IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

IN RE:	§	
	§	Adversary No. 99-6073
SUNPOINT SECURITIES, INC.	§	
	§	A Liquidation Proceeding Under
	§	the Securities Investor Protection Act
Debtor	§	(15 U.S.C. §78aaa, et seq.)

SECURITIES INVESTOR PROTECTION CORPORATION and ROBERT G. RICHARDSON, Trustee of the Estate of Sunpoint Securities, Inc.	§	
Plaintiffs	§	Adversary No. 01-6079
v.	§	
CITY NATIONAL BANK	§	
Defendant	§	

MEMORANDUM OF DECISION

Now before the Court in the above-referenced adversary proceeding is "Defendant City National Bank's Motion for Partial Summary Judgment as to Plaintiffs' Negligent Misrepresentation Claim in Paragraph 59 of the Second Amended [Original] Complaint" (the "Motion") filed on February 8, 2006. Upon due consideration of the proper summary judgment evidence, the written legal arguments submitted by the parties,[1] and the relevant legal authorities, the Court concludes that, for the reasons stated herein, the Defendant's

[1] Including the Motion, the response in opposition filed jointly by the plaintiffs Robert G. Richardson, Trustee for the liquidation of Sunpoint Securities, Inc. (the "Trustee") and the Securities Investor Protection Corp. ("SIPC") (collectively, the "Plaintiffs"), the reply of City National Bank, N.A. ("CNB"), and the sur-reply filed by the Plaintiffs.

Motion for Partial Summary Judgment as to the Plaintiffs' Negligent Misrepresentation Claim should be granted.

Factual Background

This adversary proceeding is brought by the Trustee and SIPC against CNB as a result of its former relationship with Sunpoint Securities Inc. ("Sunpoint"), a securities brokerage firm formerly based in Longview, Texas, which was forced into liquidation in November 1999, pursuant to the provisions of the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa, et seq. The entry of a protective decree against Sunpoint, and its subsequent liquidation, was triggered by a misappropriation of customer funds by the CEO, director, and controlling shareholder of Sunpoint, Van R. Lewis, Jr. a/k/a Van R. Lewis, III ("Lewis"), and certain of his subordinates, in an amount exceeding $25 million.

The banking relationship between CNB and Sunpoint, Lewis, and/or various entities controlled by Lewis (the "Affiliates")[2] began around 1995. CNB loaned significant sums of money to Sunpoint, Lewis and the Affiliates. Some of those loans were secured. Others were not. As Sunpoint grew, and then in June 1997, achieved the status of a "self-clearing broker" (which would place customer funds relating to the purchase and sale of securities directly under Sunpoint's custody and control), so did its

[2] The Affiliates include: Sunpoint Aviation, Inc.; Sunpoint Insurance, Inc., a/k/a Sunpoint Insurance Agency, Inc.; Sunpoint Air Transport, Inc.; Sunpoint Institute of Aeronautics, Inc.; Judith Ann Guess, Inc. d/b/a New Territory; Van Lewis, Inc. a/k/a Van Lewis III, Inc.; Financial Firms Exchange, Inc.; and Moonshadow, L.L.P.

financial activity. CNB was clearly a beneficiary of that growth. To satisfy Sunpoint's need for greater space, it became a tenant in a building owned by CNB. Eventually, CNB's business relationship with Sunpoint and the Affiliates was one of the bank's largest in terms of revenue, deposits, and lending. CNB also served as the IRA custodian for Sunpoint customers from July 1996 until May 1998.

The complaint of the Trustee and SIPC against CNB is comprehensive in nature and scope. The Plaintiffs seek to recover the entire $25 million of lost customer funds in actual damages, treble damages of $75 million, plus an assessment of additional exemplary damages, interest and attorneys' fees under various theories of alleged liability including negligence, gross negligence, negligent misrepresentation, breach of fiduciary duty, breach of contract, securities fraud, and violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO").

CNB brings this Motion for Partial Summary Judgment as to Plaintiffs' Negligent Misrepresentation Claim, seeking partial summary judgment only as to the allegations of ¶ 59 of Plaintiffs' Second Amended Original Complaint. That paragraph alleges that:

> CNB intended, knew or should have known that federal regulators, the NASD, and Sunpoint's customers would rely on CNB's statements regarding the source of the funds contributed in December 1997 as new capital in making decisions regarding whether to permit Sunpoint to continue in operation, or commence or continue their respective relationships with Sunpoint. CNB knew or should have known that a purpose of its January 1998 letter to the NASD was to ensure that Sunpoint

had satisfied its net capital requirements in order to continue in business. CNB knew or should have known that these statements were false when made. CNB's false statements robbed Sunpoint customers of the full benefit of proper regulatory oversight and the early warning systems based on the minimum net capital requirements applicable to Sunpoint.

To understand the allegations contained in ¶ 59, it is necessary to understand the events giving rise to CNB's alleged negligent misrepresentation. In late December, 1997, it came to the attention of Sunpoint's independent auditors that the company was not in compliance with certain statutory requirements regarding disposable net capital. Sunpoint's auditors and management advised the National Association of Securities Dealers (the "NASD") of this fact, as the NASD was the designated examining authority responsible for the regulation and oversight of Sunpoint.[3]

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[3] The New York Court of Appeals has provided a succinct summary of SIPC and its place in the regulatory structure:

> SIPC was created by the Securities Investor Protection Act of 1970 (SIPA) (15 USC §§ 78aaa-78lll) to protect customers of broker-dealers and maintain confidence in the United States securities markets. These goals are accomplished in two principal ways. First, when a broker is in or approaching financial difficulty, SIPC has the authority to petition the courts for protection of the broker's customers in a "protective proceeding." Such protection can include the court-ordered appointment of a trustee to liquidate the firm and satisfy customer claims from the proceeds of the liquidation (15 USC § 78fff). Second, SIPC is endowed with funds raised by assessments on its members, who are all the brokers registered under Securities Exchange Act § 15(b) (15 USC § 78o [b]). From these funds, SIPC can advance monies to the trustee to settle claims (15 USC § 78fff-3).
> ...
> While SIPC is not an agency of the government, the SEC exercises extensive control over its business affairs (*see,* 15 USC § 78ccc). SIPC does not have independent investigatory powers to certify the financial health of its members. It does not receive financial statements from its members, much less audit them. No statute or rule requires brokers to submit their audited financial statements to SIPC as they are required to do for the SEC or the designated self-regulatory organization, here the NASD.

In response to this situation, Lewis arranged for various transfers into and between accounts at CNB, which at the time appeared sufficient to the NASD to bring Sunpoint into net capital compliance. The NASD, in attempting to verify the legitimacy of Lewis' capital infusion, requested Lewis to procure a letter from CNB that would assure the NASD that the funds infused into Sunpoint were not "pledged, loaned, or encumbered" or subject to a right of offset.[4] Lewis forwarded that request to the then-president of CNB, Latricia Nichols ("Nichols").[5] On January 8, 1998, Nichols provided the following letter (the "NASD Letter") on CNB letterhead to Lewis for transmission to the NASD:

Sec. Investor Protection Corp. v. BDO Seidman, L.L.P., 95 N.Y.2d 702, 707, 746 N.E.2d 1042, 1045-46, 723 N.Y.S.2d 750, 753-54 (N.Y. 2001).

[4] *See* App. at 380, 412. (In support of the Response, Plaintiffs have submitted an Appendix containing their summary judgment evidence. As the pages of that appendix have been separately numbered, cites to Plaintiffs' evidence will be in the form of "App. at ___.")

[5] *See* App. at 412.

January 8, 1998

Mr. Jim Greening
NASD
Dallas, Texas

RE: Van Lewis, III
Sunpoint Securities, Inc.

Dear Mr. Greening:

This will confirm information on the following accounts at City National Bank:

- Account #6001491 is the Van Lewis, III personal account;
- Account #9000119 is an account that belongs to Sunpoint Securities;
- Account #60399 is an account that belongs to Sunpoint Securities;
- Account #61808 is an account that belongs to Sunpoint Insurance Agency, Inc.;

The transfer of funds in these accounts on 12/30/97 and 12/31/97 are not encumbered by City National Bank or otherwise pledged, loaned or encumbered. Also, City National Bank does not have any right of offset on any of these funds.

Yours very truly,

/s/
Latricia B. Nichols
President

/s/
Kevin Hood
Senior Vice President

LBN/dlw

See Exhibit A to Defendant's Motion. The Plaintiffs contend that this letter, which allegedly contains material falsehoods, constitutes a negligent misrepresentation by CNB. It is uncontested that neither SIPC nor the Sunpoint customers were aware of this letter prior to Sunpoint's liquidation in November, 1999.

Discussion

Standards for Summary Judgment

CNB brings its Motion for Partial Summary Judgment as to the Plaintiffs' negligent misrepresentation claim regarding ¶ 59 pursuant to Federal Rule of Bankruptcy Procedure 7056. That rule incorporates Federal Rule of Civil Procedure 56 which provides that summary judgment shall be rendered "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c). "Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed 'to secure the just, speedy and inexpensive determination of every action.'" *Celotex Corp. v. Catrett*, 477 U.S. 317, 327, 106 S.Ct. 2548, 2555, 91 L.Ed.2d 265 (1986). "The inquiry to be performed is the threshold inquiry of determining whether there is the need for a trial — whether, in other words, there are any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 250, 106 S.Ct. 2505, 2511, 91 L.Ed.2d 202 (1986).

The party seeking summary judgment always bears the initial responsibility of informing the court of the basis for its motion, identifying those portions of the "pleadings, depositions, answers to interrogatories, and affidavits, if any," which it

believes demonstrate the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323, 106 S.Ct. at 2553. Only once the moving party has met this burden does the non-moving party assume the burden of showing that a genuine issue of material fact exists. *Gillory v. PPG Indus., Inc.*, 434 F.3d 303, 309 (5th Cir. 2005) (*citing Catrett*, 477 U.S. at 321-25, 106 S.Ct. at 2548). As more particularly described by Judge William Wayne Justice in *Marshall Indep. Sch. Dist. v. U.S. Gypsum Co.*, 790 F. Supp. 1291 (E.D. Tex. 1992):

> Even where the non-moving party has the burden of persuasion on an issue, the summary judgment movant still has the initial burden of showing the absence of a genuine issue of material fact. It is not enough to move for summary judgment without supporting the motion in any way or with a conclusory assertion that the plaintiff has no evidence to prove its case. If there is literally no evidence in the record, the moving party may demonstrate this by reviewing for the court the admissions, interrogatories, and other exchanges between the parties that are in the record. If the moving party has not fully discharged this initial burden of production, its motion for summary judgment must be denied, and the court need not consider either any evidence submitted by the non-moving party or whether the moving party has met its ultimate burden of persuasion that summary judgment should be granted in its favor.

Id. at 1299-1300.

The manner in which this showing can be made depends upon which party will bear the burden of persuasion at trial. If the burden of persuasion at trial must be borne by the non-moving party, as in the present case, the party moving for summary judgment

may satisfy the burden of production under Rule 56 by either submitting affirmative evidence that negates an essential element of the non-moving party's claim, or by demonstrating that the non-moving party's evidence is insufficient to establish an essential element of the non-moving party's claim. See 10A WRIGHT, MILLER, & KANE, FEDERAL PRACTICE AND PROCEDURE: CIVIL 3d §2727 at pp. 471-72 (1998). *See also, Brewer v. Quaker State Oil Ref. Corp*., 72 F.3d 326, 329-30 (3d Cir. 1995); *Cannon v. Cherry Hill Toyota, Inc.*, 161 F. Supp.2d 362, 366 (D.N.J. 2001).

Once the motion is supported by a *prima facie* showing that the moving party is entitled to judgment as a matter of law, a party opposing the motion may not rest upon the mere allegations or denials in its pleadings, but rather must demonstrate in specific responsive pleadings the existence of specific facts constituting a genuine issue of material fact for which a trial is necessary. *Anderson,* 477 U.S. at 248-49, 106 S.Ct. at 2510 (*citing* FED. R. CIV. P. 56(e)). The substantive law will identify which facts are material. *Id.*

Thus, if a non-movant fails to set forth specific facts that present a triable issue, its claims should not survive summary judgment. *Giles v. Gen. Elec. Co.,* 245 F.3d 474, 494 (5th Cir. 2001). As the Supreme Court has stated,

> In our view, the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. In such a situation, there can be

> "no genuine issue as to any material fact," since a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial. The moving party is "entitled to a judgment as a matter of law" because the nonmoving party has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof.

Celotex, 477 U.S. at 322-23, 106 S.Ct. at 2552. Thus, "in the absence of the necessary minimal showing by the plaintiff that the defendant may be liable under the claims alleged, the defendant should not be required to undergo the considerable expense of preparing for and participating in a trial." *Robinson v. Cutchin*, 140 F.Supp.2d 488, 491 (D. Md. 2001) (*citing Catrett*, 477 U.S. at 323-24, 106 S.Ct. at 2548 *and Anderson*, 477 U.S. at 256-57, 106 S.Ct. at 2505); *see also Little v. Liquid Air Corp.*, 37 F.3d 1069, 1076 (5th Cir. 1994) ["A plaintiff should not be required to wait indefinitely for a trial when the defendant has a meritless defense that can be resolved on motion for summary judgment. Nor should a defendant be required to bear the unnecessary costs of delay and trial to defend against a claim that has no merit. Neither party should be required to bear the costs of trying all of the issues in a case when some can and should be resolved on summary judgment."].

To determine whether summary judgment is appropriate, the record presented is reviewed in the light most favorable to the non-moving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986). However, if the evidence demonstrating the need for trial "is merely colorable or

is not significantly probative, summary judgment may be granted." *Anderson*, 477 U.S. at 249-50, 106 S.Ct. at 2511. Thus, a non-movant must show more than a "mere disagreement" between the parties, *Calpetco 1981 v. Marshall Explor. Inc.*, 989 F.2d 1408, 1413 (5th Cir. 1993), or that there is merely "some metaphysical doubt as to the material facts." *Matsushita*, 475 U.S. at 586, 106 S.Ct. at 1356. However, "[t]he issue of material fact which must be present in order to entitle a party to proceed to trial is not required to be resolved conclusively in favor of the party asserting its existence; rather, all that is required is that sufficient evidence supporting the claimed factual dispute be shown to require a jury or judge to resolve the parties' differing versions of the truth at trial." *Anderson*, 477 U.S. at 248-49, 106 S.Ct. at 2510. Accordingly, the process has been described by the Supreme Court as one which mandates the entry of summary judgment where the evidence is such that it would require a directed verdict for the moving party. "In essence, . . the inquiry. . . is. . : whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Id*. at 251-52, 106 S.Ct. at 2512; *see also Harken Explor. Co. v. Sphere Drake Ins. PLC*, 261 F.3d 466 (5th Cir. 2001) ["There is a genuine issue as to a material fact if the evidence is such that a reasonable jury could return a verdict for the non-movant."].

Negligent Misrepresentation

CNB proffers two reasons why it believes it is entitled to summary judgment on the Plaintiffs' negligent misrepresentation claim as expressed by ¶59 of the current complaint: (1) the Plaintiffs are not within the limited group to which CNB owed a duty to avoid negligent misrepresentations; and (2) the Plaintiffs as a matter of law cannot demonstrate that they actually relied on the alleged misrepresentations contained in the NASD Letter.

A. Duty

Before a plaintiff may recover for negligent misrepresentation, he must establish that the defendant owed him a duty to avoid any inaccurate representations. *Cook Consultants Inc. v. Larson*, 700 S.W.2d 231 (Tex. App.–Dallas 1985, writ ref'd n.r.e.) ["Actionable negligence presupposes the existence of a legal relationship between the parties through which the wrongdoer owed a duty to the injured party."]. While such a duty was historically limited to relationships of privity between parties, *see generally First Nat. Bank of Commerce v. Monco Agency, Inc.*, 911 F.2d 1053, 1057-60 (5th Cir. 1990), that standard was eventually expanded to impose liability for the benefit of any party whose use of the misrepresented information was foreseeable. *See generally Compass Bank v. King, Griffin & Adamson P.C.*, No. Civ. A. 3:01-CV-2028-N, 2003 WL 22077721, at *2 (N.D. Tex. Sept. 5, 2003) *aff'd*, 388 F.3d 504 (5th Cir. 2004). Attempting a more moderate expansion, Texas has judicially adopted the Restatement

(Second) of Torts §552,[6] which provides for an information supplier's liability only to that limited group of persons to whom the supplier intends to tender such information and from whom he expects reliance upon such information. *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 612 (5th Cir. 1996) [noting that Texas has adopted §552]; *Fed. Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991). Clearly this standard is more expansive than the limited bounds of privity, but is more restrictive than a standard based upon foreseeability.

The Texas Supreme Court has adopted and applied §552, requiring that the provider of information be aware of the relying party and have intended for that party to rely on the information. *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 794 (Tex. 1999). In so doing, the court has stated, "In other words, a section 552 cause of action is available only when information is transferred ... to a

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[6] §552 provides in part:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
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> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

known party for a known purpose." *Id.*

It is critical to note that the standard embraced under the Texas interpretation of §552 is decidedly not whether an information provider *should have known* that a certain party would rely on his statements, but rather whether the information provider *knew* that a certain party would rely on his statements. *Compass Bank*, 2003 WL 22077721, at *5; *see also Compass Bank v. King, Griffin & Adamson P.C.*, 388 F.3d 504, 505 (5th Cir. 2004) (affirming and noting the "cogent and sound arguments of the district court"). As a result, when an accountant negligently misrepresented the financial condition of an audit client, but did so without knowledge that the financial statements would be provided to a bank to assist in the bank's lending decisions, the accountant was not liable to the bank for negligent misrepresentation. *Compass Bank*, 2003 WL 22077721, at *5. This result was reached despite the fact that the bank was one of the audit client's lenders at the time the audit statement was issued, and despite the fact that the auditor marketed its services to clients on the basis that the auditor's work would engender credibility with a potential client's lenders. *Id.* Hence, despite the existence of a market in which accountants generally know that lenders will review financial statements, [7] such generalized knowledge is insufficient to demonstrate that an auditor has actual knowledge that a

[7] The Court notes that audits of public companies are contemplated as part of a regulatory structure within which the Securities and Exchange Commission executes its regulatory function, but this does not render negligently misrepresented audit opinions or financial statements actionable as to all parties for all purposes, or even to all parties who are aware of and choose to rely on the existence of the regulatory system.

particular party would rely on the audit statement.

In the present case, CNB contends that when it sent the January 8 letter to the NASD, it did not have actual knowledge that the information in the letter would be provided to SIPC or to the Sunpoint customers, nor did it intend that result.[8] The summary judgment evidence, even when viewed in the light most favorable to the Plaintiffs, supports this conclusion. Most importantly, there is no evidence that the information in the letter was actually ever transferred to SIPC or to any of the Sunpoint customers. CNB sent the letter, addressed to the NASD,[9] at the request of its client, Van Lewis. It sent the letter to a known party [the NASD] for a known purpose — to assert its own opinion about its own collateral position as an accommodation to its client. CNB did not send the letter for the purpose of confirming the adequacy of Sunpoint's capital position. Nor did it send the letter to fulfill any independent role or duty in the regulatory process. This conclusion is buttressed by the NASD's own admission that *it did not rely* on CNB's representation, but rather relied upon its own investigation and the

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[8] *See* Affidavit of Latricia Nichols, ¶¶ 4-6.

[9] Plaintiffs would have the Court infer that CNB knew others, including SIPC and the Sunpoint customers, would rely on its statement simply from the fact that it addressed the letter exclusively to NASD in an obvious attempt to limit liability. It is Plaintiffs' position, hence, that such an attempt to limit liability is not only futile, but damning because it constitutes evidence of scienter. But Plaintiffs' position on this point cannot be harmonized with the controlling statement of the Texas Supreme Court that, "A [provider of information] may also avoid or minimize the risk of liability to a nonclient by setting forth ... limitations as to whom the representation is directed and who should rely on it..." *McCamish*, 991 S.W.2d at 794.

investigative efforts of other state and federal regulatory authorities.[10]

In attempting to articulate more succinctly the standard contemplated by the Restatement, the Fifth Circuit has noted that §552 "realistically recognizes that business [persons] who justifiably rely on the advice and expertise of other business [persons], holding themselves out in the community as possessing unique skills, are entitled to expect that one possessing skill will exercise it with due care in the course of his business relationships." *First Nat'l Bank, Henrietta v. Small Bus. Admin.*, 429 F.2d 280, 287 (5th Cir. 1970). This capsulization of the restatement standard illustrates another weakness of Plaintiffs' position. Plaintiffs' theory is fatally flawed because it attempts to shift a duty belonging to the NASD [namely, the duty to verify the adequacy of Sunpoint's net capital position] to third parties from whom the NASD elected to solicit information in support of its own investigation. CNB did not hold itself out to the NASD as having particular skill in evaluating the statutorily mandated capital position of its clients,[11] nor did it

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[10] Greening Depo., pp. 191-92. Whereas the NASD had such other sources at its disposal in evaluating the net capital position of Sunpoint, it is doubtful that NASD would be justified in relying on the statements contained in CNB's January 8th letter. *See Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 615 (5th Cir. 1996) [noting that Texas courts are "particularly disinclined to entertain claims of justifiable reliance when [a] sophisticated plaintiff has access to information that would reveal fraud at a time when harm could be averted."]. The NASD, clearly a sophisticated entity, had broad investigative powers, and could have gone to any length it chose to satisfy itself with respect to Sunpoint's net capital position.

[11] The Court notes what it believes is an important distinction between banks and other entities more commonly the subject of negligent misrepresentation suits. Auditors, attorneys, physicians, title companies, surveyors, and the like exist for the purpose of expressing a professional opinion, and hold themselves out as having the necessary skill to do so accurately. While the scope of their liability may be subject to debate, it should not be surprising to people engaged in these professions that their opinions may become the subject of reliance. A bank, on the other hand, exists for a different purpose entirely.

attempt to do so. In fact, CNB could not have provided a disinterested opinion regarding its collateral position to the NASD since it was obviously a potentially adverse competitor for the assets of Sunpoint in the event of a financial meltdown. The letter upon which the Plaintiffs rest their claim in this instance is simply CNB's own evaluation of its own legal entitlement to seizure or setoff of the referenced funds. While it might be reasonable under the circumstances for CNB to be bound by the principles of estoppel from later asserting a superior right to the referenced funds vis-a-vis the NASD, §552 does not supply a basis by which even the NASD, much less SIPC or the Sunpoint customers, is entitled to assess liability against CNB for its allegedly negligent failure either to properly evaluate its own secured status, or to communicate that secured status. It certainly does not supply a basis by which CNB can be rendered liable to SIPC or to the Sunpoint customers for the entire sum of money subsequently stolen by Van Lewis from the brokerage firm.

The jurisprudence in this area properly notes the importance of the opportunity for parties making representations to evaluate the risk and exposure to which a negligent misrepresentation could potentially expose them. *McCamish*, 991 S.W.2d at 794. There is simply no way CNB could have contemplated that its alleged failure to properly

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While there are certainly circumstances wherein a bank has been subjected to liability for negligent misrepresentation, *see e.g. First Nat'l Bank, Henrietta v. Small Bus. Admin.*, 429 F.2d 280 (5th Cir. 1970); *and Fed. Land Bank Ass'n of Tyler v. Sloane,* 825 S.W.2d 439, 442 (Tex.1991), a bank is not generally in the business of rendering legal opinions upon which justifiable reliance can be reasonably exercised under §552, particularly when comprised of an assessment of its own legal position.

evaluate its own collateral position with respect to funds on deposit within its walls would expose the bank to liability far in excess of any proportionality with its secured positions. For the above-stated reasons, the Court concludes as a matter of law that the Plaintiffs were not within the limited group to which Defendant City National Bank owed a duty to avoid negligent misrepresentations.

B. Justifiable Reliance

CNB also contends that it is entitled to summary judgment on Plaintiffs' negligent misrepresentation claim contained in ¶ 59 because the Plaintiffs cannot show that they justifiably relied on the NASD Letter. Indeed, the Plaintiffs have not provided the Court with evidence that either SIPC or the Sunpoint customers were even *aware* of the existence of the NASD letter prior to Sunpoint's liquidation. In lieu thereof, the Plaintiffs claim that either direct evidence of reliance is not necessary, or that they can meet the necessary requirement by showing that the NASD relied on the letter. Both positions are without merit.

There is no question that justifiable reliance is a necessary element of a cause of action for negligent misrepresentation under Texas law. *See* RESTATEMENT (SECOND) OF TORTS §552 ["One who ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them *by their justifiable reliance* upon the information, if he fails to exercise reasonable care..."]

(emphasis added); *Scottish Heritable Trust*, 81 F.3d at 614-15 ["In addition to the 'limited group' requirement discussed above, the Restatement requires that a plaintiff justifiably rely on the information that the defendant negligently misrepresents."]; *McCamish*, 991 S.W.2d at 794 ["Moreover, section 552 guards against exposure to unlimited liability by requiring that a claimant justifiably rely on a lawyer's representation..."].

Despite this fact, Plaintiffs cite to a single (and arguably superseded)[12] Texas appellate court decision for the proposition that they need not show that they even knew about CNB's alleged misrepresentation, nor that they directly relied upon such statement. *See Cook Consultants, Inc. v. Larson*, 700 S.W.2d 231 (Tex. App.–Dallas 1985, writ ref'd n.r.e.). In *Cook*, the appellate court refused to overturn a jury finding of liability in favor of a homebuyer who, though she had not seen the survey, sued a surveyor for negligent misrepresentation. *Id.* at 237. The parties have not cited, nor has the Court independently located, any Texas Supreme Court opinion endorsing the assessment of liability for a negligent misrepresentation absent some evidence of direct reliance.[13] In this context, this Court is not bound by a questionable decision of an intermediate Texas court, but rather is charged with the duty of determining whether the Supreme Court of Texas would require actual reliance. *See Am. Int'l Spec. Lines Ins. Co. v. Canal Indem. Co.*, 352 F.3d 254, 260

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[12] *See Tara Capital Partners I, L.P. v. Deloitte & Touche, L.L.P.*, No 05-03-00746-CV, 2004 WL 1119947 (Tex. App.–Dallas, May 20, 2004).

[13] Such a result is not surprising since the Supreme Court of Texas has specifically identified reliance as an element of a negligent misrepresentation cause of action under Texas law. *McCamish*, 991 S.W.2d at 794.

(5th Cir. 2003) ["To determine state law, federal courts ... look to the final decisions of the state's highest court. In the absence of a final decision by the state's highest court on the issue at hand, it is the duty of the federal court to determine, in its best judgment, how the highest court of the state would resolve the issue if presented with the same case."]. In light of the Texas Supreme Court's strict application of §552 in *McCamish*, and other federal courts' reasoning on the general subject, *McNamara v. Bre-X Minerals Ltd.*, 197 F.Supp.2d 622, 698-99 (E.D.Tex. 2001) ["Because the Complaint fails to allege that any of the named Plaintiffs actually relied on any statements by these Defendants, these causes of action are dismissed."]; *Compass Bank*, 2003 WL 22077721, at *4, this Court believes that, if faced with the issue today, the Supreme Court of Texas would reject the "no knowledge or actual reliance" standard endorsed in *Cook* and would instead insist upon the proof of actual reliance in order to recover under a theory of negligent misrepresentation.

Secondly, the Plaintiffs' attempt to transform NASD's reliance into their own is equally erroneous. The existence of a regulatory structure is not a surrogate for actual reliance in the context of a state law action for negligent misrepresentation.[14] Even if the Plaintiffs could show that NASD justifiably relied on CNB's statements in the NASD

[14] The Court is cognizant of the "fraud-on-the-market" theory and its application in the context of federal securities actions, but is not persuaded that the Supreme Court of Texas would embrace an analogous argument in the context of a negligent misrepresentation action.

Letter,[15] such reliance would not be transferable either to SIPC or to the Sunpoint customers in order to create an illusion of reliance upon representations contained in a letter that neither the SIPC nor any Sunpoint customer had ever seen. *See Sec. Investor Protection Corp. v. BDO Seidman, L.L.P.*, 95 N.Y.2d 702, 746 N.E.2d 1042, 723 N.Y.S.2d 750 (N.Y. 2001). As the New York Court of Appeals cogently stated:

> Plaintiff cannot sustain a cause of action for fraud if defendant's misrepresentations did not form the basis of reliance... SIPC relied to its detriment on the implication of the NASD's silence, not on representations from [the defendant]. ... [T]he absence of communication from the NASD to SIPC could have meant any number of things, among them that the regulators were not carefully reading defendant's [statements]. The vagaries inherent in SIPC's theory of liability convince us that no information at all is simply too little information on which to base a claim....

Id. at 709-11, 746 N.E.2d at 1047-48; *see also Sec. Investor Protection Corp. v. Munninghoff Lange & Co. (In re Donahue Sec., Inc.*), Adversary Case No. 02-1179, 2004 Bankr. LEXIS 1955 (Bankr. S.D. Ohio Nov. 23, 2004). The Plaintiffs seek to distinguish the present case from *BDO Seidman* and *Munninghoff* based on the supposition that, in the present case, if the NASD had realized that the net capital violation had not been adequately cured, NASD itself would have acted immediately to shut down Sunpoint. While such an assertion is clearly speculative, even if one assumes its accuracy for the

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[15] See footnote 10, *supra,* and accompanying textual discussion.

purpose of argument, it is equally clear that the NASD had total discretion to decide what sources would be consulted, and how the information from such sources would be evaluated, in order to reach its determination of the adequacy of Sunpoint's net capital position. *See BDO Seidman*, 95 N.Y.2d at 710, 746 N.E.2d at 1047 [noting that NASD had a significant role not only in choosing its response to the information received, but also in choosing *what* information it would receive]. If the NASD had done nothing to determine the adequacy of Sunpoint's net capital position, the Plaintiffs would have been unaware. If the NASD had decided to flip a coin to decide its plan of action, the Plaintiffs would have been unaware. If the NASD had decided to hire the most well-trained forensic accountants on the planet to conduct a thorough investigation of all aspects regarding Sunpoint, the Plaintiffs would still be relying upon no source other than the discretion of the NASD.[16]

In sum, because SIPC and the Sunpoint customers were never even aware that CNB ever sent a letter regarding its collateral position to the NASD, they cannot demonstrate that they justifiably relied on any statement of CNB contained therein, and therefore, they cannot recover against CNB, as a matter of Texas law, upon a theory of negligent misrepresentation.

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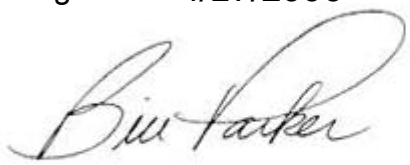
[16] This is the conclusion reached by the United States Bankruptcy Court for the Southern District of Ohio which recognized that "the regulatory system is not structured in such a way as to permit SIPC to prevail on any legal theory that requires proof of reliance.... If [a right of recovery] is the intended effect of the regulatory scheme, then it is up to the legislature, not the courts, to bring this to pass." *Munninghoff*, 2004 Bankr. LEXIS 1955, at *24 n.9.

Conclusion

For the foregoing reasons, the Court concludes that CNB's Motion for Partial Summary Judgment as to Plaintiffs' Negligent Misrepresentation Claim should be granted, such that summary judgment is rendered in favor of City National Bank on Plaintiffs' negligent misrepresentation claims asserted under ¶ 59 of the Plaintiffs' Second Amended Original Complaint. An appropriate order will be entered consistent with this opinion.

Signed on 4/17/2006



THE HONORABLE BILL PARKER
CHIEF UNITED STATES BANKRUPTCY JUDGE