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INSURANCE CO. OF NORTH AMERICA V. MORRIS

LAWYER: In a general sense, the fundamental issue in this case is whether INA as a commercial surety may be held legally responsible for the wrongful conduct of the promoters and the salesmen in connection with an investment solicitation as distinguished from the surety bond that INA provided in this case.

I would like to address two principle reasons why the judgment against INA in this case should be reversed. First, the investors were not consumers of INA's internal surety underwriting services, and as such, like standing under the DTPA. Secondly, the promoters and salesmen who sold these limited partnership investment vehicles to the respondents were not in that capacity acting as INA's agents. As such, INA is not responsible for their wrongful conduct nor bound by their conduct.

I would like to address the DTPA issue first. And I would like to say at the outset that no other court has ever found before the 14th court in this case, that a commercial surety has provided internal underwriting services to investors in speculative oil and gas investments, such that those investors are consumers of the underwriting services the surety provided or produced for its own internal purposes. In this case, of course, the jury clearly found that there were no deceptive trade practices acts, omissions or misrepresentations with regard to the only good or service INA provided - its commercial surety bond - its financial guarantee in this transaction.

OWEN: Would you explain for us the relationship between INA and respectively Waite, Phillips and Colony?

LAWYER: INA is the named insurance company who issued the bond. Waite Hill Services acted as INA's managing agent pursuant to an agency contract, and conducted through its offices some of the due diligence and underwriting services associated with the evaluation generally of the program, and specifically of the investor's credit worthiness. Phillips was an insurance broker and financial broker out of Florida, that acted as a conduit between the promoters and syndicators in Tennessee and Waite Hill Services in Virginia acting as managing agent for INA. Colony was what we call a reinsurer. It is a company to whom a portion of the risk under the surety bonds receded after the bonds were issued. Of course, INA remains principally liable on the bonds as the company that signed the bonds.

OWEN: But you do concede that Waide is your agent?

LAWYER: It was conceded at trial, and it is conceded for purposes of argument today, yes.

ABBOTT: What were the jury findings concerning Waite with regard to deceptive acts?

LAWYER: There were no separate finding as to Waite or INA. They were submitted collectively. And in response to question 12, the jurors clearly found as follows: That INA and its agents, if any, did not cause any misunderstanding among the investors regarding the source, sponsorship approval or certification of the surety bonds, that INA and its agents did not misrepresent the terms "used benefits" or "obligations" associated with those surety bonds, that INA did not fail to disclose any information to the investors to induce the transactions, that INA did not cause any confusion in the investors as to its affiliation, if any, with the promoter and the salesman with regard to the transactions, and that INA did not otherwise misrepresent its status in connection with this transaction.

BAKER: Do I recall, however, that the jury found that INA had some unconscionable actions?

LAWYER: That is the only basis for the DTPA finding in this case.

BAKER: Can that stand alone aside from the answer to question 12?

LAWYER: It was part of question 12. There were several subparts. And what I've generally summarized were 8 of the 9 subparts. And the 9th subpart was: Do you find that INA engaged in unconscionable conduct? And the answer to that question was, Yes. It was otherwise, no. And the only way that unconscionable conduct under the DTPA can form a basis of responsibility here getting back to the point I was making, is you have to be a consumer. And in this case, the jury found no misrepresentations, no deceptive laundry list acts. They only found unconscionable conduct. The CA correctly concluded, that the purchase of a surety bond even if intertwined with an investment is not the purchase of a good, because you're buying either an intangible or you're buying a security neither of which are recognized as goods. But the CA said: "Nevertheless, the investors purchased INA's internal underwriting services, it's own due diligence INA's investigation of generally these programs for its own benefit, and specifically the credit worthiness of these investors. That was the consumer status that the CA found in this case. And that holding is unsupported by any precedent and it's fundamentally flawed, because INA's internal underwriting services was not an important objective of this transaction. The objective of the transaction from the investor's standpoint was to acquire an investment, a speculative oil and gas limited partnership investment nor did the provision of, as the CA characterized it, INA's internal underwriting services formed the basis of the investors' complaints. What they complained about in this case was a bad investment, inducement into a bad investment based upon investors fraud in connection with the investment solicitation.

This CA holding opens the door for the DTPA to be used as a litigation tool in a whole host of business enterprises who engage in underwriting activities. Example: auto dealerships that promote the ability for _____ package deal: I will sell you the car, and I will give

you prearranged financing at a favorable below-market rate; and I've got this credible lender GMAC that's got a program that I can provide to you. If this holding stands, anyone who buys a car that turns out to be a lemon coupled with that kind of lending program that's prearranged through the auto dealership has standing to claim that the lender's internal due diligence concerning the dealership or that person's credit worthiness is somehow a service that they acquired in addition to the automobile which was the objective of their transaction, and gives them consumer status. That's what this holding says in essence.

Here of course, the principal objective of the transaction, as I described, was the acquisition of an investment. It was not the acquisition of underwriting services performed by a commercial surety. In addition those underwriting services, as a host of cases have held - the *Dealy* case out of the 5th circuit - they have all held that the acts of the surety in conducting its own due diligence are conducted solely for the surety's benefit and they are not intended to nor do they provide a service or a benefit to investors. What the investors bought was the surety's obligation to bond and to cover their defaults on the promissory notes. They have the right to expect the surety to honor that contract, and in this case as the jury found, the surety did in fact honor its contract.

The CA's analogized the underwriting to cases which hold that services may include investment and counsel. And they said: These are investment and counseling services that the surety somehow provided to these investors. In this case, none of the CA's citations to Frizzell, _____ or Nottingham are on point for a lot of reasons, and I will summarize 4 of them. INA did not provide any investment advice to these investors nor did it purport to do so. In fact, it specifically disavowed that in the documents made available to these investors, although many of them chose not to read them. There was no premium paid above the cost of the bond for this investment advice and counsel that the CA characterized. There was no promise made to these investors by the surety other than the promises and obligations undertaken in the bond. And there was no separate contract entered into for services other than the services reflected by the bond document.

BAKER: But there was a separate contract of indemnity between INA and the investors, is that right?

LAWYER: Yes it was. And that contract was essentially an obligation in the event that INA was obligated to honor the bond if an investor defaulted, that the investor then undertook an obligation to indemnify _____ costs and expenses. That contract nowhere addresses investment advice or counseling.

The conclusion to be reached here is that there's no claim under the bond, the jury found that. There is no consumer status with regard to INA's internal underwriting services for the reason that those were conducted solely for INA's benefit, and they do not constitute investment or counseling advice. As such, these investors lack standing as consumers under the DTPA, and the DTPA findings and judgment must be reversed.

I would like to turn briefly to the agency issue. The issue here is really two-fold. Is there the existence of an agency relationship, and if so, what is the scope of that relationship?

HECHT: And there could be depending on the evidence?

LAWYER: Depending on the evidence under a common law apparent agency or a statutory agency theory. There could be some evidence of an agency relationship, and we need to deal with the scope of that agency relationship. We have taken really two points here. There is no evidence of a common law apparent agent relationship. And with regard to the statutory agents under 21.02 of the Insurance Code, those duties and obligations are limited to the ability to deal with, explain and concerned if you were agency relationship with the insurance product. And in this case, again getting back to the jury findings, there was no finding of any problem with regard to the insurance product.

The CA really in a co-mingle of these common law and statutory concepts, and I'm paraphrasing, concluded: that the investment salesmen were INA's agents because they were statutory agents acting with implied or apparent authority within the scope of that authority to sell the investments, and the bonds. And that's where the problem lies in this case. While they may have been a statutory agent to sell the bonds, there was no problem with the bonds, they were not a statutory agent to sell the investment. And that's shows plainly wrong that decision because the plain language of 21.02 says: You are a statutory agent as to the insurance product. And this court of course in *Celtic Life* said: The ability or the authority to explain a policy doesn't give you the authority to go beyond the policy. And logically it doesn't give one the authority to become a statutory agent with respect to an investment product as opposed to the insurance product.

Now with regard to the question of common law apparent agency as to the investment product in this case, the investors had to demonstrate that they had a reasonable belief based upon INA's conduct, and that that belief was justified and that their reliance was justified based upon INA's representations of its agents' authority. In this case, the investors admitted as follows: None of the salesmen told them that they were acting for or on behalf of INA. The investors simply believed that subjectively and they believed it because the investors touted INA's involvement as a commercial surety providing the surety bond. That's basically what the investors said.

Let's get back to my automobile example. If, I, as a dealer sell a car and I taut the fact that GMAC is going to provide below market financing, and what a great deal this is, am I acting as GMAC's agent with regard to representations concerning whether this car is new or used, whether it has certain attributes that it may or may not have? Of course not. Logically I am not. In this case, we have the regulatory framework in addition that draws a distinction between the agency authority as to the insurance product and the authority as to the investment vehicle.

Moreover, the conduct of INA did not clothe these salesmen with agency authority with regard to the investment. Cases have directly dealt with these issues, the *Dealy* case in particular said: That the act of putting someone in the position of taking and transmitting applications, accepting bond premiums in connection with these investment solicitations is merely a clerical function, daily brisk of the meal, does not give rise to any agency relationship. The _____ court dealing with identical investments solicitation transactions wrote out loud about how the surety's involvement in these kinds of programs, its underwriting activities, its actions associated with the program, its placing of the salesmen in a position to take the bond applications. None of that gives rise to an assumption of an apparent agency relationship. And moreover, the investors in this case were not misled. The agency relationship was expressly disclaimed both in the private placement memorandum, which was given to them at the time of the solicitation, and in the letters they signed thereafter. And for those reasons they were not acting as agents.

GONZALEZ: If the facts are as you say that they are, why then the estoppel letter later on after the fact?

LAWYER: The estoppel letter was not later on after the fact. There was an estoppel letter, a representation letter submitted to these investors when they signed their first package of documents. There was a second letter submitted with a new bond document that had been requested by the lender to include some provisions of waiver of defenses as to the lender. Then with regard to Overlord IV, that was Overlord III, there were two letters Overlord IV, the estoppel letters you've characterized it was part of the initial package. There never was a second _____.

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RESPONDENT:

LAWYER: If I may address Justice Gonzalez's last question. There is nothing in the record in this case to show that the investors signed an estoppel letter when they paid their money, when they subscribed to these agreements on Overlord III, the only evidence in this case, and there was nothing ever produced in this case to suggest that an estoppel letter was provided to these investors before they subscribed to Overlord III. The evidence is, you can look all through the record, but the estoppel letter of Overlord III was provided by the unlicenced salesman sanctioned by Waite Hill and INA to the investors after they had already paid their money. Ms. Rebecca Red, a retired public school teacher in this state, put up, bought 1 unit of Overlord III, two units of Overlord IV, and she was told by the salesman, "that unless she signed the letter as well as the 6-page bond, she would lose her $5,000 down payment and jeopardize the partnership.

Mr. Lowe and Mr. Morris were told that they have to sign the documents or the deal would not go through. They had already paid the money.

BAKER: Is that Mr. Ace or Mr. Gunnels that made those statements to Ms. Red?

LAWYER: Yes sir.

BAKER: So whether they were true or not depends on whether those two were agents of the INA, is that right?

LAWYER: Yes.

BAKER: And that's the bottom line issue isn't it how those two were agents of INA and how do you say that they were?

LAWYER: Under the apparent agency argument, INA through Waite Hill Services, which was the managing agent of INA, allowed the surety bond to be sold with the private placement memorandum with the package. And the reason for that was they had to get 80% of the investors to subscribe on the deal.

BAKER: But would they have had to get 80% with or without the bond, or was that the INA requirement?

LAWYER: That was an underwriting requirement of Waite Hill Services.

ABBOTT: Isn't it common, in fact, almost always you are going to have a surety bond in this type of situation, and isn't it true that the entity issuing the surety bond is going to require certain percentages like the 80% rule?

LAWYER: At the time I don't know if it was common. We had a witness, Bruno Trimpoli, who was the CEO of Commonwealth, who testified: "that actually he developed the concept of surety bond financing. And the reason why he developed it was in order to get an A+ 15 rated company, because the companies that he was dealing with Waite Hill & Colony were unrated, unregistered small time companies out of Virginia (they were not registered here in Texas), and they needed the reputation and credibility of a company like INA to sell the programs."

BAKER: So it was he who was the head of the Overlord III & IV crews that did the deal with INA for that purpose, is that correct?

LAWYER: That's correct. To market the programs.

BAKER: So their dealings were between he and INA, and not the investors and INA?

LAWYER: Well the investor dealt through the PPM.

BAKER: I understand, but is it correct that the head of the Overlord partnership who was selling dealt with INA to get the bond part of the package?

LAWYER: Through Waite Hill Services and _____.

BAKER: And the investors dealt with Mr. Ace & Mr. Gunnels, who were employees of the Overlord group?

LAWYER: That's correct.

HECHT: Are you saying that you cannot structure this transaction that involves a minimal amount of bonding for the deal to go through, and a selling of the two at the same time that there is no way to structure that without making whoever is selling them the bonding company's agent?

LAWYER: No.

HECHT: Well Judge Baker asked you why under the common law were they the agent, and you said because the underwriting requirement was 80%, and because the bonds were sold with the investment?

LAWYER: And because INA through Waite Hill Services allowed these salesmen to represent the fact that INA had investigated the principals, had backed the program and found the program to be sound. It was a marketing tool that Waite Hill Services allowed these salesmen to use. And only after the fact in the bait and switch do they present an estoppel letter to have the investors sign. If the court were to hold that the estoppel letter for instance precluded agency in the case it would allow salesmen in any kind of transaction to say anything they want to to produce the sale, take the money, and then send a disclaimer or have the persons who signed the disclaimer after the purchase.

ENOCH: The problem here is that there's apparent authority because INA didn't prohibit the Commonwealth from telling people that INA was insuring the loan in this transaction?

LAWYER: They didn't do that. They didn't have a licensed agent on the grounds required by Texas law to sell the insurance product, to explain the product.

ENOCH: But wouldn't they then be in violation of the private placement memorandum by failing to disclose their involvement in the transaction? How is Commonwealth complying with what it's supposed to do if it cannot disclose INA's involvement in the transaction?

LAWYER: Commonwealth can disclose it. But my position with regard to the participation fraud in the case is that Waite Hill Services controlled most of the terms of the program, and had the right to change the PPM, had the right to rewrite portions of the PPM, had the right to set the number of wells.

BAKER: Wasn't that as between them and the person offering the investment as opposed as between them and the investors?

LAWYER: I think it doesn't matter because they are joint participants in the fraud.

OWEN: What if the lenders had those requirements? What if the lender said: We won't finance unless you change the structure of the deal. Would that make the lender liable to the investors?

LAWYER: I think the lender as well as the surety would have the right to review the PPM. But if the lender as well as the surety controlled the terms of the program...

OWEN: The lender said, "I will not fund under this structure, you change the structure and then I will fund."

LAWYER: And if the lender reviewed the private placement memorandum and had the right to write portions of it and had the right to discover the background of the principals and discovered the fact that John Meatte who served time in Tennessee in prison for this scheme, discovered that fact and failed to require disclosure of it in the PPM, I would be here before you saying that the lender was and aider and abetter as well because of the absolute control that Waite Hill Services had in this particular program. There is not a case, none of the cases cited by Mr. _____ in regard to the aiding and abetting deal with companies or surety that failed to follow the insurance code to have licensed agents on the ground explaining the complicated product.

OWEN: Well you're assuming that a surety bond is an insurance product, aren't you?

LAWYER: Absolutely as it is stated in the insurance code under 27.01. Under 21.07 and 21.09, sureties are expressly included in the statute.

HECHT: Your argument seems to come close to saying that if you lend money to a crook you're liable for what he does. It seems to go too far.

LAWYER: Under the facts of the case there are bad findings. And let me just show you one of these in evidence. Waite Hill Services discovered that John Meatte had been enjoined 4 years earlier for an SEC violation. None of us in this courtroom would have purchased this security at all had we known of that and had it been disclosed. The evidence is that ____ Burgess who worked for Gordon Phillips, who is a marketing agent for INA, discovered that, and in fact, for a short time said: We're not going to bond the deal. But because Waite Hill Services engaged in a subterfuge and set up a paper trail to protect themselves for this very day in court here we are in Austin arguing for this very day, and one of the pieces of evidence we have was a report with the underwriting procedures that said: All the reports received from Bank Capitol who is the due diligence investigator are positive reports. If the due diligence review will provide a negative recommendation contained in the business proposal the _____ offering must be amended. If the recommendations _____ are not met then the due diligence report to the surety is discontinued and no report is issued. Meaning, that the surety will never have in any case, even if the money disappears like

what happened to Rebecca Red, will never have a negative due diligence report. It will always be positive. So when the faithful day comes, when the fraud is discovered, they can stand up before the court and they can say: We relied upon the due diligence report. We relied upon the attorney's opinion letter. The attorney's opinion letters and the due diligence reports were received by Waite Hill Services after the programs were already out on the street and after Mr. Morris, here, subscribed in Overlord IV. What kind of reliance is that?

GONZALEZ: The PPM at least in Overlord III says: "No dealers, salesmen or any other person have been authorized to give any information or to make any representations on behalf of the partnership or general partners related to this offer, other than set forth this offering memorandum. The units involved a high degree of risk and the availability of any cash returns from this investment is speculative. A limited partner should understand that it is extremely difficult to predict return from the oil and gas drilling program, and it is possible that no wells drilled will produce any oil and gas or any revenues." And if you look at the drilling program, the prior activities and you analyze that, it has a very, very poor return. In light of all of that where the investor knows that they are getting into a speculative venture, where is the fraud, where is the misrepresentation?

LAWYER: First of all with regard to the high risk speculative disclosure on the front page of the PPM, that's virtually in every limited partnership that's formed.

GONZALEZ: Are they bound by those terms?

LAWYER: I would say not, because there are other provisions in the offering memorandum that say that the drilling, particularly in this case, let me get you another exhibit. In the surety section, this is the section that admittedly the surety has the right to modify. Diversified programs are best adapted to a surety bond feature. Risks are less in a program involving multiple wells and several or a number of prospects than a program in which drills only a single well. A surety bond program should engage primarily in low risk developmental drilling.

GONZALEZ: You say that negates the _____ of the PPM?

LAWYER: It goes directly to the kind of program that's being drilled. It's more specific than the general boiler plate that you just read. When you look at the geology, when you look at the process in the back of the PPM, that Mr. Glass read, when he invested, he went to the prospects and he read the conclusions about the prospect. And the last prospect on Overlord IV says: This prospect offers an excellent chance for a low risk drilling venture. That coupled with the fact that the salesman sanctioned by Waite Hill were touting these things not as just low risk, but on past programs, that past programs had return 2 or 3 to 1 on the dollar, when in fact it only returned 10¢.

BAKER: Is there any evidence that INA knew that these salespeople were making those statements? Is it correct that when we're talking about common law apparent agency, we look to the conduct of the principal, not the conduct of the alleged agent?

LAWYER: That's correct.

BAKER: What conduct is there in the record, if any, that shows INA permitted, authorized or otherwise said you can tell them those kind of things?

LAWYER: Well simply because Waite Hill and INA allowed the salesmen, who are the security salesmen, who are unlicenced to sell the product. They needed to make those kinds of representations in order to sell the product at the 80% surety financing.

ENOCH: What product?

LAWYER: The investment.

ENOCH: INA was investing in this. What did INA do in this case?

LAWYER: INA was actually paid by Waite Hill Services 25¢ of the premium to lend the name and assume only 25% of the risk.

ENOCH: But assume risk of what? That the investors would not pay their $20,000 unit price?

LAWYER: That's correct.

ENOCH: INA was taking the risk that the investors, not Commonwealth, but that the investors would not pay their $20,000 unit price?

LAWYER: Correct.

ENOCH: That was the risk they were taking. So the product that was being sold was a unit in an investment at $1,000 apiece to these investors. And that's the product that's being sold.

LAWYER: As well as the surety bond. It's an intergraded product.

ENOCH: And the investors bought that, but paid just a portion of the price?

LAWYER: And when they learned of the fraud they refused to pay.

ENOCH: And so INA did what the investors asked INA to do, which is to payoff their debt to the lender?

LAWYER: That's correct. They are forced to. But I will make this note, too. INA did that with notice of the fraud in the first instance, because knew _____. And two, they did

that, they paid the lender with notice of fraud claims. And that's in the record as well. They had to make a choice, and the choice they made was not to fight with the lender, but to fight and try to pick off everyone of these small investors, 3,000 of them, with the hope that they would never discover the fraud, with the hope that they would never discover evidence like this where they set up a subterfuge and create bogus due diligence reports.

ENOCH: I don't understand. INA paid off that lender. And now they are trying to get their money back from these investors. And you're saying: Well they shouldn't get the money back because they were participants?

LAWYER: They were aiders and abetters.

ENOCH: They agreed to pay 100% back to the lender knowing that this was a fraudulent transaction. So they were going to be on the hook for all this money. Why would a bonding company say: We're going to take on 100% of risk for all these fraudulent people out there?

LAWYER: Because the, and this is in the record as well, the recapture penalties under the IRS code make it awfully difficult for investors to fight this thing. And I think it was Mr. Frazier or Mr. Holberg from Waite Hill admitted that they thought the default rate on the loans would be very minimal, because of the recapture penalties. So they took the chance to payoff the lender and to fight the investors knowing that the investors, hoping the investors wouldn't discover this fraud.

BAKER: Is it correct that Ms. Red was the only person who paid the entire amount and all the other investors, at least in this litigation, made only the $5,000 down payment?

LAWYER: Paid $5,000 plus the one installment of $1,666.

BAKER: And what was the interval of the payments on the note?

LAWYER: I think yearly.

BAKER: So they made the first payment up front, and then didn't pay the second one, and you state because they learned of the fraud by Ace and Gunnels?

LAWYER: Not just by them but by Waite Hill Services.

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REBUTTAL

ENOCH: It seems to me that Mr. Harvin is essentially arguing that INA by its conduct took control of this investment. It seems to me it would be possible that the bonding company if it exercised so much control of the investment, that it probably would be the principal for these agents

who were out misrepresenting the nature of this investment. Where would you draw the line between where the bonding company steps over the line and becomes a principal in the investment scheme as opposed to just simply someone who is basically insuring the loan on this transaction?

LAWYER: It didn't happen in this case. The bonding company I think would have to step over the line by controlling the manner and method in which these investments are solicited by controlling the way in which they are presented to the investors, by directing the supposed agents in those activities, by participating directly in the investment solicitation activities. And in this case, frankly the bonding company was far removed not only mileage wise in terms of across the country, but involvement wise from any solicitation of this investment activities. The bonding company as Justice Gonzalez pointed out is described in the private placement memorandum. It's relationship to the transaction is described in the PPM, the disclaimer of any agency relationship is described in the PPM. And in this case, this bonding company did what every case that has considered these kinds of transactions says is ordinary, prudent internal underwriting activities. Because obviously a bonding company that takes a $42,000 premium to assume $800,000 in risks associated with defaulted loans is going to want to do some internal due diligence to make a determination whether they want to assume that kind of risk. I think that's an important factor here when we talk about subterfuges and frauds and intergraded offering. What the insurance company was doing here was being paid a premium of $42,000 to assume $800,000 of risks. And in this case, that's what this company did and when that risk came to pass and these investors defaulted, the insurance company stepped up to the bar, paid the money on behalf of these investors, and assumed the obligations that they have failed to do in connection with those investments.

BAKER: But they two other things didn't they? They got an indemnification agreement from each investor and they got assignments of the notes that they paid off?

LAWYER: They did indeed in hopes that they might recruit some or all of the loss of the risk in this case.

BAKER: So they got protection on both sides of the case?

LAWYER: No question about it. And that is prudent insurance surety practice. When I take out a supersedes bond to appeal a case, the bonding company looks to the principal in the event the bonding company is called to honor the judgment. And that's prudent underwriting practices.

BAKER: Was each investor a principal on a surety bond?

LAWYER: Absolutely. Each investor was a principal on each of the surety bonds. And with regard to the first installment payment, the evidence in this case is that was paid out of the proceeds from the program. I don't know where they came from. We had no evidence in this case as to why these programs failed to begin with. But each investor put $5,000 down, signed a

promissory note for $15,000, a year later the program paid one of those installments. When apparently these programs went south, the investors said: I'm not paying anymore money. You investor salesmen told me I wouldn't have to ever pay on these notes because the program would pay it. And now look it's failed and I've got to pay and I'm not going to do it. INA stepped up and said: we're obligated to pay the lender - and they did.

GONZALEZ: Yes but then you want to go after the investors to recoup your losses.

LAWYER: Absolutely.

GONZALEZ: Commonwealth needed a cover, needed a front, needed a big name company. So they got INA to give it the ora of respectability and credibility with these investors. INA's in the business of insuring risks, taking risks. But you're saying: Well, we're in that business, we're covered either way because if the investors don't pay, the investors have to pay us. So we are in a win-win situation. So INA can turn loose its agents that crossed the line and misrepresent and induce investors because you're in a win-win situation. And then now you come up here and say: Oh, but we didn't even have to tell them about the injunction and the _____ of securities because we had no duty and because we're covered either way. Is that the posture of the case, here? What am I missing?

LAWYER: First of all, INA was not the only insurance company in the industry doing these kinds of programs.

GONZALEZ: So if it's just anybody doing it it's okay?

LAWYER: No, I'm not saying everybody's doing it it's okay. I'm saying Commonwealth could very well have found a number of other people to do this. It isn't INA standing alone that acts as the surety in these types of programs. But, yes, INA is providing not insurance really. They are providing a credit enhancement. They are providing the ability for these lenders to make a tax leverage investment...

GONZALEZ: But they want their salesmen to sell and induce the investors because they can collect all these premiums? And they are not at risk.

LAWYER: Of course they are at risk.

GONZALEZ: How are they at risk?

LAWYER: They assumed the obligation in the first instance to pay the lender. Then they have the risk of trying to recover from the individual investors across the country, which is no easy proposition and there is a risk associated with defaults. If investors are going to default on note payments they likewise are going to default on indemnification obligations and the costs and risks

associated with that is a risk that this insurance company took on for the $42,000 it got paid. And it provided not an insurance product, but a credit enhancement vehicle. It's not really in the insurance business. It's in the credit enhancement business in this connection.

OWEN: Is the $42,000 all that it would ever have made or would it have made more money?

LAWYER: All of this is a single premium for the issuance of the bond.