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Securities Regulation

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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 the Texas Stock Fraud Act (TSFA). Since the legislature modeled the fraud provisions of the TSA on the federal statutes, Texas courts use federal court decisions interpreting the federal statutes to interpret the TSA’s similar language. This Article, therefore, includes the Fifth Circuit cases involving state law and securities fraud under federal law. The author does not intend for this Article to exhaust all aspects of securities regulation but rather to update the Texas-based securities practitioner on new developments of interest.

I. COVERAGE OF THE TEXAS SECURITIES ACTS

The statutory definitions, especially those relating to what constitutes a

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


security or a stock and the persons liable, as well as federal preclusion of state securities fraud actions, determine the fraudulent transactions subject to the state’s securities acts. Texas courts have joined the rest of the nation in concluding that interests in life settlements constitute “investment contracts” and therefore are securities under the TSA.4 Texas courts also rejected aider and abettor liability in the absence of proof of a violation of the TSA by the primary violator.5

A. INTERESTS IN LIFE SETTLEMENTS ARE SECURITIES

The key issue for the Texas Appellate Court in Arnold v. Life Partners, Inc.6 involved interests in life settlements. 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 a lump sum to spend. Life Partners is a financial intermediary that locates policy sellers, negotiates the discount, locates investors to provide the purchase price of fractional interests in the life insurance policies,7 takes title to the policies as agents of the investors, and maintains a trust fund to pay the premiums. If the insured outlives the life expectancy used to discount the sale price of the policy, Life Partners requires the investors to contribute additional amounts to pay premiums needed to continue the policies.8 Life Partners is notorious for underestimating the life expectancies used in calculating the discounts,9 information Life Partners concealed from the investors. These miscalculations have the effect of reducing expected rates of return and increasing the premium costs potentially leading to losses on the investment. Life Partners concealed those errors by providing investors with only the total acquisition cost, with no breakdown of the amounts paid by the policy owners, the escrow amount, Life Partners’ fees, and expenses such as physician fees, escrow fees, consultant fees, and broker fees.10

4. See infra note 22 for the Securities and Exchange Commission’s (SEC) report on life settlements as securities.
5. See infra Part B.
7. See Brief of Appellant, Arnold v. Life Partners, Inc., 2013 WL 4553379 (Tex. App.—Dallas Aug. 28, 2013), No. 05-12-000922012 WL 1936145, at *4–6 (investors do not generally invest in a particular policy, but only provide the amount they desire to invest and the range of life expectancies they desire), *7 –8 (investors generally become owners of fractional interests in several policies).
8. Id. at *10.
10. See Brief for Appellant, Arnold v. Life Partners, Inc., 2013 WL 4553379 (Tex. App.—Dallas Aug. 28, 2013), No. 05-12-000922012 WL 1936145, at *6–7 (acquisition cost includes amount paid to policy owner, an escrowed amount for paying future premiums, fees paid the policy owner’s broker, fees paid physicians to determine life expectancy, fees paid escrow agents, fees paid the investor’s consultant, and fees paid Life Partners for facilitating the purchase). The principal behind Life Partners, Inc., a subsidiary of Life Partners Holdings, Inc., a public company located in Waco, Texas, is Brian D. Pardo. See Life Partners Holdings, Inc., Quarterly Report (Form 10-Q)(Oct. 15, 2013), at 6, 28 (president and chief executive officer), available under Westlaw’s SEC’s Edgar filings. The author’s former law firm represented Pardo’s prior public company, American Solar King Corporation, with respect to securities matters (private placements, registrations under
In *Arnold*, the investors of interests in life settlements sued under the TSA for rescission or damages for failure to register the interests with the Texas State Securities Board (TSSB) and for making an untrue statement of a material fact by claiming the life settlements were not securities. Life Partners filed a counterclaim against the investors asserting that the investors’ claims were groundless, brought for the purposes of harassment. Life Partners then moved for a summary judgment on the investors’ claims and their counterclaim, contending that no violation of the TSA occurred because the interests in the life settlements were not securities as a matter of law, the TSA excludes contracts of insurance from the definition of security, and the TSA’s statute of limitations had run on most of the claims. The trial court granted the motion for the Securities Act, and periodic reports under the Exchange Act). After the author left Waco, the Securities and Exchange Commission (hereinafter SEC) sanctioned Pardo for filing fraudulent financial statements for American Solar King Corporation. See Accounting & Auditing Enforcement Act, SEC Release No. 12762, 48 SEC Docket 64 (Jan. 18, 1991) (consent to permanent injunction); Complaint Names Ask Corp. & Brian D. Pardo SEC NEWS DIGEST, July 20, 1989, (complaint for materially overstating revenues in 1983, 1984, and 1985); see also Fine v. Am. Solar King Corp., 919 F.2d 290, 293–95 (5th Cir. 1990) (securities fraud claim against corporation, corporate officers, including Brian D. Pardo, and accounting firm for inflating earnings and detailing the method of overstatement); cert. denied sub nom. Main Hurdman v. Fine, 502 U.S. 976 (1991); see also Final Judgment of Permanent Injunction Against ASK Corporation and Brian Pardo, SEC NEWS DIGEST 91-14, 1991 WL 77075 (for the same offense). This fraudster did not stop with American Solar King Corporation. See SEC v. Life Partners, Inc., 87 F.3d 536, 537–38 (5th Cir. 1996) (SEC’s first attempt to stop Brian D. Pardo’s scheme of selling interests in life settlements with unfavorable discounts by focusing on the investors in the life settlements); SEC v. Life Partners Holdings, Inc., Brian D. Pardo, R. Scott Peden and David M. Martin, SEC NEWS DIGEST 2012-2, 2012 WL 12723 (SEC’s second attempt to stop the life settlement fraud by focusing on the overvaluation of a public company’s assets and accounting tricks to create the appearance of steady earnings [Pardo’s second effort to overstate a public company’s revenue]) (for a copy of the complaint, see www.sec.gov/litigation/complaints/2012/comp-pr2012-2.pdf (last visited Nov. 23, 2014)); see also Rob Wells, House GOP Candidate Questioned about $3Million FDIC Claim, ASSOCIATED PRESS, available at http://www.apnewsarchive.com/1996/House-GOP-Candidate-Questioned-About-$3-Million-FDIC-Claim/id-fc696c06d79a3ec354363ec6a80d9f02 (last visited Nov. 23, 2014) (SEC lawsuit claiming Brian D. Pardo’s manipulation of the sale of his bank loan for four cents on the dollar defrauded FDIC; also discusses the other two frauds).

11. See TEX. REV. CIV. STAT. ANN. art. 581-33(A)(1) (West 2012) (“A person who offers or sells a security in violation of Section 7 [requiring registration with the TSSB] . . . is liable to the person buying the security from him . . . for rescission or for damages if the buyer no longer owns the security”); Arnold v. Life Partners, Inc., 2013 WL 4553779 (Tex. App.–Dallas Aug. 28, 2013). The action was brought as a class action, but the trial court did not certify a class. Since the securities involved are not covered securities, the class action need not be brought in federal court. See, e.g., 15 U.S.C. § 77p(b) & (c) (2012) (Securities Act: requiring class actions involving covered securities based on state law alleging an untrue statement or omission to be maintained in federal court); 15 U.S.C. § 77p(f)(3) & 77r(b) (2012) (Securities Act: defining covered securities as listed on a national exchange).

12. See TEX. REV. CIV. STAT. ANN. art. 581-33(A)(2) (West 2012) (“A person who offers or sells a security . . . by means of an untrue statement of a material fact . . . is liable to the person buying the security from him . . . for rescission or for damages if the buyer no longer owns the security.”).

13. Apparently the fashionable thing for the well-heeled when sued for securities fraud is to file harassment suits against the investors and those that represent them. See, e.g., SEC v. Cuban, No. 3:08-CV-2050-D, 2009 WL 4544178, at *1 (N.D. Tex. Dec. 4, 2009) (Mark Cuban seeking legal fees from the SEC, which sued him on behalf of investors for insider trading, for prosecutorial misconduct in its pre-suit investigation motivated by a bias against him evidenced among other actions by e-mails sent between SEC officials mocking him and repeated questioning of key witnesses in the case).

summary judgment and found the investors’ claims frivolous. The appellate court affirmed in part, reversed and rendered in part, and reversed and remanded in part.  

The TSA’s definition of a “security” includes an “investment contract.” The United States Supreme Court has construed the term “investment contract” under the federal securities laws. The Texas Supreme Court has accepted that construction for the TSA definition since the legislature took that definition from the federal securities laws. Under the Texas version, the purported investment contract must satisfy four requirements: (1) an investment of money, (2) a common enterprise, (3) an expectation of profit, and (4) a profit solely from the efforts of others. The only real question for interests in life settlements is the last element.

The question of whether Life Partners’ fraudulent scheme constitutes an investment contract has appeared in the courts before. The earliest case, with a less-than-spectacular opinion by a less than competent justice of the federal D.C. Circuit, created a distinction between pre-sale efforts and post-sale efforts, concluding that only post-sale efforts count towards the “solely from the efforts of others” element. Since the justice viewed those efforts as merely ministerial (paying premiums, ascertaining the insured location and death), there was no profit from the effort of others and so no investment contract was involved. Life Partners won a similar case in its hometown of Waco.

Since these decisions, however, the United States Supreme Court has made it clear that even investments that have a fixed return satisfy the “solely from the efforts of others” requirement and constitute securities as investment contracts. There is no reason to distinguish between promises of fixed returns and variable returns, which the pre-sale and post-sale distinction creates.
Consequently, the federal Eleventh Circuit has determined that interests in life settlements are indeed investment contracts under the federal securities laws. A staff report of the federal Securities and Exchange Commission (SEC) in 2010 indicated that by that time, most states had determined that interests in life settlements constituted securities. The TSSB has recently determined that interests in life settlements are investment contracts and are therefore securities subject to the requirements of the TSA—specifically those regarding registration of securities and sellers and avoidance of misstatements and omissions. Moreover, the TSSB through the Attorney General filed a lawsuit against Life Partners and its principals in district court in Travis County for violations of the TSA seeking injunctive relief, the appointment of a receiver over both Life Partners, Inc. and Life Partners Holdings, Inc., restitution, disgorgement, a constructive trust, and civil penalties. Consequently, the TSSB, through the


27. See LIFE SETTLEMENTS TASK FORCE, STAFF REPORT TO THE U.S. SEC (July 22, 2010), available at www.sec.gov/news/studies/2010/lifesettlements-report.pdf (last visited Nov. 23, 2014). The report indicated that by 2010 thirty-five states had amended their securities statutes to include life settlements in the definition of security (although Ky, Iowa, Me., Neb., N.J., N.C., N.D., Ohio, and Wis. exempt the sale between the policy owner to the promoter), that nine additional states (Del., La., Md., Mass., N.H., N.Y., Ore., Va., and Wash.) had found life settlements securities under an investment contract analysis, and that securities regulators in three additional states (Ala., Pa., and R.L.) had issued policy statements concluding life settlements as securities under an investment contract analysis. Id. at 36. Only Connecticut and Wyoming had made no determinations. Id. Texas was listed as divided with the Waco Appellate Court determining that life settlements were not securities, citing Griffitts v. Life Partners, Inc., 2004 WL 1178418, *2 (Tex. App.—Waco May 26, 2004, no pet.) (mem. op.), and the TSSB issuing cease and desist orders finding life settlements securities, citing In the Matter of Retirement Value, LLC, Bruce Collins and Richard “Dick” Gray, No. ENF-10-CDO-1686, 2010 WL 1267213, *9 (Tex. St. Sec. Bd. Mar. 29, 2010). Id. The staff report recommended an amendment to the federal securities laws to include life settlements in the definition of securities under the federal securities laws. Id. at 39.


Texas Attorney General, filed an amicus brief in *Arnold* to ensure a correct interpretation of the TSA.30

The Dallas Appellate Court recognized it was not bound by a decision of the Waco Appellate Court, much less by an opinion of the federal D.C. Circuit. The court noted the post-sale dependence by investors on Life Partners to track the insured’s health status, whereabouts, and death, and for premium administration and policy benefit collection, and determined that the success of the entire transaction depended on the pre-sale expertise of Life Partners. So the court decided that the Eleventh Circuit’s opinion, based on the pronouncement of the U.S. Supreme Court to broadly interpret “security” to apply to all schemes that seek to use the money of others on the promise of profits,31 and those of the several state courts were better reasoned. Such is the majority opinion of most state courts and legislatures.32 Consequently, all the efforts of Life Partners in structuring the transaction was found to have satisfied the “solely from the efforts of others” requirement.

The court then quickly dispensed Life Partners’ argument that the TSA excluded life settlements from the definition of securities as insurance policies.33 There was no evidence that Life Partners filed anything with the Department of Insurance with respect to the life settlements as required by the definitional exclusion for insurance policies.34 Moreover, the life settlement transaction was effectively the opposite of an insurance transaction. Life settlements trade increased future risk for current consumption, while insurance transactions trade current consumption for reduced future risk.

Having determined that the interests in the life settlements were securities, the court dealt with the statute of limitations. Failure to register a claim carries a three year statute of limitations, which begins running at the time of the sale.35 A “sale by misstatement” claim carries limitations of five years from the sale, and three years from the time the buyer should have discovered the misstatement.36 Unfortunately for the investors, they had plead that the interests in the life

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31. See SEC v. Mut. Benefits Corp., 408 F.3d 737, 742 (citing SEC v. Edwards, 540 U.S. 389, 393–94: Congressional intent with the definition of investment contract was provide flexibility to adapt to the various schemes fraudsters are likely to conjure).

32. See *supra* note 22 for the SEC’s report on life settlements as securities.

33. See Tex. Rev. Civ. Stat. Ann. art. 581-4(A) (West 2012) (“Provided, however, that this definition [of "security"] shall not apply to any insurance policy, endowment policy, annuity contract, optional annuity contract, or any contract or agreement in relation to and in consequence of any such policy or contract, issued by an insurance company subject to the supervision or control of the Texas Department of Insurance when the form or such policy or contract has been duly filed with the Department . . .”).

34. Another Texas Appellate Court had similarly determined that selling a life settlement did not constitute the business of insurance. See Employers Reinsurance Corp. v. Thrallkind & Co. Ins. Agency, 152 S.W.3d 595, 599 (Tex. App.—Tyler 2003, pet. denied) (interpretation of insurance contract provision, not a securities law case).

35. See Tex. Rev. Civ. Stat. Ann. art. 581-33(H)(1) (West 2012) (“(1) No person may sue under Section 33A(1) more than three years after the sale . . .”)

36. See Tex. Rev. Civ. Stat. Ann. art. 581-33(H)(2) (West 2012) (“(2) No person may sue under Section 33A(2) . . . more than three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence; or more than five years after the sale . . .”).
settlements were securities when issued under a 1977 Texas Supreme Court case, and therefore the court concluded they should have known at the time of sale of the misstatement that the interests were not securities. This incredible conclusion suggests that the district court judge in this case and the several Waco appellate judges in the Griffitts case were also grossly incompetent for failing to realize the same and that Life Partners and its lawyers behaved unethically when they filed their answer, doing so only to drive up the litigation cost of the investors. Based on the conclusion that the investors should have known interests in life settlements were securities, the court applied the three year statute of limitation. The court then affirmed summary judgment for those investments occurring before the three year period, and reversed and remanded summary judgment for those investments occurring within the three year period. With respect to the harassment charges against the investors, since they were correct on the securities issue, the court vacated the sanction order.

Although the Attorney General, as amicus curiae, obtained a favorable ruling from the Arnold court, it lost a Travis county district court case against Life Partners, now on appeal. Thus, there should shortly be another ruling on the issue of whether interests in life settlements are investment contracts—hopefully decided correctly—to shut down Life Partners’ fraud once and for all.

Because of this pending appeal from Travis County, the Texas Appellate Court in Austin will no longer be able to dodge the issue of whether life settlements are securities by virtue of being investment contracts. In Trinity Settlement Services, LLC v. Texas State Securities Board, the Austin Appellate Court did manage to dodge the issue. Trinity Settlement Services, designing to encounter the life settlement business, challenged the TSSB’s actions, noted in the SEC staff report, against another life settlement business, Retirement Value, LLC. Trinity Settlement Services sought a declaratory judgment that the TSSB’s action against Retirement Value, LLC, was without statutory authority and a declaratory judgment that interests in life settlements were not securities under the TSA. The TSSB had issued a cease and desist order against selling interests in life settlements worth $100 million to

39. See TEX. CIV. PRAC. & REM. CODE §§ 9.011 & 10.001 (West 2012) (attorney’s signing pleadings and motions certify that the pleading or motion is not brought for an improper purpose such as harassment, delay, or to increase litigation costs; TEX. R. CIV. P. 13 (attorney’s signing pleadings and motions certify to the best of the attorney’s knowledge after reasonable inquiry the instrument is not groundless, in bad faith, or brought to harass, and a court on its own motion can sanction the lawyer, the represented party, or both). Sanctions, however, require the absence of a reasonable inquiry, see Low v. Henry, 221 S.W.3d 609, 616 (Tex. 2007), and the existence of cases on both sides of the issue may preclude such sanctions.
42. See supra note 22 for the SEC’s report on life settlements as securities.
800 investors, telling each they would receive 16.5% annual returns on their investment. Retirement Value’s alleged TSA violations involved sales of unregistered securities, sales by unregistered agents, securities fraud, and making materially misleading statements. Because of the TSSB order against Retirement Value and rather than comply with the TSA, Trinity Settlement Services had ceased “its own anticipated business operations and refused any business” from potential customers. The TSSB filed a plea to the jurisdiction. The trial court granted the plea. The appellate court affirmed. With respect to the first action challenging the TSSB’s action against Retirement Value, under the Texas Administrative Procedures Act (TAPA), jurisdiction is conferred to challenge a rule of the agency, even an ad-hoc rule. But the TSSB had limited its action against Retirement Value to the specific life settlement sold by Retirement Value, and repeatedly stated in the hearing that the TSSB must analyze the specific facts of each challenged investment in interests in life settlements before making a determination as to whether the investment constituted a security. Consequently, there was no ad-hoc rule and no jurisdiction under the TAPA. With respect to the action for a declaration that interests in life settlements are not securities, under the Texas Uniform Declaratory Judgment Act (TUDJA), a party may have a declaration of its rights under a statute, but only for an actual situation, not a hypothetical or contingent situation. Since Trinity Settlement Services had yet to structure a transaction involving interests in life settlements and engage in various selling practices, there were no facts upon which to determine whether the transaction was a security. Consequently, the appellate court in Trinity Settlement Services did not need to reach the key issue of the Arnold court, whether interests in life settlements are securities.

Arnold puts Texas securities law back in the American mainstream with respect to interests in life settlements. A finding that interests in life settlements are securities will end the fraud of Life Partners, but will not stop legitimate sales of interests in life settlements. It would only require the appropriate registrations and disclosures required by the TSA, thus exposing the expense structures and track record for life settlement sellers. Life Partners and other life settlement companies.

44. See In the Matter of Ret. Value, LLC, 2010 WL 1267213, at *3.
45. See id. at *9.
46. Omitted from this article are the grounds for jurisdiction relating to a declaratory judgment that the TSSB acted without statutory authority against a non-party (Retirement Value) and that the TSSB acted ultra viresly.
47. See TEX. GOV’T CODE § 2001.038 (West 2012) (if an agency rule impairs a legal right or privilege of the plaintiff); CenterPoint Energy Entex v. R.R. Comm’n of Tex., 213 S.W.3d 364, 369 (Tex. App.—Austin 2006, pet. dismissed) (ad-hoc rules occur when the agency makes a determination against the instant party that has implications to others; made for the purpose of avoiding providing support for a formal rule).
B. NO AIDER AND ABETTOR LIABILITY IN THE ABSENCE OF A PRIMARY VIOLATOR

The ease of becoming judgment proof in Texas, with liberal exemptions from execution of judgment, makes secondary liability very important. The Texas statutes provide for several vicarious liability theories, including aiding and abetting and control person liability. Since federal securities law does not allow a private investor to recover against aiders and abettors, aiding and abetting has become a significant aspect of state securities law. One Texas appellate opinion dealt with aiding and abetting when there had been no finding of a primary violator of the TSA.

Every now and then an appellate court has to deal with a less-than-capable lawyer. Willis v. Marshall is one such case. In Willis, a promoter controlled two limited partnerships engaged in medical imaging, one as a 99% limited partner, the other as 50% owner and president of the general partner. The promoter obtained permission from two limited partners who desired to sell their interests to disclose financial information on the limited partnerships to prospective investor-buyers. The promoter hired an accounting firm to perform accounting services for the limited partnerships. Shortly, the limited partners, desiring to sell, sued the promoter for various breaches of fiduciary duty and failure to keep adequate accounting records. The promoter got the accounting firm to prepare financial scenarios for the financing and buy-out of the two limited partnerships, and to prepare two financial statements and compilation reports for several accounting periods, one set using straight-line depreciation, the other set using accelerated depreciation. Each statement and compilation report advised the reader to see the disclaimer letter addressed from the accounting firm to the partners of the two limited partnerships. The disclaimer letters warned that the accountants had not audited or reviewed the financial statements comprising the compilation and explained that the compilation was merely a presentation of information and representations of the promoter, that the promoter had elected to omit substantially all the disclosures required by generally accepted accounting practices, and that inclusion of that omitted information may influence the reader’s conclusions about the financial condition of the limited partnerships. After the selling partners sold their interests to the plaintiffs, the accounting firm continued to prepare the financial statements and compilation reports for several additional accounting periods, again with the reference to read the disclaimer letter. The new limited partners brought suit against the accounting firm for violation of the TSFA and TSA.

51. See id.
52. The investors also sued additionally for harm done to the limited partnerships after their entry, and before their entry as is typical with many fraud cases, for negligent misrepresentation, negligence, fraudulent inducement, and conspiracy. These issues are not discussed in this article other than as follows concerning the capability of the investors’ attorney. The accounting firm had filed a denial that in part the plaintiffs could not recover in the capacity they sued. See Appellee’s Brief, Willis v. Marshall, 401 S.W.3d 689 (Tex. App.—El Paso 2013, no pet.), 2011 WL 7164393, at *1. For the harm done after the investors’ entry was in the nature of a derivative action. See TEX.
The appellate court quickly dismissed the TSFA claim stating the investors’ lawyer cited no authority challenging the trial court’s conclusion. The real problem is that the TSFA applies to “a transaction in valuing real estate or stock in a corporation or joint stock company.” Since limited partnerships own personalty but not stock, TSFA does not apply. Similarly, a partner in a medical imaging limited partnership would not be considered to own stock in the partnership.

The investors’ aider and abettor claim under the TSA fared no better. Again the appellate court expressed frustration concerning the absence of authority in the documents submitted by the investors’ attorney (no citation to any provision of the TSA violated or applicability of those provisions to the acts of the accounting firm). Under the TSA provision for aider and abettor liability, the Texas appellate courts have determined four elements of the cause of action: (1) a primary violator; (2) general awareness by the aider; (3) substantial assistance by the aider; and (4) the aider intended to deceive or acted with reckless disregard for the truth. The claim for aiding and abetting requires a primary violator of the TSA. In explaining the scienter requirement for aiders and abettors, the Texas Supreme Court noted that the TSA differed from the Uniform Securities Act provision used in other states by expanding the possible aiders and abettors but requiring a more difficult scienter. With respect to the suggestion that a primary violator could escape liability because of an affirmative defense (such as buyer knowledge of the misstatement or the seller in the exercise of reasonable care could not have known of the investment), while an aider and abettor had no affirmative defenses, the Texas Supreme Court noted that the aider and abettor did have a defense, namely the defense that the primary violator was not liable since the statute only provides for aider and

BUS. ORG. CODE §§ 153.401 (West 2012) (limited partners may bring suit in the name of the limited partnership for harm done the limited partnership) & 153.403 (required effort to get the general partner to bring the action or explain reasons for not so doing). Consequently, the appellate court quickly dispatched these claims, citing an appellate court decision involving a similarly situated limited partnership. See Naustar v. Coors Brewing Co., 170 S.W.3d 242, 250–51 (Tex. App.—Dallas 2005, no pet.).

53. See TEX. BUS. & COM. CODE ANN. § 27.01(a) (West 2012).


55. See Willis, 401 S.W.3d 689.

56. See TEX. REV. CIV. STAT. ANN. art. 581-33(F)(2) (West 2012) (“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.”).


abettor liability to the same extent as if he were “the primary violator.”60 Thus, the investors in Willis needed to prove the promoter had violated the TSA. They had not joined the promoter to the action nor provided any evidence that the promoter had been found as a primary violator of the TSA.61

Willis shows the importance of background checks by service providers, including lawyers, when representing disreputable clients in business deals. Another partner in the ill-fortuned business indicated that before entering the deal in 2004 he should have checked the court records for the fraudster, which would have revealed a number of disgruntled former partners and creditors, including the former chief executive officer of Dr. Pepper.62 When the Willis fraudster declared bankruptcy, 63 the accounting firm was sued as an aider and abettor. Those fraudsters desirous of escaping through bankruptcy should remember there is a homestead exemption cap of $155,675 for violators of the securities laws.64

II. SECURITIES FRAUD DECISIONS UNDER THE FEDERAL ACTS

The fraud provisions of the TSA are modeled on the federal statutes. Therefore, in interpreting the TSA’s similar language, Texas courts look to federal decisions under the federal statutes.65 As a result, there is an interest in Fifth Circuit securities law fraud opinions. 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) “loss causation,” that is, a causal connection between the material misrepresentation and the loss.66 The last element comes from the Private Securities Litigation Reform Act (PSLRA).67 The Fifth Circuit dealt with situations involving the reliance requirement and the scienter

60. See Sterling Trust, 168 S.W.3d at 845.
61. Instead, they relied on presenting some evidence that might have led to a finding of a primary violation had the promoter been joined to the lawsuit and allowed to defend himself. See Brief of Appellant, Willis v. Marshall, 401 S.W.3d 689 (Tex. App.—El Paso 2013, no pet.), 2011 WL 4501165, *41 (promoter sold the securities by means of untrue statements and omissions of material facts).
63. See id.
64. See 11 U.S.C.A. § 522(q) (2012); see also In re Bounds, 491 B.R. 440, 444–50 (W.D. Tex. 2013) (permitting the bankruptcy trustee to sell the $500,000 homestead house and return to the debtor $136,875, the then limit, to help satisfy Fernea’s $2,289,349 judgment against debtor of violating the TSA and TSFA); Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc., 2011 WL 2769838 (Tex. App.—Austin, no pet.), appeal abated, 2011 WL 4424291 (Tex. App.—Austin, no pet.) (Ferne’s lawsuit against the bankrupt Bound’s former employer for aiding and abetting); Flint, Securities Regulation, 66, supra note 3, at 118–22 (discussing Fernea).
65. See supra notes 2–3 and accompanying text.
requirement.68 The burning issue for the Fifth Circuit, after the Supreme Court’s reversal of one of its cases,69 concerned whether an issuer can challenge “loss causation” to rebut the fraud-on-the-market theory’s rebuttable presumption of reliance at the class certification stage. The Fifth Circuit has also dealt with whether accounting irregularities made by an executive officer establish a strong inference of scienter.

A. PRICE IMPACT NOT ADMISSIBLE AT CLASS CERTIFICATION TO REBUT THE RELIANCE PRESUMPTION

Congress passed the PSLRA70 to discourage extortionate securities litigation, such as filing class action lawsuits for securities fraud whenever a significant change in the issuer’s price occurred, and abusing the discovery process to impose such burdensome costs on the issuer so as to make it more economical for the victimized issuer to settle (thereby harming its current shareholders).71 To lessen the extortionate impact of class certification and to bring the implied cause of action under Rule 10b-5 more in line with its purpose to protect investors,72 the Fifth Circuit had imposed a 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.73 To invoke the rebuttable presumption under that requirement, investors must establish (1) the perpetrator made public misrepresentations, (2) the misrepresentations were material, (3) the securities traded in an efficient market, and (4) the investor traded between the misstatement and the revealing of the truth.74

The United States Supreme Court reversed the Fifth Circuit, ruling that proof of “loss causation” is not required to obtain benefit of the presumption of reliance.75 But the Supreme Court left open the issue of whether the issuer could use “price impact” to rebut the presumption at the class certification stage.76 After a cursory remand to the district court77 and the district court’s

77. See Erica P. John Fund, 131 S. Ct. at 2187 (to the extent the issuer preserved any further arguments against class certification).
78. See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 647 F.3d 533,
certification of the class,\textsuperscript{79} the issue of rebutting the presumption at the class certification stage came back before the Fifth Circuit in \textit{Erica P. John Fund, Inc. v. Halliburton Co. (II)}.\textsuperscript{80} Since the circuit courts were split on the issue of rebutting materiality,\textsuperscript{81} the Supreme Court opined on the subject before the Fifth Circuit could act.\textsuperscript{82} The Supreme Court considered whether the issuer could use evidence the market already knew the truth because of analysts' reports and public documents to rebut the materiality element of the rebuttable presumption at class certification and determined it could not.\textsuperscript{83} The Supreme Court indicated that evidence rebutting the other elements might be admissible at the class certification stage.\textsuperscript{84} For this determination the Supreme Court set forth a two-pronged test: (1) is the rebuttable element an objective inquiry proved through evidence common to the class and (2) is there no risk that failure to prove the rebutted element will result in individual questions predominating.\textsuperscript{85} An affirmative answer to both prongs would exclude the evidence of the element at the class certification stage.

An ensuing Fifth Circuit case involved whether the issuer could use “price impact,” to rebut not one of the specific other elements of the rebuttable presumption but the presumption in toto.\textsuperscript{86} Using the Supreme Court's test, the Fifth Circuit determined that ”price impact” would be established by expert evaluation of the stock market price following a specific event (objective evidence) and would apply to everyone in the class, answering the first prong in the positive.\textsuperscript{87} With respect to the second prong, the issuer claimed that failure to prove the various elements of the rebuttable presumption would leave each member of the class with viable fraud actions based on their own reliance rather

\textsuperscript{79} See Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., 2012 W.L. 565997 (N.D. Tex. 2012) (also denying the issuer any ability to supplement the record as untimely, despite using an incorrect principle when making that record).

\textsuperscript{80} See 718 F.3d 423 (5th Cir. 2013), cert. granted 134 S. Ct. 636 (2013).

\textsuperscript{81} Compare \textit{In re Salomon Analyst Metromedia Litigation}, 544 F.3d 474, 484 (2d Cir. 2008) (“allowed to rebut the presumption prior to class certification, by showing, for example, the absence of a price impact”) and \textit{In re DVI}, Inc. Securities Litigation, 639 F.3d 623, 638 (3rd Cir. 2011) (“we believe rebuttal of the presumption of reliance falls within the ambit of issues that, if relevant, should be addressed by district courts at the class certification stage), with Schleicher v. Wendt, 618 F.3d 679, 685 (7th Cir. 2010) (“Defendants say that, before certifying a class, a court must determine whether false statements materially affected the price. But whether statements were false, or whether the effects were large enough to be called material, are questions on the merits.”) and \textit{Connecticut Retirement Plans and Trust Funds v. Amgen, Inc.}, 660 F.3d 1170, 1177 (9th Cir. 2011) (“we hold that plaintiffs need not prove materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage.”) (emphasis in original), aff'd, 133 S. Ct. 1184 (2013) (abrogating \textit{Salomon Analyst Metromedia and DVI}).


\textsuperscript{83} See id. at 1203–04; see also Brief for Petitioners, Amgen, 2012 WL 3277030, at *5–6 (describing the rebuttal evidence).

\textsuperscript{84} See \textit{Amgen}, 133 S. Ct. at 1199 (specifically mentioning market efficiency and statement publicity).

\textsuperscript{85} See id. at 1195–96 (using materiality as the subject of the evidence).

\textsuperscript{86} See Basic Inc. v. Levinson, 485 U.S. 224, 248 (1988) (“Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff . . . will be sufficient to rebut the presumption of reliance”).

\textsuperscript{87} \textit{Erica P. John Fund, Inc. v. Halliburton Co. (II)}, 718 F.3d 423, 433 (5th Cir. 2013).
than the class presumption. The Fifth Circuit disagreed. The failure to prove “price impact” also relates to the “loss causation” element of the fraud action, so each member of the class, although showing individual reliance, could not prevail on the fraud action. Consequently, the failure to prove “price impact” would not lead to individual claim dominance but a dismissal of all, and so the second prong was also answered in the positive. The proffered “price impact” evidence was thus excluded at the class certification stage.

It is ironic to allow investors claiming to rely on market price to rely on a misrepresentation that did not affect that market price. The Fifth Circuit’s problem was how to handle an evidentiary item, “price impact,” that could serve as evidence for several of the precondition items for the rebuttable presumption, such as market efficiency and materiality, and also serve as evidence of several of the elements of the fraud, such as materiality again and loss causation. How efficient is a market that does not move upon the disclosure of the truth? The United States Supreme Court had indicated only that those precondition elements that are simultaneously elements of the cause of action are ruled out—the remainder must be proved at class certification. The Fifth Circuit, however, could never divorce “price impact” from the “loss causation” foreclosed at the class certification stage by the United States Supreme Court. Consequently, the Fifth Circuit found for class certification, causing a divergence from its sister Circuit Courts and prompting another appeal of the case. Several amici curiae support the appeal, seeking abolition of the rebuttable presumption that has become no longer rebuttable and to replace it with a remedy resembling the only other aftermarket securities law remedy for

88. Id. at 434.
89. Id.
90. See id.
91. The Fifth Circuit opinion has a second part tacked on at the end as a slap at the winning investors who obtained the Supreme Court’s reversal. The investors’ claimed that the issuer waived the “price impact” evidence by not preserving it in the lower court. The United States Supreme Court’s opinion only saved the issuer’s rebuttal arguments to the extent they had been preserved. The Fifth Circuit dismissed this position since the issuer complied with the Fifth Circuit’s interpretation of the law at the time. The court refused to apply subsequent changes in the law ex post facto. See id. at 435–36.
92. See id. at 434–55.
93. See In re DVI, Inc. Securities Litigation, 639 F.3d 623, 634 (3rd Cir. 2011) (“security price is normally the most important factor in a [market] efficiency analysis”).
94. See Amgen, Inc. v. Conn. Ret. Plans and Trust Funds, 135 S. Ct. 1184, 1199 (2013), 133 S. Ct. at 1199 (must prove market efficiency and public nature of the alleged misrepresentation before the class can be certified; materiality in contrast also establishes the merits; so failure to prove market efficiency or public nature leaves open individual proof of reliance, while failure to prove materiality ends the case for the whole class).
95. See Erica P. John Fund (II), 718 F.3d at 434 (if issuer were successful on proving “price change” in rebuttal, no investor could prove “loss causation”).
96. See Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2187 (2011) (price impact is not loss causation, which is not required to be proved at class certification).
97. See DVI, Inc., 639 F.3d at 634 (price impact admissible at class certification to rebut market efficiency). In re Salomon Analyst Metromedia Litigation, 544 F.3d 474, 483–84 (price impact admissible at class certification in toto to sever the causation link of the presumption); see also Schleicher v. Wendt, 618 F.3d 679, 683 (price impact not admissible to rebut materiality).
fraud—fraud in documents filed with the SEC, which statutorily requires a showing of individual reliance. 99 State courts generally have not adopted the presumption. 100

B. ROGUE OFFICER’S DISREGARD OF ACCOUNTING POLICIES DOES NOT ESTABLISH A STRONG INFERENCE OF SCIENTER

The PSLRA also requires that investors’ petition recite facts giving a strong inference of scienter. 101 In the Fifth Circuit, scienter requires an intent to defraud or either severe recklessness while knowing of the danger to investors or action despite danger so obvious the officer must have been aware of the danger. 102 Moreover, the Fifth Circuit has rejected the group pleading doctrine, so the scienter must be of a specific issuer officer, it may not be implied from prospectuses, registration statements, and press releases. 103

In  Pipefitters Local No. 636 Defined Benefit Plan v. Zale Corporation 104 the Fifth Circuit faced overbearing class action investors, for which Congress designed the PSLRA, trying to recoup some of their 2008 stock crash losses by demanding money from Zale Corporation, which had the misfortune of discovering and revealing, as required by the securities laws, 105 an accounting irregularity in September 2009 involving over $40 million. 106 The revelation triggered an SEC investigation, 107 and this fraud class action lawsuit. 108

99. See Brief for Former SEC Commissioners and Officials and Law Professors as Amici Curiae in Support of Petitioners, Erica P. John Fund (II), 718 F.3d 423 (5th Cir. 2013), 2013 WL 5652547, *9–19 (investors should have to prove actual reliance as in section 18(a) of the Securities Exchange Act of 1934; where “in reliance upon” the falsity must be shown, these cases are the most analogous statutory action) and *19–22 (overrule the presumption since it is effectively irrebuttable); see also Brief for Chamber of Commerce For the United States of America & National Association of Manufacturers as Amici Curiae, Erica P. John Fund (II), 718 F.3d 423 (5th Cir. 2013), 2013 WL 5652546, *20 –24 (to resolve circuit split); Brief for DRI-The Voice of the Defense Bar as Amicus Curiae in Support of Petitioners, Erica P. John Fund (II), 718 F.3d 423 (5th Cir. 2013), 2013 WL 5652548.


101. See 15 U.S.C. § 78u-4(b)(2) (2012) (“the complaint shall . . . state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind”).


103. See Southland, 365 F.3d at 366.


105. See 17 C.F.R. § 249.308, item 4,02 (non-reliance on previously issued financial statements).

106. See Zale Corporation, Form 8-K (Sept. 18, 2009), at 1–2, available at http://www.sec.gov/Archives/edgar/data/109156/00011046590905266/0001104659-09-055266.txt (last visited Nov. 16, 2014) (issuer to restate 2007 and 2008 financial statement and 2009 interim financial statements to reflect significant portions of prepaid advertising costs that should have been expensed totaling $23 million in 2008 and $18 million in 2007. Zale Corporation stock generally was priced around $30, rose to $43 before the 2008 crash, dropped to $1 and recovered to about $8 at the time of the adverse disclosure. See www.stockcharts.com for historical stock price information (last visited Nov. 23, 2014).

There is not much of an incentive to correct erroneous financial statements when such action triggers an extortive class action lawsuit. Through the Sarbanes-Oxley Act of 2002 (SO), Congress amended the securities laws to require the SEC to make rules for real time disclosure on a rapid and current basis of material changes in financial condition or operations. In response to the Congressional directive, the SEC made revisions to its Form 8-K, the form the SEC specified for reporting these material financial changes, to add numerous triggering events mandating public disclosure. The revised Form 8-K lists as triggering events, among others, creation of a material direct financial obligation, events that accelerate or increase direct financial obligations, material charges for impairment to the corporation’s assets (if determined by certain specified directors and officers), and non-reliance on previously issued financial statements due to an error in such financial statements (if determined by certain specified directors and officers). The Form 8-K must be filed within four business days of the triggering event. Fortunately, envious and greedy class action investors must plead a strong inference of scienter, which should be absent in the simple mistake situation.

The crux of the matter for Pipefitters Local No. 636 Defined Benefit Plan involved a Vice President of marketing, who caused the issuer between 2004 and 2009 to record certain television advertising costs as prepaid advertising (an asset) when those costs should have been expensed in the periods in which they occurred (reducing income) contrary to the issuer’s policy and generally accepted accounting principles (GAAP). The SEC’s action against the (by that time) former vice president resulted in a $25,000 civil fine, not for fraud, but for failure to make and keep records fairly reflecting the transactions and for failure to maintain accounting controls to permit preparation of financial statements in accordance with management’s policies and GAAP.

111. See 17 C.F.R. § 249.308, items 2.03 (creation of financial obligations), 2.04 (acceleration or increase in financial obligation), 2.06 (material impairments), & 4.02 (2013) (non-reliance on previously issued financial statements).
113. See Rains, 2011 WL 3331213, *4 (N.D. Tex.) (determining whether the scienter of Higgins, an executive in the marketing department, was strong enough to meet the pleading standards, and whether Higgins’s scienter could be imputed onto Zale and the liability of the individual defendant). Higgins was not an executive officer; someone else served as Executive Vice President, Marketing and E-Commerce. See Zale Corporation, Form 10-K (Oct. 29, 2009), supra note 92, at 31 (Richard Lennox, Executive Vice President, Chief of Marketing and E-Commerce since August 2009); Zale Corporation, Form 10-K (Sept. 26, 2008), at 12, available at www.sec.gov/Archives/edgar/data/109156/000104746908010329/a2187916e10-k.htm (last visited Nov. 23, 2014) (Steven Larkin, Executive Vice President, Marketing and E-Commerce since 2006).
The complaint in the fraud lawsuit directed at the issuer and several of its chief officers needed to allege facts indicating a strong inference of scienter. The only facts offered by the investors dealt with two items: public pronouncements during the class period of a focus on expense reduction and commitment to financial rigor and SO certifications that the financial reports were accurate. For the investors, this meant the officers were paying close attention to expenses and must have noticed the vice president’s misreporting and ignored it. The Fifth Circuit found that the public pronouncements and SO certifications in no way indicated the officers knew the information was inaccurate or ignored evidence of its falsity. Secondly, the investors argued that the scienter of the vice president should be imputed to the other officers. The Fifth Circuit, noting that the vice president was a non-accountant, unlikely to know the implications of her efforts to make her division look good, refused to consider as “seriously reckless” the reliance of the chief officers on the vice president to provide accurate information and follow the issuer’s accounting policies. Thirdly, to the investors, the after-the-fact corrective disclosures constituted admissions. The Fifth Circuit pointed out that the corrective disclosures in no way relate to the officers’ scienter at the time of the preparation of the misleading financial statements.

In *Pipefitters Local No. 636 Defined Benefit Plan*, the Fifth Circuit fortuitously stopped the investors’ from fouling up the SO mandated rapid disclosure system for accounting errors. But before anyone concludes the Fifth Circuit favors rapid disclosure to the investing public concerning false accounting, that person should examine *Kopp v. Klein*. That opinion involves an eligible individual account plan (EIAP) under the Employee Retirement Income Security Act of 1974 (ERISA). EIAPs permit plan participants of public employers to invest their retirement moneys in their employer’s stock. A problem arises when the employer’s stock will decline if management corrects the false financial statements. The issue is when the plan trustees, as a part of management, must urge those responsible to make the disclosure while continuing to allow plan participants to direct the trustees to purchase and sell company stock. The Fifth Circuit continues to follow the pre-SO Moench rule and its misinterpretation.

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117. See id.
118. See id.
119. See id.
120. See *Kopp v. Klein*, 722 F.3d 327 (5th Cir. 2013).
122. See 29 U.S.C. §§ 1107(d)(3) (defining EIAP as a type of individual account plan that has a provision for the acquisition and holding of employer securities) & 1107(d)(6) (2006) (defining ESOP as designed to invest “primarily” in employer securities; see also 29 U.S.C. §§ 1002(34) (2006) (defining an individual account plan as a pension plan) & 1002(2) (defining pension plan as providing retirement benefits or deferral of income until termination of service or beyond).
123. See Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995) (creating a rebuttable presumption that plan administrators acted properly), cert. den. 516 U.S. 1115 (1996), adopted in, Kirschbaum v. Reliant Energy, 526 F.3d 243, 254 (5th Cir. 2008) (J. Jones: EIAP with option to invest in employer stock). The author served with Edith Jones on the Texas Law Review in 1974–75. As with the fraud-on-the-market rebuttable presumption, the Moench presumption is virtually irrebuttable. See *Kopp*, 722 F.3d at 341 (mentioning the horrific stock drops that have failed to
of ERISA, in conflict with post-SO securities law, permitting abstention of trading, but neglecting the alternative of disclosure. The Fifth Circuit specifically rejected the disclosure option for the Kopp participants, because it would cause the stock price to drop. But post-SO securities law fosters the Congressional desire for disclosure by the issuance of the corrective financial statements for the investing public. One of the items slated for rapid disclosure is the Fifth Circuit’s approved suspension of trading in EIAPs of employers with faulty financial statements. Once the disclosure occurs further damage to investors, including plan participants, will cease. In its eagerness to protect insider trading, the Fifth Circuit refused to consider whether the EIAP trustees’ actions constituted securities law violations. That, of course, is the key issue in the case. Whatever ERISA’s fiduciary duty of prudence means, certainly it includes obeying the law, including securities law, as do all prudent persons.

III. CONCLUSION

The securities law opinions under Texas law during this Survey periods can be divided into two groups. The first grouping deals with the scope of the TSA. Two Texas appellate courts dealt with interests in life settlements, one dodging the issue as not involving an actual controversy under the TUDJA, the other, rebut the presumption).


125. See S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968); In the Matter of Cady, Roberts & Co., 40 S.E.C. 907 (insider failure to disclose material nonpublic information when trading constitutes a violation of the anti-fraud provisions; if disclosure unrealistic, the alternative is to forego the transaction). The Supreme Court has recognized this duty on the part of insiders to abstain or disclose. See United States v. O'Hagan, 521 U.S. 642, 661 (1997) (“duty to disclose or abstain from trading ‘arises from a specific relationship between two parties’”).

126. See Kopp, 722 F.3d at 339–40.

127. The disclosure operates as follows. Under ERISA, the plan administrator must provide notice to (1) the employees (see 29 U.S.C. § 1021(h)(2)(B) (2006) (notice to participants)); 29 C.F.R. § 2520.104-1(b)(same), (2) the employer (see 29 U.S.C. § 1021(h)(2)(E) (2006) (notice to issuer)); 29 C.F.R. § 2520.101-3(c)(same); and (3) the SEC. See 15 U.S.C. § 7244(a)(6) (2006) (timely notice to SEC); 17 C.F.R. § 249.308, item 5.04 (2013) (blackout periods for self-directed EIAPs). The Kopp fraudsters evaded this mandated disclosure by making their “suspension” permanent. See Kopp, 722 F.3d at 332; Edgar filings for Idearc, Inc. (no Form 8-K relating to the suspension under the post-bankruptcy name Supermedia, Inc.), available under Westlaw’s SEC’s Edgar filings. The Department of Labor’s “blackout” rules apply only to temporary suspensions, not permanent ones. See Final Rule Relating to Notice of Blackout Periods to Participants and Beneficiaries; Civil Penalties and Conforming Technical Changes on Civil Penalties Under ERISA; Final Rules, 68 Fed. Reg. 16,372, 16,3722 (Jan. 24, 2003) (to be codified at 29 C.F.R. pts. 2520 et al.) (blackout periods do not include permanent elimination such as a permanent restriction on new contributions to an investment option, replacement of one investment option with another of a similar type, or termination of the plan since these restrictions are not temporary (as required by the statute) unless some right is temporarily suspended, such as when replacing option A with option B, there is a restriction on option B while transferring funds from option A to option B).

128. See Kopp, 722 F.3d at 340 n.8.

129. See id. at 333 (whether the actions breach ERISA’s fiduciary duties).


joining the American trend in finding these investments securities since they are investment contracts. The TSSB had previously so determined, and has an adverse decision on appeal to the same appellate court that earlier dodged the issue. With respect to aiding and abetting, another Texas appellate court determined that a service provider compiling accounting information for a fraudster does not incur liability for aiding and abetting when the investor fails to provide evidence or obtain a finding that the fraudster committed a violation of the TSA.

The Fifth Circuit had two securities fraud class action cases of note. In the first, the Fifth Circuit continued to wrestle with the application of pricing evidence at the class certification stage. Having imposed a “loss causation” requirement at the class certification stage before, and having had the United States Supreme Court overrule any such requirement, the Fifth Circuit attempted to apply the Supreme Court’s new test, devised for another circuit’s misuse of pricing information to disprove materiality, and found pricing evidence inadmissible at the class certification stage. This has prompted another appeal since it differs from the procedure of two other circuit courts. In the second case, the Fifth Circuit protected an issuer issuing corrective financial statements in accordance with SO after a series of misstatements were caused by a rogue employee, who provided management with inaccurate accounting records contrary to company policies in an attempt to bolster her division’s performance. The investors did not plead a substantial inference of scienter. Pre-correction strict accounting pronouncements did not mean management knew of the employee’s accounting inaccuracies; the employee’s scienter would not be imputed to management since they had a right to believe underlings would follow the issuer’s policies and GAAP; and the corrective statements did not amount to admissions that management earlier knew of the accounting misstatements.

133. See Willis v. Marshall, 401 S.W.3d 689 (Tex. App.—El Paso 2013, no pet.).
135. See id.
137. See id. at 350.