Securities Liability for Transactional Lawyers under Oregon's Blue Sky Law, ORS 59.115

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I. Why should I care as a transactional lawyer?

Oregon courts hold that a lawyer preparing documents in a transaction with investors may be liable for participating in or material aiding the unlawful sale of securities to those investors. *Prince v. Brydon*, 307 Or. 146, 764 P.2d 1370 (1988).

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- Here's the kicker: the investors do not need to prove the lawyer knew about the unlawful conduct:

  > "ORS 59.115(3) makes one who is not himself the seller of a security liable for an unlawful sale if he 'participates or materially aids in the sale.' * * * Whether one's assistance in the sale is 'material' ***does not depend on one's knowledge of the facts that make it unlawful***; it depends on the importance of one's personal contribution to the transaction." *Prince*, 307 Or. at 149 (emphasis added).

- One consolation is that the lawyer can avoid liability by proving that the lawyer "did not know, and, in the **exercise of reasonable care**, ***could not have known***, of the existence of facts on which the liability is based." ORS 59.115(3) (emphasis added).

[1] **All commentary, suggestions and snarky quips contained in these materials constitute the opinions solely of the author and are not intended to create a standard of care, insurmountable defense, or safe harbor from securities claims.**

But proving this "negative" is difficult. And maybe hasn't happened in an Oregon trial court in recent history. 💣

So it's better to avoid the risk of securities liability altogether . . . .

II. Does my client's deal involve the sale of a security in Oregon?

A. What is a security?

- All-encompassing definition in ORS 59.015 (19).
- The usual stuff: stocks, bonds, debentures, notes.
  - **Beware:** stock sale of a small business is a sale of securities.
  - Asset sales of a business may avoid securities problems.

❖ **Wait . . . did you say notes?**

- ➢ Promissory notes are often securities.
- ➢ *See Lahn v. Vaisbort*, 276 Or. App. 468, 369 P.3d 85 (2016) (holding that promissory notes in private loans could be securities).
- ➢ Certain commercial loans or mortgage loans ***might*** not be securities if Oregon adopted the federal "family resemblance test" under *Reves v. Ernst & Young,* 494 U.S. 56, 63–64, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990) (involving the federal Securities Exchange Act).
- ➢ May also meet the definition of investment contracts.

❖ Catchall: "**investment contracts**" are defined as securities.

- ➢ Four-part test for investment contracts:
  (1) **investment** of money (or money's worth)
  (2) in a **common enterprise**,
  (3) with the **expectations of a profit**,
  (4) to be made through the **management and control of others**.
- o *Pratt v. Kross*, 276 Or. 483, 497, 555 P.2d 765 (1976) (holding that limited partnership interest was a security); *see also Computer Concepts, Inc. v. Brandt*,

310 Or. 706, 714–15, 801 P.2d 800 (1990) (discussing contours of *Pratt* test).

- Common investment contracts
  - **Limited Liability Company** membership interests — especially in a manager-managed LLC, but can be any LLC that meets the test.
  - **Limited Partnerships** — or any partnership that meets the test.
  - **Tenant-in-Common** or other joint ownership interests in real estate. *See Bergquist v. Int'l Realty, Ltd*., 272 Or. 416, 427, 537 P.2d 553 (1975) (undivided fractional interests in a sale and leaseback transaction was investment contract).
  - **Other jointly-owned assets**, *e.g.*, a *racehorse! Marshall v. Harris***,** 276 Or. 447, 455, 555 P.2d 756 (1976) (sale of a fractional interest in a racehorse is an investment contract).

B. What is a "sale" of a security?

- Includes virtually any "disposition" of a security for value.
- *Towery v. Lucas*, 128 Or. App. 555, 560, 876 P.2d 814, 817 (1994) ("disposition of" stock in settlement agreement constituted a sale of security).
- See definition in ORS 59.015 (17)(a).

C. When does Oregon Securities law apply to a sale?

- An offer to sell is made in or directed to Oregon.
- An offer to buy is made and accepted in Oregon.
- The offer to sell or buy originates in Oregon.
- The offer to buy or sell is communicated in Oregon.
- See ORS 59.335 and 59.345.
  - ➢ Practically any Oregon connection is enough!

III. What makes the sale of a security unlawful and actionable?

A. Untrue statements and misleading omissions

- The most common seller liability allegation in Oregon securities litigation.
- Security sold "by means of" untrue statement of material fact.
- Or "by means of" omission to state a material fact necessary to make statements made not misleading (i.e. half-truths).
- Purchaser does not know the truth.
- Seller has burden to prove affirmative defense that the person did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.
- ORS 59.115 (1)(b).

B. Securities Fraud

- To employ any devise, scheme or artifice to defraud.
- To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.
- ORS 59.115 (1)(b) and ORS 59.135 (1) and (3).
- Note: Fraud claims may also be asserted under ORS 59.137, which can be more difficult to prove. *See State ex rel. Oregon State Treasurer v. Marsh & McLennan Companies, Inc.*, 269 Or. App. 31, 50, 346 P.3d 504 (2015).

C. Technical violation of the Oregon Securities Law

- Failure to register or to qualify for registration exemption
  - Registration unrealistic in many small business deals.
  - Commonly-used exemptions:
    - **Accredited investors —**
      - individual or joint **net worth** with spouse, exceeds **$1,000,000**, excluding the value of the natural investor's primary residence, **or**
      - **individual income in excess of $200,000** in each of the two most recent years or **joint income with spouse in excess of $300,000** in

each of those years and has a reasonable expectation of reaching the same income level in the current year.
    - **No public advertising/solicitation**.
    - See ORS 59.035 (5); OAR 441-035-0010.
    - See also 15 USC § 77b (15).
  - **Under 10 Purchasers of securities**
    - For last 12 months.
    - No commissions or remuneration for sale.
    - No public advertising.
    - ORS 59.035 (12).
  - **Exemption analysis is even more complicated than this!** — Get help from experienced securities counsel.
- Other technical violations, e.g, unlicensed brokers.

IV. Statutory Damages for Seller Liability

- Amount investor paid for security minus amount received on security — sometimes called a rescissionary remedy.
  Bottom line: a $5 million investment deal = $5 million base damages. ORS 59.115(2).
- Plus interest at 9% or at the rate stated in the security — whichever is higher.
- Plus discretionary court-awarded attorney fees. ORS 59.115 (10).

V. Nonseller Liability — *The Scary Part.* ☠

These nonsellers are **jointly and severally liable** with **and to same extent as the seller** of securities under ORS 59.115(3):

- Any person who directly or indirectly controlled the seller.
- Every partner, LLC manager, officer, director, manager, or person who occupied a similar role.
- **Any Person who participated or materially aided** in the sale — including professionals just doing their jobs such as:
  - **Attorneys**
    - Especially if prepared prospectus, private placement memorandum, offering circular or similar offering documents. *See Prince*, 307 Or. at 148 (preparing partnership agreement and offering circular sufficient to give rise to liability for materially aiding).

    - **Don't like it? Move north of the Columbia River:**
      - *Compare* Washington vs. Oregon securities law:
        - *Hines v. Data Line Sys., Inc.*, 114 Wash. 2d 127, 150, 787 P.2d 8 (1990) (affirming **summary judgment in favor of law firm** that prepared offering documents). — Lawyers win! ☺
        - *Ainslie v. Spolyar*, 144 Or. App. 134, 145, 926 P.2d 822, 828 (1996) (affirming **summary judgment in favor of investors against lawyer** who prepared securities documents) — Lawyer loses. (Ouch!) ☹
    - Doubtful whether mere business formation and basic entity documentation is material aid in the sale — but there are no safe harbors.
    - It's going to be a case-by-case analysis of the importance of the attorney's work to the transaction. *Prince*, 307 Or. at 149 ("it is a drafter's knowledge, judgment, and assertions reflected in the contents of the documents that are 'material' to the sale.").

- Accountants
  - Doubtful whether audits or tax work materially aids sale of securities, but there are no safe harbors.
  - Preparation of financial projections or pro formas provided to investors might increase risk of liability for material aiding.
- Brokers / Finders
  - Recommending or promoting investment is risky.
  - Bringing in investors is probably enough, but depends on circumstances.
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- Banks / Financial Institutions
  - Loans to facilitate investor financing may be risky.
  - Doubtful whether merely acting as a lender or custodian materially aids in security.
  - Recommending investments to customers is probably risky.

➢ Note: Nonsellers can also be liable in securities fraud claims brought under ORS 59.137. But in contrast with ORS 59.115(3) to prove material aiding liability, the investor must prove that the person **materially aided in *the violation*** of the anti-fraud provisions of ORS 59.135 (i.e. not merely materially aid in *the sale* of securities).

VI. Affirmative Defenses

A. “Due diligence” defense to nonseller liability:

“[E]very person who participates or materially aids in the sale is also liable jointly and severally with and to the same extent as the seller, **unless the nonseller sustains the burden of proof that the nonseller did not know, and, in the exercise of reasonable care, could not have known, of the existence of facts on which the liability is based.**” ORS 59.115(3). This means:

- The nonsellers must prove **they could not have known** about bad facts giving rise to investor liability.
- For lawyers, this can be difficult if the lawyer has a close relationship with the client.
- Also requires the nonseller to **prove a negative** "could not have known."
- This must be evaluated on a case-by-case basis.

B. Statutes of Limitation Defense

- For claims alleging untrue statements, material omissions or securities fraud under ORS 59.115(1)(b) (or under ORS 59.137): **three years from the sale of securities or two years from discovery** of the facts giving rise to liability. ORS 59.115(6). *See also Anderson v. Carden*, 146 Or. App. 675, 934 P.2d 562 (1997) (construing earlier version of the statute of limitation).
- For registration or other technical violations, the statute of limitations for private rights of action is three years from the sale. ORS 59.115(6).

VII. What can I do as a transactional lawyer to manage these risks?

❖ The remainder of this outline contains tips and general suggestions, but they are not "litigation tested" or supported by specific legal authorities:

➢ Unfortunately, there are no safe harbors — and no established best practices and no clear standards.
  - o Even if your legal work is perfect, you can still be sued and taken to trial under ORS 59.115 (3).
  - o Securities law is not for beginners — get securities law advice if you have a deal involving investors.
  - o Don't assume you will be protected from claims by the accredited investor exemption.
  - o If the deal loses money, disgruntled investors and their lawyers may take advantage of any minor problem they can find with the deal or with the offering documents and allege a material misrepresentation or misleading omission.

- Choose your transactions carefully:
    - Avoid deals involving passive investors if possible.
    - Ideally, all people putting in money should have a role in management of the business.
    - Refer out cases involving passive investors to securities counsel.
    - Stay away from the financing part of a transaction — try to limit your role to non-financing aspects of the transaction, e.g., just the transfer of real estate.
    - Avoid deals that seem unlikely to succeed or are poorly conceived.
    - Beware of deals that depend heavily on existing market conditions, market bubbles, or overly optimistic views of reality.
    - Consider having a business or investment consultant or similar professional conduct an analysis of the deal.
    - Avoid deals involving investors using self-directed IRAs or that rely heavily on tax avoidance strategies.
    - Be skeptical of businesses lacking in financial controls.

- Choose your clients carefully:
    - Good business clients should have a solid business plan and financial controls in place.
    - Avoid clients who will oversell or puff about their project.
    - Emphasize the need for transparency with investors.
    - Beware of clients who intend to solicit investors from their religious congregation or social organization in which trust among members is unquestioned.

- Try to persuade your client to choose investors carefully:
    - Ideally, investors should be wealthy, accredited, experienced, cognizant of risks and maybe even represented by their own counsel before investing.
    - Avoid investors who plan to invest their retirement savings, are inexperienced, uneducated or vulnerable.
    - Avoid investors who will place unearned trust in promoters regardless of the merits of the business idea, business strategy or business risks.

- Tips for preparing offering documents and disclosures:
    - ❖ Reminder: These are not safe harbors, standards of care or best practices — they are only suggestions that are untested in litigation. Every situation requires judgment and a fact-specific approach.
    - Don't do securities offering documents unless you know what you are doing. Bring in an experienced securities lawyer.
    - Assume your documents will be scrutinized for accuracy and completeness in litigation by counsel representing the investors as plaintiffs.
    - Avoid having the offering circular or private placement memo that reads like a marketing brochure — it should be a risk disclosure document.
    - Try to identify all obvious and nonobvious investment and business risk factors. Consider adding risk factors that are specific to this particular deal.
    - Beware of forms and boilerplate.
    - Consider using a detailed questionnaire or other method to discover and disclose potentially "bad facts" including any black marks against your clients.
    - Consider using management (client) representation letters or similar documents for having your clients "sign off" on all disclosures and certify that they cannot think of any other risks or material matters to disclose.
    - Consider having a business financial or investment professional analyze the deal and potential risks.
    - Recommend your client use financial projections or pro formas that are conservative, realistic, and based on the most reliable information available.
    - If possible, try to make sure at least two registration exemptions apply.
    - Make sure you are adequately insured.

About the Presenter:
Dan Keppler is an attorney in the Portland office of Garvey Schubert Barer. He focuses on helping lawyers, accountants and other professionals mitigate risks and resolve complex disputes, often involving securities and business-related litigation.

His practice includes complex business litigation, securities litigation, professional malpractice, class action litigation, appeals and alternative dispute resolution. He also counsels professional and institutional clients on risk management issues.