

**PJC 105.12      Question and Instruction on Violation of Texas Securities Act—Factual Misrepresentation**

QUESTION \_\_\_\_\_

Did *Don Davis* commit a securities law violation against *Paul Payne*?

A securities law violation occurred if—

1. *Don Davis* [sold or offered to sell/bought or offered to buy] a security by means of either—
  - a. an untrue statement of a material fact; or
  - b. an omission to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and
2. *Paul Payne* [purchased the security from/sold the security to] him; and
3. *Paul Payne* suffered injury.

A fact is “material” if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to [purchase/sell] a security, because it would significantly alter the total mix of information made available.

**COMMENT**

**When to use.** PJC 105.12 is based on Tex. Rev. Civ. Stat. art. 581–33A(2), –33B, which applies only to fraud in a transaction involving the sale or purchase of a security.

In a case involving an alleged registration violation of Tex. Rev. Civ. Stat. art. 581–33A(1) or –33C, parts a. and b. of this instruction should be modified as necessary to reflect the statutory elements of such a violation.

**Source of instruction.** The elements of the claim are derived from Tex. Rev. Civ. Stat. art. 581–33A(2), –33B; *Duperier v. Texas State Bank*, 28 S.W.3d 740, 745–46 (Tex. App.—Corpus Christi 2000, pet. dismiss’d by agr.); and *Anderson v. Vinson Exploration, Inc.*, 832 S.W.2d 657, 661–62 (Tex. App.—El Paso 1992, writ denied). Regarding the definition of “material,” see *Duperier*, 28 S.W.3d at 745, and *Weatherly v. Deloitte & Touche*, 905 S.W.2d 642, 649–50 (Tex. App.—Houston [14th Dist.] 1995, writ dismiss’d w.o.j.), abrogated by *Tracker Marine, L.P. v. Ogle*, 108 S.W.3d 349, 351–52 (Tex. App.—Houston [14th Dist.] 2003, no pet.), and compare *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). As to the requirement of privity between buyer and seller, see *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 383 (Tex. App.—Houston [14th Dist.] 2000, pet. denied), and *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 258 F. Supp. 2d 576, 602–07 (S.D. Tex. 2003). Regarding the injury

requirement in rescission cases, see *Adickes v. Andreoli*, 600 S.W.2d 939, 946 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ *dism'd*).

**Sells or offers to sell.** The Texas Securities Act broadly defines “sell,” as well as “sale” and “offer for sale,” in Tex. Rev. Civ. Stat. art. 581–4(E). See *In re Enron Corp.*, 258 F. Supp. 2d at 603–04. If there is a dispute about whether a sale occurred or an offer was made, additional instructions may be necessary.

If the person who allegedly committed fraud sold the security, then “sells or offers to sell” should be used in part a of this instruction, and “purchases the security from” should be used in part b. If the person who allegedly committed fraud bought the security, then “buys or offers to buy” should be used in part a, and “sells the security to” should be used in part b. The italicized word *him* in part b may be replaced with *her* or *it* depending on the defendant that allegedly committed fraud.

**Person.** The Texas Securities Act broadly defines “person” to “include a corporation, person, joint stock company, partnership, limited partnership, association, company, firm, syndicate, trust, incorporated or unincorporated,” as well as “a government, or a political subdivision or agency thereof.” Tex. Rev. Civ. Stat. art. 581–4(B). When necessary for clarity in a particular case, one of these terms may be substituted for “person” or “the other person” in the violation instruction. Similarly, the italicized word *him* in part b of the instruction may be replaced with *her* or *it* as necessary.

**Security.** The Texas Securities Act defines the term “security” or “securities” to include—

any limited partner interest in a limited partnership, share, stock, treasury stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not.

The term applies “regardless of whether the ‘security’ or ‘securities’ are evidenced by a written instrument.” The definition of “security” does 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 similar policy or contract, issued by an insurance company subject to the supervision or control of the Texas Department of Insurance, when the form of the policy or contract has been duly filed with the Department as required by law. Tex. Rev. Civ. Stat. art. 581–4(A).

Whether something constitutes a “security” under the Texas Securities Act will usually be a question of law for the court. *See Grotjohn Precise Connexiones Int’l, S.A. v. JEM Financial, Inc.*, 12 S.W.3d 859, 868 (Tex. App.—Texarkana 2000, no pet.); *Campbell v. C.D. Payne & Geldermann Securities, Inc.*, 894 S.W.2d 411, 417–18 (Tex. App.—Amarillo 1995, writ. denied). However, in some cases there may be predicate factual disputes for the jury to resolve regarding whether something is a security under the TSA. For example, the TSA lists an “investment contract” as a security, but the definition of “investment contract” includes multiple elements that may raise a factual dispute. *See Anderson*, 832 S.W.2d at 662.

**Damages.** PJC 115.19, which addresses direct damages in fraud cases, may be modified to submit damages resulting from a securities law violation. The *comment* to PJC 115.19 explains the necessary modifications and also addresses the remedy of rescission.

**PJC 105.13      Instruction on Violation of Texas Securities Act—Material Fact—Prediction or Statement of Belief**

A [prediction/projection/other statement of belief] in connection with the sale of a security is an untrue statement of a material fact when it is material and—

- a. the speaker did not genuinely believe the statement was accurate, or
- b. there was no reasonable basis for the speaker’s belief that the statement was accurate, or
- c. the speaker was aware of any undisclosed facts that would tend to seriously undermine the accuracy of the statement.

**COMMENT**

**When to use.** This instruction should be used with PJC 105.12 in cases in which a person offers or sells a security by means of an alleged untrue statement rather than by an omission and the statement implies, rather than states, factual assertions such as projections, predictions, opinions, or beliefs. “[A] pure expression of opinion will not support an action for [securities] fraud.” *Transport Insurance Co. v. Faircloth*, 898 S.W.2d 269, 276 (Tex. 1995); *see also In re Westcap Enterprises*, 230 F.3d 717, 728 (5th Cir. 2000) (“[The buyer knew the seller’s] expression of opinion or prediction was based on unpredictable interest rate changes, or in other words, was just a best guess.”); *Texas Capital Securities, Inc. v. Sandefer*, 58 S.W.3d 760, 776 (Tex. App.—Houston [1st Dist] 2001, pet. denied) (“[P]uffing or dealer’s talk . . . do not amount to actionable misrepresentation.”); *Paull v. Capital Resource Management, Inc.*, 987 S.W.2d 214, 218 (Tex. App.—Austin 1999, pet. denied) (explaining that “[statements] of opinion, including opinion regarding value,” are generally not actionable under the Act). “Whether a statement is an actionable statement of ‘fact’ or merely one of ‘opinion’ often depends on the circumstances in which the statement is made. Among the relevant circumstances are the statement’s specificity, the speaker’s knowledge, the comparative levels of the speaker’s and the hearer’s knowledge, and whether the statement relates to the present or to the future.” *In re Westcap Enterprises*, 230 F.3d at 726 (quoting *Faircloth*, 898 S.W.2d at 276 (involving a common-law fraud claim)). However, predictions and statements of belief may be actionable if they are made with knowledge of their inaccuracy or falseness. *See Paull*, 987 S.W.2d at 219; *cf. Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1090–94 (1991).

The statement may be oral or written, and the use of the term “speaker” in the instruction is not intended to limit this instruction to oral communications.

**Source of instruction.** PJC 105.13 is based on *Duperier v. Texas State Bank*, 28 S.W.3d 740, 745–46 (Tex. App.—Corpus Christi 2000, pet. dism’d by agr.). For a

similar analysis, see *Paull*, 987 S.W.2d at 220 (citing *Rubinstein v. Collins*, 20 F.3d 160, 166 (5th Cir. 1994)).

**PJC 105.14      Question and Instruction on Defenses to Violation of Texas Securities Act—Factual Misrepresentation**

If you answered “Yes” to Question \_\_ [105.12], then answer the following question. Otherwise, do not answer the following question.

QUESTION \_\_

Do you find that *Paul Payne* knew, by the time of the [purchase/sale], of the untruth or omission found by you in your answer to Question \_\_ [105.12]?

Answer: \_\_\_\_\_

**COMMENT**

**When to use.** PJC 105.14 submits one of the two affirmative defenses to liability for a securities violation. *See* Tex. Rev. Civ. Stat. art. 581–33A(2), –33B. PJC 105.15 submits the other defense. An affirmative answer to either question is a defense to liability.

**PJC 105.15      Question and Instruction on Defenses to Violation of Texas Securities Act—Buyer**

If you answered “Yes” to Question \_\_ [105.12], then answer the following question. Otherwise, do not answer the following question.

QUESTION \_\_

Do you find that *Don Davis* did not know, and in the exercise of reasonable care could not have known, of the untruth or omission found by you in your answer to Question \_\_ [105.12]?

Answer: \_\_\_\_\_

**COMMENT**

**When to use.** PJC 105.15 submits one of the two affirmative defenses to liability for a securities violation. *See* Tex. Rev. Civ. Stat. art. 581–33A(2), –33B. PJC 105.14 submits the other defense. An affirmative answer to either question is a defense to liability.

To determine whether an issuer is entitled to this defense, see Tex. Rev. Civ. Stat. art. 581–33A(2), –33C and comments.

## **PJC 105.16      Violation of Texas Securities Act—Control Person Liability (Comment)**

**When to use.** A question with appropriate instructions should be submitted when “control person” liability is alleged under Tex. Rev. Civ. Stat. art. 581–33F, which imposes liability on persons who control a seller, buyer, or issuer of a security who commits a securities violation as defined by the Texas Securities Act. The trial court must condition the submission of such questions on a finding of a securities violation by the primary buyer, seller, or issuer.

**Definition of “control person.”** The Committee believes that “control person” should be defined. However, because of uncertainty in the law regarding the requirements for “control person” status, the Committee expresses no opinion about the proper definition.

Under the Texas Securities Act—

A person who directly or indirectly controls 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, unless the controlling person sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

Tex. Rev. Civ. Stat. art. 581–33F(1).

The Act does not provide a definition of “control.” However, the comments to the statute provide that, “[d]epending on the circumstances, a control person might include an employer, an officer or director, a large shareholder, a parent company, and a management company.” Tex. Rev. Civ. Stat. art. 581–33F cmt. *See Busse v. Pacific Cattle Feeding Fund No.1, Ltd.*, 896 S.W.2d 807, 815 (Tex. App.—Texarkana 1995, writ denied) (“Major shareholders . . . and directors . . . are control persons.”); *Texas Capital Securities Management, Inc. v. Sandefer*, 80 S.W.3d 260, 268 n.3 (Tex. App.—Texarkana 2002, pet. struck) (“Although in [*Busse*] we found Busse, who was a majority shareholder and a director, to be a control person, we do not construe this case to mean evidence solely of status creates a prima facie showing of control person.”).

The comments also provide that “[c]ontrol is used in the same broad sense as in federal securities law,” Tex. Rev. Civ. Stat. art. 581–33F cmt., and the Texas Supreme Court has recognized that the legislature “intended the [Texas Securities Act] to be interpreted in harmony with federal securities law.” *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835, 840–41 (Tex. 2005). Accordingly, some Texas courts of appeals cite to the definition of “control” found in the federal securities laws, under which control “means the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract, or otherwise.” *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 384 (Tex. App.—Houston [14th Dist.] 2000, pet. denied); *Barnes v. SWS Financial*

*Services, Inc.*, 97 S.W.3d 759, 763 (Tex. App.—Dallas 2003, no pet.). See 17 C.F.R. § 230.405.

In analyzing control person liability, Texas courts of appeals have articulated different tests. Some courts apply a two-prong test requiring proof that the defendant (1) exercised control over the operations of the corporation in general and (2) had the power to control the specific transaction or activity on which the primary violation is predicated. See *Frank*, 11 S.W.3d at 384 (citing *Abbott v. Equity Group Inc.*, 2 F.3d 613, 620 (5th Cir. 1993)); see also *Hagerty Partners Partnership v. Livingston*, 128 S.W.3d 416, 421 (Tex. App.—Dallas 2004, pet. denied); *Barnes*, 97 S.W.3d at 764. The Texarkana court of appeals requires a showing that the defendant (1) had actual power or influence over the controlled person and (2) induced or participated in the alleged violation. *Sandefur*, 80 S.W.3d at 268 (relying on *Dennis v. General Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990)). But see *Abbott*, 2 F.3d at 620 n.18 (“We note that *Dennis* does not accurately reflect our rejection in [*G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 957–58 (5th Cir. 1981)] of a ‘culpable participation’ requirement. . . . We need not resolve this inconsistency, because our holding turns on [plaintiffs’] failure to establish [defendants’] power to control [controlled person].”). See also Bromberg & Lowenfels, 4 *Securities Fraud & Commodities Fraud* § 7:340 (2008) (discussing additional differences among the federal circuit courts of appeals regarding the proper test for control person liability under the federal securities laws).

**Parties.** It is unnecessary to join the seller, buyer, or issuer as a party to a suit against alleged control persons as long as the evidence shows the defendant’s control over the seller, buyer, or issuer and a violation of the Texas Securities Act by the seller, buyer, or issuer. *Summers v. WellTech, Inc.*, 935 S.W.2d 228, 231 (Tex. App.—Houston [1st Dist.] 1996, no writ). If the seller, buyer, or issuer is not a party to the suit, a predicate jury question (such as PJC 105.1 used with PJC 105.12A) is still required if the material facts are disputed as to the seller’s, buyer’s, or issuer’s violation of the Act. If the seller’s, buyer’s, or issuer’s violation is undisputed, the jury should be instructed about the violation and part b should be modified to focus on the undisputed violation. In such a case, no predicate to 105.12D is required.

## **PJC 105.17      Question on Defense to Control Person Liability**

If you answered “Yes” to Question \_\_\_\_\_ [105.12], then answer the following question. Otherwise, do not answer the following question.

QUESTION \_\_\_\_\_

Do you find that *Deborah Dennis* did not know, and in the exercise of reasonable care could not have known, of the existence of the facts that you found to be a violation in Question [105.12] \_\_?

Answer: \_\_\_\_\_

### **COMMENT**

**When to use.** PJC 105.17 may accompany a question regarding control person liability (see PJC 105.16) if the defendant raises the defense that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the primary actor’s liability is alleged to exist. Tex. Rev. Civ. Stat. art 581–33F(1).

**Source of instruction.** PJC 105.17 is based on Tex. Rev. Civ. Stat. art 581–33F(1).

**Damages.** PJC 115.19, which addresses direct damages in fraud cases, may be **modified** to submit damages resulting from a securities law violation. The comment to PJC 115.19 explains the necessary modifications and also addresses the remedy of rescission.

**PJC 105.18      Question and Instruction on Violation of Texas Securities Act—Aiding Violation**

If you answered “Yes” to Question \_\_\_\_\_ [105.12], then answer the following question. Otherwise do not answer the following question.

QUESTION \_\_\_\_\_

Did *Deborah Dennis* materially aid *Don Davis* in committing the securities law violation that you found in Question \_\_?

*Deborah Dennis* materially aided a securities law violation if she—

- a. directly or indirectly,
- b. with an intent to deceive or defraud or with a reckless disregard for the truth or the law,
- c. materially assisted *Don Davis* in committing a securities law violation.

*Deborah Dennis* acted with a “reckless disregard for the truth or the law” if she provided material assistance to *Don Davis* with a general awareness that her assistance would facilitate his untruthful or illegal activity.

Answer: \_\_\_\_\_

**COMMENT**

**When to use.** PJC 105.18 is based on Tex. Rev. Civ. Stat. art. 581~~–~~33F(2), which imposes liability on persons who aid or abet a seller, buyer, or issuer of a security who commits fraud as defined by the Texas Securities Act. The trial court must condition the submission of PJC 105.17 on a finding of a securities violation by the primary seller, buyer, or issuer.

**Source of instruction.** For the elements of the claim, see Tex. Rev. Civ. Stat. art. 581–33F(2). Regarding the definition of “reckless disregard,” see *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835, 842 (Tex. 2005).