ORAL ARGUMENT – 01/03/01
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ERNST & YOUNG V. PACIFIC MUTUAL

MILLER: Disregarding 70 years of established Texas law without explanations, the Dallas CA relied on part of §531 of the Restatement of Tort Second to adopt an unworkable new reason to expect standard for common law fraud in Texas.

The result is a direct conflict with the Houston 14th District court's opinion in Kanon v. Methodist Hospital, and the opinion of the Dallas court in the off cited case of Blue Bell v. Peat Marwick. There are also conflicts with earlier decisions of this court, including the oil well division US Steel case, the Formosa Plastics case, and the earlier line of cases cited in our briefs.

We are grateful the court is going to clarify this confusion and the expansion of litigation it's likely to cause. As the Texas Society of Certified Public Accountants pointed out on page 17 of its amicus brief, this quote "expansion of the common law definition of fraud what is professionals without guidance or predictability with regard to future liability."

We're here because the court below decided to change Texas law without giving a reason for the change or citing any Texas precedent supporting the change. In fact, this court's cases use an enlightened intent to induce action test that's flexible, well understood by practitioners, and effective.

If this court wished to review the tort law of Texas, it should undertake a cost benefit analysis similar to that that the California SC undertook in its opinion in Merkin v. Wasserman, which is cited in our brief, 858 Pacific 2nd. Now California law fraud is different. There is a lot of statutory provisions. The issue there was different. But what the California court asked is, first of all, is something broken that needs to be fixed? And they concluded that the common law of tort of fraud served an important function in part operating with other torts such as securities violations and statutory violations and negligent misrepresentation. And that there was no need to change the law.

ABBOTT: How broad do you paint a scope of who should be able to sue a cattle company for a misrepresentation contained in a report like this?

MILLER: We believe everyone who is in the zone where there was an intent to induce action...

ABBOTT: And where do you draw the line for that zone?

MILLER: We think that obviously is a factual issue in most cases. In these facts it's easy to say that we are outside that zone. But it can include a limited group.

ABBOTT: If it's a fact issue in most cases, as you just said, then doesn't that depart from your earlier request for us to create a bright line?

MILLER: I think there already is a bright line. We believe that the bright line is an intent to induce action. And these facts are helpful on that.

O'NEILL: An attempt to induce action from who?

MILLER: An attempt to induce action from either a limited group or through an intermediator from someone that the fraud feasor is attempting to influence.

OWEN: What if all the facts in this case were the same except that Ernst & Young's audit opinion letter had been written with respect to First Republic?

MILLER: We don't believe it would have made any difference.

OWEN: What's the point of a public auditor's opinion in a 10K or an S3 if it's not to induce reliance by investors?

MILLER: First of all, this was in a proxy statement, which is a critical point. This was first of all financials that were issued in 1987 at a time that Interfirst was a completely separate thing. The inclusion in the SEC filings was in connection with a merger, and the purpose of those documents was to inform voters, basically the shareholders who were going to vote. That was the type of transaction that was involved.

These Interfirst notes that were bought by the purchaser had been traded on the open market for years. The people that were buying these notes were buying from complete third-parties.

O'NEILL: But why would those investors who were voting on the merger, the shareholders, why would they be interested in Republic Bank's financial position?

MILLER: People who are voting on the merger would be interested in those financial statements because they are trading stock for stock.

O'NEILL: They have a financial interest in the stream of the merged entity. And why does an investor who buys a stock or buys an instrument backed by the merged entity any less than for a stockholder?

MILLER: They might not be any less than a stake holder, but they are completely outside the intent to induce any action. The key point of fraud is it is an intentional tort. And the tort of fraud in Texas gives certain preferential rights to the intended victim. It strips away, for example,

the defense of comparative negligence. It allows punitive damages and it gives a longer statute of limitations. The key point in fraud is that the people who are intended victims get ahead of the line.

O'NEILL: You say in your brief that even under the restatement you would prevail in this case?

MILLER: That's correct.

O'NEILL: So let's look at the reason to expect standard. Why wouldn't we have a reason to expect that investors and securities backed by this merged entity wouldn't similarly have a stake?

MILLER: The CA found there was a fact issue on reason to expect. And I think we are probably bound by that finding in this court. The reason we think we would prevail under §531 of the restatement is best illustrated by illustration 7 to the restatement, which explains the type of transaction illustration. Illustration 7 says that (A) seeking to sell his own lot publishes some misrepresentations in the newspaper about a group of lots. Someone relies on those misrepresentations, which is certainly foreseeable, and buys a different lot in that subdivision from another person. The restatement says that there is no liability there, because the transaction that occurs is not the type of transaction in which the actor intended to induce action.

We think that that is clearly the case here, because there is some evidence in the record that perhaps Republic Bank or Interfirst or maybe Arthur Young cared how people voted in this merger.

O'NEILL: But the restatement doesn't say intent to induce action. It says reason to expect.

MILLER: There are two parts to the restatement. It says, first there has to be a reason to expect, and then it continues...

O'NEILL: And you would expect this particular class of investors to rely on this type of information.

MILLER: There is a fact issue raised by the experts as to whether there is a reason to expect. And we think by the way the Dallas court misapplied probably reason to expect, because the restatement says, that reason to expect has to be a special reason to expect. And the affidavits in this case are going to create fact issues over this in virtually all kinds of accounting cases.

O'NEILL: Are you saying if we go with the restatement position then there is a fact issue with _____?

MILLER: No. I'm saying if you go with the restatement and you apply all of the

restatement, the restatement continues. It says, one who makes a fraudulent misrepresentation is subject to liability to the person or class of persons who he intends or has reason to expect to act. And then it continues, or refrain from action in reliance upon the misrepresentation for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

This was not argued in the court below, because frankly we thought that the Blue Bell opinion absolutely controlled, and we thought Texas law in the oil well division case, which talked about the intent to induce action, Justice Greenhill's opinion for the unanimous court says that that's the test, that was going to control. The Dallas court went off and frankly on a tangent and adopted only the first half of restatement, §531. They never did an examination of whether it was the same type of transaction.

ABBOTT: But when you say type of transaction, you're talking about the merger here?

MILLER: Yes.

ABBOTT: Why couldn't we categorize the type of transaction as an investment in the entity?

MILLER: It's easy to look at that. In all of the restatement illustrations, and frankly in all of the case law that they are synthesizing, it's clear that when the purchaser deals with a third-party outside of the group that the person who is charged with fraud is trying to benefit, that that is a different type of transaction. There are a couple of good illustrations here. Again, illustration 7 I think is actually probably the most compelling that I have talked about. But there is also an illustration of a mortgage in the amount of $10,000 secured by a particular land, and if that's replaced by a bond issue in the amount of $1 million secured by all the assets of a corporation, the transaction is of a different type.

HECHT: What if Republic Bank had told Ernst & Young that it needed a good report, not only to induce shareholders to vote for the merger, but also because as you know accounting firm, institutional investors look at this kind of information and we want them to buy these bonds even though they shouldn't, so we want you to help us lie to them. It seems like that would clearly would be fraud.

MILLER: Of course there is absolutely nothing in the record like that. But if there were, you could have a fact issue on whether there was an intent to induce action in some _____. If these had been convertible securities for example, if these had been convertible to stock and could have voted, there is a lot of stuff in the proxy statement talking about convertible securities. If you can get to the hypothetical that you have there, there might have been some interest in this. But the record is really clear here. All the experts are saying is, Gosh accountants know that all kinds of people look at financials. Frankly, the opinion below would allow an investor in a completely

different entity to make a claim. We all know for example that when Intel stock goes down it has a tendency to affect the stock of PC makers - Dell and Compaq and so on. You can postulate under under what the Dallas CA did, that if the audit opinion on Intel has an error in it, they have reason to expect as auditors that people who invest in Compaq and who invest in...

ABBOTT: No, because there would be no reliance.

MILLER: There certainly would be a reliance. There is reliance all the time on that. Because the expectation is, that if the chip shipments are down, then PC shipments are going to be down.

ABBOTT: But no one who buys Compaq stock would be looking at anything done for Intel.

MILLER: I believe they do in the sense that - there are all sorts of indications that different industries move. The theory is that the sale of PC chips are an upstream indication of what the sale of PCs are going to be. So if Intel has its sales of chips down, then that's considered a leading indicator of what's going to happen to the PC market. That was the assumption.

OWEN: Let's go back to a little bit narrower reliance. My example is let's assume that Ernst & Young had audited First Republic, the merged entity, and the audit letter was done in connection with their 10K. Would the plaintiffs in this case be able to recover on a fraud theory under those facts?

MILLER: And the assumption further is that there was an intent - what was the purpose of the fraud?

OWEN: It's the 10K. That to misrepresent the financial condition of First Republic, the merged entity.

MILLER: Obviously we don't have those facts. I believe the answer is that they would not be able to recover.

OWEN: And why not?

MILLER: The reason is that the notes here have nothing to do with the entities. These notes were put out and they were just going along...

OWEN: Well I'm the purchaser for Pacific Mutual and I'm looking at buying these junk bonds, and I've just learned that First Republic has merged, it's a new entity. I know that they will be backing up these junk bonds. And my decision to purchase or not to purchase, why is that not influenced by the financial condition of First Republic?

MILLER: It may be influenced, and they would have a negligent misrepresentation claim.

OWEN: Why not a fraud claim if the auditor knowingly misrepresented First Republic's financial condition in a 10K?

MILLER: They would not have a fraud claim under existing Texas law, or under the restatement if the auditors alleged fraud was intending to induce a different kind of transaction.

OWEN: What's a 10K intended to induce?

MILLER: I think a 10K is intended to report on the financial condition of the entity. Again, this wasn't a 10K. So that's not the facts.

OWEN: But that's my example. Where would you draw the line and why wouldn't an investor look at a 10K, for example, of a publicly held company to decide whether to invest in bonds if that company is backing _____?

MILLER: An investor will look at the 10K of the entity in which they are making an investment. But I would point out that there is a lot of law out there that says that future open market purchasers are an unlimited group and they may not even have a negligent misrepresentation claim. And they are very broadly out there. But if there is an intent to defraud that group, if there is an intent to induce action by those future purchasers of stock, if you postulate that you would have a fraud claim. And you could have a fraud claim.

HANKINSON: What would the proof like of intent to induce?

MILLER: I think the proof would look like some kind of motivation or some kind of a possible causal link between what the auditors were doing and what these parties who are being - they intend to induce action to do might do. In this case for example, there is some evidence, which we dispute that the auditors wanted the entity to survive and so they may have pumped up the audit a little bit, so that the merger would go through and the entity would survive. That makes sense. But has nothing to do with whether these junk bonds were traded, not traded, what the price was, if they came or went, or anything about that. Because essentially that's completely irrelevant. If the proof were that they wanted to get people to vote in a certain way, you would have a fact issue to go to a jury.

HANKINSON: That's my question. Doesn't your whole - isn't your whole argument bottomed on the fact that the audit report was part of the proxy statement, and unrelated to the purchase of the junk bonds later on and, therefore, that's the missing link on the intent to induce? Is that the underpinning for your argument?

MILLER: I think the underpinning for our argument is, that we absolutely negated any intent to induce action on the part of purchasers of junk bonds. And the controverted...

HANKINSON: And my question is, how did you do that?

MILLER: First of all, we had an affidavit from the audit partner, Bud Ward, who said, We had absolutely no intent to do anything about any of these things. And in fact, there is no evidence in the record that Ernst & Young even knew that these junk bonds existed. The countervailing proof is some experts who say, gosh, auditors know that all kinds of investors rely upon on things. Their proof goes to what the Dallas CA did, which is to look at expectation of reliance. It does not go to intent to induce action.

HANKINSON: So it's not critical to your analysis that Ernst & Young approved the use of the audit, the opinions on the audit in connection with the proxy statement related to the merger as opposed to using the opinions on the audit for any other purpose?

MILLER: That's not critical to our opinion as long as they did not intend do induce some action by what they did on the parties who are making a claim. These people are outside of the zone. The people who ought to be in line first, and have in fact been in line and have already had other lawsuits, are the people who were voting on the merger. And the purpose of fraud is to reward and put a recovery in the hands of the people who were the targets of the fraud. Here you have these remote parties who really don't have any reason to be defrauded. And they come in without regard to any of their negligence. There is a lot of comparative negligence evidence here, which is completely irrelevant in a fraud case.

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RESPONDENT

ABBOTT: What was the evidence concerning the scope of the expectation of reliance other than what your expert may have said?

BUDNER: Well we have two experts. In addition to that, we had an employee of Pacific Mutual who discussed the industry.

ABBOTT: But there was no evidence indicating any expectation of reliance either by the defendant or by anyone affiliated with the bank?

BUDNER: Actually, I believe there was. And that evidence was in the form of an admission by Bud Ward himself, that Mr. Miller has referred to, in which he acknowledged that he and Ernest & Young knew that when they prepared these audit opinions and again when they consented for the audit opinions to be filed with the merger documents with the SEC, that the public investors would rely on those documents, that it was not just for the limited purpose of the

shareholders.

If we are looking at intent as opposed to reason to expect, I actually believe that there is evidence that creates a fact question on intent. And I believe they intended to induce anyone that was an investor or potential investor during the period of time in which that audit opinion was still current.

ABBOTT: What is the evidence that supports that intent?

BUDNER: The knowledge coupled with action. The knowledge by Ernst & Young of the realities of the securities industry, and the action that followed, which was, Okay we sign off, we will take another fee and we will sign off on having this filed with the merger.

OWEN: But they signed off on Republic Bank. And had nothing in their audit did it that said that the merged entity would have a strong financial position?

BUDNER: They did audit Republic Bank. But the audit went to the merged company, because the merger really wasn't a merger. It was an acquisition. And the record is clear that what happened as a result of that merger was, Interfirst was acquired as a wholly unsubsidiary.

OWEN: But my point is, the audit only covered the premerger condition. That audit said nothing about what the financial condition of Republic Bank would look like after the acquisition.

BUDNER: I disagree with that. When the consent was given to the filing of that audit opinion in connection with the merger document, some 6 months later, it was reviewed and updated and the consent was given.

OWEN: The consent was given again, but it only dealt with an audit as of 12/31/86 of Republic Bank, not an audit of what Republic Bank would look like after that date, after it had merged with Interfirst?

BUDNER: I submit that in this instance there is no difference. Because it was clearly understood, and the record is replete with evidence of this, that the financial where with all of this acquisition came from Republic Bank. Interfirst was not being looked to as a source of financial strength. The financial strength that the public looked to and the financial strengths that my client looked to was Republic Bank.

OWEN: But my point is, in acquiring Interfirst it had liabilities presumably that might have affected the bottom line of Republic Bank after it made the acquisition. And the audit does not speak to what that new entity will look like does it?

BUDNER: That is correct.

OWEN: So how could Ernst & Young have intended someone to rely on what First Republic would look like when its audit only dealt with Republic Bank premerger?

BUDNER: Because I think Ernst & Young knew when it signed off on this and consented to its audit being included in the merger document, investors were looking to the strength of Republic, that's what was touted about this acquisition. Admittedly, Interfirst brought some liabilities to the table. But it turned out that's not what brought this entity down. It was the Republic loan portfolio that went South that brought this entity down. And that's what Ernst & Young falsely audited.

HANKINSON: What are the limitations on the liability that you are suggesting in this case? If your position is that Ernst & Young intended the investing public to rely upon the audit opinion that was contained in this proxy statement, does that mean that there were no limits? Anyone who says that they've read the proxy statement and purchased something as a result of it, whether it was stock or debt instruments or whatever that they are liable to everyone, or are there any limits on the parameters of the theory that would arise under this transaction?

BUDNER: If we're looking at intent, I don't know if your honor is intending to limit this just to an intent standard or also to a reason to expect standard.

HANKINSON: Start with intent.

BUDNER: I think that there are limitations. Certainly trade creditors would not be within the group because these public filings are not for the benefit of trade creditors. They are for the benefit of investors, and the securities laws are clear and the cases interpreting them are clear that that's what the purpose is.

HECHT: Well why does it have to be for the benefit of? Why can't you make the argument, I never would have sold them - $5 million worth of computers on credit if I didn't know they had publically filed the documents that they have to file, which include an audit by a responsible accounting firm.

BUDNER: Under the reason to expect standard, our evidence is that in the securities industry, as opposed to in a lending arrangement, an accountant knows who's going to rely on its audit. And we don't have evidence as to what other transaction might have been induced by this _____ audit.

HECHT: But if it did have evidence it would put them within the scope.

BUDNER: I think the reason to expect standard and particularly when you look at §536

of the Restatement, it talks about when an audit is publically filed it's for the protection of a particular class of people. That is what helps us to understand the meaning of reason to expect. And what we have here is filed under the securities laws, not under some banking regulations, for the protection of investors.

HANKINSON: I thought this was for the protection so that the shareholders would be able to know how to vote with respect to the acquisition?

BUDNER: That was certainly one of the purposes of filing the merger documents.

HANKINSON: And the audit opinion was part of the merger documents?

BUDNER: It was part of the merger documents. And in the merger document it specifically said, Republic Bank is backing the securities of Interfirst.

HANKINSON: But then that takes me back to - my question is what the limitations are as to who could have a good claim against Ernst & Young for allowing this audit opinion to be filed in this kind of document with the SEC?

BUDNER: First of all, only people that can demonstrate that there was an intentionally false statement, a fraudulent statement, not a mere negligent misrepresentation. Second, only people who can demonstrate actual reliance. And that's very important here. This is not a fraud on the market kind of an allegation we are making. We're asking for a presumption of reliance. We're saying only the people that can come into court and say we read this...

HECHT: Just the proxy statement?

BUDNER: The audit opinion that was contained in the proxy statement.

HECHT: The petitioner's brief said you didn't see the audit report, doesn't it?

BUDNER: It says that, and they are incorrect. The CA cited in its opinion some of the evidence where we talked about that, and I can point the court to some right now. Larry Card's(?) affidavit in paragraph 8 says, I recall that either I personally or someone under my supervision who then reported to me carefully reviewed these written materials, including the audited financial information opined upon by Arthur Young & Co.

OWEN: The audit financial information, not the audit letter.

BUDNER: Well I think that included the ultimate opinion. It talks abut the opinion in other parts of that affidavit. The opinion letter is something that Mr. Card placed emphasis on in his affidavit.

So we have to prove intentional falsity. We have to prove actual and justifiable reliance, which we have evidence of in this record. We have to prove as I said before a reason to expect standard. In other words, if we take guidance from §536, what was the purpose of this filing? For whose protection was this information required to be publically filed? So we've got that issue, and then we have the temporal issue of a limited time span. These audit opinions aren't good forever. Everybody knows that. The investing public knows that. We have evidence here that this one was still current. It still was fresh enough when we made our investment, about ½ year after the merger documents were filed with the newly consented audit opinion, that we were within that time span where we were justified in relying on the currency of that report.

HANKINSON: In other words then, your position is that you can't have a bright line rule in terms of which investors may or may not be in the zone, so to speak, and instead we're looking at a case-by-case determination based on the evidence that is presented as to whether or not a particular plaintiff can meet the required elements.

BUDNER: I know this court and every court likes bright line rules, but I think that's correct. We can't have one. But we do have standards. The reason to expect standard is clearly defined in the restatement.

ENOCH: Would it be your position that if the auditing firm permits its audit letters to be filed with the SEC, then the universe of people who can sue them for fraud is any investor, assuming they meet the justifiable reliance and actual reliance?

BUDNER: Well subject to the limitations that I stated to Justice Hankinson, I think that's right. And I think that when Ernst & Young takes a fee...

ENOCH: What makes the universe all investors?

BUDNER: The public filing and the fact that the purpose of the statute requiring public filing is for the protection of investors.

O'NEILL: Your brief on page 17, you say Ernst & Young knew and intended that the false report to be included in Republic Bank's annual report in order to satisfy legal reasons. What legal reasons?

BUDNER: I'm talking about the securities and exchange rule.

O'NEILL: What requirements are you looking at that addresses specifically institutional investors and securities backed by the _____ rule?

BUDNER: I don't know of any specific portion of the securities rule that have a specific provision protecting investors in securities backed by the entity. But they are generally for the

protection of investors in that entity.

OWEN: Is there anything in evidence other than the proxy statement?

BUDNER: There was the S3 registration. There was the 10K.

OWEN: The 10K was in evidence?

BUDNER: Yes.

OWEN: A 10K Republic Bank not a First Republic?

BUDNER: That's correct.

OWEN: Pre-merger?

BUDNER: Yes, the audit was clearly done pre-merger. We don't argue that the audit was done at the time of the merger. It was updated and consented to at the time of the merger.

O'NEILL: The portion of the restatement we've been talking about that references the type of transaction, in the type of transaction in which he has reason to expect their conduct to be influenced, is that a question of law? Do we apply what type of transaction was intended to be influenced?

BUDNER: I think that there are legal lines that this court can draw. Then there is a fact finding as to whether it's a type of transaction. But if this court is to draw, it's going to try to craft some sort of bright line rule, I ask the court to look carefully at §534 of the restatement, which talks about types of transactions. And it specifically refers to...it talks about multiple types of transactions, and in its comment C it says, A statement by the directors of a corporation of its financial position, whether published by it or by a public official to whom the corporation is by statute required to furnish it, is made with the intention or expectation of inducing the public to deal with the corporation in any one of a variety of different ways in which the financial status of the corporation is material.

I think the restatement clearly contemplated not just one kind of transaction, not just - this wasn't just for the stockholders who were voting on the merger, this was for people that dealt with the corporation in any number of a variety of different ways.

The Dallas CA drew distinction by talking about affirmative knowledge.

O'NEILL: Well it seems like they drew a distinction but applied reason to expect.

BUDNER: I noticed that that was a criticism that Ernst & Young leveled at the CA. And without trying to protect the CA, perhaps they did have an inconsistency between a comment they made in their footnote. But they didn't need to have that inconsistency. There is plenty of evidence that Ernst & Young had reason to expect, had affirmative knowledge that investors are out there, that they were actively involved in these merger negotiations. So they had all sorts of affirmative knowledge, including the knowledge that Bud Ward, their audit engagement partner, admitted to. So they had the knowledge about the realities of the securities industry. They had the knowledge that investors such as Specific Mutual would invest or might invest in these stocks and would rely on these audit...

OWEN: Did they have any knowledge about Interfirst junk bonds or Interfirst debt obligations at all, any stocks, bonds that Interfirst had issued?

BUDNER: I believe the record does reflect that they had knowledge, that these bonds were mentioned in the securities filings in the S3 that were filed with the...

OWEN: But that's the company's S3. That's not Ernst & Young's opinions. Is there any knowledge that Ernst & Young had any knowledge about the junk bonds - at the time that they did this audit, at the time they consented to include it in the SEC filing?

BUDNER: Ernst & Young admitted that they were intimately involved in the merger negotiations. That they were intimate in the advice...

OWEN: What evidence is there, if any, about the junk bonds or Interfirst's bonds in general?

BUDNER: I frankly don't' know whether there is any evidence in the record from Bud Ward, for example, saying I knew specifically about these 12-3/4% notes. Larry Card in his affidavit disputes the characterization of them as junk bonds.

OWEN: By the time that your client made the purchase, was there an audit of First Republic publically available?

BUDNER: No. The only audit that was available that was relevant to all this was the audit that Ernst & Young had done.

OWEN: So the merger had occurred in June, and there was no second quarter audit that was done of 10K or the 10Q done, or even like that on First Republic that publically available by July 22?

BUDNER: My understanding is that there was not.

HANKINSON: Would this court's adoption of the reason to expect language from §531 of the restatement effect a change in Texas law on fraud?

BUDNER: I don't think so. I know that that's Ernst & Young's position that it does. But I think it reads these cases far more narrowly than they can fairly be read. I think what Ernst & Young is suggesting that this court do is apply in fraud cases the standard that the American Law Institute created for who may sue in a negligent misrepresentation case. And yet, in those cases, ALI says that they intentionally created a standard for negligent misrepresentation that was much narrower than for fraud.

HANKINSON: Current Texas law has an element that there must be an intent to induce reliance. And isn't the reason to expect that someone's going to rely on the representation different, and isn't that changing the intent element of fraud law in Texas?

BUDNER: I think that if it's a change, it's a massage of the rule. It's a massage to make the rule comport with the realities of the financial markets today. In fact, the realities of new communications today, we are no longer a face to face society the way we once were. And when we make statements that go out there, I think we have a reason to expect even though we may not have intended a specific person to induce.

Ernst & Young can't say if they stand up in front of a big crowd and shoot a rifle that they didn't intend to hit the person that got hit. I think that's in essence what they are saying here today.

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REBUTTAL

HANKINSON: Mr. Miller, are you asking for a bright line rule, or are we looking at this on a case-by-case basis looking at the elements of the cause of action and deciding whether or not an accounting firm can prevail as a matter of law based upon the evidence presented?

MILLER: We are asking for Texas law as it has always existed to continue to apply, which does provide a bright line that allows summary judgment in fraud cases frequently.

HANKINSON: But that would be evaluating the evidence on a case-by-case basis as presented in the record on the summary judgment motion. Right?

MILLER: I think basically all summary judgment motions have to be evaluated on a case-by-case basis of course. But there are many instances like this one and the illustrations in the restatement where summary judgment is now possible under Texas law, and everybody agrees it's not a fraud case, which changes the whole dynamic of whether the case can be settled or not.

Let me give you a example of one of the problems this is going to create. And I think you're point was very well taken, that there is no limit to liability if this reason to expect standard is adopted, especially if only part of the restatement is adopted. Assume we had a dot com company here in Silicon Prairie that was a small company with a few employees and a few shareholders and just a little bit of debit and it wanted an audit. Right now that's going to be a pretty cheap audit. If it's known that it is looking at a stock for stock trade with Microsoft, for example, what the CA has said is, that the auditors or the attorneys who work for that dot com company are now exposed to the downstream liability that might be caused by Microsoft, by all the people down the way. Right now, that is not anything that Texas law is going to _____, we are not going to have to have the trial on that. We are going to be able to resolve on summary judgment.

HECHT: Well not if they don't lie they won't be. It's one thing to say if you make a mistake, if you don't exercise direct duty of care, your ripple shouldn't go forever. But if you make an intentional misrepresentation it's harder to justify that.

MILLER: It certainly is. And by the way the transferred intent argument which Mr. Budner made at the end, does not apply in fraud. Section 531 illustration - 3 for example, 2 make it clear that transferred intent is a criminal intent _____ and the bullet can ricochet. The key point is that there are a series of elements of fraud in Texas. The focus now is on this element, the intent to defraud the parties who are claiming. False representation fact issues have been raised on, we don't think there is a false representation. And the CA said that there are fact issues on the rest of these. But this is actually the brightest line we have in fraud law, because it does draw a circle and we can see from time to time clearly is outside that circle. If you eliminate that, you make fraud the tort of a new millennium.

HANKINSON: You just lost me on where you just said that there is basically a line to be drawn around that element, which sounds like a bright line test. Where is the line to be drawn? How are you asking us to draw it?

MILLER: I think the line is already drawn in the case law. If you look at the oil well division opinion, for example, Justice Greenhill's language there is intent to induce action. If you look at the _____ v. Wall case it's intent to influence. The line is that there are only certain people who are intended to be influenced. If you look at the illustrations in the restatement, there are many transactions when it's clear that a fraud feasor could have no rational intent to influence or induce action for bystanders and people who are around. Now it's much easier for a plaintiff to show that they had some recognition that a bystander might rely. It's a completely different issue as...

O'NEILL: In the merger documents, I understand specifically says that First Republic Bank is backing Interfirst bonds. Is that correct?

MILLER: I don't believe that is - I have not seen that in the merger documents. The evidence in the record is that there is a supplemental indenture...

O'NEILL: Assume with me that the documents say that, or something to that effect. What's the purpose of them wanting to make that _____. It benefits First Republic for these bonds to be sold doesn't it?

MILLER: No. It doesn't. These bonds are completely irrelevant to the future of this business. These bonds were sent out. The money was given to the business and they don't care whether the bonds tried higher or lower, because they are just being traded out here. When the redemption time comes they pay the same amount whether the price has gone up or down, people have bought them, people have sold them, the people have held them the whole time. There is absolutely no way that the trading of these bonds suggested in the _____ or in reality can have any effect at all on First Republic or Republic Bank or Interfirst. Because these bonds have been sent out here and they been on the market. The only time they have to deal with them is when they have to pay them, and they pay them the same whether Pacific Mutual bought or whatever they paid or whatever happened. And that's a critical fact in this case. That's where we draw the bright line when we can see that it can't possibly make any difference. In illustration 7, for example, where a person is trying to sell his lot and somebody else goes off and buys some other lot. It's easy for us to draw a bright line and say he can't possibly intend to sell somebody elses lot.

ABBOTT: We could apply this same analysis to a situation where it's the person who bought the bond and they are waiting on how many paid up and they never pay up.

MILLER: I don't follow the question exactly. The intent we look at is the actor's intent, the person charged with fraud, not the intent of the person who relies. That's a separate element. That's reliance down here. All kinds of people can rely on all sorts of things. But fraud is an intentional tort. And if there were no intent to harm or cause action, then it's not intentional.

As Oliver Wendell Homes said in his great work on the common law, even a dog distinguishes between stumbled over and being kicked. This is about kicking. The question is: Who did you kick at? And if these are people that were not being kicked, then we don't have fraud. We have securities fraud or negligent misrepresentations.