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For the Civil Practitioner: Review of Fourth Circuit Opinions in Civil Cases Decided November 1, 1991 Through December 31, 1992: XI - Securities Regulation

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Revenue Service (IRS) did not exercise reasonable diligence in mailing the notice to the taxpayers' last known address. The taxpayers moved from their old address in late 1987. On February 29, 1988, the IRS sent the notice of deficiency to the taxpayers' old address by certified mail. The Post Office erroneously ignored the taxpayers' timely filed change of address forms and returned the undelivered notice to the IRS. On December 26, 1988, the IRS mailed a final notice of intention to levy to the taxpayers' new address. On January 11, 1989, the taxpayers filed a petition with the Tax Court in order to avoid payment of the deficiency prior to a determination on the merits. The Tax Court dismissed the petition because the taxpayers filed it more than ninety days after the mailing of the notice of deficiency.

The Fourth Circuit stated that the IRS's mailing of a notice of deficiency is sufficient if the IRS mails the notice to the taxpayer's last known address. The "last known address" is what, after the exercise of reasonable diligence, the IRS may consider to be the address of the taxpayer on the date the IRS mails the notice. 958 F.2d at 55. The Post Office's error of nondelivery made the notice insufficient and the IRS's receipt of the undelivered notice showed a lack of reasonable diligence in finding the last known address. *Id.* at 56. Thus, the taxpayers' timely filed their petition and the Fourth Circuit remanded the case to the Tax Court where the Powells could contest the asserted deficiency prior to the payment thereof.

The case indirectly provides a lesson for all taxpayers: Use registered or certified return receipt mail in filing estimated payments, tax returns and all other documents with the IRS. The registration or return receipt will provide prima facie evidence of the fact that the taxpayer filed the item and of the date of filing. I.R.C. § 7502(c) (1988); Treas. Reg. § 301.7502-1(d)(1) (as amended in 1960). If the IRS had lost the Powell's return in the above case, the Powells would have had a much more difficult time in court unless they retained the registration or return receipt with respect to that return.

XI. SECURITIES REGULATION

Reviewed by PROFESSOR LYMAN P.Q. JOHNSON

A. Reliance on Oral Representations

In *Myers v. Finkle*, 950 F.2d 165 (4th Cir. 1991), the United States Court of Appeals for the Fourth Circuit held that a determination of whether a purchaser of securities may be justified in relying on oral representations that conflict with contemporaneous written statements contained in a private placement memorandum delivered to the investor requires a consideration of eight relevant factors. These relevant factors include: (1) the sophistication and expertise of the plaintiff in financial and securities matters; (2) the existence of long standing business or personal relationships; (3) access to relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations. Because no

single factor is dispositive, consideration of all eight factors is necessary.

The court, presented with an unusual factual situation in which oral representations were contradicted by express warnings in private placement memoranda, stated that knowledge of information should be imputed to investors who fail to exercise caution when they have in their possession documents apprising them of the risks associated with the investments. In short, investors are charged with constructive knowledge of the risks and warnings contained in private placement memoranda. Therefore, in evaluating the eight factors relevant to justifiable reliance, the conduct of investors must be examined as if they had knowledge of all attendant warnings.

In *Myers*, the Fourth Circuit also discussed its interpretation of the "sophistication" requirement. 950 F.2d at 167. The court stated that while wealth alone may be an important factor in determining the sophistication of an investor, it is not the dispositive factor. The court stated that other criteria, such as age, education, professional status, investment experience, and business background, may also be relevant in such determinations.

B. Fraud—Duty to Disclose

In *Forston v. Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469 (4th Cir. 1992), investors in a real estate limited partnership brought a securities fraud suit against the syndicator of the securities offering, the general partners, and the law firm retained by the general partners to prepare the tax opinions for the offering memorandum. The Fourth Circuit held that under section 10b of the Securities Exchange Act of 1934, 15 U.S.C. section 78j(b), the failure to disclose material information constitutes securities fraud only upon proof of a duty to disclose. Looking to cases previously decided in the Fourth, Fifth, and Seventh Circuits, the court stated that federal securities laws are not themselves, with respect to the section 10b claim, the source of a duty to disclose material facts. Thus, with respect to a section 10b claim, the duty to disclose material facts arises only where there is some basis outside the federal securities laws, such as, for example, a state law, for finding a fiduciary or other confidential relationship.

The court found that such a duty to disclose material facts plainly ran from the syndicator of the offering and the general partners. However, the court questioned whether such a duty ran from the law firm. Appellants argued that the law firm's duty to disclose arose under Texas common law, a Treasury Department regulation, and an American Bar Association ethics opinion. The court did not find merit in appellant's contentions. Appellants further asked the court, in the absence of a duty grounded in law, to create a duty of disclosure grounded in public policy—the policy of having law firms monitor, on pain of liability, the representations that their clients make to any third party. The court declined to accept this argument, stating that the result of appellant's position would be a rigid rule charging all attorneys who involve themselves in any facet of a commercial transaction with responsibility for the entire transaction. The court found that an "omnipresent" duty of disclosure would not only be unfair to law firms, but would also

destroy incentives for clients to be forthcoming with their attorneys and would artificially inflate the cost of involving legal counsel in commercial transactions. 961 F.2d at 475.