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The court recognized that to promote the goal of section 1384, which is to encourage employers to sell companies who contribute to the plan rather than shut them down, all of a company's contribution history should shift away from the seller upon a sale of assets, so Borden should not be burdened with withdrawal liability a year after Drake's sale. However, the court determined that Congress did not necessarily intend to burden the purchaser with the full cost of this shift. Instead, the court suggested that responsibility for the liability from the first five years of the ten year period should shift, pro rata, to all other employers in the plan. Because this interpretation serves the twin goals of protecting plan stability through sales of assets instead of closings, while also assigning liability for all unfunded benefits to active plan members based on their participation, the *Borden* court reversed the decision of the District Court on this issue.

R. SECURITIES REGULATION

Sandberg v. Virginia Bankshares, Inc.

979 F.2d 332 (4th Cir. 1992)

The doctrine of issue preclusion forecloses the relitigation of issues of fact that are identical to issues determined and necessarily decided in prior litigation.[614] However, the party against whom issue preclusion is sought must have had a full opportunity to litigate the issue in the preceding case.[615] Generally, a litigant can obtain preclusionary effect only through a final, valid judgment.[616] In addition, courts usually apply issue preclusion only when no unfairness will result to the party opposing preclusion.[617]

Another important litigation doctrine is the attorney-client privilege. The attorney-client privilege usually prohibits the full discovery of communications made in confidence between attorneys and their clients.[618] In this manner, the privilege encourages frank discussions between attorneys and clients.[619] However, this principle is not an absolute privilege. It is subject to the qualification that any injury to the attorney-client relationship by disclosure must be greater than the benefit gained toward the just disposal

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614. Virginia Hosp. Ass'n v. Baliles, 830 F.2d 1308, 1311 (4th Cir. 1987).

615. *Id.*

616. *See* 18 CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 4432, at 298 (1981) (discussing traditional requirement that judgments be final to have preclusive effect).

617. *See* Swentek v. USAir, Inc., 830 F.2d 552, 561 (4th Cir. 1987) (stating that collateral estoppel is appropriate where identical issue was litigated, issue was necessarily determined by court of competent jurisdiction, and preclusion does not work unfairness in second trial); *see also* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 332-33 (1979) (holding that corporation had full opportunity to litigate claims in prior action and that use of collateral estoppel did not violate Seventh Amendment right to jury trial).

618. *See* 8 JOHN H. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2292, at 554 (McNaughton rev. 1961) (discussing general principle of attorney-client privilege).

619. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

of the litigation.[620] Moreover, courts confine the privilege to its narrowest possible limits because it impedes complete discovery of the truth and derogates litigants' rights to present all relevant evidence.[621]

The United States Court of Appeals for the Fourth Circuit contemplated the doctrines of issue preclusion and attorney-client privilege in *Sandberg v. Virginia Bankshares, Inc.*[622] The facts and procedural history of *Sandberg* are complex. First American Bankshares, Inc. (FABI), a holding company, sought to consolidate its operations by merging the First American Bank, Inc. (Bank) with Virginia Bankshares, Inc. (VBI). VBI owned eighty-five percent of the Bank's stock. Minority shareholders possessed the remaining fifteen percent of the Bank's stock. An investment banking firm, hired by FABI, recommended forty-two dollars per share as the price the Bank should offer its minority shareholders for their stock. The Bank did not obtain an independent evaluation of the stock on behalf of the minority shareholders. At the annual shareholders' meeting, the directors of the Bank urged adoption of the merger proposal at the recommended price, asserting that it was in the best interest of the minority stockholders because the price offered for the stock was thirty percent higher than the price at which the stock then traded. Doris I. Sandberg, a minority shareholder, withheld the requested proxy, and after the shareholders had approved the merger, she filed suit in the United States District Court for the Eastern District of Virginia against both VBI and FABI (referred to collectively as "Bankshares") and the directors of the Bank.

Sandberg's first claim alleged that defendants had solicited proxies in violation of section 14(a) of the Securities and Exchange Act of 1934[623] and Securities and Exchange Commission Rule 14a-9[624] due to the proxy statement's false and misleading statements of fact. Sandberg's second claim maintained that the defendants had breached fiduciary duties owed to the minority shareholders under Virginia law.[625] At trial, the jury found that all of the defendants had violated section 14(a) and Rule 14a-9 but that only the directors of the Bank had breached their fiduciary duties. Accordingly, the jury found that Sandberg was entitled to eighteen dollars per share above the price authorized at the shareholders' meeting and awarded her $43,956.

620. *See* WIGMORE, *supra* note 618, § 2285, at 527 (discussing conditions necessary for establishment of privilege against disclosure of communications).

621. *In re* Grand Jury Proceedings, 727 F.2d 1352, 1355 (4th Cir. 1984).

622. 979 F.2d 332 (4th Cir. 1992).

623. Securities and Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1988) (prohibiting solicitation of proxies in manner inconsistent with SEC regulations).

624. 17 C.F.R. 240.14a-9 (1992) (prohibiting solicitation by means of proxy statement containing false or misleading statement of material fact).

625. *See* Mardel Sec., Inc. v. Alexandria Gazette Corp., 320 F.2d 890, 894 (4th Cir. 1963) (holding that majority shareholders owe fiduciary duty to minority shareholders under Virginia law); Adelman v. Conotti Corp., 213 S.E.2d 774, 779 (Va. 1975) (holding that directors of bank owe fiduciary duty to shareholders).

While Sandberg's case was pending trial, Weinstein and other minority shareholders filed a separate action against Bankshares in the United States District Court for the District of Columbia pursuant to the same Securities and Exchange law and Virginia breach of fiduciary duty arguments invoked by Sandberg. The court transferred the case to the District Court for the Eastern District of Virginia. Following the Sandberg judgment, the District Court for the Eastern District of Virginia applied issue preclusion and granted the Weinstein plaintiffs' motion for summary judgment on both the federal securities law and the state fiduciary duties claims. Defendants appealed both judgments to the United States Court of Appeals for the Fourth Circuit, which affirmed the district court judgments.[626] The defendants then appealed to the United States Supreme Court, and the Supreme Court granted certiorari. In the Supreme Court, the defendants first argued that they were not liable under section 14(a) and Rule 14a-9 because the misrepresentations in the proxy statements were only statements of opinion. Secondly, the defendants asserted that plaintiffs had not proven causation because the Bank controlled sufficient stock to authorize merger without the approval of any minority stockholders. The Supreme Court reversed the judgment for the plaintiffs, holding the plaintiffs had failed to show causation, but the Court rejected the defendants' first argument, holding that knowingly false statements in the form of opinions are actionable.[627] In addition, the Supreme Court expressly upheld the jury's conclusion that the directors had violated Rule 14a-9.[628] Thus, the issue could have the benefit on remand of full consideration at the trial and appellate levels.[629] On remand from the Supreme Court, the Fourth Circuit denied the plaintiffs' motion to affirm the alternative judgment for breach of fiduciary duty and instead sent the case to the district court to consider the effects of the Supreme Court's holding upon the alternative judgments.

The district court certified a class of minority shareholders that were entitled to vote on the merger. The court vacated both the Sandberg and Weinstein judgments and entered a claim for breach of fiduciary duty on behalf of the named class. Furthermore, the district court applied a cap to plaintiffs' recovery on the fiduciary duty claim pursuant to a Virginia statute limiting the liability of corporate directors.[630] However, this statute contains an exception if the corporate officers engaged in willful misconduct or a knowing violation of any federal or state securities law.[631] The plaintiffs argued that the cap was inapplicable because the jury's finding that the directors violated Rule 14a-9 precluded argument over whether the director's

626. Sandberg v. Virginia Bankshares, Inc., 891 F.2d 1112, 1116 (4th Cir. 1989), *cert. granted in part*, 495 U.S. 903 (1990).

627. Sandberg v. Virginia Bankshares, Inc., 111 S. Ct. 2749, 2755, 2761 (1991).

628. 111 S. Ct. at 2757-61.

629. *Id.*

630. *See* VA. CODE ANN. § 13.1-692.1 (Michie 1989) (placing limit on corporate officers' liability in proceedings brought on behalf of shareholders of corporation).

631. *Id.* § 13.1-62.1(B).

knowingly violated federal securities law. The district court rejected this argument. The court also denied plaintiffs' motion for a new trial against Bankshares, choosing not to accept plaintiffs' argument that the district court had erred in denying a motion to compel discovery on the grounds of attorney-client privilege. The plaintiffs appealed.

On appeal, the Fourth Circuit dealt with the principles of issue preclusion and attorney-client privilege. The appellate court vacated the district court's judgment and remanded the case once again. The Fourth Circuit first applied issue preclusion and held that the jury implicitly had concluded that the liability cap did not apply to Sandberg. Next, the appellate court reversed the trial court's denial of a new trial on grounds that the trial court improperly excluded discovery concerning a meeting between the defendants, finding the evidence at issue was not privileged.

The Fourth Circuit began its analysis by addressing the plaintiffs' issue preclusion argument concerning the application of the liability cap. The appellate court decided that the Weinstein plaintiffs had waived their right to challenge the cap because they could have anticipated recovery exceeding the statutory limit and failed to challenge the cap at trial. However, the Fourth Circuit found that the cap was not at issue in Sandberg's trial because the district court had denied class certification making Sandberg's maximum recovery well below the statutory limit. After the Fourth Circuit reversed the district court on the class certification issue and after the Supreme Court reversed on the federal securities claims, the cap became relevant to the Sandberg plaintiffs. Therefore, the court found that the Sandberg plaintiffs had raised their argument concerning the cap in a timely fashion.

The Fourth Circuit considered the plaintiffs' argument that the appellate court should construe the original jury verdict as a finding that the directors knowingly violated Rule 14a-9. The statute placing a cap on directors' liability is inapplicable if the directors have engaged in willful misconduct or a knowing violation of federal or state security law.[632] The Fourth Circuit explained that for the plaintiffs to convince the court to apply the jury's factual finding of a violation of Rule 14a-9 to the separate question of whether the Virginia cap was applicable, they must satisfy the four requirements of issue preclusion: (1) that the issue is identical to the one previously litigated; (2) that the issue was actually determined in the litigation; (3) that the issue was necessarily decided in the case; and (4) that the prior judgment was final and valid. The court concluded that these factors involved mixed questions of law and fact and should be reviewed de novo. However, the court noted that an appellate court ordinarily should review the fairness of the application of issue preclusion under an abuse of discretion standard. Nevertheless, the Fourth Circuit retained the discretion to determine fairness, without the district court having considered the issue, because the Fourth

632. *Id.*

Circuit felt the proper resolution of the fairness question was clear beyond any doubt.

Next, the Fourth Circuit examined whether the issues were identical to one another. The court considered whether the jury's finding that the directors acted in conscious disregard of misrepresentations in the proxy statement satisfied the requirement in the Virginia statute that the directors knowingly violated federal securities law. The Fourth Circuit determined that the knowing component of the exception to the liability cap was analogous to the scienter component of an intentional misrepresentation. Accordingly, the court decided the jury's finding was comparable to the knowing requirement of the statute because both knowledge that a statement is true and conscious disregard of whether a statement is true satisfy the scienter element of common law deceit. Thus, the Fourth Circuit found that the issues were identical for the purpose of issue preclusion.

The Fourth Circuit then considered whether the issue was actually determined in the previous litigation. The court found that the jury verdict, in light of the jury instructions, indicated that the directors had consciously disregarded whether the proxy statement contained misrepresentations. Rule 14a-9 prohibits solicitation by means of a proxy statement containing false or misleading statements of material facts. The court stated that an action brought pursuant to Rule 14a-9 is analogous to a common law action for deceit because both concern a party making misrepresentations to another party. The Fourth Circuit concluded that to find the directors liable under Rule 14a-9, the jury had to decide that the proxy statement contained material misrepresentations. The existence of such misrepresentations demonstrated that each individual director had asserted a fact as to his own knowledge in the proxy statement when no director actually knew whether the fact was true. The court felt this determination was equivalent to a finding of conscious disregard, the scienter requirement for common law deceit. Consequently, in recognizing a Rule 14a-9 violation, the jury implicitly found that the directors had acted knowingly and in conscious disregard of whether or not the proxy statement contained misrepresentations.

Furthermore, the Fourth Circuit decided that the jury's determination that the proxy statement contained material misrepresentations was necessary to the judgment. All of the factual theories that the district court described to the jury as comprising a Rule 14a-9 violation involved the directors' conscious disregard of the truthfulness of the proxy statement. The Fourth Circuit also concluded that the judgment was final and valid. The court interpreted the finality requirement as ensuring that the parties are not denied appellate review. Because the Fourth Circuit and the Supreme Court had considered and upheld the jury's conclusion that the directors had violated Rule 14a-9, the court found this requirement satisfied.

The Fourth Circuit also considered the fairness of the application of issue preclusion. The directors of the Bank argued that they did not have a full opportunity to litigate whether they had acted knowingly. The court concluded that the presentation of more evidence would not provide the

directors with a fairer opportunity to litigate the issue. A key issue at trial was whether the directors had a basis for making the representations in the proxy statement. To help the directors' argument, any additional evidence as to whether they had acted knowingly would have to indicate that the directors did not know they lacked a sufficient basis for making the representations in the proxy statement. However, such a showing would demonstrate the directors were ignorant of their own responsibilities. The Bank directors had struggled at trial to prove their competence, and the Fourth Circuit found it unlikely that they would have offered evidence of their incompetence under those circumstances. Consequently, the court found that the directors' inability to present additional evidence on the "knowing" issue worked no prejudice. Therefore, the Fourth Circuit construed the jury verdict, which found the Bank's directors guilty of violating Rule 14a-9, as rendering Virginia's statutory limitation on the directors' liability inapplicable by virtue of issue preclusion.

The Fourth Circuit then addressed the plaintiffs' contention that the district court had erred in applying attorney-client privilege to deny plaintiffs' motion to compel the production of evidence regarding a meeting between representatives of the Bank and Bankshares on April 20, 1987. The Chairman and Executive Vice-President of the Bank, the Bank's general counsel, two attorneys for VBI, and lawyers for FABI attended the meeting. The gathering occurred one day before the shareholders' meeting at which the shareholders were to vote on the merger. The Fourth Circuit determined that it should review the application of the attorney-client privilege de novo because the issue presented a mixed question of law and fact. The plaintiffs argued that the purpose of the meeting was business, not legal advice or strategy and that the communications were not confidential because third parties were present. Although the court assumed for the purposes of appeal that the participants discussed legal advice and strategy at the meeting, the court found that the Bank could not assert the privilege against its shareholders because the plaintiffs had shown good cause why they should have access to the communications.

The Fourth Circuit explained that a corporation's assertion of the attorney-client privilege complicates analysis of the doctrine, especially when shareholders are seeking the protected information. Because the shareholders are the persons for whose benefit the directors of the corporation are acting, the court concluded it must balance the management's need to manage, and its concomitant ability to seek legal counsel, with the interests of the shareholders. Adopting the rule of a United States Court of Appeals for the Fifth Circuit decision concerning a similar class action brought by shareholders of a corporation against the corporation's officers and directors,[633] the court held that under such circumstances shareholders may show

633. Garner v. Wolfinbarger, 430 F.2d 1093, 1103-04 (5th Cir. 1970) (holding that minority stockholders are not automatically entitled to discovery of all corporate secrets, but where stockholders allege actions by directors inimicable to stockholders' interests, discovery is allowable

"good cause" why the officers should not be permitted to invoke the attorney-client privilege.

In making this "good cause" determination, the court considered a number of factors to be important. The Fourth Circuit found that the plaintiffs' good faith was not in doubt and that their claim was obviously colorable, the plaintiffs having already prevailed at trial. Moreover, the evidence sought was not available from other sources. The plaintiffs had good reason to seek these communications, and trade secrets were not at stake. In addition, the certified class held a substantial portion—fifteen percent—of the stock of the corporation. The Fourth Circuit felt the facts were inconclusive as to whether the communications were concerning the litigation itself.

Finally, the court found that the communications in the April 20 meeting were analogous to communications with an attorney for the purpose of facilitating a fraud, which are not protected by the attorney-client privilege. Under the fraud exception, the societal interests in preventing fraud outweigh the interest of maintaining confidentiality between a client and his attorney. Similarly, society's interest in enforcing fiduciary duties is greater under certain circumstances than a corporation's interest in confidential communications with its attorneys. Therefore, the Fourth Circuit found the shareholders' interest in obtaining information relating to the April 20 meeting outweighed the policy concerns supporting the attorney-client privilege. The Fourth Circuit further concluded that the district court's error in applying the attorney-client privilege was not harmless. Because the minority shareholders did not prevail on their breach of fiduciary duty claim against Bankshares and the excluded evidence was directly relevant to this issue, the Fourth Circuit ordered a new trial on the state law claim.

The Fourth Circuit's handling of both the issue preclusion question and the applicability of the attorney-client privilege in *Sandberg* was proper and fair. Although not obvious, the relationship between the jury's verdict that the directors were guilty of violating Rule 14a-9 and a finding of a knowing violation of federal securities law was strong enough for the court to apply issue preclusion. It should not be necessary for a judgment to expressly state a factual finding to have preclusive effect if a court clearly can conclude that the factual determination was necessarily implicit in the verdict.[634] Also, a court's full examination of the specific requirements of

under showing of "good cause"). The Fifth Circuit identified relevant factors in making a determination as to whether "good cause" exists: (1) the number of stockholders and the percentage of stock they possess; (2) the bona fides of the shareholders; (3) the nature of the shareholders' claim; (4) the apparent necessity or desirability of the shareholders having the information; (5) whether the shareholders' claim involves wrongful action by the corporation; (6) whether the communication related to past or to prospective litigation; (7) whether the communication is of advice concerning the litigation itself; (8) the extent to which the shareholders are blindly fishing for information; and (9) the risk of revelation of trade secrets. *Id.* at 1104.

634. *See* Myrha v. Park, 258 N.W. 515, 518 (Minn. 1935) (finding that issue preclusion is applicable if any of possible grounds for prior verdict determined question at issue).

issue preclusion should ensure that the doctrine is fairly applied. Similarly, the Fourth Circuit correctly balanced the interests of both the directors of the corporation and the minority shareholders in deciding whether the corporate officers could utilize the attorney client-privilege. When shareholders allege that directors acted inimically to the shareholders' interests, that the shareholders have a good basis for desiring the information, that the information cannot be obtained from any other source, and that the information bears directly on an important issue in the case, a court should not deprive minority shareholders of discovery.[635] However, requiring proof of "good cause" from minority shareholders provides for derogation of the attorney-client privilege only when shareholders can show that such derogation is absolutely necessary.

Fortson v. Winstead, McGuire, Sechrest & Minick

961 F.2d 469 (4th Cir. 1992)

In order to prove a claim of securities fraud under section 10(b) of the Securities Exchange Act of 1934[636] (1934 Act) based on a failure to disclose material information, a plaintiff must first prove that the defendant was under a duty to disclose that information to the plaintiff.[637] However, federal securities laws, in and of themselves, do not set forth a basis upon which a duty to disclose can be established.

In *Fortson v. Winstead, McGuire, Sechrest & Minick*[638] the United States Court of Appeals for the Fourth Circuit examined the relationship between the plaintiffs and defendant to determine if the defendant owed the plaintiffs a duty to disclose. The court refused to find that the defendant law firm, which the general partners of a limited partnership had retained to prepare a tax opinion for the offering memorandum, owed a duty to the limited partners to disclose certain material facts in the offering memorandum. Additionally, the court denied the plaintiffs' plea to create such a duty based on sound public policy.

The *Fortson* plaintiffs, limited partners in City Centre Partnership, a real estate partnership, alleged that the offering memorandum for the partnership failed to disclose certain material facts regarding the financial condition of the general partners and the projected success of the partnership. The plaintiffs asserted their claims against the syndicator of the offering, Craig Hall; the general partners and other Hall affiliates; and the

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635. *See* Garner v. Wolfinbarger, 430 F.2d 1093, 1103-04 (5th Cir. 1970) (stating factors that will determine that "good cause" exists where minority shareholders asserted claim against directors of corporation for taking actions inimicable to shareholders' interests); *see supra* note 633 (listing factors in "good cause" determination).

636. 15 U.S.C. § 78j(b)(1988).

637. *See* Dirks v. Securities & Exch. Comm'n, 463 U.S. 646, 657-58 (1983) (holding that plaintiff must prove that defendant owes plaintiff duty to disclose) (citing Chiarella v. United States, 445 U.S. 222, 231-32 n.14 (1980)).

638. 961 F.2d 469 (4th Cir. 1992).

law firm of Winstead, McGuire, Sechrest & Minick (Winstead). Hall Financial Real Estate Group (HFG), which formed the limited partnership, retained Winstead to render a tax opinion concerning certain tax aspects of the City Centre Partnership. Although the plaintiffs did not challenge the accuracy of the tax opinion, they contended that Winstead breached its duty under federal securities laws and state common law by failing to inquire into the financial disclosures of the partnership and ensuring the completeness and accuracy of the disclosures. The United States District Court for the Eastern District of Virginia granted Winstead's motion for summary judgment on all counts, holding that Winstead owed no duty to the limited partners.

On appeal, the Fourth Circuit affirmed the district court's holding. Applying Texas law, which was the governing law pursuant to the terms of the partnership agreement and subscription documents, the court found that Winstead owed no duty of disclosure to the limited partners. The plaintiffs alleged that Winstead failed to ensure that the financial disclosures made by Hall and HFG in the Private Placement Memorandum (PPM) were not misleading and that Winstead was thus liable under Section 10(b) of the 1934 Act and under state common law for fraud, negligent misrepresentation, and breach of fiduciary duty. However, in order for liability to attach to the federal securities claim, plaintiffs had to establish the existence of a duty of disclosure on the part of the law firm arising out of a fiduciary or other relationship of trust. Federal securities laws, in and of themselves, do not create a duty to disclose. Likewise, in order to prove the state law claims, which were governed by the laws of Texas, plaintiffs had to show the existence of a similar duty.

Plaintiffs asserted three arguments to establish the existence of Winstead's duty to disclose: first, Winstead owed the limited partners a duty as the intended third-party beneficiaries of the legal services rendered for the general partners; second, American Bar Association Ethics Opinion 346 (ABA Ethics Opinion)[639] and a certain Treasury Department regulation[640] established Winstead's duty to disclose; and third, absent a legal basis for Winstead's duty of disclosure, public policy demanded that the court find the existence of a duty.

The PPM identified Winstead as counsel for the partnership and explained that Winstead was writing the tax opinion for the benefit of the partnership and the partners. Based on this language and the fact that Winstead had drafted disclosure letters to investors in other HFG partnerships, plaintiffs argued that Winstead had knowledge that the limited partners would rely on the offering documents and would therefore be entitled to sue as the foreseeable and intended third-party beneficiaries of Winstead's tax opinion.

639. ABA Comm. on Professional Ethics and Professional Responsibility, Formal Op. 346 (1982).

640. Tax Shelter Opinions, 31 C.F.R. § 10.33(a)(1)(ii)(1992).

The Fourth Circuit rejected this argument for two reasons. First, the court questioned the foreseeability of the limited partners' reliance. According to the Fourth Circuit, Winstead could have expected the plaintiffs to rely on its tax opinion; however, it could not have expected that the limited partners would rely on the law firm for financial disclosures by the general partners, despite the firm's involvement in other HFG projects. In fact, the firm specifically stated in its opinion letter that it had relied upon Arthur Anderson's financial projections and had not verified them nor expressed an opinion concerning their validity. Based on these disclaimers, the court refused to assume Winstead's knowledge of a foreseeable reliance. Second, the court explained that even if Winstead could have foreseen that the limited partners would rely on the law firm for financial disclosures, Texas law does not recognize a duty to disclose material information to intended third-party beneficiaries unless they are in privity with the defendant.

Plaintiffs further contended that Winstead's duty of disclosure was based on the language of a Treasury Department regulation regarding tax shelter opinions and an ABA Ethics Opinion. Plaintiffs believed that Winstead's reliance on the partnership's representations, absent independent verification, was at odds with both standards. The court noted that although language in both the ABA opinion and the cited Treasury regulation supported a number of positions not alleged in the case, Winstead's conduct was not facially inconsistent with either standard. The standards state that an attorney does not have the responsibility to audit his client's representations nor should he be required to assume that those representations are unreliable unless he has a reasonable cause to believe that those representations are untrue.[641]

Even had the Fourth Circuit determined that Winstead's activities were inconsistent with the standards cited by the plaintiffs, the court was unwilling to use these standards to establish a legal duty to disclose. According to the court, the cited ABA Ethics Opinion was created to provide guidance to attorneys and to regulate their conduct; it was not intended to create an actionable duty in favor of third parties. The court further explained that although treasury regulations do have the force of law, the noted regulation was not applicable in the case *sub judice* because the regulation governs an attorney's practice before the Internal Revenue Service and does not create a third-party claim against an attorney. Thus, the court held the standards could not establish a legal duty of disclosure or serve as the basis for a securities fraud claim.

The Fourth Circuit summarily dismissed plaintiffs' final argument, that Winstead's duty was grounded in sound public policy. The court found that

641. *See* Tax Shelter Opinions, 31 C.F.R. § 10.33(a)(1)(ii) (1992) (stating that attorney can rely on asserted fact unless attorney has reason to believe that facts are untrue); ABA Comm. on Professional Ethics and Professional Responsibility, Formal Op. 346 (1982) (stating that attorney can depend on accuracy of client's statement as long as attorney has no knowledge that would raise suspicion).

imposing a duty on attorneys to monitor the representations that their clients make to third parties would in effect make lawyers "designated watchdogs." The court refused to find this implicit duty, especially given the express disclaimer printed by Winstead in the PPM.

In requiring plaintiffs to establish the existence of a fiduciary or confidential relationship in order to prove a duty to disclose, the Fourth Circuit has joined other circuits that hold that federal securities laws do not act as a source of such a duty.[642] Although plaintiffs attempted to establish a duty to disclose through the use of a third-party beneficiary argument, the Fourth Circuit correctly applied Texas law in requiring privity before such a duty could be imposed.[643] Although a minority trend has developed, including a decision by the Fourth Circuit,[644] that does not require a finding a privity, the Fourth Circuit was required in this case to decide the issue based on Texas law.

Howard v. Haddad

962 F.2d 328 (4th Cir. 1992)

Section 10(b) of the Securities and Exchange Act of 1934 (1934 Act) prohibits deceptive or manipulative sales of registered securities.[645] To determine the relevant limitations period for filing claims under section 10(b), the United States Court of Appeals for the Fourth Circuit previously utilized the closest analogous state statute of limitations that addressed the relevant interests and policy considerations.[646] However, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,[647] the United States Supreme Court established a uniform statute of limitations period for all claims under section 10(b) of the 1934 Act.[648] In *Gilbertson*, the Supreme Court held that claims alleging violation of section 10(b) of the 1934 Act must be filed within one

642. Schatz v. Rosenberg, 943 F.2d 485, 490-92 (4th Cir. 1991); Abell v. Potomac Ins. Co., 858 F.2d 1104, 1124 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495-96 (7th Cir. 1986).

643. *See* Dickey v. Jansen, 731 S.W.2d 581, 582-83 (Tex. Civ. App. 1987) (holding third parties have no standing to sue attorney based on attorney's representation of others); First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart, P.C., 648 S.W.2d 410, 413 (Tex. Civ. App. 1983) (stating absence of privity relieves attorney from any duty of discloure, even if attorney knows that third party will rely on attorney's opinion).

644. *See* Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847, 851 (4th Cir. 1972) (imposing liability on accountant despite absence of privity); Roberts v. Ball, Hunt, Hart, Brown and Baerwitz, 128 Cal. Rptr. 901, 905 (Ct. App. 1976) (holding that privity is not required when attorney is acting with malicious motive). *But see* Fickett v. Superior Court, 558 P.2d 988, 990 (Ariz. 1976) (holding that liability to third parties not in privity is matter of policy and involves balancing of factors).

645. Securities & Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1988).

646. Gurley v. Documation, Inc., 674 F.2d 253, 257-58 (4th Cir. 1982).

647. 111 S. Ct. 2773 (1991).

648. Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773, 2781-82 (1991).

year after discovery of facts comprising the violation and within three years after the violation.[649] On the same day, in *James B. Beam Distilling Co. v. Georgia*,[650] the Supreme Court decided that when it retroactively applies a new civil rule to a case, it must also retroactively apply the rule to similar, pending cases.[651]

In *Howard v. Haddad*,[652] the Fourth Circuit considered whether the plaintiff, Edward G. Howard, filed his claim within one year of discovering the facts underlying an alleged violation of section 10(b) of the 1934 Act. The Fourth Circuit also considered whether *Beam* compelled retroactive application of the uniform one year limitations period established in *Gilbertson*. In addition, because violations of section 13.1-522(a) of the Virginia Securities Act,[653] like violations of section 10(b) of the 1934 Act, require a showing of materiality, the Fourth Circuit examined whether the alleged misrepresentations were material or mere puffery.

The plaintiff, Howard, first met the defendant, Said Haddad, while travelling in 1967. Following this meeting, Howard and Haddad played golf together a few times each year in Florida. Haddad was a director of Trust Bank, a state-chartered bank in Florida. Howard alleged that while playing golf in September 1986, Haddad induced him to purchase shares of Trust Bank stock by misrepresenting and omitting material facts concerning the bank's financial health. Haddad allegedly stated that Trust Bank was "growing" and "doing well." Haddad also purportedly said that the stock was "a good investment," "a good opportunity," and "would be difficult to secure for Howard." In fact, Trust Bank had suffered substantial losses every year since its inception in 1984, would incur a significant loss in 1986, held poor quality assets, and was operating under a memorandum of understanding with the Florida Department of Banking. In October 1986, Howard purchased a total of 100,000 shares of Trust Bank stock for $500,000. Three months after purchasing the shares, Howard joined Trust Bank's board of directors. In October 1987, Howard became chairman of Trust Bank and retained this position until the bank closed in January 1988.

After the failure of Trust Bank, Howard filed a two count complaint against Haddad in the United States District Court for the Eastern District of Virginia based on alleged violations of the 1934 Act and the Virginia Securities Act. The Federal Deposit Insurance Company filed for intervention and moved to dismiss the complaint. The district court granted both motions. On appeal, the Fourth Circuit granted intervention, but reversed the dismissal and remanded the case for further hearings. On remand, the district court again granted dismissal of the complaint, finding that Howard

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649. *Id.* at 2781.

650. 111 S. Ct. 2439 (1991).

651. James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439, 2447-48 (1991).

652. 962 F.2d 328 (4th Cir. 1992).

653. VA. CODE ANN. § 13.1-522 (Michie 1992).

failed to establish the alleged misrepresentations and any affirmative duty for Haddad to disclose relevant financial information.

Howard appealed, arguing that issues of material fact precluded summary judgment. To resolve the issue, the Fourth Circuit first decided that *Beam* mandated retroactive application of the statute of limitations period established in *Gilbertson* for alleged section 10(b) violations of the 1934 Act. Next, the Fourth Circuit attempted to discover whether Howard filed suit within one year of discovering the alleged violations of the 1934 Act. The Fourth Circuit reasoned that the uniform one-year limitations period began to run either at the time of discovery or when, by reasonable diligence, Howard should have discovered the alleged violations.

Based on Howard's own testimony, the Fourth Circuit concluded that Howard had notice of the facts constituting the alleged section 10(b) violations at least fifteen months before he filed suit on September 28, 1988. Howard's testimony revealed that he had attended his first board meeting in January 1987 and had discovered then that the bank was not a sound investment. Likewise, Howard's deposition testimony revealed that by May 1987 he had knowledge of the bank's prior losses, the bank's precarious financial condition, and the existence of the Memorandum of Understanding with the Florida Department of Banking. The Fourth Circuit refused to remand the case for further factual findings because Howard had prior opportunities to establish any issues of material fact and had failed to do so. Thus, the Fourth Circuit affirmed the district court's dismissal of Howard's section 10(b) claim because, as a matter of law, Howard had discovered the facts comprising the alleged section 10(b) violation more than one year before commencement of the suit.

The Fourth Circuit next addressed Howard's claim that Haddad violated section 13.1-522 of the Virginia Securities Act. Section 13.1-522(a) of the Virginia Securities Act, like section 10(b) of the 1934 Act, requires a showing that the alleged misrepresentations were material. The Fourth Circuit believed that Haddad's general statements were mere puffery and therefore lacked the materiality essential to a securities fraud claim. In addition, the Fourth Circuit reasoned that the atmosphere—a golf game between casual acquaintances—undermined Howard's arguments that the misrepresentations were material. The Fourth Circuit also concluded that Howard failed to establish any basis for a fiduciary relationship between Haddad and Howard, which would have imposed an affirmative duty upon Haddad to disclose relevant financial information about Trust Bank. Thus, the Fourth Circuit alternatively affirmed the district court's dismissal of Howard's claim under the Virginia Securities Act.

The Fourth Circuit's decision in *Howard*, applying retroactively the uniform period of limitations established in *Gilbertson* to claims alleging section 10(b) violations, is in accord with a decision of the United States Court of Appeals for the Eighth Circuit.[654] Likewise, the Fourth Circuit's

654. *See* Boudreau v. Deloitte, Haskins, & Sells, 942 F.2d 497, 498 (8th Cir. 1991) (stating that *Beam* forced retroactive application of *Gilbertson* holding).