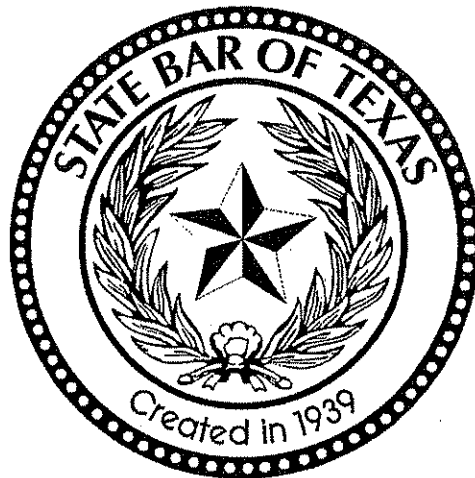


Causes of Action

A CLE course featuring the respected reference work,
O'Connor's Texas Causes of Action 2006



March 30-31, 2006 - *Irving*
April 6-7, 2006 - *Houston*

OVERVIEW OF TEXAS SECURITIES FRAUD

1. Overview of Possible Claims

- A. Common law
 - 1. Common-law fraud
 - 2. Negligent misrepresentation
- B. Statutory Causes of Action
 - 1. Tex. Bus & Com. Code §27.01 (Statutory Fraud)
 - 2. Texas Securities Act
 - 3. Federal Causes of Action

2. Scope of Outline

- A. Federal Causes of Action are not included
 - 1. Federal pleading requirements under 1995 reforms are onerous
 - 2. Federal elements have higher standard of proof
- B. Texas Statutory Causes of Action Included
 - 1. Statutory Fraud
 - 2. Texas Securities Act

3. Texas Statutory Fraud

- A. Two types of fraud recognized under §27.01
 - 1. Misrepresentation
 - 2. False promise
- B. Misrepresentation
 - 1. False representation of past or existing material fact
 - 2. Made to a person for the purpose of inducing that person to enter into a contract
 - 3. Relied upon by that person when entering into a contract
- C. False Promise
 - 1. False promise is material
 - 2. Made with the intention of not fulfilling it
 - 3. Made to a person for the purpose of inducing that person to enter into a contract
 - 4. Relied upon by that person when entering into a contract
- D. Scienter or Intent to Deceive
 - 1. Plaintiff does NOT have to prove that defendant knew of the falsity at the time the statement was made
 - 2. If the plaintiff can prove that defendant had actual awareness of the falsity, then plaintiff may seek exemplary damages. Plaintiff must show that the defendant:
 - 3. A plaintiff can also establish liability if the plaintiff can prove that a person:
 - a. has actual awareness of the falsity of a representation or promise made by another person, and
 - b. fails to disclose the falsity of the representation or promise to the person defrauded, and
 - c. benefits from the false representation or promise
- E. Reliance
 - 1. Plaintiff must prove actual reliance, and

2. Justifiable reliance
 - a. sophistication of buyer is considered in the analysis of justifiable reliance
 - b. buyer is not required to investigate representations made by seller
- F. Damages
 1. Actual damages
 2. Costs including: attorney fees, expert witness fees, costs for copies of depositions, and costs of court
 3. Exemplary damages only if scienter is proved (see above)
4. **Texas Securities Act**
 - A. Parties
 1. Plaintiffs
 - a. a buyer who acquires a security for value, or
 - b. a seller who has been defrauded by a buyer
 2. Defendants
 - a. a person who offers or sells a security
 - b. an issuer
 - c. control persons
 - i. a person who has the power to control the corporation's operations generally and the power to control the transaction in question
 - ii. may include major shareholders or directors
 - B. Elements of Liability
 1. A person must sell or offer a security
 - a. offer or sale is defined as "every disposition or attempt to dispose of a security for value"
 - b. "sell" means any act by which a sale is made, including a solicitation to sell, an offer to sell, or an attempt to sell
 - c. the term security is broadly defined as a stock, bond, debenture, investment contract, any form of commercial paper, any instrument representing any interest in oil, gas or mining lease, and many other types of interests *See Tex. Rev. Civ. Stat. art. 581-4 (A)*
 2. The sale or offer must involve an untruth or an omission of material fact
 - a. the untruth or omission must be made prior to the investment decision
 - b. statements of opinion do not create liability. (For example, the statement that an oil well investment was "low risk" was held to be an opinion. *Paull v. Capital Resource Management Inc.*, 987 S.W.2d 214 (Tex. App.—Austin 1999, pet. denied). Statement that yogurt franchise was a good opportunity for profit held not to be false because it was possible. *Crescendo Investments v. Brice*, 61 S.W.3d 465 (Tex. App.—San Antonio 2001, review denied)
 - C. Elements not Required
 1. Texas statute does not require reliance
 2. Texas statute does not require that plaintiff used due diligence
 3. Texas statute does not require plaintiff to prove scienter. *See Busse v. Pacific Cattle Feeding Fund*, 895 S.W.2d 807 (Tex. App.—Texarkana 1995, writ denied)
 - D. Defenses
 1. Plaintiff's knowledge

- a. if plaintiff knows that statement made is false before the investment decision, then defendant will not be liable
 - b. Plaintiff is not required to use due diligence or care to determine the truth of statements before the investment decision
2. Defendant's reasonable care
 - a. if the defendant can show that he did not know of the falsity, and
 - b. in the exercise of reasonable care could not have known of the untruth or omission, then the defendant will not be liable. Tex. R. Civ. Stat. 581-33 (A)(2)
 - c. some of the factors in determining reasonable care:
 - the relationship of the parties
 - the parties' respective knowledge of information about the security
 - the parties' relative sophistication and access to such information
 - the parties' respective expectations of benefit from the transaction
 - whether the untruth or omission was in a document prepared for use in the purchase or sale of the security. See comments to the statute for other factors.
 3. Waiver is NOT a permissible defense
 - a. the statute explicitly says waivers are void. Tex. Rev. Civ. Stat. 581-33 (L)
 - b. this does not mean that a subsequent release as a part of a settlement would be invalid
- E. Aider and Abettor Liability
1. A person who directly or indirectly controls a seller or issuer of a security is liable jointly and severally with the seller or issuer to the same extent as if he/she were the seller or issuer. The reasonable care defense is available to a person who directly or indirectly controls a seller or issuer.
 2. A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or law materially aids a seller or issuer of a security is liable jointly and severally with the seller or issuer and to the same extent as if he were the seller or issuer.
 3. Recent decision by Texas Supreme Court makes it clear that an aider must have rendered assistance in the face of a perceived risk that its assistance would facilitate untruthful or illegal activity by the primary violator. See *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835 (Tex. 2005)
- F. Statute of Limitations
1. General rule is three years
 2. Exception: If plaintiff served defendant with an offer of rescission that meets the provisions of Tex. R. Civ. Stat. 581-33(I), and defendant rejected the offer, the limitations is one year after the rejection.
- G. Damages
1. Rescission: A buyer may recover the consideration paid plus interest minus any income received on the security.
 2. Damages: A buyer may recover the consideration paid plus interest less the greater of
 - a. the value of the security at the time the buyer sold it plus any income received on the security, or
 - b. the actual consideration received for the security at the time the buyer sold it plus any income received on the security.

3. **Costs and Attorney Fees:** Whether suing for recession or damages, a plaintiff may recover costs, and reasonable attorneys fees provided the court finds that equity justifies recovery of attorney fees.