Oregon Securities Law
things look different here

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By Cody Hoesly
OTLA Guardian

"Things look different here," goes the old slogan of the Oregon Tourism Commission. And there are a lot of things that draw folks to live here that they cannot get in other states. Our securities law is not usually listed among the foremost of Oregon's advantages, but it should be. When investors have been scammed, Oregon is the best in the nation at helping them recover what they lost.

I've represented many kinds of investors over the years, from the janitor who, on retiring, threw all his PERS money into what turned out to be a real estate scam, to the sophisticated businessperson who just didn't see it coming, "Everything looked so professional and promising!" I am glad I can always tell clients, "At least you live in Oregon."

A case in point

The benefits of Oregon's approach to securities regulation is obvious. Take, for example, the case of Lake Oswego investment company Iris Capital. Iris was a home-grown investment scheme put together by Shayne Kniss, an investment advisor and soon-to-be marijuana entrepreneur. Iris' apparent purpose was to take advantage of the real estate collapse of 2010 by purchasing repossessed residential real estate. Kniss planned to rehabilitate and "flip" the properties (*i.e.*, sell them quickly at a profit). Ultimately, Kniss sold investment notes and limited partnership interests in four separate funds to dozens of investors.

The investments, however, were doomed from the start. Among other things, the entities and projects funded by the investors suffered from a lack of financial controls, chronic undercapitalization and mismanagement. For example, Kniss embezzled over $500,000 in investor funds, using the money to fund a marijuana business he was starting. Predictably, the Iris scheme collapsed, but not before it had raised more than $5.7 million.

While some of the investors had significant other assets on which to live, for others the loss of their investment in Iris was a huge blow. One investor, for example, was a retiring janitor who took a lump sum payout of his PERS account and invested it all with Iris. He was promised his investment was safe and would yield reliable returns, but he ended up living off of Social Security and a home equity line of credit he had to take out on his home, which had previously been paid for.

My firm worked together with Esler Stephens & Buckley and Stoll Berne to bring suit to help the investors recover their losses. Because Iris had only a few remaining assets, and Kniss had squandered all the money he'd embezzled (and was ultimately sent to federal prison), we focused our claims on other participants such as the lawyers who drafted Iris' marketing materials.

Before filing suit, we engaged in extensive settlement discussions with those participants, including a review of their documents. These efforts resulted in settlements with some participants, but not all. We subsequently brought suit against two law firms and, after some motion practice, reached a settlement with them, too. The settlements resulted in the Iris investors getting back approximately 80% of what they had invested.

This result would not have been possible under federal law or the law of any other state.

Seller liability

The first defendant most investors think of when they've been fleeced is the person who sold them the securities at issue. That makes sense, as this person is usually the head of the scheme (Ponzi in a typical Ponzi scheme, for example, or Kniss in the case of Iris Capital). However, the seller is rarely the best target of a civil suit. They have usually squandered all their ill-gotten gains before they are found out, encumbered their assets with third-party loans, or otherwise rendered themselves judgment-proof or its practical equivalent (as was the case with Kniss).

Nonetheless, if the seller is worth going after, then Oregon law is better than federal law in multiple respects. Among other things, Oregon law defines a "seller" more broadly than federal law (to include those who solicit sales), it gives investors greater ability to challenge the seller's false projections of future economic performance and allows the investor to recover attorney fees (on top of getting money back with interest).

Secondary participant liability

Who is the best target for a securities claim? Secondary participants: the attorneys who prepare the seller's offering documents, the accountants who prepare the seller's tax returns, the commercial bankers who lend the seller money, and others who help the seller get their investment scheme up and running, and who help keep it afloat often even long after the "storm warnings" have given way to a full hurricane of securities law violations.

Under Oregon law, "[e]very person who…participates or materially aids in the sale [of a security] is also liable jointly and severally with and to the same extent as the seller." ORS 59.115(3). This is significant because these professionals often have significant insurance policies and other assets that can make investors whole. Moreover, while a secondary participant can be exonerated by a showing that they "did not know, and, in the exercise of reasonable care, could not have known" about the seller's misconduct, the participant bears the burden of proving it. The investor does not need to prove the opposite (the participant's knowledge). *Id.*

This secondary liability provision alone makes Oregon law far more investor-friendly than federal law and the law of many states. Those states either have no private right of action against secondary participants, or, if they do, they require that the plaintiff prove the participant knew of the seller's misconduct or that the participant was a manager or employee of the seller. But even compared to those few states that do have statutory provisions similar to Oregon's, Oregon's case law has taken secondary liability further than anywhere else, by broadly defining what constitutes "participation" and "material aid." Where other jurisdictions have defined those terms not to include routine services provided by lawyers, accountants and other professionals, Oregon has held that the professional judgment exercised by such actors is exactly why they are liable. *Prince v. Brydon*, 307 Or 146, 149-51 (1988) ("[I]t is a drafter's knowledge, judgment, and assertions reflected in the contents of the documents that are 'material' to the sale.").

Oregon's legislative policy choice makes sense for many reasons, not least of which is because it reflects the reality of how these schemes operate. The seller hires the professionals to do the due diligence and passes that cost onto investors. Having effectively paid for the professionals' services, investors ought to be able to hold the professionals to account. Moreover, these professionals give credibility to the seller's solicitations, create an illusion of financial strength and enable the seller to continue selling securities illegally to investors. Indeed, even if a participant eventually ceases

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doing business with the seller, the aid they gave beforehand can have ripple effects long afterward and can continue to expose them to liability. *Ciuffitelli v. Deloitte & Touche LLP*, 2017 WL 2927481 (D Or Apr 10, 2017), report adopted, 2017 WL 2927150 (D Or July 5, 2017).

Another notable aspect of Oregon's law on participant liability is it requires no proof of fraud or any violation of law or standard of care by the participant. The participant's liability "is predicated on the violation of the seller," and ORS 59.115(3) merely "expands the class of potentially liable persons from whom damages may be obtained for a seller's violation of the securities laws." *Anderson v. Carden*, 146 Or App 675, 683 (1997); see also *Ainslie v. First Interstate Bank, N.A.*, 148 Or App 162, 175 (1997) (participant "would not have to be directly culpable, nor would its conduct have to be the cause of damage, in order for it to be liable under ORS chapter 59") (emphasis in original).

These critical provisions are what separates Oregon from the rest of the country and makes Oregon the foremost protector of investors.

Iris revisited

In the case of Iris Capital, for example, federal law would have left the investors with no recovery, because it bars the claims that we brought against secondary participants, the claims that resulted in over $4 million in settlements.

If Iris had not been based in Oregon or if the investors had lived in another state, they likewise would have been left with nothing or near-nothing. The participants in the Iris scheme were not managers or employees of Iris. The lawyers readily could have argued under other states' laws they were merely providing routine professional services to Iris, which would have absolved them from liability. And while it may not have ultimately been difficult for us to prove the participants' knowledge of Kniss' misconduct, as other states require, Oregon law made that hurdle easier to overcome. It put the onus on the participants to prove not only that they did not know, but that they could not have known had they exercised the due diligence that professional standards and the securities law required of them.

In short, while it is possible that some other states' laws would have gotten the Iris investors some recovery, only Oregon law made it possible for them to get as much back as they did.

Practical considerations

Because Oregon's law is uniquely investor-friendly, anyone seeking to plaintiff an investor case should be prepared to educate the participant's out-of-state counsel and insurance adjuster, who often come to the case with assumptions about securities law derived from experience in other, relatively investor-hostile jurisdictions. The mediator and court likely will need education too, even if they are local, simply because securities law is complex. My briefs and mediation statements are lengthy for each of these reasons.

Another issue arising in the litigation of these cases is client management. Often these cases involve dozens of investors, and you need to have a good procedure for communicating with all of them, both to keep them updated and to get their input when needed. Regular all-hands conference calls are one good method for doing this. Another solution is to file a class action, because it reduces the manageability problem significantly. In some cases, that approach makes much more sense.

But beware that in the Class Action Fairness Act of 2005, Congress mandated that state-law securities class actions and mass actions of 100 or more investors be removable to federal court if the damages exceed $5 million and there is "minimal diversity." 28 USC § 1332(d). The best way to stay in state court, given the Act, is to define your plaintiff group narrowly to stay under the 100-investor limit. If you must litigate in federal court, the *Ciuffitelli* opinion cited above shows federal district court in Oregon is capable of rendering sound opinions in cases involving the Oregon Securities Law.

Parting thoughts

How did Oregon investors come to enjoy such robust protection under the securities law? The genesis goes back over 50 years, to 1967, when the Oregon Legislature completely revamped the securities law it had had on the books since 1939. The Legislature initially intended to just adopt the Uniform Securities Act of 1956, which most states at the time did. But during the legislative process the Legislature realized the Oregon Supreme Court had interpreted the prior act in a manner that protected investors with more safeguards than the uniform act provided. The Legislature and various stakeholder groups agreed to modify the uniform act to retain these desirable features.

Starting in the mid-1970s, the U.S. Supreme Court launched a sustained attack on investors by repeatedly issuing decisions narrowly interpreting federal securities law and imposing obstacle upon obstacle on investors seeking to be made whole. Congress joined this effort in the 1990s and early 2000s, resulting in an absolute gauntlet that investors relying on federal law must run when bringing securities claims. Many states followed suit, through both legislation and court decision.

But Oregon went the opposite direction. Justice Linde's 1988 opinion for the Oregon Supreme Court in *Prince* stands as a beacon of judicial restraint by giving effect to the Legislature's 1967 policy choice rather than imposing judicially-crafted obstacles in the guise of interpretation. And in 2003, the Oregon Legislature expanded liability under the securities law even further, to make it applicable to securities sold on the market, not just face-to-face transactions, among other things.

This history of political and judicial decision-making shows Oregon law did not default into its present position — we chose this path. We should celebrate that choice and reaffirm it, lest future legislators or judges forget why things look different here and begin to blindly adopt the law of other jurisdictions as the law of Oregon.

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