Appeals for the Fifth Circuit dealt with the territorial limitations of a registration exemption under the TSA, also authorized as a registration exemption under the Federal Securities Act[6] for a seller of penny stock on the secondary market throughout the nation.[7] The U.S. District Court for the Northern District of Texas handled the issue of whether convertible notes are transactions in stock under the TSFA.[8]

A. DETERMINATION OF THE TYPE OF NOTES THAT ARE SECURITIES UNDER THE TSA

The TSA clearly includes notes within the definition of "securities."[9] But the TSA also exempts notes of less than nine months from registration if sold by registered agents.[10] In interpreting the corresponding lan-

(discussing *Anglo-Dutch Petroleum International*) [hereinafter Flint, *Securities Regulation* 2007].

4. *See* 15 U.S.C. § 77b(a)(1)–(3) (2012); TEX. REV. CIV. STAT. ANN. art. 581-4(A)–(B) (West 2010).

5. *See* Khoury v. Tomlinson, 518 S.W.3d 568, 572–73 (Tex. App.—Houston [1st Dist.] 2017, no pet.).

6. *See* 15 U.S.C. § 77c(b).

7. *See* Securities & Exchange Comm'n v. Kahlon, 873 F.3d 500, 503 (5th Cir. 2017) (per curiam).

8. *See* Ginsburg v. ICC Holdings, LLC, No. 3:16-CV-2311-D, 2017 WL 5467688, at *19 (N.D. Tex. Nov. 13, 2017).

9. *See* TEX. REV. CIV. STAT. ANN. art. 581-4(A) (West 2010) ("The term 'security' or 'securities' shall include any . . . note, bond, debenture, mortgage certificate or other evidence of indebtedness . . .").

10. *See id.* art. 581-6(H) ("Except as hereinafter in this Act expressly provided, the provisions of this Act shall not apply to any of the following securities when offered for sale, or sold, or dealt in by a registered dealer: . . . Any commercial paper that arises out of a current transaction . . . and that evidences an obligation to pay cash within nine months of the date of issuance . . . ."); *id.* art. 581-33(A)(2) ("A person who offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of an untrue statement of a material fact or an omission to state a material fact . . . is liable to the person buying . . . ."); *id.* art. 581-33(B) (same for buyer misrepresentations and omissions).

guage in the Securities Exchange Act,[11] the U.S. Supreme Court has determined that not all notes are included in the definition of "security."[12] After considering but not rejecting the Fifth Circuit's "investment versus commercial" test[13] and rejecting the "investment contract" approach used in other circuits,[14] the Supreme Court adopted the "family resemblance" test.[15] Under this test, a note is presumed to be a security, but this presumption may be rebutted by showing a strong resemblance to notes held not to be securities. Such a showing may be made by examining four factors: (1) the motivations that prompted the buyer and seller to enter into the transaction; (2) the distribution plan in order to determine whether the note is subject to common trading, offered to a broad segment of the public, or intended to be sold on a secondary market; (3) the reasonable expectation of the investing public as to whether the note is an investment; and (4) the presence of risk-reducing mechanisms rendering securities law protection unnecessary.[16]

In *Khoury v. Tomlinson*, the First Houston Court of Appeals confronted a chief executive officer (CEO) who formed a company to trade fuel oil and crude oil from Iraq into nearby markets.[17] The CEO used the company's business plan to market the investment, which touted a contract to sell fuel oil in Kurdistan in 2008 and in Syria in 2009. The contract offered 14% interest on the investment along with a net share of 10% of the profits distributed quarterly from the various contracts.[18] The investor in this case invested $400,000 and signed a subscription agreement acknowledging that the company had given him the opportunity to obtain information necessary to evaluate the risks and merits of the investment, that all questions about the investment had been answered, and that he had carefully reviewed the risks associated with the investment. Meanwhile, the company, as part of the investment, signed a note.[19] The investor subsequently became dissatisfied with the investment when the company failed to provide financial information disclosures.[20] The CEO personally agreed to repay the amount loaned to the company over a four to five-year period and confirmed the repayment agreement by email. When the CEO failed to make the agreed payments, however, the investor sued for breach of repayment contract, common law fraud, and viola-

11. *See* 15 U.S.C. § 78c(a)(10) (2012) ("The term 'security' means any note, . . . bond, [or] debenture, . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months . . . .").

12. *See* Reeves v. Ernst & Young, 494 U.S. 56, 64–65 (1990).

13. *See id.*; *see also* McClure v. First Nat'l Bank of Lubbock, Tex., 497 F.2d 490, 492–94 (5th Cir. 1974).

14. *See Reeves*, 494 U.S. at 63–64.

15. *See id.* at 66–67.

16. *See id.*

17. Khoury v. Tomlinson, 518 S.W.3d 568, 572 (Tex. App.—Houston [1st Dist.] 2017, no pet.).

18. *Id.* at 572 (oil contracts), 582 (10% of profits).

19. *Id.*

20. *Id.* at 573.

tion of the TSA.[21] At trial, the CEO admitted that the contract to sell fuel oil to Syria had been declined before the investor invested.[22] The jury found for the investor on all three claims, awarded $400,000 in damages on each claim, and awarded attorney's fees.[23] After trial, the CEO's attorneys moved for judgment notwithstanding the verdict, which was granted with respect to the contract claim and the TSA claim but not the fraud claim.[24]

The investor appealed and the court of appeals reversed and remanded.[25] The main securities issue was whether the note constituted a "security" as defined by the TSA. The investor's brief laid out the above-described "family resemblance" test, noted the Texas Supreme Court's instruction to apply federal interpretations of federal statutes to similar language in the TSA,[26] and applied the family resemblance test to show that the note in this case was a security.[27] The Texarkana Court of Appeals and, recently, the U.S. District Court for the Western District of Texas have applied this "family resemblance" test to the TSA definition for a promissory note.[28] But rather than follow this well-known securities law test for notes, the *Khoury* court followed the U. S. Court of Appeals for the Fifth Circuit's old "investment versus commercial" approach obtained from the CEO's motion for judgment notwithstanding the verdict.[29] The Fifth Circuit adopted the "family resemblance" test twenty years ago.[30] Nevertheless, since 10% of the profits were paid quarterly, the appellate court determined that this was not a commercial loan but an investment and therefore a security.[31]

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21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.* at 573–74.
25. *Id.* at 584–85. The breach of contract claim issues involved the statute of frauds (the email confirmation was held to be a sufficient signature) and indefiniteness (definiteness was found where the parties agreed to allow the CEO four to five years for payment). *Id.* at 579–80.
26. *See* Searsy v. Commercial Trading Corp., 560 S.W.2d 637, 639–42 (Tex. 1977) (noting that Texas courts follow federal court opinions in interpreting similar language in the TSA, specifically when defining "investment contract" and "evidence of indebtedness").
27. *See* Appellant's Brief at 16–23, *Khoury*, 518 S.W.3d 568 (No. 01–16–00006–CV), 2016 WL 4076781, at *16–23.
28. *See* Grotjohn Precise Connexiones Int'l v. JEM Fin., Inc., 12 S.W.3d 859, 868–70 (Tex. App.—Texarkana 2000, no pet.); Aubrey v. Barlin, 159 F. Supp. 3d 752, 754–57 (W.D. Tex. 2016).
29. *Compare Khoury*, 518 S.W.3d at 581–82 (citing Bellah v. First Nat'l Bank of Hereford, Tex., 495 F.2d 1109, 1113 (5th Cir. 1974)) *and* C.S. Ltd. v. Nw. Mut. Life Ins. Co., No. 814-89-00908-CV, 1990 WL 107888, at *2 (Tex. App.—Houston [14th Dist.] 1990, writ denied), *with* Defendant's Motion for Judgment Notwithstanding the Verdict at 2, *Khoury*, 518 S.W.3d 568 (No. 2012-61491), 2015 WL 9392520, at *2 (citing same two cases before advocating erroneous "investment contract" approach).
30. *See* Tr. Co. of La. v. N.N.P. Inc., 104 F.3d 1478, 1489 (5th Cir. 1997).
31. *Khoury*, 518 S.W.3d at 582. With respect to the three remaining securities-law issues, the disingenuous arguments made by the CEO's attorneys failed to bamboozle the appellate court. Regarding materiality, the attorneys asserted that the cautionary language in the subscription agreement triggered the "bespeaks caution doctrine" of federal securities law for "forecasts, opinions, or projections," making materiality a question of law rather than a jury question and therefore destroying materiality. *See* Brief of Cross-Appel-

B. Territorial Limitation of Registration Exemptions Under the TSA

Under Rule 504 of the Federal Securities Act, the Securities and Exchange Commission (SEC) has provided for an exemption from registration for limited offerings and sales of securities not exceeding $5 million.[32] The rule provides for three situations in which the exemption may arise: (1) where all sales are made in states that require registration and delivery of a disclosure document to the investors; (2) where sales are made in at least one state requiring registration and delivery of a disclosure document to that state's investors and in other states not requiring registration, provided that the registering state's disclosure document is also delivered to those other state's investors; and (3) where sales are made in states not requiring registration but which exempt from registration solicitation and general advertising for sales made only to accredited investors.[33] Under this rule, Texas qualifies as an exemption state by providing an exemption for sales to financial institutions and certain institutional investors (excluding individuals).[34]

The seller in *Securities & Exchange Commission v. Kahlon* sought to

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lee at 4, *Khoury*, 518 S.W.3d 568 (No. 01-16-00006-CV), 2016 WL 5720922, at *4 (question of law); *id.* at *13 (destroys capacity of a misleading statement to influence a reasonable investor); *see also* Highland Capital Mgmt., L.P. v. Ryder Scott Co., 402 S.W.3d 719, 744–46 (Tex. App.—Houston [1st Dist.] 2012, no pet.); Flint, *Securities Regulation* 2013, *supra* note 3, at 1129, 1133–36 (discussing *Highland Capital Management*). Unfortunately for the CEO's attorneys, the court of appeals found that the material misstatement concerned a contract for Syrian oil appearing numerous times in the prospectus and not in projections as is required for the bespeaks caution doctrine, and applied Texas cases stating that, under the TSA, investors have no duty to verify sellers' claims. *Khoury*, 518 S.W.3d at 582–83; *see also In re* Westcap Enters., 230 F.3d 717, 726 (5th Cir. 2000); Summers v. WellTech, Inc., 935 S.W.2d 228, 234 (Tex. App.—Houston [1st Dist.] 1996, no writ).

With respect to the three-years-from-discovery statute of limitations, these attorneys claimed that the TSA three-year period was an element of the cause of action. *See* Brief of Cross-Appellee, *supra*, at *15–16 (not a statute of limitations but an element); *see also* Shields v. State, 27 S.W.3d 267, 275 (Tex. App.—Austin 2000, no pet.) (finding limitations inapplicable for an action by the state under the TSA). The court of appeals refused to treat the three-year period as an element of the cause of action and instead followed those cases treating it as a statute of limitations. *Khoury*, 518 S.W.3d at 584; *see also* Arnold v. Life Partners, Inc., 416 S.W.3d 577, 589 (Tex. App.—Dallas 2013), *aff'd*, 464 S.W.3d 660 (Tex. 2015); Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 401–03 (Tex. App.—Houston [1st Dist.] 2012, judgm't vacated w.r.m.); George Lee Flint, Jr., *Securities Regulation*, 1 SMU Ann. Tex. Surv. 101, 102–06 (2014) (discussing *Life Partners*) [hereinafter Flint, *Securities Regulation* 2014]; Flint, *Securities Regulation* 2013, *supra* note 3, at 1129, 1143–49 (discussing *Allen*).

With respect to the damages issue, the attorneys claimed that the investor suffered no damages because the note was payable to the investor's lender and that the calculation of damages should have been used for disposition of the security. The appellate court found that there was some evidence that the investor suffered damages because he paid the investment amount and requested that the interest payments be sent to his lender, and because there was no evidence that the investor disposed of the security before trial. *Khoury*, 518 S.W.3d at 584.

32. *See* 17 C.F.R. § 230.504 (2017).

33. *See id.* at § 230.504(b)(1)(i) (registering states), (ii) (one registering state), (iii) (all exemption states for accredited investors).

34. *See* 7 Tex. Admin. Code § 109.4 (2017) (State Sec. Bd., Securities Registration Exemption for Sales to Financial Institutions and Certain Institutional Investors).

utilize the federal and Texas registration exemptions for penny stocks[35] by incorporating as a New York limited liability company, purchasing 100 acres in Texas, registering as a foreign limited liability company in Texas, hiring a registered agent in Texas, and obtaining a Texas mailing address, yet conducting all business transactions from New York.[36] The seller would "purchase large blocks of shares of [penny stock companies] at a discount," representing that the purchases were for the seller's own account and were not to be distributed to other purchasers.[37] Thus, the seller acquired stock certificates with no restrictive legend requiring registration of the securities or an exemption from restriction before being resold, yet within a few days the seller began to resell the unregistered shares on the open market for a profit.[38] The seller was advised that its business plan was legal, but failed to inform the opining attorney that the plan included a public distribution of the penny stock shares as soon as possible after acquisition and that the seller's operations were conducted from New York.[39] When the SEC notified the seller that it was considering charges against the seller, the seller ceased trading in penny stocks.[40] The SEC brought charges in the U.S. District Court for the Eastern District of Texas against the seller for selling unregistered securities and obtained a summary judgment as to liability, a permanent injunction against future registration violations, disgorgement of the seller's profit, a civil penalty, and a lifetime ban on trading penny stock.[41]

The U.S. Court of Appeals for the Fifth Circuit affirmed.[42] The seller's theory of the interplay between the two registration exemptions was that a Texas company could purchase anywhere (only one penny stock company was from Texas) and rely on the Texas exemption for resale anywhere.[43] The Fifth Circuit rejected this theory because Texas cannot regulate securities transactions outside its borders;[44] hence, the Texas ex-

35. *See* 17 C.F.R. § 240.3a51–1(d) (2017) (defining penny stock as a security with a price below $5.00).

36. Securities & Exchange Comm'n v. Kahlon, 873 F.3d 500, 503 (5th Cir. 2017) (per curiam).

37. *Id.*

38. *Id.*

39. *Id.* at 508.

40. *Id.* at 503.

41. *Id.* The SEC also pursued an underwriter claim against the seller under federal law, which was not before the Fifth Circuit. *Id.*

42. *Id.*

43. *Id.* at 505.

44. This is an overbroad proposition under Texas securities law. In the 1970s, Texas oil and gas scams sold to nonresidents outside of Texas were injuring the Texas oil and gas industry's reputation. Thus, upon request of the State Securities Commissioner, the Texas Attorney General sued these securities sellers and obtained injunctions. *See* Enntex Oil & Gas Co. v. State, 560 S.W.2d 494, 497 (Tex. App.—Texarkana 1977, writ ref'd n.r.e.) (holding regulation of sales outside of Texas of interests in Texas oil and gas leases to persons not resident in Texas not a burden on interstate commerce); Rio Grande Oil Co. v. State, 539 S.W.2d 917, 921–22 (Tex. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.) (same). Texas has since exempted these interstate sales from registration when sold by registered dealers, but not from the TSA's fraud provisions. *See* 7 TEX. ADMIN. CODE § 139.7 (2017) (State Sec. Bd., Sale of Securities to Nonresidents) (sales to nonresidents not present in

emption does not apply to sales in other states.[45] Instead, a seller must either resell exclusively in Texas or comply with the exemption requirements of the other states in which the seller made resales.[46]

C. Convertible Notes Are Not a Transaction in Stock Under the TSFA

To succeed under the TSFA, an investor must show: (1) a transaction involving stock; (2) a false representation of fact or a false promise made during the transaction; (3) the false representation or promise was made to induce a party into the contract; (4) the party relied on the falsity; and (5) the reliance led to injury.[47] The scope issue faced by the Texas courts related to whether convertible notes are "a transaction involving real estate or stock in a corporation."[48]

In *Ginsburg v. ICC Holdings, LLC*, the U.S. District Court for the Northern District of Texas dealt with an investment in an Illinois medical marijuana business under a private placement memorandum containing estimates of projected revenue and earnings. The memorandum stated that the estimates were forward-looking statements not prepared in compliance with published government guidelines.[49] The investor purchased $7 million of the company's notes, which were convertible into Class B

Texas by Texas-registered dealers exempt from registration; offer not deemed from Texas merely because offering material was prepared in Texas, and sale not deemed made in Texas if nonresident merely sends money to Texas).

45. *Kahlon*, 873 F.3d at 506. The SEC has won against a similar scheme by another New York limited liability company using the Delaware registration exemption in conjunction with the federal registration exemption. *See* Securities & Exchange Comm'n v. Bronson, 14 F. Supp. 3d 402, 405 (S.D.N.Y. 2014) (business plan); *id.* at 415 (finding exemption violated).

46. *Kahlon*, 873 F.3d at 505. The remaining securities-law issues related to the appropriateness of the penalty imposed by the district court. The Fifth Circuit noted that although the offense (selling without registration) does not require scienter, the fact that the seller misrepresented its presence in Texas and its intent to immediately resell constituted recklessness and possibly intentional conduct, meriting a lifetime ban on trading in penny stocks. *Id.* at 508. The Fifth Circuit also affirmed the injunction against future registration violations because the injunction was tailored to the offense committed. *Id.* Finally, the Fifth Circuit affirmed the disgorgement of profits based on gross revenues rather than net profit because securities violators may not offset their disgorgement amount with business expenses. *Id.* at 508–09. Justice Jones dissented with respect to the overly harsh penalties of the penny stock trading ban and disgorgement because no investors were harmed by the seller's activities and the district court did not rule on the seller's potential underwriter status. *Id.* at 509 (no injury), 511 (underwriter theory). Justice Jones reasoned that the ban was overbroad because the penny stocks could be traded other than in a transaction falling within the registration exemptions at issue in the case, and there was no indication that the offense would be replicated because the seller stopped when the offense was pointed out to it by the SEC. *Id.* at 510–11. As to disgorgement, Justice Jones pointed out that gross revenue rather than net profit is used where there is a showing of scienter. *Id.* at 511. Justice Jones served on the Texas Law Review with the author in 1975.

47. *See* Tex. Rev. Civ. Stats. Ann. arts. 581-1 to 581-600 (West 2010 & Supp. 2017); Tex. Bus. & Com. Code Ann. § 27.01 (West 2015).

48. Tex. Bus. & Com. Code Ann. § 27.01(a).

49. Ginsburg v. ICC Holdings, LLC, No. 3:16-CV-2311-D, 2017 WL 5467688, at *1 (N.D. Tex. Nov. 13, 2017).

units of the company.[50] After subsequently viewing three-year projections and hearing some puffing about a bright future, the investor purchased $3.6 million more of the convertible notes. Thereafter, the company provided the investor with five-year projections showing losses and failed to pay interest on the notes, so the investor sued for statutory fraud under the TSFA among other claims.[51] The company moved to dismiss because there had been no actual conveyance of stock,[52] and the investor countered that contracts to convey stock qualify as transactions involving stock in a corporation.[53] The district court dismissed, noting that the contract to convey stock must actually convey stock.[54] The district court found that convertible notes are similar to unvested options, which Texas courts have determined do not constitute "transactions in stock."[55]

II. REGISTRATION AND ENFORCEMENT

The TSA created the Texas State Securities Board (TSSB) to serve as an enforcement agency and handle TSA-required registrations.[56] Most securities laws require that securities be registered with their corresponding regulatory agency unless they are exempt.[57] Similarly, securities sellers must register before selling securities in the state, and investment advisers must register before rendering investment advice in the state unless they are exempt.[58] Enforcement actions generally focus on issuers failing to register their securities (and simultaneously their selling agents) and making misleading statements to aid their sales.

A. Confidentiality of Investigative Documents Acquired by the TSSB

The TSSB obtained an informal letter ruling from the Texas Attorney General addressing exemptions to the Public Information Act's required public disclosure so the TSA may keep certain TSSB investigatory docu-

50. *Id.*

51. *Id.* at *3. The investor also sued for breach of contract for default on the notes, common law fraud, and violation of the federal securities laws, the TSA, the Illinois securities laws, and the Racketeer Influenced and Corrupt Organization Act (RICO).

52. *Id.* at *18.

53. *Id.* at *19.

54. *Id.* at *20. The district court did not dismiss the contract claim since the company failed to establish that the notes were unenforceable as against public policy. *Id.* at *9. The district court also refused to dismiss the Illinois securities law complaint. *Id.* at *21. But the district court did dismiss: (1) the common law fraud claim and the TSA claim since the investor failed to plead material misrepresentation (just predictions and opinions); (2) the federal securities law claims for failure to plead a strong inference of scienter; and (3) the RICO claim. *Id.* at *13, *17–18, *22.

55. *Id.* at *20 (citing Ginn v. NCI Bldg. Sys., Inc., 472 S.W.3d 802, 823 (Tex. App.—Houston [1st Dist.] 2015, no pet.); *see also* George Flint, Jr., 2 SMU Ann. Tex. Surv. 437, 449–51 (2016) (discussing *Ginn*) [hereinafter Flint, *Securities Regulation* 2016].

56. *See* Tex. Rev. Civ. Stat. Ann. art. 581-2 (West 2010).

57. *See id.* art. 581-7(A).

58. *See id.* art. 581-13(A).

ments confidential.[59] The Government Code exempts from the required disclosures information made confidential by the constitution, a statute, or a judicial decision.[60] The TSSB acquired part of the subject information in connection with an investigation to prevent or detect a violation of the TSA, which is made confidential by statute.[61] Another part of the subject information was acquired by the TSSB during an inspection of a registered dealer and a registered investment adviser to ensure compliance with the TSA, which is also rendered confidential by statute.[62] The remaining information was not acquired through an investigation and so was not exempted from the Public Information Act.[63]

B. Exempt Transactions

The TSA does not apply to sales of securities by registered dealers of certain outstanding securities if certain statutory conditions are met.[64] The TSSB has a rule concerning this secondary trading exemption.[65] One condition is that securities of the same class must be registered or certain information must be available in a recognized securities manual.[66] The TSSB recently amended its rule to update the manual exemption, requiring that information relied on to claim the exemption must be current, adding a reference to required information contained elsewhere in the rule, noting that the financial information must be no more than eighteen months old, adding as an acceptable manual the electronic information available on otcmarkets.com, avoiding future amendments to the manual exemption, and recognizing any manual of the Mergent manuals publisher, rather than the name of each one.[67]

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59. Tex. Att'y Gen., No. OR2017-18823, 2017 WL 3740790, at *1; *see* Tex. Gov't Code Ann. § 552 (West 2012 & Supp. 2017) (Public Information Act).

60. *See* Tex. Gov't Code Ann. § 552.101 (West 2012).

61. *See* Tex. Rev. Civ. Stat. Ann. art. 581-28(A) (West 2010) (requiring information connected to a TSSB investigation into potential TSA violations to be treated as confidential). Part of the information satisfied the elements of a previous determination, for which the request was superfluous. Tex. Att'y Gen., No. OR2017-18823, 2017 WL 3740790, *2; *see also* Tex. Att'y Gen., No. OR2004-0239, 2004 WL 121275 (previous determination letter recognizing TSA art. 581-28(A) confidential exception to open records). Another part of the information did not satisfy those elements, yet the attorney general exempted it as fitting the confidentiality provided by the statute, but declined to give it a previous determination status. Tex. Att'y Gen., No. OR2017-18823, 2017 WL 3740790, *1–3.

62. Tex. Att'y Gen., No. OR2017-18823, 2017 WL 3740790, *2–3 (also refusing to give previous determinations status); *see also* Tex. Rev. Civ. Stat. Ann. art. 581-13-1(A) (West 2010) (authorizing inspection); *id.* art. 581-13-1(E) (rendering the information obtained confidential).

63. Tex. Att'y Gen., No. OR2017-18823, 2017 WL 3740790, *2–3.

64. *See* Tex. Rev. Civ. Stat. Ann. art. 581-5(O) (West 2010).

65. *See* 7 Tex. Admin. Code § 109.7 (2017) (State Sec. Bd., Secondary Trading Exemption Under the Texas Securities Act, § 5.O).

66. *See* Tex. Rev. Civ. Stat. Ann. art. 581(O)(9) (West 2010).

67. *See* 41 Tex. Reg. 8159 (2016), *adopted* 2017 Tx. Reg. Text 439023 (NS) (with one comment) (codified at 7 Tex. Admin. Code § 109.7 (2017)).

C. Market Operators

Commonly, state securities regulations will require a person to register as a seller of securities before selling securities in the state and to register as an investment adviser before rendering investment advice.[68] Registration infractions usually come up when applying or reapplying for registration.

The Texas Legislature increased the burden on dealers and investment advisers in order to protect vulnerable adults from financial exploitation by enlisting those dealers and investment advisers in ferreting out securities fraud on the elderly.[69] For some time the TSSB has attempted to stop investment scams that prey on the elderly.[70] A "vulnerable adult" is someone over age sixty-four or a person with disabilities, "exploitation" means exercising undue influence over the person inconsistent with the person's past behavior, and "financial exploitation" is an unauthorized taking of the person's property or depriving the person of the use of their property.[71] A "securities professional" is an agent of a securities dealer or investment adviser.[72] A securities professional must report suspected financial exploitation of vulnerable adults to the dealer or investment adviser, who must assess the suspected financial exploitation and submit a report to the Texas Securities Commissioner by the earlier of completion of the investigation or the fifth business day, after which the dealer or investment adviser may notify a third party associated with the vulnerable adult unless that person is the financial exploiter.[73] The dealer or investment adviser may place a hold on the vulnerable adult's account for up to ten business days, *must* place a hold when requested by the Texas Securities Commissioner, and may extend the hold for an additional thirty days when requested by the state or federal agency investigating the suspected financial exploitation.[74] Dealers and investment advisers are to adopt internal policies and procedures for notification, assessment, submission of reports, and placing holds.[75] The securities professional is immune from civil and criminal liability arising from the notification, report, testimony, or participation in a judicial proceeding as long as the securities professional acted in good faith. The same is true for the dealer or investment adviser when deciding whether or not to place a hold, so

68. *See* Tex. Rev. Civ. Stat. Ann. art. 581-13(A) (West 2010).

69. *See* Act of June 1, 2017, 85th Leg., R.S., ch. 376, 2017 Tex. Sess. Law Serv. Ch. 376 (adding Tex. Rev. Civ. Stat. Ann. art. 581-45 (West 2017) as well as Chapter 280 to the Texas Finance Code).

70. *See* Flint, *Securities Regulation* 2013, *supra* note 3, at 1129, 1141–42 (discussing the TSSB's concern with securities fraud on elders in 2010, leading to increased criminal penalties under the TSA in 2013 for such fraud).

71. *See* Tex. Rev. Civ. Stat. Ann. art. 581-45(A)(2) (West Supp. 2017) (referring to the newly amended Finance Code for definition of these terms).

72. *See id.* art. 581-45(A)(3).

73. *See id.* arts. 581-45(B) (report suspicions), 45(C) (report to Securities Commissioner), 45(F) (notify associates).

74. *See id.* arts. 581-45(G) (the hold), 45(H) (initial ten-day hold), 45(I) (thirty-day extension).

75. *See id.* arts. 581-45(E) (notifications), 45(J) (holds).

long as the dealer or adviser also acted in good faith.[76] The dealer or investment adviser must also provide access to the records of a suspected financial exploitation to the Securities Commissioner and other law enforcement agencies.[77]

D. Enforcement

The TSSB generally enforces its registration requirements through emergency orders.[78] Because con artists exploit current news and technology to confound unwary investors, the TSSB enumerates the following top ten threats to investors: (1) unregistered individuals, because investors do not know about the information available from the registration requirement; (2) cyberattacks using fake websites to convince investors that they are dealing with a legitimate firm; (3) oil and gas deals, because investors cannot investigate the claim; (4) cashing out to invest the funds with an investment manager; (5) high yield notes, because investors cannot evaluate credit worthiness; (6) foreign currency trading, because it is volatile and can result in huge losses in a few hours; (7) cryptocurrencies, because they are not backed by the government and their price is not set by a centralized authority; (8) overseas investing due to the inability to understand how the money will be made; (9) private placements, because the investments lack transparency; and (10) real estate, because the hard asset masks other risks.[79] The TSSB's actions focus on these threats.

The TSSB prosecuted several enforcement actions against dealers and selling agents. One involved an advance fee scam in which the investment promoters impersonated an advisory firm by approaching investors through fake websites, social media, forged documents, and purported affiliation with the U.S. Internal Revenue Service (IRS).[80] The promoters offered to purchase the investors' shares, provided the investors paid in advance the costs of the sale to a company in the Philippines.[81] Several actions involved the failure of a registered agent to timely report various

76. *See id.* arts. 581-45(K) (securities professional), 45(L) (dealer or investment adviser).

77. *See id.* art. 581-45(M).

78. *See* Tex. Rev. Civ. Stat. Ann. art. 581-23 (West 2010).

79. *See* Top 10 Investor Threats (In Time for the Holidays), Tex. St. Sec. Bd. (Nov. 29, 2017), https://www.ssb.texas.gov/news-publications/top-10-investor-threats-time-holidays [https://perma.cc/J3WG-AT3B].

80. *See In re* Raymond Hill, Mark Diaz, & Wales Mktg. & Consultancy, No. ENF-17-CDO-1751, 2017 WL 2039607, at *3 (Tex. St. Sec. Bd., May 5, 2017).

81. *See id.* (emergency cease and desist order to stop engaging in fraud in offering to buy; the fraud at issue involved using social media sites disguised as a registered Dallas investment adviser, portraying themselves as associated with the registered investment adviser, and claiming to be authorized to collect for the Internal Revenue Service; the costs to collect were a de-restriction fee, a 2% brokerage fee, and sales taxes of the Internal Revenue Service).

embarrassing matters[82] including (1) compromises with creditors[83]; (2) judgment liens[84]; (3) imposition of tax liens[85]; and (4) arrest for a felony.[86] One involved the failure to follow the dealer's written policies concerning client blank forms previously signed.[87]

The TSSB had several enforcement actions against investment advisers and investment-adviser representatives. These involved (1) failing to enforce a written system of supervising the investment advisers' activities[88]; (2) maintaining custody of client funds and securities without implementing required safeguards[89]; (3) participating in block trades with clients

82. *See* 7 TEX. ADMIN. CODE § 115.9(a)(6) (2017) (State Sec. Bd., Post-Registration Reporting Requirements) (requiring dealers and their agents to report changes on previously filed forms within thirty days).

83. *See In re* Agent Registration and Inv. Adviser Representative Registration of Brad Cain, No. REG17-CAF-02, 2017 WL 1393152, at *2 (Tex. St. Sec. Bd. Apr. 5, 2017) (failed to report settlement with three creditors seven years earlier within the thirty-day requirement; current registrations granted; reprimanded and fined $3,500).

84. *See In re* Agent Registration of Octavio Tovar, No. REG17-CAF-06, 2017 WL 5689554, at *2 (Tex. St. Sec. Bd. Nov. 21, 2017) (failed to report compromises with three creditors for a year and two judgments for a year and a half; current registration granted; reprimanded and fined $3,000).

85. *See In re* Agent Registration of Trevor M. Carney, No. REG17-CAF-05, 2017 WL 2748622 (Tex. St. Sec. Bd. June 21, 2017) (failed to report two tax liens for over $100,000 for more than six years; registration granted; reprimanded and fined $7,500).

86. *See In re* Agent Registration of Michael Delao, No. REG16-CAF-04, 2016 WL 7217451, at *1–2 (Tex. St. Sec. Bd. Dec. 6, 2016) (dealer's policy required reporting arrests for felonies, which agent failed to do, although charges were later dismissed; registration granted; reprimanded and fined $7,500).

87. *See In re* Inv. Adviser Registration and Agent Registration of Marie P. Goforth, No. REG17-SUS-04, 2017 WL 2039604, at *1–2 (Tex. St. Sec. Bd. May 4, 2017) (maintained signed client blank forms and reused signed client forms for two third-party checks against dealer's policy, for which she was terminated; current registration granted, suspended for forty-five days, and required to comply with an agreement calling for unannounced review of her files: for a one-year period, all client submissions were subject to review by a supervisor, and for a five-year period, all complaints were to be submitted to the TSSB).

88. *See In re* Inv. Adviser Registration of Provident Capital Mgmt. Inc., No. IC-17-CAF-02, 2017 WL 2748628, at *1 (Tex. St. Sec. Bd. June 19, 2017) (failed to supervise investment advisers in accordance with written policy, failed to establish written policy to prevent misuse of nonpublic information, failed to update form reporting changes to TSSB and clients, and failed to include required language on client form; suspended for sixty days; required to make and maintain necessary policies, provide clients with updated information, and retain an independent compliance consultant who reported to the TSSB; fined $8,000); *see also* 7 TEX. ADMIN. CODE §§ 116.11(4) (2017) (State Sec. Bd., Disclosure Requirement/Brochure Rule) (requiring disclosure of certain part of form information annually to clients), 116.12(a) (Advisory Contract Requirements) (specifying language in client disclosure), 116.9(a)(6) (Post-Registration Reporting Requirements) (2017) (requiring dealers and their agents to report changes on previously filed forms within thirty days).

89. *See In re* Inv. Adviser Registration of Michael Keith Parish, No. IC17-CAF-03, 2017 WL 3226045, at *1 (Tex. St. Sec. Bd. July 18, 2017) (maintained custody of client funds and securities without implementing required safeguards and failed to maintain current balance sheet, income statements, general ledger, and auxiliary ledgers; suspended for thirty days to provide required records and fined $5,000); *see also* 7 TEX. ADMIN. CODE §§ 116.5(a) (2017) (State Sec. Bd., Minimum Records) (requiring investment advisers to maintain certain records), 116.17(b) (Custody of Funds or Securities of Clients by Registered Investment Advisers) (requiring safekeeping of client funds and securities).

contrary to the investment adviser's policy[90]; (4) failing to abide by an undertaking concerning registration of an investment adviser subject to a Financial Industry Regulatory Authority Order (FINRA)[91]; and (5) failing to timely report tax liens and civil judgments filed against the agent.[92]

E. Criminal Enforcement

The TSA provides criminal penalties for various acts in connection with securities transactions.[93] The recent criminal cases reaching the appellate courts involved several of the top ten threats to investors—namely, unregistered securities, high-risk notes in connection with real estate, and high-yield life settlements—and some involved scams to raise money for the criminal's personal expenses. These appellate courts also faced imaginative criminal lawyers who attacked the constitutionality of the TSA's criminal provision and the requisite criminal mental state.

In *Villarreal v. State*, the Corpus Christi Court of Appeals considered a criminal case involving the sale of an unregistered membership in a limited liability company engaged in the insurance business.[94] The con artist (the seller of the membership) needed money for the mortgages on his mansion, various real estate properties, and his yacht.[95] The con artist saw an opportunity to pay these amounts by enticing a businessman (the purchaser) to purchase a membership in the con artist's to-be-formed

90. *See In re* Inv. Adviser Representative Registration of Kermit Gordon Gable Jr., No. REG 17-SUS-03, 2017 WL 1393158, at *2 (Tex. St. Sec. Bd. Apr. 10, 2017) (investment adviser representative failed to follow investment adviser's policy requiring block trades under which aggregate orders of multiple clients are handled as one transaction; also included investment adviser representative's orders to specify how investment adviser representative would allocate shares among himself and clients; registration granted; suspended for 150 days).

91. *See In re* Inv. Adviser Registration of 212 Advisory Grp., LLC, No. IC17-CAF-04, 2017 WL 4940237, at *1–3 (Tex. St. Sec. Bd. Oct. 23, 2017) (undertaking (1) forbade using investment adviser representative in a supervisory position, which was violated by allowing representative to be the only agent at an office; (2) required bi-annual compliance reviews by an outside monitor, which was not done; and (3) required establishment and maintenance of procedures for heightened supervision of investment adviser representative. FINRA offense involved (1) failure to disclose outside business ventures—namely, the private, undisclosed purchase of promissory notes; (2) fined $15,000; and (3) investment adviser representative was suspended for ninety days); *see also* 7 Tex. Admin. Code § 116.10 (2017) (State Sec. Bd., Supervisory Requirements) (requiring investment advisers to have supervision policies over their investment adviser representatives).

92. *See In re* Inv. Adviser Representative Registration of Robert Yrshus, No. REG 17-CAF-01, 2017 WL 663924, at *2 (Tex. St. Sec. Bd. Feb. 13, 2017) (failed to report tax liens and civil judgment while registered as a dealer's agent before 2013; application granted; suspended for sixty days and fined $5,000); *see also* 7 Tex. Admin. Code § 115.9(a)(6) (2017) (State Sec. Bd., Post-Registration Reporting Requirements) (requiring dealers and their agents to report changes on previously filed forms within thirty days).

93. *See* Tex. Rev. Civ. Stat. Ann. art. 581-29 (West 2010).

94. Villarreal v. State, 504 S.W.3d 494, 501 (Tex. App.—Corpus Christi 2016), *cert. denied*, Villarreal v. Texas, 138 S. Ct. 398 (2017) (mem.); *see also Alberto Alba Villarreal, Daniel Thomas Hernandez: Indicted*, Tex. St. Sec. Bd. (Aug. 28, 2013), https://www.ssb.texas.gov/news-publications/alberto-alba-villarreal-0 [https://perma.cc/8SZH-GJ33] (selling securities without registration).

95. *See* State's Appellate Brief at *12–13, *Villareal*, 504 S.W.3d 494 (No. 13-15-00037-CR), 2016 WL 1118197, at *12–13.

limited liability company rather than that of the con artist's brother.[96] Realizing that the businessman would only invest if the con artist also invested, the con artist obtained a $2 million bank loan and deposited the amount in a certificate of deposit.[97]

The con artist then represented to the businessman that his brother's proposal did not have sufficient funds, that Texas required $4 million to start an insurance company, and that he had sufficient funds by exhibiting the certificate of deposit. The con artist also showed the businessman his struggling insurance businesses in Mexico, representing that they were doing well.[98] The con artist formed the limited liability company, with the con artist and businessman each to contribute $2 million. The con artist was to manage the company under the company agreement, and the businessman would eventually own 48% of the company.[99] The businessman deposited $1 million into a company account for which both the con artist and the businessman were signatories.[100]

The con artist then moved the money to another bank for which only he was the signatory.[101] The businessman's money was spent in three months on the loan payments for the con artist's certificate of deposit and various real estate loans.[102] Before investing further amounts, the businessman requested an accounting and received only a list of expenses exceeding $1 million.[103] Neither the con artist nor the businessman invested further, and the businessman filed a complaint with the TSSB after failing to obtain the return of his money.[104] The con artist was indicted for securities fraud and theft by deception, found guilty, and sentenced to ten years for securities fraud and five years for theft by deception.[105]

The court of appeals reversed the criminal securities fraud conviction,[106] addressing issues involving the constitutionality of the TSA's penal provision and the application of its five-year statute of limitations for criminal indictments.[107] The enterprising attorneys for the con artist

96. *See id.* at *7 (purchaser's negotiations with brother),*14 (seller's opportunity to pay off debts).
97. *See id.* at *8.
98. *See id.* at *14–16.
99. *Villarreal*, 504 S.W.3d at 501.
100. *Id.*
101. *Id.*
102. *See* State's Appellate Brief, *supra* note 95, at *20–21.
103. *Villarreal*, 504 S.W.3d at 501–02.
104. *Id.* at 502.
105. *Id.*
106. *Id.* at 512. The case also involved a theft conviction, which the appellate court affirmed.*Id.* at 512–16. The petition for writ of certiorari to the U.S. Supreme Court was based on the spillover effect from the statements made about the securities fraud case influencing the theft conviction in violation of due process under the 14th Amendment. *See* Petition for Writ of Certiorari, Villareal v. Texas, 2017 WL 3948484, at *5–6 (2017) (No. 12-347), *cert. denied*, 138 S. Ct. 398 (2017); *see also* U.S. CONST. amend XIV, § 1.
107. *Villarreal*, 504 S.W.3d at 507–12; *see also* TEX. REV. CIV. STAT. ANN. art. 581-29-1 (West 2010) ("An indictment for an offense under Subsection C of Section 29 may be brought only before the fifth anniversary of the day on which the offense is committed."). Another securities law issue was whether the TSSB's prosecution violated the constitutional separation of power between the executive and legislative branches. *Villareal*, 504

urged that the TSA's criminal provision for securities fraud was unconstitutional because it assigns criminal penalties for ordinary negligence.[108] The Texas Court of Criminal Appeals determines whether securities fraud is material by using a "reasonable investor" standard applicable to civil proceedings, which requires a lower burden of proof.[109] These enterprising attorneys asserted that this standard violated the Fifth Amendment's requirement of proof beyond a reasonable doubt and the Sixth Amendment's requirement of a jury verdict in accordance with the Fifth Amendment, both applicable to the State of Texas by the Fourteenth Amendment.[110] The attorneys argued for the application of a recent U.S. Supreme Court case overruling a criminal conviction where the Congressional criminal statute was silent on the mental state required for conviction.[111] The court of appeals observed that, as an intermediate appellate court, it was required to follow the Texas Court of Criminal Appeals' decision; however, it also noted that the TSA criminal provision did require a specific mental state—intentional failure to disclose a material fact—which would satisfy the requirement.[112] Having concluded that the TSA criminal provision was constitutional, the court of appeals then considered the TSA's five-year statute of limitations and concluded that the TSA's definition of "sale" was broad and included "any transfer or agreement to transfer."[113] Therefore, the offer occurred when the parties signed the company agreement five years and three days before the criminal indictment.[114]

In *Nelson v. State*, the Dallas Court of Appeals dealt with a real estate scheme marketing high interest notes.[115] The fraudster sold several series

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S.W. 3d at 501. The appellate court found no violation because the district attorney merely used two TSSB attorneys as assistants without relinquishing control over them.*Id.* at 502–07.

108. *Villareal*, 504 S.W.3d at 501; *see* TEX. REV. CIV. STAT. ANN. art. 581-29(C)(1) (West 2010) ("Any person who shall . . . in connection with the sale [of] any security . . . engage in any fraud or fraudulent practice . . . is guilty of a felony of the first degree, if the amount involved is $100,000 or more."); *see also id.* art. 581-4(F) ("The terms 'fraud' or 'fraudulent practice' shall include . . . any misrepresentations, in any manner, of a relevant fact . . . or an intentional failure to disclose a material fact . . . .").

109. *Villarreal*, 504 S.W.3d at 508. The Texas Court of Criminal Appeals adopted the definition of "materiality" for the TSA's criminal provision from the U.S. Supreme Court's interpretation of "materiality" for civil fraud. *See* Birdwell v. State, 804 S.W.2d 900, 903–04 (Tex. Crim. App. 1991) (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

110. *See* Brief for Appellant at 14–21, *Villareal*, 504 S.W.3d 494 (No. 13-15-00037-CR), 2015 WL 5559621, at *14–21 (citing Sullivan v. Louisiana, 508 U.S. 275, 278 (1993)); *see also* U.S. CONST. amends. V, VI, XIV.

111. *Villarreal*, 504 S.W.3d at 509; *see also* Elonis v. United States, 135 S. Ct. 2001, 2012 (2015) (overturning conviction for issuing a threat under 18 U.S.C. § 875(c) because federal criminal law must examine defendant's mental state, not just the perceived result).

112. *Villarreal*, 504 S.W.3d at 509–10.

113. TEX. REV. CIV. STAT. ANN. art. 581-4(E) (West 2010) ("The term 'sale' means and includes contracts and agreements whereby securities are sold . . . or any transfer or agreement to transfer in trust or otherwise").

114. *Villarreal*, 504 S.W.3d at 512.

115. Nelson v. State, No. 05-16-00494-CR, 2017 WL 2334237, at *1–2 (Tex. App.—Dallas May 30, 2017, no pet.) (mem. op.).

of notes, bringing in an excess of $37 million; one series promised returns of 10% per month for three months, and another supposedly paid a return of 18% annually for five years.[116] The fraudster told investors that he would use the proceeds from the sale of the promissory notes to buy distressed properties, renovate them, and then lease or sell them, thereby generating the money to pay the notes.[117] Instead, the fraudster used at least $20 million of the investor funds to pay off earlier investors and $2.7 million for personal expenses and contributions to his church.[118] The misrepresentations and omissions essentially consisted of failing to disclose: (1) that the funds for payment on the notes came from subsequent investors; (2) that funds were used for personal purposes; and (3) that the investment program was not generating sufficient profits to pay interest on the notes.[119] A jury convicted the fraudster of securities fraud and assessed a penalty of nineteen years in prison and a fine of $10,000.[120]

The court of appeals affirmed.[121] The securities issue for the court of appeals concerned the sufficiency of the evidence to show the requisite mental state for the misrepresentations.[122] With respect to the misrepresentation concerning the use of the funds for personal uses, the fraudster's inventive attorneys claimed that the jury could not "rationally infer an intent to defraud when so much money was given to churches" and charities.[123] The court of appeals rejected this assertion, finding no authority for the proposition that the use of fraudulently gained money for charitable purposes defeats the intent to defraud.[124] With respect to the misrepresentations about the Ponzi nature of the program and the belief that the program was profitable, the fraudster's inventive attorneys asserted that the jury could not rationally infer an intent to defraud due to the fraudster's lack of an educational background—he left high school as a senior, earned a general education diploma, and attended a few college classes.[125] Again, the court of appeals rejected this claim because there was no authority for the proposition that the absence of diplomas and degrees negates an intent to defraud.[126]

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116. *Id.* at *2 (series of notes), *3 (total $37 million).
117. *Id.* at *1.
118. *Id.* at *3.
119. *Id.* at *1–2.
120. *Id.* at *1.
121. *Id.*
122. *Id.* at *6–8. The appellate court also examined two other issues: sufficiency of the jury charge and the prosecutor-witness as an expert witness. The fraudster's attorneys challenged the jury charge for failing to separate fraudulent and non-fraudulent acts in calculating the $100,000 amount; but the charge and statements made clear that the transactions used to calculate the $100,000 had to consist of securities fraud. *Id.* at *8–11. The fraudster's attorneys raised a structural challenge to the expert witness because he was a TSSB prosecutor, but the appellate court rejected the assertion because no authority indicated that such an error was structural. *Id.* at *11–12.
123. *Id.* at *7.
124. *Id.*
125. *Id.* at *5 (educational background), *8 (jury could not infer).
126. *Id.* at *8.

In *Ex parte McDermott*, the Dallas Court of Appeals confronted a peddler of life settlements under an investment program instituted by his employer, a financial intermediary.[127] A life settlement is a transaction under which an owner of a life insurance policy sells the policy at a discount (reflecting a future rate of return and premium costs over the owner's expected life) in order to obtain money to spend.[128] The financial intermediary locates the policy sellers, negotiates the discount, locates investors to provide the purchase price of fractional interests in the life insurance policies, takes title to the policies as an agent of the investors, and maintains a trust fund to pay the premiums.[129]

The financial intermediary's program provided "16.5% interest per year for the insured's life expectancy" to the investors.[130] If the insured died early, the investors also received the saved premiums, but if the insured outlived the life expectancy used to discount the sales price of the policy by more than two years, the investors had to pay the additional premiums or forfeit their investment.[131] These financial intermediaries are notorious for underestimating the life expectancies used in calculating the discounts, which is information they conceal from the investors prior to their purchases.[132] This financial intermediary knew about the very poor reputation of the company it used for estimating life expectancies, including its practice of falsifying life expectancies in order to sell policies, diverting millions of dollars to its officers and a subsidiary used to reimburse investors in a Ponzi scheme, and comingling funds for future premiums with other operational expenses.[133] In the TSSB's securities fraud action against the peddler, the peddler's creative attorneys challenged the constitutionality of the TSA in a "habeas corpus [action] to prohibit prosecution on vagueness grounds" and "to prohibit retroactive

127. *Ex parte* McDermott, No. 05-16-01357-CR, 2017 WL 1953286, at *1 (Tex. App.—Dallas May 11, 2017, pet. ref'd) (mem. op., not designated for publication) (Resale Life Insurance Policy Program); *see also R. Gray, W. Rogers, R. James, & D. James, MeDermott: Indicted*, TEX. ST. SEC. BD. (Feb. 26, 2015), https://www.ssb.texas.gov/news-publications/r-gray-w-rogers-r-james-d-james-mcdermott-indicted [https://perma.cc/GG5P-4E8F] (a $77 million securities investment program of Retirement Value LLC acquired life insurance policies from third parties and sold interests in the proceeds from the policies to investors).

128. *See* Magaraci v. Espinosa, No. 03-14-00515-CV, 2016 WL 858989, at *1 (Tex. App.—Austin Mar. 4, 2016, no pet.) (mem. op.) (explaining the workings of the Retirement Value LLC program).

129. *See id.*

130. *See id.*

131. *See id.*

132. *See* Nathan Vardi, *Early Death*, FORBES (Sept. 17, 2009), www.forbes.com/2009/09/17/life-insurance-settlements-a-and-o-business-insurance.html [permalink unavailable] (discussing the life settlement practices of A&O Life Fund and its bankruptcy causing tens of millions of dollars in losses); *see also* Mark Maremont & Leslie Scism, *Odds Skew Against Investors in Bets on Strangers' Lives*, WALL ST. J. (Dec. 21, 2010), http://wsj.com/articles/SB10001424052748704694004576019344291967866 [https://perma.cc/5ERS-WHHH] (for life settlement investments made from 2002 to 2005, 83% of the insureds lived past their life expectancies as calculated by Life Partners, Inc.).

133. *See Magaraci*, 2016 WL 858989 at *1 n.3 (explaining the TSSB's action against the financial intermediary for securities fraud, its partial judgment, and its order to repay $77 million to its investors).

application of a judicial decision."[134] The district court concluded that the claims were "not cognizable by a pretrial habeas" corpus action.[135]

The court of appeals affirmed.[136] For a habeas corpus action, the court may only consider how the statute is written, not how it is applied in a particular situation.[137] The alleged vagueness claim and retroactive claim were based on the discrepancy between a 2004 court of appeals decision and a 2015 Texas Supreme Court decision.[138] The 2004 case found that life settlements did not fall within the definition of "security" under the TSA, but the 2015 case found the contrary five years after the peddler had made his sales, which created uncertainty about whether the new definition retroactively proscribed his conduct in violation of his due process right to fair notice.[139] The court of appeals noted that the supreme court's pronouncement was based on decades of decisions from throughout the nation, including Texas.[140] But the court of appeals rested its affirmation on the supreme court's indication that the life settlements in its case were securities, meaning that other life settlements might not be securities, which would require a record, and so the habeas corpus action was inappropriate.[141]

III. SECURITIES FRAUD

One major reason legislatures passed securities acts was to facilitate investors' actions to recover their money through a simplified fraud action that removed scienter and privity, the most difficult elements to prove in a common law fraud action. These securities act changes generally apply only to the primary market. When investors purchase in the secondary market, their actions reintroduce these obstacles.

A. Court Decisions Under the Texas Acts

Under the TSA, attorneys for investors have had difficulty with the statute of limitations and materiality, probably caused by the inability to discern significant misrepresentations and omissions. One case involved purchases of interests in a start-up company in the process of being

134. *Ex Parte* McDermott, No. 05-16-01357-CR, 2017 WL 1953286, at *1 (Tex. App.—Dallas May 11, 2017, pet. ref'd) (mem. op., not designated for publication). One of the creative attorneys in the *McDermott* case, Keith S. Hampton, was a student of the author in 1988.

135. *Id.*

136. *Id.*

137. *Id.* at *2.

138. *Id.* at *1–2.

139. *Id.* at *1–2; *see also* Life Partners, Inc. v. Arnold, 464 S.W.3d 660, 684 (Tex. 2015); Griffitts v. Life Partners, Inc., No. 10-01000271-CV, 2004 WL 1178418, at *2 (Tex. App.—Waco May 26, 2004, no pet.); *see also* Flint, *Securities Regulation* 2016, *supra* note 55, at 439–45 (discussing *Arnold*), 445 n.57 (discussing the same conclusion on the other states); George Lee Flint, Jr., *Securities Regulation*, 58 SMU L. Rev. 1135, 1136–37 (2005) (discussing *Griffitts*) [hereinafter Flint, *Securities Regulation* 2005].

140. *McDermott*, 2017 WL 1953286, at *3.

141. *Id.*

formed, so the structure may not have initially been clearly formulated.[142] Another case dealt with the sale of interests in an insolvent company that was sold a year and a half later for a significant amount, so the investors rued missing out on significant gains.[143]

In *Mad-Mag Development, LLC v. Cargle*, investors bought interests in a limited liability company being formed to operate a retirement facility.[144] The investors alleged that a number of misrepresentations and omissions were contained in the private placement memorandum they had received in April 2008 prior to signing the company agreement at the end of that month.[145] These misrepresentations and omissions related to the shifting structure of the start-up—the investors were not sure whether the entity was a limited partnership, limited liability company, or something else.[146] The misrepresentations and omissions in the private placement memorandum consisted of: (1) offering interests in an entity labeled a "company" that did not yet exist, but came clear when signing the company agreement; (2) referring to an "attached" company agreement that was not actually attached, which the investors' attorneys claimed should have been read with the private placement memorandum (the investors later did receive the company agreement to sign within the month); and (3) a vague explanation that the officers would own a larger percentage of the company than the other members without explaining how to calculate that percentage. The investors' attorneys asserted that the investors would have hesitated to invest if the information had been included in the private placement memorandum, yet the percentage was attached as an exhibit to the company agreement that the investors received and signed.[147] The investors filed suit in December 2011, alleging two causes of action under the TSA for selling unregistered securities and selling securities by means of misrepresentations and omissions.[148] The trial court granted the investors' motion for summary judgment.[149]

The Amarillo Court of Appeals reversed and remanded.[150] The statute

142. *See* Mad-Mag Dev., LLC, v. Cargle, No. 07-16-00132-CV, 2017 WL 2791217, at *1 (Tex. App.—Amarillo June 26, 2017, no pet.) (mem. op.).

143. *See* Gonzalez v. UniversalPegasus Int'l, Inc., 531 S.W.3d 276, 279 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

144. *Mad-Mag Dev.*, 2017 WL 2791217, at *1; *see also* Appellee's Brief at *5, *Mad-Mag Dev.*, 2017 WL 2791217 (No. 07-16-00132-CV), 2016 WL 4620684, at *5 (purchased limited-liability company interests).

145. *Mad-Mag Dev.*, 2017 WL 2791217, at *1.

146. *See* Appellee's Brief, *supra* note 144, at *5 (early approaches by the promoters indicated that the entity was a limited partnership while the private placement memorandum described it as a company).

147. *Mad-Mag Dev.*, 2017 WL 2791217, at *1.

148. *Id.* at *2–3; *see also* Plaintiff's Original Petition at *8–9, *Mad-Mag Dev.*, 2017 WL 2791217 (No. 100159), 2011 WL 13064079 (item 34 for violation of TSA's registration requirement). The TSA actions were brought under TEX. REV. CIV. STAT. ANN. art. 581-33(A)(1),(2) (West 2010). The investors also sued for violation of the federal securities laws. Plaintiff's Original Petition at *3, *Mad-Mag Dev.*, 2017 WL 2791217 (No. 100159), 2011 WL 13064079; *see also* Appellee's Brief, *supra* note 146, at *7 (item 28 for violation of § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (2017)).

149. *Mad-Mag Dev.*, 2017 WL 2791217, at *1.

150. *Id.* at *4.

of limitations for a TSA action involving the sale of unregistered securities is three years; for a sale by means of misrepresentation or omission, the statute of limitations is three years from the time of discovery but no more than five years after the violation.[151] The party asserting an affirmative defense, such as the statute of limitations, need only show a fact issue to defeat a motion for summary judgment.[152] The record and evidence indicated that the company agreement had been signed by the investors at the end of April 2008 and the investors had not brought the lawsuit until three years and seven months later, creating a fact issue as to whether the investors had acted within the statute of limitations.[153] Thus, the appellate court did not need to examine the other securities law issues such as the materiality of the misrepresentations and omissions.[154]

In *Gonzalez v. UniversalPegasus International, Inc.*, the former common stock investors in a Delaware company cashed out in a merger, thereby missing a 150-fold increase when the survivor of the merger was sold twenty months later. The investors sued the directors and the surviving company under the TSA for various misrepresentations and omissions in the merger disclosures.[155] In connection with the merger, under which the common stock investors had the choice of receiving one cent per share of stock or seeking a court appraisal of the stock's fair value, the investors received an information statement and notice of appraisal.[156] The common stock investors claimed the following as misrepresentations in the information statement: (1) that the investors' shares had been cancelled by the merger when shares for appraisal were not cancelled; (2) that the company's equity was of no value when a subsequent appraisal showed otherwise; and (3) that the conversion price of one cent required signing a liability release of the directors and waiver of the appraisal.[157] The investors also asserted omissions of: (1) the most recent financial statements; (2) the method of determining value; (3) a

151. *See* TEX. REV. CIV. STAT. ANN. art. 581-33(H)(1)(a) (three years with a possible extension for a rescission offer), 33(H)(2) (West 2010) (within three years of discovery). The federal securities law cause of action similarly has a within two years of discovery but no more than five years after the violation limitations period. *See* 28 U.S.C.A. § 1658(b) (West 2017).

152. *Mad-Mag Dev.*, 2017 WL 2791217, at *2.

153. *Id.* at *3. The federal securities cause of action has the same fact issue with respect to its statute of limitations, defeating a summary judgment for the federal action. *Id.*

154. *See* Defendant's Response to Motion for Summary Judgment at *5, *Mad-Mag Dev.*, 2017 WL 2791217 (No. 100159), 2016 WL 1329153 (paragraph 9 discusses whether there was a misrepresentation or omission, its materiality, and the investors' reliance).

155. Gonzalez v. UniversalPegasus Int'l, Inc., 531 S.W.3d 276, 287 (Tex. App.—Houston [14th Dist.] 2017, no pet.); *see also* Appellant's Brief at *13–14, *33, *Gonzalez*, 531 S.W.3d 276 (No. 14-16-00009-CV), 2016 WL 1532534, at *13–14, *33 (appraised value determined by extrapolating back from acquisition price; received $9,000 in the merger for shares appraised at $1,356,000 by the extrapolation back). The common stock investors also sued for failure to comply with the original certificate of formation requiring notice of a fundamental change and breach of fiduciary duty. *Gonzalez*, 531 S.W.3d at 279 (terms of the certificate of formation), 280 (the three claims).

156. *Gonzalez*, 531 S.W.3d at 279.

157. *Id.* at 286–87.

fairness opinion; and (4) the directors' potential conflicts.[158] The trial court granted a motion for summary judgment in favor of the company and directors.[159]

The Fourteenth Houston Court of Appeals affirmed.[160] With respect to the conversion misrepresentation, the court of appeals found that the information statement required the shares to be transmitted by a letter of transmittal, which was attached to the information statement and contained the release information.[161] With respect to the no-equity misrepresentation, the court of appeals found within the information statement that the valuation report (provided by a valuation firm the company hired) concluded that the company had no intrinsic value because the company owed $150 million more than it was worth and had defaulted on $200 million in debt.[162] With respect to the non-cancellation misrepresentation, the court of appeals found in the information statement that all shares were cancelled and converted into the right to receive one cent or an appraisal.[163] With respect to the omissions of the most recent financial statements and a fairness opinion, the court of appeals found the information within the information statement adequate in the absence of an investor explanation that the most recent financial statements and a fairness opinion would have changed significantly the information contained in the information statement.[164] With respect to the methodology omission, the court of appeals found that the information statement contained enough information on the company's financial condition to lead a reasonable person to the conclusion that the company's shares were valueless.[165] Finally, with respect to the potential conflicts omission, the court of appeals determined that Delaware law finds no conflict when all shareholders are treated equally and receive the same compensation for their shares.[166]

B. Court Decisions Under the Federal Acts

The TSA's fraud provisions are modeled on the federal statutes, so Texas courts look to federal decisions under these statutes to interpret TSA provisions with similar language.[167] As a result, Texas courts often analyze Fifth Circuit opinions involving securities law fraud. Fraud actions under the federal statutes generally possess six elements: (1) a material misrepresentation or omission; (2) scienter; (3) a connection with a purchase or sale of a security; (4) reliance; (5) economic loss; and (6)

158. *Id.*
159. *Id.* at 278. The appellate court also found no breach of the certificate of formation and no breach of fiduciary duty. *Id.* at 284, 288–89.
160. *Id.* at 278.
161. *Id.* at 285.
162. *Id.*
163. *Id.* at 287.
164. *Id.*
165. *Id.*
166. *Id.*
167. *See* sources cited *supra* note 3 and accompanying text.

"loss causation"—that is, a causal connection between the material misrepresentation and the loss.[168] The last element comes from the Private Securities Litigation Reform Act (PSLRA).[169] The PSLRA also requires the investor's petition to recite facts giving rise to a strong inference of scienter.[170] In the Fifth Circuit, scienter requires an intent to defraud, severe recklessness with knowledge of the danger to investors, or action despite danger so obvious that the officer must have been aware of the danger.[171] Moreover, the Fifth Circuit has rejected the group-pleading doctrine, so the scienter must be of a specific issuer officer; thus, scienter may not be implied from prospectuses, registration statements, or press releases.[172]

Attorneys for shareholders in securities class actions find it difficult to plead facts giving rise to a strong inference of scienter. In *Neiman v. Bulmahn*, the U.S. Court of Appeals for the Fifth Circuit dealt with an oil and gas company that had collapsed into bankruptcy.[173] Those who purchased the company's common stock in the public market during the one-and-a-half-year period before the bankruptcy filing brought a class action against the company's officers.[174] Most of the company's drilling was in the Gulf of Mexico and was subject to government drilling moratoria due to an oil spill. Nonetheless, the company continued to spend on infrastructure construction, which included the construction of a pipeline extending from deepwater wells in the Gulf of Mexico.[175] The shareholders alleged misstatements made by several officers, including the chief financial officer, concerning the production from one well of 104 Gulf of Mexico wells, the company's liquidity and funds to complete the pipeline, and

168. *See* Dura Pharms. Inc. v. Broudo, 544 U.S. 336, 341–42 (2005) (discussing Commission Rule 10b-5, 17 C.F.R. § 240.10b-5).

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

170. *See id.* § 78u-4(b)(2)(A) ("[T]he complaint shall . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.").

171. *See* Southland Secs. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004); *see also* Flint, *Securities Regulation* 2005, *supra* note 139, at 1135, 1155–56 (discussing *Southland*).

172. *See Southland*, 365 F.3d at 366.

173. Neiman v. Bulmahn, 854 F.3d 741, 744 (5th Cir. 2017). The case was originally filed in the Southern District of Texas and removed to the Eastern District of Louisiana. *See Neiman v. Bulmahn et al.*, JURAL INDEX, https://www.juralindex.com/civil/neiman-v-bulmahn-et-al [permalink unavailable] (filed in Tex. Aug. 5, 2013); *Neiman v. Bulmahn et al.*, PACER MONITOR, https://www.pacermonitor.com/public/case/1740880/Neiman_v_Bulmahn [https://perma.cc/TJM5-RZWU] (removed to La. Oct. 4, 2013). The oil and gas company filed for bankruptcy in the Southern District of Texas on August 27, 2012. *See In re* ATP Oil & Gas Corp., No. 12-36187, 2013 WL 3866495, at *1 (Bankr. S.D. Tex. June 19, 2013) (mem. op.). The bankruptcy trustee sued the officers and directors of the oil company for reckless spending pending the bankruptcy, but the bankruptcy trustee fared no better than the investors. *See* Tow v. Bulmahn, No. 15-3141, 2016 WL 1722246, at *3–4 (E.D. La. Apr. 29, 2016), *aff'd sub nom. In re* ATP Oil & Gas Corp., 711 Fed. App'x 216, 225 (5th Cir. 2017) (per curiam) (no breach of fiduciary duty, fraudulent transfers, civil conspiracy, or legal malpractice against the corporate counsel); *see also id.* at *31 (granting summary judgment for the officers).

174. *See* Firefighters Pension & Relief Fund of N.O. v. Bulmahn, 147 F. Supp. 3d 493, 497–98 (E.D. La. 2015), *aff'd sub nom. Neiman*, 854 F.3d at 744.

175. *See id.* at 498–99.

the true reason the newly appointed chief executive officer resigned.[176] The trial court dismissed the complaint because the petition did not plead facts giving rise to a strong inference of scienter.[177]

The Fifth Circuit affirmed.[178] The petition was unsuccessful primarily due to its failure to plead a motive for the alleged misstatements and omissions.[179] With respect to the one-well-production misstatement, the Fifth Circuit provided three reasons that the pleadings failed to give rise to a strong inference of scienter.[180] First, the subsequent disclosure negated an inference of scienter where there were no fact allegations suggesting a reason to lie about the production in September, only to later disclose the correct amount in November.[181] Second, access to internal reports containing the correct information did not raise a strong inference of scienter in the absence of fact allegations that the reports were actually read by the misstating officer.[182] And third, the misstating officer's position within the company did not give rise to a strong inference of scienter because the company's large size prevented it from using the Fifth Circuit inference of scienter for special circumstances involving small companies.[183]

With respect to the company's liquidity and funds to complete the pipeline, the Fifth Circuit provided five reasons that the pleadings failed to give rise to a strong inference of scienter.[184] First, the continuous disclosure of the deteriorating cash position undercut any inference of scienter.[185] Second, reasonable persons could disagree on the meaning of statements that the company's financial condition depended on future production that might not be met and the explanation that the company would seek alternative means of financing that might not be readily available.[186] Third, the three-month timespan between the statements on the adequacy of liquidity and the filing of bankruptcy did not establish scienter because the officers had disclosed their liquidity concerns at the beginning of the period.[187] Similarly, the two-month timespan between

176. *Neiman*, 854 F.3d at 744–46.

177. *Id.* at 744, 746. The bankruptcy trustee's lawsuit fared no better. The Fifth Circuit rejected the trustee's claims against the officers of the company for breach of fiduciary duty in paying preferred stock dividends at the time of the company's impending bankruptcy and for breach of fiduciary duty and the fraudulent conveyance statute for the payment of cash bonuses to certain officers in the two-year period before bankruptcy for pleading deficiencies as well. *See In re* ATP Oil & Gas Corp., 711 Fed. App'x 216, 221–22 (5th Cir. 2017) (per curiam).

178. *Neiman*, 854 F.3d at 744.

179. *Id.* at 747 (the production misstatement), 752 (the pipeline misstatement, the resignation misstatement). In fact, the officers had lost approximately $100 million as a result of the company's bankruptcy. *See Firefighters*, 147 F. Supp. 3d at 520.

180. *Neiman*, 854 F.3d at 747–50.

181. *Id.* at 747–48.

182. *Id.* at 748–49.

183. *Id.* at 749–50.

184. *Id.* at 750–52.

185. *Id.* at 750.

186. *Id.* at 751.

187. *Id.*

consulting with bankruptcy lawyers and filing bankruptcy did not establish scienter because companies commonly consult bankruptcy counsel to explore options before deciding to file for bankruptcy.[188] Fourth, assessments of the company's liquidity by others did not establish scienter because such assessments do not indicate whether the officers' assessments were reasonably held.[189] Finally, the petition's failure to allege that the officers profited from their misstatements undercut any inference of scienter.[190] With respect to the misstatements concerning the resignation of the new chief executive officer, the Fifth Circuit found no scienter because the petition failed to allege that the new chief executive officer communicated his reasons for resigning to the misstating officers.[191]

IV. CONCLUSION

As discussed previously, several courts have addressed the scope of the TSA and TSFA. One Texas court of appeals refused to adopt the U.S. Supreme Court's "family resemblance" test for determining whether a promissory note is a security. Instead, it continued to abide by the Fifth Circuit's investment/commercial distinction, nonetheless finding the note to be a security because it paid 10% of the profits. The Fifth Circuit considered the interplay between state and federal exemptions for offerings of less than $1 million under the SEC's Rule 504, concluding that the seller must rely on the exemptions provided in the states where the securities are sold rather than on the Texas exemption. The U.S. District Court for the Northern District of Texas determined that the purchase of convertible notes was not a transaction in stock under the TSFA.

The TSSB clarified its confidential status and broadened an exemption by obtaining an Attorney General opinion that the TSSB's confidential investigative documents are not subject to disclosure under the Public Information Act because such documents are rendered confidential by statute and fit within the disclosure exemption contained in the Act. The TSSB also amended its manual secondary trading exemption for sales by registered dealers to include the otcmarkets.com and Mergent manuals.

The Texas Legislature added a new section to the TSA to provide protection for vulnerable adults—those over age sixty-five or disabled—by requiring dealers' agents and investment advisers' representatives to monitor their client records and report any suspected financial exploitation of vulnerable adults to their dealers and investment advisers, who are required to investigate and report to the TSSB within five days.

The TSSB's enforcement efforts against dealers included an advance fee scheme involving purported affiliation with the IRS; failure to report compromises with creditors, imposition of tax liens, and felony arrests; and failure to follow dealers' written policies concerning client-signed

188. *Id.*
189. *Id.* at 752.
190. *Id.*
191. *Id.*

blank forms. The enforcement efforts against investment advisors involved failure to enforce written policies, failure to maintain custody of client funds with the required safeguards, participation in client block trades contrary to the investment adviser's policy, failure to abide by FINRA undertakings, and failure to report tax liens and civil judgments against the representative.

Criminal enforcement efforts involved the sale of unregistered securities, high interest notes, and life settlements. One court of appeals dealing with unregistered securities found the TSA's criminal section constitutional against the charge that a finding of materiality under the TSA required the application of the "reasonable investor" test used in civil cases. The appellate court found that, because the statute required intentional conduct, the mental-state requirement for criminal conduct was satisfied. The appellate court then reversed the securities fraud conviction due to the five-year statute of limitations.

Another court of appeals dealing with high-interest real estate notes and a Ponzi scheme upheld a securities fraud conviction, finding that the criminal mental state required under the TSA was sufficiently established despite the claim that donation of fraudulently obtained funds for charitable purposes and lack of an educational background defeat an intent to defraud. A court of appeals dealing with life settlements rejected a claim in a habeas corpus proceeding that a criminal provision under the TSA was unconstitutional due to vagueness and the retroactive application of a judicial opinion. Although the decision after indictment held that the life settlement was a security, the appellate court relied on a Texas case holding that a life settlement was not a security, finding that the claim dealt with a statute's application rather than its form.

Regarding fraud actions under the TSA, one court of appeals reversed a summary judgment in favor of investors in a start-up company in which not all provisions were initially known. The company's alleged misrepresentations and omissions were cleared up by a company agreement signed three years and seven months before the investors filed suit, so there was a fact issue as to whether the statute of limitations was satisfied. Another court of appeals affirmed a summary judgment in favor of a company that purchased its investors' shares in a cash-out merger. The appellate court rejected the investors' claims of alleged misrepresentations and omissions where the insolvent company was sold a year and a half later for many times more than the cash-out price, finding that the investors had failed to establish the materiality of the alleged misrepresentations and omissions. Finally, in the federal sphere, the Fifth Circuit held that investors in a company failed to establish a strong inference of scienter on the part of the company's officers where the officers were not enriched by their misstatements, therefore rendering the investors incapable of pleading a required motive for the alleged misrepresentations and omissions.