

2904 SECURITIES FRAUD: MAKING AN UNTRUE STATEMENT OF MATERIAL FACT IN CONNECTION WITH THE SALE OF A SECURITY — §§ 551.501(2) and 551.508

Statutory Definition of the Crime

Section 551.501(2) of the Wisconsin Statutes is violated by a person who willfully makes an untrue statement of material fact, or omits to state a material fact necessary to make the statements made not misleading, in connection with the offer, sale or purchase of any security in this state.

State's Burden of Proof

Before you may find the defendant guilty of this offense, the State must prove by evidence which satisfies you beyond a reasonable doubt that the following three elements were present.

Elements of the Crime That the State Must Prove

1. The item [offered] [sold] was a security as defined by Wisconsin law.

A [insert applicable term from § 551.102(28)] is a security.¹

2. The defendant [made an untrue statement of material fact] [omitted to state a material fact necessary to make the statements made not misleading] in connection with the offer, sale or purchase of a security in this state.²

["Offered" includes every attempt or offer to sell or dispose of a security or interest in a security for value.]³

["Sold" includes every sale, disposition or exchange, and every contract of sale of, or contract to sell, a security or interest in a security for value.]⁴

A fact is a "material fact" if it could be expected to influence a reasonable investor in making a decision whether to purchase an investment.⁵

[A fact is also a "material fact" if the maker of the representation knows that the investor regards the matter as important in making a decision whether to purchase an investment, even though a reasonable investor would not regard it as important.]⁶

3. The defendant acted willfully.

"Willfully" requires that the defendant knowingly [made an untrue statement of material fact] [omitted to state a material fact necessary to make the statements made not misleading] in connection with the offer, sale or purchase of a security. Proof of intent to violate the law or knowledge that the law was being violated is not required.⁷

Deciding About Knowledge

You cannot look into a person's mind to find knowledge. Knowledge must be found, if found at all, from the defendant's acts, words, and statements, if any, and from all the facts and circumstances in this case bearing upon knowledge.

Jury's Decision

If you are satisfied beyond a reasonable doubt that all three elements of this offense have been proved, you should find the defendant guilty.

If you are not so satisfied, you must find the defendant not guilty.

ADD THE FOLLOWING⁸ IF THE DEFENDANT HAS BEEN CHARGED UNDER § 551.508(1m): THE VICTIM WAS AT LEAST 65 YEARS OF AGE WHEN THE CRIME WAS COMMITTED:

If you find the defendant guilty, you must consider the following question:

Was (name of victim) at least 65 years of age when the crime was committed?

Before you may answer the question "yes," the State must satisfy you beyond a reasonable doubt that (name of victim) was at least 65 years of age when the crime was committed.

If you are not so satisfied, you must answer this question "no."

COMMENT

Wis JI-Criminal 2904 was originally published in 1998 and revised in 2004, 2009 and 2010. The 2010 revision added the special question for cases involving victims over 65 years of age. The 2014 revision made a correction in footnote 1.

This instruction is for violations of § 551.501(2). Section 551.508 provides that persons who violate the provisions of Chapter 551 are guilty of a Class H felony. 2009 Wisconsin Act 196 created § 551.508(1m) which provides for a penalty increase if the crime is committed against a person who is at least 65 years of age when the crime is committed. A special question has been added for cases where the penalty increase applies.

1. Section 551.102(28) provides an extensive definition of "security." If the item involved in the case is alleged to be an item specified in that definition, the Committee recommends that the jury simply be told, for example, that "common stock is a security." It is for the jury to determine whether the item involved in the case is in fact common stock.

Until the 2014 revision, this footnote referred to a definition of "investment contract" in the Wisconsin Administrative Code – DCF 1.02(6)(a). That definition was deleted from the Administrative Code when the securities law statutes were revised effective January 1, 2009, but the revision incorporated the equivalent of the former Code definition into the statutory definition of "security" – see § 551.102(208). This process is explained in *State v. Hudson*, 2013 WI App 120, 351 Wis.2d 73, 839 N.W.2d 147, ¶¶14 and 15.

In *State v. Johnson*, 2002 WI App 224, 257 Wis.2d 736, 652 N.W.2d 642, the court held that offers involving promises to repay loans at above market rates were offers to sell "securities." The court adopted the "family resemblance" test articulated in *Reves v. Ernst & Young*, 494 U.S. (1990), previously applied in *State v. Mueller*, 201 Wis.2d 121, 549 N.W.2d 455 (Ct. App. 1996).

In *State v. LaCount*, 2008 WI 59, 310 Wis.2d 85, 750 N.W.2d 780, the court held that it was not error to allow a lawyer to testify as an expert regarding what an "investment contract" is. Further, the evidence was sufficient to establish that the investment in this case was a security.

A promissory note issued to a sold investor is "security" under the securities fraud statute. *State v. McGuire*, 2007 WI App 139, 302 Wis.2d 688, 735 N.W.2d 555.

2. Section 551.613 describes situations that are covered by the "in this state" requirement but where not all of the aspects of the transactions or the participants are present in Wisconsin. If a particular situation raises a factual issue in the case, it may be necessary to provide instruction on that situation.

3. The definition of "offer" is based on the one provided in § 551.102(26).

4. The definition of "sale" is based on the definition of "offer to sell" provided in § 551.102(26).

5. The definition of "material fact" is based on the definition used in 23.06 Materiality, *Federal Criminal Jury Instructions*, Potuto, Saltzburg and Perlman (2d edition) Michie 1993. The Comment to that instruction indicates that the definition is taken from the test in *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). The *Texas Gulf Sulphur* test is based on § 538(2)(a), *Restatement of Torts 2d*. The test is an objective one, asking whether a reasonable person would attach importance to a particular fact. The actual importance accorded a fact by the investor in any particular case is not determinative if the hypothetical reasonable investor would have considered the fact to be material.

This definition is consistent with the standard adopted in *State v. Johnson*, 2002 WI App 224, ¶21, 257 Wis.2d 736, 652 N.W.2d 642: ". . . an objective standard, wherein the fact finder assesses whether the omitted or misrepresented fact would have made a difference to a reasonable investor's decision to invest. See *Ollerman v. O'Rourke Co.*, 94 Wis.2d 17, 42, 288 N.W.2d 95 (1980); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976)."

6. This is based on § 538 (2)(b) of the Restatement of Torts, 2d. The full text of that provision reads as follows:

(2) The matter is material if

...

(b) the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it.

The Committee concluded this should be included in brackets in the instruction, for use in a case where it is supported by the facts.

7. The origin of the "willfully" requirement is § 551.508(1), which provides that "[a]ny person who willfully violates any provision of this chapter . . . may be fined not more than \$5,000 or imprisoned not more than 5 years or both." Wisconsin courts have held that for violations of § 551.4 [now 551.501], "willfully" does not require proof of intent to defraud or knowledge that the law was violated; it is sufficient that the defendant "knowingly committed the act charged." State v. Mueller, 201 Wis.2d 121, 549 N.W.2d 455 (Ct. App. 1996).

8. Section 551.508(1m) provides that if a securities fraud offense "is committed against another person who is at least 65 years of age when the crime is committed, . . . the maximum fine . . . may be increased by not more than \$5000 and the maximum term of imprisonment . . . may be increased by not more than 5 years." Where the offense involving the penalty increase is charged, the Committee recommends that a separate question be submitted to the jury if the jury finds the defendant committed the basic offense. The following should be added to the standard verdict form:

If you find the defendant guilty, answer the following question "yes" or "no":

Was (name of victim) at least 65 years of age when the crime was committed?