Fraud Lawsuits Using The Illinois Securities Act

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Securities Fraud Examples

Penny Stocks (Pump & Dump, Bogus offerings)
"New Bank: Join Us!" (No loan business, just take your money)
Big Institutions: Big companies (eg Enron),Mutual Funds, Investment Advisers
Affinity Groups: Madoff, "New Era"
Advance Fees
Unregistered "Deals"

SEC Announcements 2021

Fraud Amounts Prosecuted:
$7-690 million

Example Defendants, April 2021:
Former Race Car Driver
Binary Options Trading Platform
Felon “Richard Richman”/oil and gas offer
Actor Zachary Horowitz “film rights” Ponzi

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Fraud Lawsuits ND Illinois 2021

6 Lawsuits on the docket

Case Types:

False Statements

Fraudulent Offerings

Injunction Needed

Illinois Securities Department Cases 2021

Case Types:

Investment Advisers With **Back Taxes Owed, Section 12(D)** Securities Act violations

Loan Broker violations

Il Act Section 11.F(2) **Temporary Order of Prohibition:**

Truck Investments Scheme violates 12F, 12G, 12I of IL Act

Private Securities Case Statute of Limitations Time After Date of Sale

815 ILCS 5/13: **6 months to notify** seller ***once you know sale voidable: 3 years to sue for failure to register***

3 years from when knew or should have known of misrepresentation to sue

Illinois Securities Department Section 11 Actions

815 ILCS 5/11(E)(4): Sanctions and up to $10k/violation

Belleville Toyota Inc. v. Toyota Motor Sales, 199 Ill. 2d 325 (2002):

A "**continuing violation**" if violations "one continuing wrong"...**later facts can keep within 3 yr.stat. limitations**

Illinois Securities Act Section 13 Remedies

Need Violation of Section 12

#2: **No plaintiff reliance** on defendant acts or omissions needed for Section 13 statutory remedy for 12F, 12G violations

Contrast To Federal Section 10b-5 Remedy

Judicially crafted remedy: **Plaintiff must prove reliance** on Defendant false statements or omissions of material facts

(*Yoon Ja Kim v. JH Song, 61 N.E.3d184 (Ill. App. 2016), per Charles Murdock,* Jasmina Hamulic, and Ronni Tansey, "Kim v. Song: A Primer on How Not To Plead A Securities Case", article provided by C. Murdock)

Definition of « Security »

815 ILCS 5/2/1: Any “investment contract” or “in general, any interest or instrument commonly known as a security”

IL follows federal law on “investment contracts” as securities, *Ronnett v. American Breeding Herds, Inc*., 124 Ill. App. 3d 842, 464 N.E.2d 1201, at 1203 (1984)

Federal Statutory Definition of "Security"

15 U.S.C. Section 77b(a)(1), 1933 Act ('34 Act same)

Landreth Timber v. Landreth, 471 U.S. 681: "Stocks" are securities since in the definition: no need for *SEC v. Howey* economic benefit test.

"Investment Contracts Definition of "Security"

SEC v. Howey, 328 U.S. 293,298-99 (1946)

Howey Test is:

One: An investment of **money**;

Two: in a **common enterprise**;

Three: **profits** solely **from the efforts of others**

(*Steinhardt Grp. Inc. v. Citicorp*, 126 F. 3d 144, at 151 (3d Cir. 1997)

« Economic Realities » Definition of « Security »

Courts read Howey definition broadly, cf. Rodeo v. Gillman, 787 F. 2d 1175, at 1177 (7th Cir. 1986): “Economic substance” determines if is investment contract, especially in securities agency enforcement actions.

Violation of Illinois Act

"...[I]t is unlawful to offer or sell any security except in accordance with the provisions of the Securities Law"

AG Edwards, Inc. v. Secretary of State, 772 N.E.2d 362, at 370, 331 Ill. App.3d 1101, 265 Ill.Dec. 324 (Ill. App. 2002)

Investment Advisor Liability Even If No "Security" Sold

Van Dyke v. White, 60 N.E.3d 1009, at 1016, 406 Ill.Dec. 458 (Ill. App. 2016

815 ILCS 5/12J violation by "**engaging in fraudulent or manipulative conduct** as an investment adviser, which does not require the sale of securities"

Illinois Act to be “Liberally Construed” to protect public

Carpenter v. Exelon Enterprises Co., 399 Ill. App. 3d 330, 334 (Ill. App. 2010)

The **purpose of the Act** is **to protect innocent persons who might be induced to invest** their money in speculative enterprises over which they have little control”

AG Edwards v. Secretary of State, 331 Ill. App. 3d 1101 Ill. App.2002)

815 ILCS 5/12F

"…**[N]either scienter nor loss causation are required elements of proof** under the ISL."

Meyer v. Krista Ward & Calhoun Asset Mgmt. LLC (N.D. Ill. 2016), at p. 14

Fraud: 815 ILCS 5/12F

"makes it a violation of the law for "**any person**" "to engage in **any transaction, practice or course of business in connection with the sale or purchase of securities which works or tends to work a fraud or deceit** upon the purchaser or seller thereof“

Klein v. George G. Kerasotes Corp., 500 F.3d 669, at p. 672 (7th Cir. 2007)

Illinois Act Sections 12 (F)-(G) = 1933 Act Sec. 17(a)(2)-(3): So no scienter

Foster v. Alex, 213 Ill. App. 3d 1001, 1005 (1991)

Also, **no loss causation proof is required for ISL securities fraud** recovery.

Lucas v. Downtown Greenville Investors Ltd. Partnership, 284 Ill. App. 3d 37 (1996)

Promissory fraud does need proof of a “Scheme to defraud.”

Bradley Real Estate Trust v. Dolan Associates, Ltd., 266 Ill.App.3d 709, 203 Ill.Dec. 582, 640 N.E.2d 9, 12–13 (1994).

“...to **survive the pleading stage**, a claimant must be able to point to **specific, objective manifestations of fraudulent intent—a scheme or device**...”

Hollymatic Corp. v. Holly Systems, Inc., 620 F.Supp. 1366, 1369 (N.D.Ill.1985)

Scheme or Device Fraud: 815 ILCS 5/12F

Evidence would include a "**a pattern of fraudulent statements, or one particularly egregious fraudulent statement**."

BPI Energy Holdings, Inc. v. IEC (Montgomery), LLC, 664 F.3d 131, 136 (7th Cir.2011)

Scheme or Device Fraud: 815 ILCS 5/12F

Evidence would include a "**a pattern of fraudulent statements, or one particularly egregious fraudulent statement**."

BPI Energy Holdings, Inc. v. IEC (Montgomery), LLC, 664 F.3d 131, 136 (7th Cir.2011)

Scheme or Device Fraud: 815 ILCS 5/12F

Illinois courts have a "relatively expansive view of the (scheme or device) exception“ to the lack of recovery for promissory fraud.

Gruner v. Huron Consulting Grp., Inc. (N.D. Ill. 2019), at pp. 18-19

ISL Sections 12(F) and 12(G), not 12(H) modeled on 1933 Act Section 17(a)

JJR, LLC v. Turner, 58 N.E.3d 788, at 802, 405 Ill.DeISLc. 527 (Ill. App. 2016)

As the "catch-all" for any fraud in the sale of securities, section 17(a) applies more broadly and imposes liability in both private and public offerings. *Gustafson v. Alloyd Co., Inc.*, 513 U.S. at 576–77, 115 S.Ct. 1061 (1995)

Reliance is an element of **12(F)&12(G) proof, not in 12(H)** (*JJR LLC v. Turner*)

ISL Section12G

Frankfurt v. Mega Entm't Grp. II (N.D. Ill. 2018), at p. 17

"**Prohibits obtaining money or property** "through the **sale of securities by means of any untrue statement of a material fact or any omission**."

815 ILCS 5/12G

ISL 12(F), 12(G), and 12(I)

Modeled on sections 17(a)(1) through (a)(3) of federal 1933 Act, so **Illinois courts look to federal securities fraud case law in interpreting the ISL.**

People v. Whitlow, 89 Ill.2d 322, 333-34, 60 Ill.Dec. 587, 433 N.E.2d 629 (1982)

ISL 12(F), 12(G), and 12(I)

12(G-H) See the elements of proof as 17 C.F.R. Section 240.10b-5: (1) made a **misstatement or omission**, (2) of **material fact**, (3) **with *scienter,*** (4) in connection with the **purchase or sale of securities**, (5) upon which the **plaintiff relied**, and (6) that **reliance proximately caused the plaintiff's injuries**. *In re HealthCare Compare Corp. Securities Litigation,* 75 F.3d 276, 280 (7th Cir.1996).

ISL 12(F), 12(G), and 12(I)

12(G-H) Exception to the elements of proof as 17 C.F.R. Section 240.10b-5: *Foster v*. *Alex*, 213 Ill. App. 3d 1001, 1005 (1991) 815 ILCS 5/12(F)-(G) are modeled on Section 17(a)(2)-(3) of the Federal Securities Act of 1933. But **because those federal provisions do not require scienter, the *Foster* court held that paragraphs 12(F)-(G) of the Illinois Act do not require scienter.**

ISL Section12I

Based on 1933 Act Section 17(a)(3)

***Scienter* is not a required element** under section 17(a)(3) of the Securities Act. *Aaron v. Securities & Exchange Comm'n,* 446 U.S. 680, 697, 100 S.Ct. 1945, 1956, 64 L.Ed.2d 611, 626 (1980).

ISL Section12I

Aaron v. Securities & Exchange Comm'n, 446 U.S. 680, 697, 100 S.Ct. 1945, 1956, 64 L.Ed.2d 611, 626 (1980).

12I is Based on 1933 Act Section 17(a)(3): Aaron

***Scienter* is not a required element** under section 17(a)(3) of the Securities Act.

ISL 12(F), 12(G), and 12(I)

12(G) similar to "**negligent misrepresentation" tort** in Illinois law: *Foster v*. *Alex*, 213 Ill. App. 3d 1001, 572 N.E.2d 1242, 1245 (1991): "a breach of the duty to use due care in obtaining and communicating information upon which others may reasonably be expected to rely upon in the conduct of their economic affairs."

ISL 12(F), 12(G), and 12(I)

"Material" misrepresentations needed for proof: fact or lack of disclosure must '**significantly alter the total mix of information** available to the investor.'"

Adler v. William Blair & Co., 271 Ill. App. 3d 117, 130, 207 Ill. Dec. 770, 779, 648 N.E.2d 226, 235 (1st Dist. 1995)

“Control Person” Liability under ISL 12G

Elipas v. Jedynak (N.D. Ill. 2011), at pp. 6-7

815 ILCS 5/13(A):

“Controlling Persons” are among those potentially liable for sales violating the ISL.

“Control Person” Liability under ISL 12G=1934 Act Section 20(a)

Elipas v. Jedynak (N.D. Ill. 2011), at pp. 8-9

See 17 C.F.R. § 240.12b-2 ("**The term 'control'** (including the terms 'controlling,' 'controlled by' and 'under common control with') means **the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise**.").

ISL 12(F), 12(G), and 12(I)

"Transaction Causation" element of proof:

A plaintiff must provide "proof that a **knowledgeable investor would not have made the investment in question, had she known all the facts**."

Ray v. Citigroup Global Markets, Inc., 482 F.3d 991, 995 (7th Cir.2007)

Section 13(A) Persons Liable

"A plaintiff who proves a violation of the ISL is entitled to rescind the securities sale and recover the purchase price from, **the issuer, controlling person, underwriter, dealer or other person by or on behalf of whom said sale was made**... and in case the issuer, controlling person, underwriter or dealer is a corporation or unincorporated association or organization, **each of its officers and directors (or persons performing similar functions) who shall have participated** in making the sale.

“Controlling Person” Defined: 815 ILCS 5/2.4

Any person offering or selling a security, or group of persons acting in concert in the offer or sale of a security, **owning beneficially** (and in the absence of knowledge, or reasonable grounds for belief, to the contrary, record ownership shall for the purposes hereof be presumed to be beneficial ownership) either (i) **25% or more of the outstanding voting securities of the issuer** of such security where no other person owns or controls a greater percentage of such securities, or (ii) **such number of outstanding securities of the issuer of such security as would enable such person, or group of persons, to elect a majority of the board of directors or other managing body** of such issuer. In case of unincorporated issuers, "controlling person" means any person offering or selling a security, or group of persons acting in concert in the offer or sale of a security, who directly or indirectly controls the activities of the issuer.

Violations of 815 ILCS 5/12H

People v. Bartlett, 690 N.E.2d 154, 294 Ill.App.3d 435, 438-9228 Ill.Dec. 845 (Ill. App. 1998)

It shall be a violation of the provisions of this Act for any person: H. **To sign or circulate any statement, prospectus, or other paper or document** required by any provision of this Act knowing or **having reasonable grounds to know any material representation therein contained to be false or untrue**.

815 ILCS 5/12H= 1933 Act Section 12, not 17

JJR, LLC v. Turner, 58 N.E.3d 788, at 797, 405 Ill.Dec. 527 (Ill. App. 2016)

Samuel H. Young, a principal drafter of the Illinois law, explained that Illinois's section 12(H) is based on section 12 of the federal Act. Samuel H. Young, Interpretive Comments and Notes on Sections of the Securities Law of 1953 as Amended, Ill. Ann. Stat., ch. 121 ½, App'x, at 629 (Smith–Hurd 1960).

Section 12(H) No Reliance Needed For Proof

Within the federal line of cases analyzing section 12, it is well established that **a showing of reliance on an alleged false or misleading statement is not required.**

Gustafson v. Alloyd Co., 513 U.S. 561, 576, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995)

Section 12(H) Proof Needed

(1) A statement, prospectus, or other paper or document,
(2) that is required by the Act or pertains to securities,
(3) contained a material false statement or omission.

1)
JJR, LLC v. Turner, 58 N.E.3d 788, at 799 para. 35, 405 Ill.Dec. 527 (Ill. App. 2016

815 ILCS 5/12H: Only Public Offerings

JJR, LLC v. Turner, 58 N.E.3d 788, at 799 para.35, 405 Ill.Dec. 527 (Ill. App. 2016)

- " Thus, like the federal Act, because **the Illinois Securities Law exempts limited offerings from the obligations that the law imposes**, we hold that section **12(H) of the Illinois Securities Law of 1953 does not apply to limited offerings** and only applies to offerings required to be registered, that is public offerings.“

815 ILCS 5/12J: Investment Advisers Violation:

(1) To employ any **device, scheme or artifice to defraud** any client or prospective client;

(2) To engage in any **transaction, practice, or course of business which operates as a fraud or deceit** upon any **client or prospective client**; or

(3) To engage in any **act, practice, or course of business which is fraudulent, deceptive or manipulative**. The Secretary of State shall for the purposes of this paragraph (3), by rules and regulations, define and prescribe means reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative..

815 ILCS 5/12 Violation: Mental State Proof

People v. Flynn, 817 N.E.2d 1223, at 1225-6, 352 Ill. App.3d 1193, 288 Ill.Dec. 573 (Ill. App. 2004):

- "In this case, the indictment alleges that defendant engaged in a course of business that operated as a fraud or deceit upon his clients. **Fraud is generally defined as a knowing misrepresentation of the truth or a concealment of a material fact to induce another to act to his detriment. Black's Law Dictionary 670 (7th ed.1999). Given this definition, common sense dictates that a person committing a fraud has acted knowingly or intentionally."**

Section 12(I)

To employ any device, scheme or artifice to defraud in connection with the sale or purchase of any security, directly or indirectly.

815 ILCS 5/12I

Section 12(I)=1933 Act Section 17(a)

The Illinois legislature modeled sections 12(F) and 12(I) after parallel provisions in section 17(a) of the Securities Act of 1933. See Tirapelli v. Advanced Equities, Inc., 351 Ill.App.3d 450, 286 Ill.Dec. 445, 813 N.E.2d 1138, 1142 (2004). Not surprisingly, then, "Illinois courts look to federal securities fraud case law in interpreting [that section] of the Illinois Securities Law." Id.

815 ILCS 5/12I Violation: Proof

(1) **Connection to Sale of Stock**: *Menzies v. Seyfarth Shaw LLP*, 943 F.3d 328, at 345 (7th Cir. 2019): " Menzies's complaints do not supply the more because nowhere does he allege any misconduct that coincided with his sale of his AUI stock.."

(2) **Device, Scheme, or Artifice**: *First Nat'l Bank v. McGraw-Hill Cos*., 85 F.Supp.3d 963, at 968 (N.D. Ill. 2015): "." Section 12(I) prohibits "employ[ing] any device, scheme or artifice to defraud in connection with the sale or purchase of any security, directly or indirectly. " 815 ILCS 5/12(I) (emphasis added). The **factual allegations** set out in the FAC fall within both sections.that **the forgoing [sic] omissions concealed existing material facts that acted as fraud** upon FNBR and the other Class members."

815 ILCS 5/12I Violation: Proof

"In connection with" language: "Goldberg v. 401 N. Wabash Venture LLC, 904 F.Supp.2d 820, 849 (N.D.Ill.2012)aff'd in part, 755 F.3d 456 (7th Cir.2014). Directly relevant to this Court's analysis is the federal courts' interpretation of the "in connection with" **requirement from Section 10b and Rule 10b–5 of the Securities Exchange Act of 1934**. **The language in those sections mirrors the language of Section 12(F) and 12(I). Rule 10b–5:** "It shall be unlawful for any person, directly or indirectly ... (a) **To employ any device, scheme, or artifice to defraud**, (b) **To make any untrue statement of a material fact or to omit to state a material fact** necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) **To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit** upon any person, in connection with the purchase or sale of any security. " 17 C.F.R. § 240.10b–5 (emphasis added).

815 ILCS 5/12I Violation Continued...

Goldberg continued: Section 10b: "It shall be unlawful for any person, directly or indirectly ... (b) To use or employ, in connection with the **purchase or sale of any security registered on a national securities exchange or any security not so registered**, or any securities-based swap agreement **any manipulative or deceptive device or contrivan**ce in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C.A. § 78j(b) (emphasis added).

In interpreting those sections, the Seventh Circuit has noted that **when "the Supreme Court has 'sought to give meaning to the phrase ['in connection with'] in the context of § 10(b) and Rule 10b–5, it has espoused a broad interpretation**.' " United States v. Durham, 766 F.3d 672, 682 (7th Cir.2014) (citation omitted). The "in connection with" requirement only requires a misrepresentation that coincided with or touched a securities transaction. Id."

“Materiality” Is Difficult To Define

For General Guidance, see FINRA Notice 10-22,
https://www.finra.org/rules-guidance/notices/10-22

This outlines elements broker-dealers should consider when examining privately offered investment opportunities for their clients: **Look for “red flags”** in publicly available information or disclosures**. If present, do not rely on accountant or other insiders.** 10-22 lists documents you could examine for indications of fraud.

Questions?

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