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Internet Law Update

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ATTORNEYS IN DOT COM PUBLIC OFFERING ARE NOT LIABLE FOR MISSTATEMENTS

[Lawson v. Advanced Equities, et al., 2003 U.S. Dist. LEXIS 11899 (W.D. Ky. June 19, 2003).

Plaintiffs purchased stock in Pixelon, Inc. through a private offering.¹ Pixelon was in the business of developing broadcast technology for the Internet.² Plaintiffs' complaint is based on their reliance on statements made in the Private Placement Memorandum ("PPM").³ The PPM contained information about the management of Pixelon, including a backgrounder on the company president, Michael Fenne.⁴ As it turned out, Fenne had been convicted of several felonies in Virginia and had been concealing his true identity.⁵

Pixelon held a music event called iBash which was intended to launch its network.⁶ The event cost \$16.2 million, most of the proceeds from the offering, but was a failure due to Pixelon's inability to broadcast the event over its network.⁷ Following the failure of iBash, Pixelon terminated Michael Fenne.⁸ Only after terminating Mr. Fenne, did Pixelon discover his criminal background and true identity.⁹

Plaintiffs' claim against Kring and Shefky is based on their involvement in preparing the offering documents for Pixelon. Plaintiffs allege that Kring and Shefky "should have performed a background check to verify the general biographical information provided by Fenne."¹⁰ Plaintiffs do not allege that the false statements were actually made by either Kring or

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Shefky, rather they “seek to impose liability on [the] law firms by virtue of their involvement in preparing the offering documents.”¹¹

There is a split of authority on whether “outside professionals must themselves make a false or misleading statement for primary liability to attach” under §10(b) or Rule 10b-5.¹² According to the court, “the Second, Tenth and Eleventh Circuits appear to have taken the position that professionals must themselves make a false or misleading statement in order to impose liability.”¹³ In contrast, the “Ninth Circuit has held that an outside professional can be held liable based on ‘significant’ or ‘substantial’ assistance to the representation of others.”¹⁴

The court noted that were it to adopt the ‘bright line’ test of the Second, Tenth and Eleventh circuit, plaintiffs’ claim would fail because neither of the defendants actually made the statements.¹⁵ It also noted that it reached the same conclusion under the Ninth Circuit’s test because the plaintiffs failed to allege that the defendants had the requisite mental state.¹⁶

The court concluded that it could find no case law that imposed a duty on law firms involved in preparing documents to investigate absent some reason for the firm to know that they were making a misstatement.¹⁷ On this basis, the complaint against the law firms, Kring and Shefky, was dismissed.

¹ 2003 U.S. Dist. LEXIS 11899, *1.

² *Id.*

³ *Id.* at *3.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *4.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* at *5.



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¹¹ *Id.* at *6.

¹² *Id.* at *7.

¹³ *Id.*

¹⁴ *Id.* at *8.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at *10.