The Sky is Still Blue in Texas: State Law Alternatives to Federal Securities Remedies

Keith A. Rowley
University of Nevada, Las Vegas –William S. Boyd School of Law

Follow this and additional works at: https://scholars.law.unlv.edu/facpub

Part of the Securities Law Commons

Recommended Citation
https://scholars.law.unlv.edu/facpub/54

This Article is brought to you by the Scholarly Commons @ UNLV Boyd Law, an institutional repository administered by the Wiener-Rogers Law Library at the William S. Boyd School of Law. For more information, please contact youngwoo.ban@unlv.edu.
THE SKY IS STILL BLUE IN TEXAS: STATE LAW ALTERNATIVES TO FEDERAL SECURITIES REMEDIES

Keith A. Rowley

TABLE OF CONTENTS

I. INTRODUCTION .................................................................................. 102

II. RECENT DEVELOPMENTS IN FEDERAL SECURITIES LAW: A BRIEF REVIEW .................................................. 103
   A. Central Bank of Denver and Gustafson ........................................ 103
   B. The Private Securities Litigation Reform Act of 1995 ................. 106

III. LIABILITY FOR OFFERING TO SELL OR SELLING SECURITIES WITHOUT PROPER REGISTRATION .................. 107
   A. Registration of Securities Under the TSA .................................. 110
   B. Registration of Dealers, Agents, and Salespersons .................... 111
   C. Exemptions from Registration .................................................. 112
   D. Liability for Violating the TSA’s Registration Requirements ....... 114
   E. Defenses to Section 33A(1) Liability .......................................... 114
      1. Standing ............................................................................. 115
      2. Limitations ......................................................................... 116
      3. Waiver and Release ............................................................. 118
   F. Remedies for Registration Violations ......................................... 118
      1. Rescission ........................................................................... 119
      2. Statutory Damages ............................................................... 119
      3. Exemplary Damages ............................................................ 119
      4. Prejudgment Interest ........................................................... 120
      5. Attorneys’ Fees and Costs ..................................................... 120
      6. Injunctive Relief .................................................................... 121

*Of Counsel, Glidden Partners L.L.P., Houston, Texas; B.A., Baylor University; M.P.P., Harvard University, John F. Kennedy School of Government; J.D., University of Texas School of Law; Law Clerk to the Honorable Thomas M. Reavley, United States Court of Appeals for the Fifth Circuit, 1992-93; Intern to the Honorable Lloyd A. Doggett, Supreme Court of Texas, 1992. The author would like to express his gratitude to his colleagues at Glidden Partners for their comments on earlier versions of this Article and for their contributions to our collective effort, GLIDDEN PARTNERS, WEST’S TEXAS FORMS: BUSINESS LITIGATION—FORMS AND COMMENTARY (1997), which provided a foundation for portions of parts IV.A and IV.D of this Article, and to his wife, Katherine, for her assistance, support, and understanding.
IV. LIABILITY FOR MATERIAL MISREPRESENTATIONS OR OMISSIONS IN THE OFFERING, SALE, OR PURCHASE OF SECURITIES ........................................ 122
   A. Common Law Liability .................................. 124
      1. Fraud ............................................. 124
      2. Negligent Misrepresentation .................... 127
      3. Defenses to Fraud and Negligent Misrepresentation ...... 129
         a. Limitations ................................... 129
         b. Plaintiff's Sophistication or Knowledge .......... 132
         c. Intervening Cause ............................... 132
         d. Estoppel ....................................... 133
         e. Laches .......................................... 134
         f. Ratification .................................... 135
         g. Unclean Hands and In Pari Delicto ............... 137
         h. Waiver ........................................ 139
         i. Disclaimer ................................... 141
   4. Remedies for Fraud and Negligent Misrepresentation ... 141
      a. Actual Damages .................................. 141
         i. Compensatory Damages ......................... 142
         ii. Consequential Damages ......................... 143
      b. Exemplary Damages ................................ 143
      c. Rescission ...................................... 145
      d. Prejudgment Interest ............................ 147
      e. Attorneys' Fees and Costs ....................... 147
   B. Liability Under the Texas Securities Act .............. 148
      1. Liability of an Offeror or Seller ................. 148
         a. Establishing a Section 33A(2) Claim .......... 149
         b. Section 33A(2) Defenses ....................... 154
            i. Standing ................................... 154
            ii. Limitations ................................ 154
            iii. Other Statutory Defenses ................. 155
         c. Remedies for Violations of Section 33A(2) ...... 157
            i. Rescission ................................ 159
            ii. Statutory Damages ......................... 159
            iii. Prejudgment Interest ...................... 160
            iv. Attorneys' Fees and Costs ................. 160
            v. Injunctive Relief ........................... 160
      2. Liability of a Buyer .............................. 160
         a. Establishing a Section 33B Claim ............... 161
         b. Section 33B Defenses .......................... 163
            i. Limitations ................................ 163
ii. Other Statutory Defenses.......................... 163

c. Remedies for Violations of Section 33B............. 163
   i. Rescission........................................ 163
   ii. Statutory Damages.............................. 164
   iii. Prejudgment Interest........................ 164
   iv. Attorneys’ Fees and Costs.................... 164

3. Liability of a Non-Selling Issuer.................... 165
   a. The Scope of Section 33C....................... 166
   b. Section 33C Defenses............................ 167
      i. Limitations.................................... 167
      ii. Other Statutory Defense..................... 167
   c. Remedies for Violations of Section 33C......... 168
      i. Rescission.................................... 168
      ii. Statutory Damages........................... 168
      iii. Prejudgment Interest...................... 168
      iv. Attorneys’ Fees and Costs................ 169

C. Liability Under the Texas Business and Commerce Code. 169
   1. Requisites of Section 27.01 Liability........... 169
   2. Section 27.01 Defenses.......................... 171
   3. Section 27.01 Remedies........................... 172
      a. Actual Damages................................ 172
      b. Exemplary Damages............................ 173
      c. Rescission..................................... 173
      d. Prejudgment Interest........................ 173
      e. Attorney’s Fees and Costs................... 173

D. Secondary Liability for Securities Violations......... 174
   1. Control Person Liability for Violations of the TSA 174
      a. Who or What is a “Control Person?”......... 176
      b. Defenses to Control Person Liability....... 178
      c. Remedies for Violations of Section 33F(1).... 180
   2. Aiding and Abetting Liability for Violations of the Texas Securities Act.................................. 181
      a. Requisites of Aider and Abettor Liability.... 181
      b. Defenses to Aider and Abettor Liability....... 183
      c. Remedies for Violations of Section 33F(2)..... 183
   3. Statutory Secondary Liability for Violations of Section 27.01........................................... 184
      a. Secondary Liability Under Section 27.01(d).... 184
      b. Section 27.01(d) Remedies........................ 185
   4. Common Law Secondary Liability for Securities Fraud.. 185
      a. Liability of an Agent............................ 187
I. INTRODUCTION

Recent actions by the United States Supreme Court and by Congress have reduced the number of avenues by which plaintiffs relying on federal law may pursue alleged wrongdoers for securities fraud and have imposed significant additional requirements on plaintiffs suing in federal court to recover for securities fraud. As a consequence, persons who claim injury from some material misrepresentation or omission in the purchase, sale, offer for purchase, or offer for sale of securities, or who have suffered as a consequence of some other impropriety relating to such transactions, may find better options available in state court or under state law than are available in federal court or under federal law.\(^1\) For reasons explored in this Article, this seems particularly true in Texas.\(^2\)

Under Texas law,\(^3\) persons and entities who sell or offer to sell securities in violation of pertinent statutory provisions,\(^4\) or by means of some


\(^3\)While this Article focuses on Texas law, readers should familiarize themselves with the relevant federal statutory provisions and precedent, both because federal and state liability over-
misrepresentation or omission of material fact, may be liable to any person or entity who buys securities from or through them. Likewise, persons and entities that buy securities in violation of pertinent statutory provisions, or by means of some misrepresentation or omission of material fact, may be liable to any person or entity that sells securities to or through them.

II. RECENT DEVELOPMENTS IN FEDERAL SECURITIES LAW: A BRIEF REVIEW

A. Central Bank of Denver and Gustafson

In Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., the Supreme Court reversed several decades of precedent by refusing to read an implied private cause of action for aiding and abetting securities

lap to a significant degree and because numerous provisions of Texas securities law are based upon or closely resemble federal law. See Quest Med., Inc. v. Aprill, 90 F.3d 1080, 1091 n.16 (5th Cir. 1996). This leads courts frequently to resort to cases construing the parallel federal provisions in order to construe and apply the applicable Texas statute. See id.; see, e.g., Sears v. Commercial Trading Corp., 560 S.W.2d 637, 639-42 (Tex. 1977); Campbell v. Payne, 894 S.W.2d 411, 417 (Tex. App.—Amarillo 1995, writ denied); Star Supply Co. v. Jones, 665 S.W.2d 194, 196 (Tex. App.—San Antonio 1984, no writ); First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart, 648 S.W.2d 410, 414 (Tex. App.—Dallas 1983, writ ref'd n.r.e.). For a brief overview of federal securities law, as well as a bit of historical background, see Paul Gonson, The Complex Web: An Introduction to the Federal Securities Laws, BUS. L. TODAY, July-Aug. 1995, at 11-14. For a more thorough introduction to federal securities law, see LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS (3d ed. 1997), an excellent resource that is updated annually, available from the Practicing Law Institute. For a detailed discussion of the elements of and principal defenses to liability under section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5 promulgated thereunder, which is the principal avenue available to private litigants under federal securities law, see Keith A. Rowley, Cause of Action for Securities Fraud Under Section 10(b) of the 1934 Securities Exchange Act and/or Rule 10b-5, 9 CAUSES OF ACTION 2D 271 (1997).

4 See TEX. REV. CIV. STAT. ANN. art. 581-33A(1), (2) (Vernon Supp. 1998); TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1987); infra parts III, IV.B.1, and IV.C.

5 See infra part IV.A.

4 Liability for the wrongful acts or omissions of buyers of securities is a fairly unique feature of current Texas law. The relevant federal statutes do not provide for redress against a buyer of securities, although some federal courts have found implied liability against buyers. See infra note 241. Likewise, prior to the 1977 amendments to the Texas Securities Act, Texas law did not impose statutory liability on buyers of securities. See TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.; see also TEX. BUS. & COM. CODE ANN. § 27.01.

5 See TEX. REV. CIV. STAT. ANN. art. 581-33B; infra part IV.B.2.

6 See infra part IV.A.

7 511 U.S. 164 (1994).
fraud into section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5 promulgated thereunder. For many years prior to Central Bank of Denver, "suits against aiders and abettors of violations under the federal securities laws had been the most widely used theory to hold nonprivity parties responsible for such violations." Indeed, "all 11 federal courts of appeals that had considered the question had already determined that aiders and abettors could be liable under section 10(b)."

The following term, in Gustafson v. Alloyd Co., the Supreme Court held that section 12(2) of the 1933 Securities Act applies only to public offerings. Thus, the Gustafson Court deprived those securities purchasers who bought their securities in private initial offerings or on the secondary market of the protection of one of the principal anti-fraud provisions of the federal securities laws. Thus, "for offerings that neither are registered

14Bettina M. Lawton & Catherine Botticelli, New Weapon in the SEC's Arsenal: Secondary Liability After Central Bank, BUS. L. TODAY, July-Aug. 1995, at 34; see also Steinberg, Ramifications, supra note 1, at 489 (observing that the Central Bank of Denver decision "swept away decades of lower court precedent that nearly universally recognized the propriety of" aiding and abetting liability under both section 10(b) and Rule 10b-5). See infra part IV.D.2 for a more detailed discussion of liability for aiding and abetting.
17Gustafson, 513 U.S. at 569-78.
18Federal securities law contains three primary anti-fraud provisions: (1) section 11 of the 1933 Securities Act, 15 U.S.C.A. § 77k (West 1997); (2) section 12(2), id. § 77t(a)(2); and (3) section 10(b) and Rule 10b-5, 15 U.S.C. § 78j(b) & 17 C.F.R. § 240.10b-5, respectively. Section 11 addresses only fraud in registration statements filed with the Securities Exchange Commission. See 15 U.S.C.A. § 77t(a). Section 11 does not address fraud in the offering or sale of unregistered securities, nor does section 11 protect those who purchase registered securities "after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement" absent proof by the purchaser that she "acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission." Id. In the wake of Gustafson, federal courts have begun to read section 11, as the Court read section 12, to apply only to initial public offerings. See, e.g., Gould v. Harris, 929 F. Supp. 353, 358 (C.D. Cal. 1996); Stack v. Lobo, 903 F. Supp. 1361, 1375 (N.D. Cal. 1995); see also, e.g., In re AES Corp. Sec. Litig., 825 F. Supp. 578, 592 (S.D.N.Y. 1993) ("To state a
under the federal Securities Act nor are otherwise deemed ‘public’ in nature, Section 10(b) of the Exchange Act serves as the key federal securities law remedy for private litigants seeking to recover against alleged primary wrongdoers.\textsuperscript{19}

Unfortunately for those who feel they have been defrauded in a securities transaction, section 10(b) may offer little comfort for at least three reasons addressed more fully later in this Article. First, a plaintiff may bring a section 10(b) claim only in federal court,\textsuperscript{20} thus subjecting her to the inconvenience (and, likely, greater expense) of federal court litigation and to a heightened pleading standard, in the form of Rule 9(b) of the Federal Rules of Civil Procedure.\textsuperscript{21} Second, section 10(b) requires a plaintiff to prove that she relied on the defendant’s alleged misrepresentation in order to recover\textsuperscript{22}—a requirement not imposed by section 33 of the Texas Securities Act\textsuperscript{23} or, for that matter, by section 12(2) of the 1933 Securities Act.\textsuperscript{24} Third, section 10(b) requires a plaintiff to prove that the defendant made the misrepresentation or permitted the omission with the requisite amount of scienter\textsuperscript{25}—again, an element not required to make a prima facie case under either the Texas Securities Act\textsuperscript{26} or section 12(2).\textsuperscript{27}

\textsuperscript{19}Steinberg, supra note 2, at 1098.

\textsuperscript{20}See 15 U.S.C. § 78bb(a); infra part V.B.

\textsuperscript{21}See FED. R. CIV. P. 9(b); infra part V.B. See generally Steinberg, supra note 2, at 1099.

\textsuperscript{22}See infra note 207.

\textsuperscript{23}See infra note 208 and accompanying text (discussing the lack of a reliance element in Article 581-33).

\textsuperscript{24}See infra note 207.

\textsuperscript{25}See infra note 212.

\textsuperscript{26}See infra note 210.

\textsuperscript{27}See infra note 213.
B. The Private Securities Litigation Reform Act of 1995

In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA). PSLRA reformed a number of provisions of both the 1933 Securities Act and the 1934 Securities Exchange Act, including

(1) replacing the pre-PSLRA scheme of joint and several liability with a proportionate liability scheme in all cases except where the plaintiff can prove an otherwise jointly and severally liable defendant "knowingly committed" a violation of, *inter alia*, section 10(b) of the 1934 Act or Rule 10b-5;

(2) creating a "safe harbor" from liability for forward-looking statements about profitability, as long as the statements contain a disclaimer that the projections are "uncertain" and that actual results may differ;

(3) raising the requirements for pleading fraud with sufficient specificity to survive a Rule 9(b) motion; and

(4) raising the requirements for pleading and proving reliance, as well as capping the damages recoverable in cases alleging a material misstatement or omission in a prospectus or oral communication, or other act or omission actionable under section 10(b) of the 1934 Act or Rule 10b-5.

---


30Id. § 78a et seq.


III. LIABILITY FOR OFFERING TO SELL OR SELLING SECURITIES
WITHOUT PROPER REGISTRATION

Section 33A(1) of the Texas Securities Act (TSA) imposes liability on any person who offers or sells a security in violation of the registration requirements of the TSA or in violation of a cease and desist order issued, pursuant to section 23A of the TSA, by the Texas Securities Commissioner. The TSA defines the term "security" to include:

36 The discussion here and elsewhere in this Article focuses solely on civil liability for violations of the applicable provisions of the Texas Securities Act. See also infra parts IV.B & D. However, an unregistered person selling securities not otherwise exempt under the Texas Securities Act, as well as any person selling unregistered securities not otherwise exempt under the Texas Securities Act, may also face criminal liability. See TEX. REV. CIV. STAT. ANN. art. 581-29A, 29B (Vernon 1964 & Supp. 1998), as may any person dealing in securities subject to a cease and desist order issued by the Texas Securities Commissioner, see id. art. 581-29D.

37 Id. art. 581-33A(1) (Vernon Supp. 1998).

38 For purposes of the TSA, "person" includes corporations, partnerships, limited partnerships, joint stock companies, associations, syndicates, and other business entities. See id. art. 581-4B; see also Flowers v. Dempsey-Tegeler & Co., 472 S.W.2d 112, 115 (Tex. 1971) (holding, prior to the amendment of the TSA in 1971 which added a definition of "person," that a "person," for purposes of the TSA, includes a corporation).

39 The TSA's registration requirements are set forth in TEX. REV. CIV. STAT. ANN. art. 581-7, -9, -12, & -23B.

40 See id. art. 581-23A.

41 Section 33A(1) parallels section 12(1) of the 1933 Securities Act, codified as amended (by PSLRA) at 15 U.S.C.A. § 77l(a)(1) (West 1997). See TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. Section 12(1) provides, in relevant part:

Any person who . . . offers or sells a security in violation of section 77e of this title, . . . shall be liable . . . to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C.A. § 77l(a)(1). Section 77e, in turn, makes it unlawful, subject to the exemptions set forth in 15 U.S.C.A. §§ 77c & 77d, for any person to sell or deliver, or to offer to sell or offer to buy, through the use of "any means or instruments of transportation or communication in interstate commerce or of the mails," unregistered securities or securities which are subject to a refusal or stop order as provided for under the Act. Id. § 77e(c); see id. § 77e(a); Swenson v. Engelstad, 626 F.2d 421, 424 n.6 (5th Cir. 1980). Courts interpreting section 33A(1) rely upon decisions construing section 12(1) "because the language is virtually identical." Reed v. Prudential Sec., Inc., 875 F. Supp. 1285, 1292 (S.D. Tex. 1995), aff'd, 87 F.3d 1311 (5th Cir. 1996). See generally discussion supra note 3.
any limited partner interest in a limited partnership, share, stock, treasury stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument

42 "Evidence of indebtedness," a term taken from section 2 of the 1933 Securities Act, 15 U.S.C.A. § 77b(a)(1), "has been defined to mean 'all contractual obligations to pay in the future for consideration presently received.'" Searcy v. Commercial Trading Corp., 560 S.W.2d 637, 641 (Tex. 1977) (quoting United States v. Austin, 462 F.2d 724, 736 (10th Cir. 1972)). In Searcy, the Texas Supreme Court concluded that certain "naked" commodity options were "evidence of indebtedness" for purposes of the TSA. See id. at 642.

43 Although the TSA includes oil and gas interests in its definition of "securities," TEX. REV. CIV. STAT. ANN. art. 581-4A, these interests, prior to severance from the soil, are also classified as real estate. See Howard v. Simons, 285 S.W.2d 478, 480 (Tex. Civ. App.—Dallas 1955, writ ref'd n.r.e.).

44 The term[ ]... "company" shall include a corporation, joint stock company, partnership, limited partnership, association, company, firm, syndicate, trust, incorporated or unincorporated, heretofore or hereafter formed under the laws of this or any other state, country, sovereignty or political subdivision thereof, and shall include a government, or a political subdivision or agency thereof. As used herein, the term "trust" shall be deemed to include a common law trust, but shall not include a trust created or appointed under or by virtue of a last will and testament or by a court of law or equity.

TEX. REV. CIV. STAT. ANN. art. 581-4B.

45 "An investment contract involves (1) a common enterprise in which a person (2) [invests money and] expects profits (3) solely from the efforts of the promoter or a third party." Busse v. Pacific Cattle Feeding Fund #1, Ltd., 896 S.W.2d 807, 814 (Tex. App.—Texarkana 1995, writ denied) (citing SEC v. W.J. Howey Co., 328 U.S. 293 (1946); Russell v. French & Assoc., Inc., 709 S.W.2d 312, 314 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.)); see First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart, 648 S.W.2d 410, 414 (Tex. App.—Dallas 1983, writ ref'd n.r.e.) (citing W.J. Howey Co.). See generally Searcy, 560 S.W.2d at 639-41 (both identifying and carefully analyzing the elements of an investment contract for purposes of liability under the TSA); First Municipal Leasing, 648 S.W.2d at 415-17. By contrast, for example, "[t]he sale of an interest in a true joint venture or general partnership generally does not involve the sale of a security because the venturers or partners have the power to par-
commonly known as a security, whether similar to those herein referred to or not. Provided, however, that this definition shall not apply to any insurance policy, endowment policy, annuity contract, optional annuity contract, or any contract or agreement in relation to and in consequence of any such policy or contract, issued by an insurance company subject to the supervision or control of the Texas Department of Insurance when the form of such policy or contract has been duly filed with the Department as now or hereafter required by law.\textsuperscript{46}

Article 581-33A(1) is, in essence, a "strict liability" statute. A person who offers or sells an unregistered security is liable to the buyer, who may then sue for rescission or for damages,\textsuperscript{47} unless the unregistered security or the manner in which it is offered for sale is subject to one or more of the

\begin{quote}
participate in the management of the entity and, therefore, the third element of an investment contract is missing." \textit{Russell}, 709 S.W.2d at 314. Where the general partner of a limited partnership is solely responsible for management of the partnership, interests held by limited partners qualify as investment contracts and the sale of such interests to limited partners is subject to the provisions of the TSA. \textit{See Mayfield v. Troutman}, 613 S.W.2d 339, 343-44 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.).

\textsuperscript{46}\textsc{Tex. Rev. Civ. Stat. Ann.} art. 581-4A (footnotes added). Generally, Texas courts look to federal decisions to determine whether or not a particular device is a "security." \textit{See discussion supra} note 3; \textit{see, e.g., Campbell v. Payne}, 894 S.W.2d 411, 417-18 (Tex. App.—Amarillo 1995, writ denied); \textit{First Municipal Leasing}, 648 S.W.2d at 414 (analyzing the similarities between the definition of "security" in section 4A and that contained in section 2 of the 1933 Act). The 1933 Act provides:

The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, prereorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.


\textsuperscript{47}\textsc{Tex. Rev. Civ. Stat. Ann.} art. 581-33A(1); \textit{see Busse}, 896 S.W.2d at 814 (discussing damages).
exemptions contained in Article 581.48 As long as the plaintiff establishes that the security was unregistered at the time of the sale, the defendant is liable, unless the defendant can establish that the security or the transaction itself was exempt.

A. Registration of Securities Under the TSA49

The most far-reaching of the TSA's registration provisions is section 7, which provides in part:

No dealer, agent or salesman shall sell or offer for sale any securities . . . except those which shall have been registered by Notification under subsection B or by Coordination under subsection C of this Section 7 and except those which come within the classes enumerated in Section 5 or Section 6 of this Act, until the issuer of such securities or a dealer registered under the provisions of this Act shall have been granted a permit by the Commissioner. . . .50

Section 7B provides for registration "by notification" if the issuer has been in continuous operation for not less than three years and satisfies the net earnings requirements set forth, in detail, in sections 7B(1)(a)-(c).51 A security may be registered "by coordination," pursuant to section 7C, if the issuer files a registration statement with the Securities and Exchange Commission in accordance with the requirements of the 1933 Securities Act, and this filing is in connection with the same offering.52

---

48See TEX. REV. CIV. STAT. ANN. art. 581-33A(1); see id. art. 581-5 ("Exempted Transactions"); id. art. 581-6 ("Exempted Securities"). The 1933 Act's exemptions are codified at 15 U.S.C.A. § 77c(a) ("Exempted Securities"), § 77c(b) ("Additional Exemptions"), § 77d ("Exempted Transactions").


52Id. art. 581-7C(1) (Vernon Supp. 1998).
B. Registration of Dealers, Agents, and Salespersons\textsuperscript{53}

In addition to requiring registration of securities sold or offered for sale in the state of Texas, the TSA, subject to certain exemptions, also requires registration of all persons who sell or offer securities in Texas.\textsuperscript{54}

Except as provided in Section 5 of this Act, no person, firm, corporation or dealer shall, directly or through agents or salesmen, offer for sale, sell or make a sale of any securities in this state without first being registered as in this Act provided. No salesman or agent shall, in behalf of any dealer, sell, offer for sale, or make sale of any securities within the state unless registered as a salesman or agent of a registered dealer under the provisions of this Act.\textsuperscript{55}

\textsuperscript{53}TEX. REV. CIV. STAT. ANN. art. 581-4C states:

The term “dealer” shall include every person or company other than a salesman, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for any security or securities and every person or company who engages in rendering services as an investment adviser, and every person or company who deals in any other manner in any security or securities within the state. Any issuer other than a registered dealer of a security or securities, who, directly or through any person or company, other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer and shall be required to comply with the provisions hereof; provided, however, this section or provision shall not apply to such issuer when such security or securities are offered for sale or sold either to a registered dealer or only by or through a registered dealer acting as fiscal agent for the issuer; and provided further, this section or provision shall not apply to such issuer if the transaction is within the exemptions contained in the provisions of Section 5 of this Act.

\textit{Id.} The term “salesman” or “agent” includes:

\[E\]very person or company employed or appointed or authorized by a dealer to sell, offer for sale or delivery, or solicit subscriptions to or orders for, or deal in any other manner, in securities within this state, whether by direct act or through subagents; provided, that the officers of a corporation or partners of a partnership shall not be deemed salesmen or agents solely because of their status as officers or partners, where such corporation or partnership is registered as a dealer hereunder.

\textit{Id.} art. 581-4D. See generally 66 TEX. JUR. 3D Securities Regulation §§ 16-19, at 566-71.

\textsuperscript{54}TEX. REV. CIV. STAT. ANN. art. 581-12A.

\textsuperscript{55}Id.
C. Exemptions from Registration

Section 5 of the TSA identifies certain sales, offerings for sale, solicitations, subscriptions, dealings in, and deliveries of securities which—due to the nature of the transaction, the nature of the parties, or both—are exempt from the registration requirements of section 7 and, therefore, will not give rise to liability under section 33A(1).\(^57\) For example, a security offering is exempt from registration if the sale was made without public solicitation or advertisement\(^8\) and the issuer sold its securities during the preceding


\(^{57}\)See TEX. REV. CIV. STAT. ANN. art. 581-5.

\(^{58}\) The court stated in Sibley v. Horn Advertising, Inc.:

The [Texas Securities] Act contains no definition of “public solicitation” or “advertisements.” In Tumblewood Bowling Corporation v. Matise, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965, writ ref’d n.r.e.), an offering of stock to two hundred and fifty people, of whom less than thirty-five purchased, was held to be a “public solicitation.” The court said that this term does not mean that the offer must be made to the entire world, citing SEC v. Ralston Purina Co., 346 U.S. 119 . . . (1953), in which a similar interpretation was given to the exemption for transactions “not involving a public offering” in § 4(1) of the Securities Act of 1933 . . . . In that case the Supreme Court denied the exemption to an offering limited to employees of a large corporation, several hundred of whom purchased stock each year, saying that the Act must be construed in the light of its purpose to protect potential investors by promoting full disclosure of information necessary to informed investment decisions, and that applicability of the exemption should turn on whether the particular class of persons affected needs the protection of the Act. Illustrating this construction, the Court observed: “An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’ ”

We hold that a similar construction of “public solicitation” in the Texas Act is proper and brings this case within the exemption. Defendant was solicited because of his personal acquaintance with attorney Fanning, and he agreed to buy the stock because of that relationship. He was “able to fend for himself” since he was an experienced investor and had personal experience with Fanning in privately-held corporate ventures. The offering was limited, and defendant was a major subscriber. He was dealing directly with Laseter, the president of the corporation, and was in contact with Fanning, the other principal promoter. He had ample opportunity to pursue with them whatever inquiry he considered necessary to make an informed investment decision. Apparently he was not satisfied with the information presented by Laseter, but called Fanning and obtained his personal assurance about the venture. The jury found that Fanning made no misrepresentation, and defendant does not attack that finding. We conclude that these circumstances do not establish a “public solicitation.”
twelve months to not more than fifteen persons who bought for their own account, or the total number of shareholders of the issuer, after taking into account the ownership of the newly-sold shares, does not exceed thirty-five persons. Likewise, distributions of additional shares of stock as dividends to existing shareholders and commission-free offers and sales to existing shareholders are also exempt. Section 5 exemptions apply to both the securities registration requirements of section 7 and the dealer/salesperson registration requirements of section 12.

Section 6 also exempts certain securities from registration, notwithstanding whether the transaction involved is otherwise exempt. Most prominently, the offer or sale of any security fully listed at the time of sale on the American, Boston, Midwest, or New York Stock Exchange (or other exchange approved by the Texas Securities Commissioner) by a registered dealer, or a salesperson working for a registered dealer, need not comply with the registration requirements of the TSA. In addition, securities is-

---

We hold also that the "confidential memorandum" and other written materials used by Laster were not "advertisements" within the meaning of § 5(f). The materiality of the "confidential memorandum" is questionable, since defendant testified that he never saw it, but even if we disregard his testimony in that respect, the most his evidence shows is that the material was presented in personal interviews to no more than twenty selected acquaintances of one of the promoters. Thus, the case differs from Tumblewood, supra, in which the term "advertisement" was held applicable to a brochure exhibited to two hundred and fifty prospects not previously known to the salesman who solicited them. . . . We agree with [the] view that "advertisement" implies public distribution, and that to apply the term to all written information presented to a prospective purchaser of securities would defeat rather than promote the purpose of the Act to require disclosure of material information because such a holding would grant the private offering exemption only to oral communications, which would normally be less informative than written communications. Unlike the brochure in Tumblewood, the record here failed to show any public distribution of the material in question.


59See TEX. REV. CIV. STAT. ANN. art. 581-5(i(c).
60See id. art. 581-5(i(a).
61See id. art. 581-5D.
62See id. art. 581-5E.
63See supra parts III.A & B.
64See TEX. REV. CIV. STAT. ANN. art. 581-6.
65See id. art. 581-6F; Reed v. Prudential Sec., Inc., 875 F. Supp. 1285, 1292 (S.D. Tex. 1995), aff’d, 87 F.3d 1311 (5th Cir. 1996).
sued by railroads or other public utilities, and securities issued by domestic non-profit, religious, charitable, or benevolent corporations, are exempt from the registration requirements of section 7. However, unlike the exemption of section 5, which excuses both the security and the salesperson from registration, section 6 exemptions are available only to qualifying securities offered or sold by registered dealers or salespersons working under the supervision of a registered dealer.

The burden of establishing an exemption rests with the defendant claiming the exemption. And, in the absence of a pleaded exemption, a plaintiff need not plead or prove the inapplicability of any exemption.

D. Liability for Violating the TSA’s Registration Requirements

Subject to certain exemptions contained in sections 5 and 6 of the TSA, a defendant who sells or offers to sell unregistered securities is strictly liable to a plaintiff buyer. Unlike defendants charged with other violations of section 33 of the TSA that give rise to civil liability, section 33A(1) defendants have no statutory defenses if the securities or the transaction involved required registration.

E. Defenses to Section 33A(1) Liability

Article 581-33A(1), like its federal counterpart, is, in essence, a strict liability statute. As long as the plaintiff can establish that the security was

---

67 See id. art. 581-6E, -6.
71 See id. art. 581-33A(1).

A person who offers or sells a security in violation of Section 7, 9 (or a requirement of the Commissioner thereunder), 12, 23B, or an order under 23A of this Act is liable to the person buying the security from him, who may sue either at law or in equity, for rescission or for damages if the buyer no longer owns the security.

Id.; see Busse v. Pacific Cattle Feeding Fund #1, Ltd., 896 S.W.2d 807, 814 (Tex. App.—Texarkana 1995, writ denied).
72 15 U.S.C.A. § 77l(a)(1) (West 1997); see discussion supra note 41.
unregistered at the time of the sale, the defendant will be liable unless the defendant can establish that the security or the transaction itself was exempt, or in the opinion of one Texas appeals court, if the plaintiff knew that the security was unregistered and non-exempt at the time the plaintiff purchased it from the defendant. Nonetheless, certain defenses may remove a dispute from the reach of section 33A(1), thereby banishing the specter of strict liability.

1. Standing

Article 581-33A(1)'s protection extends only to buyers—persons who did not buy the security lack standing to sue the person who offered or sold the security for failing to properly register the security or failing to properly register to offer or sell the security. What, exactly, makes one a "buyer" is less than clear.

The Fifth Circuit Court of Appeals held that an individual was considered the "buyer" even though he purchased the stock with his relatives' money. Lewis v. Walston & Co., 487 F.2d 617, 622 (5th Cir. 1973). In Lewis, an individual bought stock and intended to distribute the stock to each relative according to the amount paid. Id. The court held that the individual was recognized as the "purchaser" because the stock was in his name and a letter of investment intent showed he was the sole purchaser. Id.

\footnote{In Swenson v. Engelstad the court stated:}

\begin{quote}
The Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities. Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 686 (5th Cir. 1971). Recovery may be had under section 12(1) "regardless of whether [the purchaser] can show any degree of fault, negligent or intentional, on the seller's part." Id. There are three elements to a prima facie case: (1) the sale or offer to sell securities; (2) the absence of a registration statement covering the securities; and (3) the use of the mails or facilities of interstate commerce in connection with the sale or offer. Doran v. Petroleum Management Corp., 545 F.2d 893, 899 (5th Cir. 1977); Lewis v. Walston & Co., Inc., 487 F.2d 617, 621 (5th Cir. 1973).
\end{quote}


\footnote{See TEX. REV. CIV. STAT. ANN. art. 581-33A(1).}

\footnote{See id. art. 581-5, -6. For an overview of the relevant exemptions, see supra part III.C.}

\footnote{See Ladd v. Knowles, 505 S.W.2d 662, 668 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.).}

\footnote{See Ratner v. Sioux Natural Gas Corp., 770 F.2d 512, 517 (5th Cir. 1985).}
Likewise, a federal district court held that a plaintiff
did not have to be an owner to be considered the pur-
chaser, but had to have “sufficient indicia of ownership to
effectuate a tender of the securities.” *Monetary Mgmt.
(E.D. Mo. 1985). The plaintiff in *Monetary Management*
purchased the bonds in question for a customer, and the
court found this sufficient to establish the plaintiff as the
purchaser and as the proper party to bring an action for re-
scission. *Id.* at 767.

WellTech negotiated with the control persons for the
purchase of Vanguard stock and was the record holder of
the stock. Regardless of who actually funded the sale,
WellTech had sufficient indicia of ownership to [be con-
considered a “buyer” under Article 581-33].

2. Limitations

A plaintiff must bring any claim for a violation of the TSA’s regis-
tration provisions within three years of the date of sale or within one year af-
after the plaintiff properly rejected a rescission offer tendered by the defen-
dant pursuant to the terms of section 331, whichever period expires on the
earliest date. See *id.* art. 581-33H(1); Stone v. Enstam, 541 S.W.2d 473, 478 (Tex. Civ. App.—Dallas 1976, no writ). Section 33H(1)
as applies to registration and related violations. For them the final cutoff is three years
from the sale. Suit can be barred earlier by a rescission offer. For example, a rescis-
sion offer made 90 days after the sale bars suit 30 days after received (if the offeree
does anything besides reject in writing and expressly reserve his right to sue) and one
year and 30 days after received (if the offeree so rejects and reserves). The 3-year pe-
riod would no longer be available. If the 3-year period ends sooner than one year after
rejection of the rescission offer, the 3-year period controls.

---

79See TEX. REV. CIV. STAT. ANN. art. 581-33I.
80See *id.* art. 581-33H(1); Stone v. Enstam, 541 S.W.2d 473, 478 (Tex. Civ. App.—Dallas 1976, no writ). Section 33H(1)

TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.; see also Hal M. Bateman, *Securities Litigation: The 1977 Modernization of Section 33 of the Texas Securities Act*, 15 HOU. L. REV. 839, 859 (1978) (“The first of the three periods to mature under section 33H(1) clearly will bar the action by limitations.”). *But see* TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. n.1 (“The Texas Securities Commissioner disagrees, believing that the one year period after rejection controls, and that a
rescission offer which states the opposite does not comply with [section] 331 or [section] 333 and
is therefore misleading and ineffective to cut off liability.
"

When does a cause of action under section 33A(1) begin to accrue? In Lintz v. Dillon, 568
S.W.2d 147 (Tex. Civ. App.—Beaumont 1978), rev'd, 582 S.W.2d 394 (Tex. 1979),

[the trial court found that the statute of limitations began to run on February 14, 1969,
when appellant instructed Dodd to purchase 1000 shares of Omnitec on a “when, as
and if issued” basis.

568 S.W.2d at 150. The court of civil appeals disagreed:

Under this interpretation, the statute of limitations for failure to register the securities
began to run more than two weeks before the securities were even in existence. This
interpretation would conceivably allow the limitation period to run in its entirety be-
fore the obligation to register the securities ever arose.

We cannot accept such an analysis . . . . [T]he statute of limitations for failure to
register securities should not begin to run before the securities are in existence . . .

. . . . Where there is some condition precedent to the right of action, the cause of ac-
tion does not accrue, nor the limitation period begin to run, until that condition is per-
formed . . . . In the present case, the enforcement of any rights embodied in the Febru-
ary 14, 1969, agreement was conditioned upon the securities first being issued. On
March 3, 1969, when the securities were issued, the parties’ rights became enforce-
able, and their cause of action accrued. It was on that day that the statute of limitations
began to run.

Id. (citations omitted). The Texas Supreme Court reversed:

conclud[ing], as did the trial court, that the contract was made on February 14, 1969,
and the parties then had only to await the event of issuance of the stock before being
bound on the obligation to pay. As revealed by the contract, it was not the intent to
wait for the issuance of the stock to make the contract. "When-issued trading" is
trading in unissued securities which is effected in contemplation of their issuance: a
dealer simply makes a contract to sell the securities "when, as and if issued." Such an
agreement is a conditional contract by which the parties are bound to perform if the
securities are ultimately issued according to the terms specified.

Since this suit was not filed until February 28, 1972, Lintz exceeded the three years
by two weeks. Therefore, the court of civil appeals erred in holding that his claim was
not barred by the statute of limitations.

582 S.W.2d at 395 (citations omitted).

By comparison, plaintiffs must bring claims for violations of section 12(1) of the 1933 Secu-
rities Act within one year of their occurrence, but in any event within three years of the first bona
fide offer of the security to the investing public. See 15 U.S.C.A. § 77m (West 1997). Thus, the
TSA will generally afford plaintiffs a more generous period of time in which to discover and
bring suit over the sale of unregistered (and non-exempt) securities than they are afforded by
section 12(1). See Steinberg, supra note 2, at 1099.
3. Waiver and Release

The TSA contains an anti-waiver provision.82 Because the TSA's anti-waiver provision is essentially the same as the comparable federal provision,83 Texas courts have adopted and followed the reasoning and holdings in federal cases when applying the TSA's anti-waiver provision.84

F. Remedies for Registration Violations

Section 33D affords a successful section 33A(1) plaintiff the following remedies:

---

81 See Steinberg, supra note 2, at 1099. Likewise, equitable tolling may not extend the date on or before which a section 12(1) plaintiff must sue. See Gardner v. Investors Diversified Capital, Inc., 805 F. Supp. 874, 878 (D. Colo. 1992).

82 Tex. Rev. Civ. Stat. Ann. art. 581-33L (voiding any "condition, stipulation, or provision binding a buyer or seller of a security to waive compliance with a provision of this Act or a rule or order or requirement"). "Section 33L does not apply to—and therefore does not diminish the effectiveness of—... a bona fide release or settlement of an existing claim, whether or not a suit has been filed...." Id. art. 581-33L cmt.


The federal cases applying the federal anti-waiver provision, particularly the Goodman v. Epstein opinion, are well reasoned and persuasive.

Anheuser-Busch, 858 S.W.2d at 934. Similar anti-waiver language is not found in section 27.01. See Tex. Bus. & Com. Code Ann. § 27.01 (Vernon 1987).
1. Rescission

A successful section 33A(1) plaintiff who still owns the security or securities is entitled to have the transaction rescinded and, upon making a tender of the security (or a security of the same class and series), to recover: "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the amount of any income he received on the security."85

2. Statutory Damages

A successful section 33A(1) plaintiff who no longer owns the security or securities at issue shall recover: "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the value of the security at the time he disposed of it plus the amount of any income he received on the security."86

3. Exemplary Damages

The TSA does not provide for exemplary damages.87

---

86Id. art. 581-33D(3). "Consideration paid" under section 33D(3), likewise, includes any commissions paid by the buyer. Id. art. 581-33 cmt.
87See Quest Med., Inc. v. Apprill, 90 F.3d 1080, 1092 (5th Cir. 1996). Article 581-33M provides that "[t]he rights and remedies provided by this Act are in addition to any other rights (including exemplary or punitive damages) or remedies that may exist at law or in equity." Tex. Rev. Civ. Stat. Ann. art. 581-33M.

The district court held exemplary damages were unavailable under the TSA. Apprill, however, argues that he is entitled to recover exemplary damages under the TSA, and that $500,000 in exemplary damages is reasonably proportional to his TSA award of over $101,000 in actual damages. Apprill relies on the lack of language expressly excluding such a recovery and on the "in addition to" language of Article 581-33M. Apprill's claim, thus, requires us to interpret the TSA.

We must construe the TSA so as to give effect to the intent of the enacting legislature. Union Bankers Ins. Co. v. Shelton, 889 S.W.2d 278, 280 (Tex. 1994); Sorokolit v. Rhodes, 889 S.W.2d 239, 241 (Tex. 1994). "Legislative intent can be inferred from the absence or presence of a particular provision in a statute." Green v. Watson, 860 S.W.2d 238, 244 (Tex. App.—Austin 1993, no writ) (citing Morrison v. Chan, 699 S.W.2d 205, 208 (Tex. 1985)). Albeit the Texas legislature saw fit to expressly afford an aggrieved seller the right to seek compensatory damages, costs, and attorney's fees pursuant to his TSA claim, conspicuously absent from Article 581-33D's remedial scheme is a provision for the recovery of exemplary damages. The legislature's express mention of one person, thing, consequence, or class is tantamount to the express exclusion of all others. Cole v. Huntsville Memorial Hosp., 920 S.W.2d 364, 372
4. Prejudgment Interest

Section 33D explicitly includes "interest thereon at the legal rate" as an element of a plaintiff's recovery for a violation of section 33A(1).88

5. Attorneys' Fees and Costs

Regardless of whether a section 33A(1) plaintiff seeks damages or rescission, she is entitled to recover her costs of court;89 and, "if the court finds that the recovery would be equitable in the circumstances," she may also recover her reasonable attorneys' fees.90

(Tex. App.—Houston [1st Dist.] 1996, writ denied), [cert. denied, 117 S. Ct. 1312 (1997)]; Lenhard v. Butler, 745 S.W.2d 101, 105 (Tex. App.—Fort Worth 1988, writ denied). We therefore cannot consider the Texas legislature's failure to include exemplary damages in the list of elements of relief for violations of the TSA to be a mere oversight.

Also, Apprill's argument that the "in addition to" language of Article 581-33M creates a right to exemplary damages under the TSA is equally unavailing. The Commentary to Article 581-33 provides, with respect to Article 581-33M:

The parenthetical reference to exemplary damages replaces—without substantive change—references at the end of old §§ 33A and 33C to exemplary damages and art. 4004 (now Business & Commerce Code § 27.01). Thus all common law and statutory liabilities outside the Texas Securities Act, including § 27.01 (which permits triple damages in some instances), remain intact and may be used along with the Texas and U.S. Securities Act liabilities.

(Emphasis added). As these comments and Article 581-33M's heading (i.e., "Saving of Existing Remedies") suggest, this provision merely confirms that other theories of liability that yield relief for the same transaction that gives rise to a cause of action under the TSA and that, unlike the TSA, allow recovery of exemplary damages are not preempted by the TSA. Consequently, Article 581-33M does not create a separate, affirmative right to exemplary damages on a cause of action under the TSA.

Apprill, 90 F.3d at 1091-92 (footnotes omitted). Section 12(1) of the 1933 Securities Act, 15 U.S.C.A. § 77t(a)(1) (West 1997), which section 33A(1) of the TSA closely parallels, see discussion supra note 41, likewise does not provide for exemplary damages. See Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 697 (5th Cir. 1971); see also Hunt v. Miller, 908 F.2d 1210, 1216 n.13 (4th Cir. 1990).

88TEX. REV. CIV. STAT. ANN. art. 581-33D(1), (3).
89See id. art. 581-33D(6).
90Id. art. 581-33D(7). As a general rule, a plaintiff seeking to recover attorneys' fees carries the burden of proving the amount of fees she is entitled to recover. Stewart Title Guar. Co. v. Sterling, 822 S.W.2d 1, 10 (Tex. 1991); see Mullins v. Mullins, 889 S.W.2d 550, 554 (Tex. App.—Houston [14th Dist.] 1994, writ denied). To recover attorneys' fees, the plaintiff must establish that the fees sought are "reasonable and necessary" for the prosecution of the suit. Stewart Title, 822 S.W.2d at 10; Campos v. State Farm Gen. Ins. Co., 943 S.W.2d 52, 54 (Tex. App.—San Antonio 1997, writ denied); Mullins, 889 S.W.2d at 554.
6. Injunctive Relief

Article 581-32 specifically empowers the Texas Securities Commissioner to seek an injunction to enforce certain provisions of the TSA.91

The commentary to article 581-33, discussing the recovery of attorneys’ fees on a TSA, states:

All the circumstances should be considered, e.g. the conduct of the defendant in the transaction (for example, fees are more appropriate against a fraudulent defendant than against a negligent or careful one), the conduct of the plaintiff in the transaction, the conduct of both parties in the lawsuit, whether the defendant benefited from the violation, and whether there was a special or fiduciary relationship between the plaintiff and defendant. Recovery of exemplary damages for the same transaction, under common law or Business & Commerce Code § 27.01, should also be considered, since such damages serve in part to cover attorneys fees.

TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.

More generally, the Texas Supreme Court’s recent opinion in Arthur Andersen & Co. v. Perry Equipment Corp., 945 S.W.2d 812 (Tex. 1997), identifies the factors a court must consider in determining the reasonableness of claimed attorneys’ fees (including contingent fees) in any case:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill required to perform the legal service properly;
(2) the likelihood . . . that the acceptance of the particular employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;
(6) the nature and length of the professional relationship with the client;
(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
(8) whether the fee is fixed or contingent on results obtained or uncertainty of collection before the legal services have been rendered.


91 TEX. REV. CIV. STAT. ANN. art. 581-32. Article 581-32 authorizes injunctions against persons who participate materially in fraudulent activity amounting to a violation of the Act, restraining such persons from “continuing such fraudulent practices or engaging therein or doing any act or acts in furtherance thereof or in violation of” the terms of the Act. Id. art. 581-32A. The injunction may not restrain conduct outside that designated in the statute in an action under section 32A. See State ex rel. Shook v. All Texas Racing Ass’n, 128 Tex. 384, 97 S.W.2d 669,
Private parties have no such right, notwithstanding the language in article 581-33M that "the rights and remedies provided by [the TSA] are in addition to any other rights . . . or remedies that may exist at law or in equity."92

IV. LIABILITY FOR MATERIAL MISREPRESENTATIONS OR OMISSIONS IN THE OFFERING, SALE, OR PURCHASE OF SECURITIES

A plaintiff may sue for rescission due to or damages arising from a misrepresentation or omission of material fact pursuant to (1) common law;93 (2) the Texas Securities Act;94 (3) section 27.01 of the Texas Business and Commerce Code;95 or (4) the Texas Deceptive Trade Practices-Consumer Protection Act.96 Moreover, in addition to, or in lieu of, suing the person

670 (Tex. 1936) (addressing articles 4664-4666 of the Revised Civil Statute of 1925); Wade v. Abdnor, 635 S.W.2d 937, 939 (Tex. App.—Dallas 1982, writ dism’d) (dealing with article 5561h of the Revised Civil Statutes of 1982).

In the State’s action under article 581-32A, the State alleged and the trial court found that Shields committed fraudulent acts by misrepresenting facts relevant to investments, making promises and predictions that were not honest or in good faith, and intentionally failing to disclose material facts to investors—all violations of the Act. The injunction order restrains Shields from future violations of that character but goes further to restrain his selling, brokering, or dealing in securities in any manner, without reference to fraud or the terms of the Act. The terms of article 581-32A do not authorize an injunction of that scope. Accordingly, we hold that issuance of the injunction, insofar as it restrains acts that are not fraudulent or a violation of the Act, constituted an abuse of discretion.


92TEX. REV. CIV. STAT. ANN. art. 581-33M; Simmons v. Danco, Inc., 563 S.W.2d 376, 379 (Tex. Civ. App.—Dallas 1978, writ ref’d n.r.e.).

93See discussion infra part IV.A.

94See discussion infra part IV.B.

95See discussion infra part IV.C.

96In Portland Savings & Loan Ass’n v. Bevill, Bresler & Schulman Gov’t Securities, Inc., 619 S.W.2d 241 (Tex. Civ. App.—Corpus Christi 1981, no writ), the court held that the definition of “goods” under the DTPA did not include investment securities. Id. at 245. However, other decisions have held that services related to the sale of a security, such as investment advice, may be included in the definition of “services” under the DTPA, if those services were also “objectives of the transaction.” See Nottingham v. General Am. Comm. Corp., 811 F.2d 873, 878 (5th Cir. 1987); FDIC v. Munn, 804 F.2d 860, 865 (5th Cir. 1986); Marshall v. Quinn-L. Equities, Inc., 704 F. Supp. 1384, 1393 (N.D. Tex. 1988); Insurance Co. of N. Am. v. Morris, 928 S.W.2d 133, 149 (Tex. App.—Houston [14th Dist.] 1996, writ granted); E.F. Hutton & Co. v. Youngblood, 708 S.W.2d 865, 868 (Tex. App.—Corpus Christi 1986), aff’d as modified, 741 S.W.2d 363 (Tex. 1987); Vick v. George, 671 S.W.2d 541, 549-50 (Tex. App.—San Antonio 1983), rev’d on
primarily responsible for the misrepresentation or omission, a plaintiff may sue one or more persons or entities who might be vicariously liable for the consequences of the misrepresentation or omission.\textsuperscript{97} Texas courts explicitly recognize a plaintiff's right to sue for common law fraud or negligent misrepresentation, for one or more statutory violations, or both.\textsuperscript{98}

The statutory avenues share some of the elements of common law fraud. However, there are some significant differences.

---

\textit{other grounds}, 686 S.W.2d 99 (Tex. 1984) (applying DTPA to a fraudulent sale of security action). As the San Antonio Court of Appeals reasoned:

[B]y making both the TSA and DTPA cumulative of each other and by amending section 17.43 of the DTPA after the enactment of article 581-33 A(2) (the "due diligence defense" of the TSA), it is apparent that actions can be brought under both acts. . . . There is nothing in either the TSA or the DTPA that expressly exempts securities transactions from the scope of the DTPA.


\textsuperscript{97}See discussion infra part III.D.

A. Common Law Liability

1. Fraud

To recover on a claim of common law fraud, a plaintiff must prove that:

(1) the defendant made a material representation or omission;\(^9\)
(2) the representation was false or the omission had the effect of falsifying those statements actually made;
(3) the defendant knew the representation or omission was false at the time the defendant made the representation or omission without knowledge of the truth;
(4) the defendant intended the plaintiff to act upon the representation or omission;
(5) the plaintiff relied upon the representation or omission; and

\(^9\)A "misrepresentation" may take the form of (1) a false statement of fact, (2) a promise of future performance made with intent not to perform, (3) a statement of opinion based on a false statement of fact, or (4) an expression of opinion that is false, made by one claiming or implying to have special knowledge of the subject matter of the opinion. See Eagle Properties, Ltd. v. Scharbauer, 807 S.W.2d 714, 723 (Tex. 1990); Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 434-35 (Tex. 1986); Trenholm v. Ratcliff, 646 S.W.2d 927, 930 (Tex. 1983).

\(^{100}\)"When the particular circumstances impose on a person the duty to speak and he deliberately remains silent, his silence is equivalent to a false representation." Spoljaric, 708 S.W.2d at 435 (citing Smith v. National Resort Communities, Inc., 585 S.W.2d 655, 658 (Tex. 1979)); see also New Process Steel Corp. v. Steel Corp. of Tex., 703 S.W.2d 209, 214 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) (holding that a duty to disclose arises if the defendant makes a partial disclosure which is not the whole truth or if the defendant knows that the victim is ignorant of a material fact and "does not have an equal opportunity to discover the truth"). Fraud by non-disclosure is simply a subcategory of fraud, because if a party has a duty to disclose, the non-disclosure may be as misleading as a positive misrepresentation of facts. See Schlumberger Tech. Corp. v. Swanson, 959 S.W.2d 171, 181 (Tex. 1997).

Fraudulent nondisclosure does not necessarily require the existence of a confidential or fiduciary relationship. Liability for non-disclosure can arise in three situations. First, when one voluntarily discloses information, he has a duty to disclose the whole truth. See State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661, 681 (Tex. App.—El Paso 1984, writ dism'd by agr.). Second, when one makes a representation, he has a duty to disclose new information when he is aware the new information makes the earlier representation misleading or untrue. See Susanoil, Inc. v. Continental Oil Co., 519 S.W.2d 230, 236 n.6 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.). Finally, when one makes a partial disclosure and conveys a false impression, he has a duty to speak. See Ralston Purina Co. v. McKendrick, 850 S.W.2d 629, 636 (Tex. App.—San Antonio 1993, writ denied); International Sec. Life Ins. Co. v. Finck, 475 S.W.2d 363, 370 (Tex. Civ. App.—Amarillo 1971), rev'd on other grounds, 496 S.W.2d 544 (Tex. 1973); see also Formosa Plastics Corp., USA v. Presidio Eng'rs & Contractors, Inc., 941 S.W.2d 138, 147 (Tex. App.—Corpus Christi 1995), rev'd on other grounds, 960 S.W.2d 41 (Tex. 1998).
(6) the plaintiff's reliance on the misrepresentation or omission proximately caused\textsuperscript{101} injury to the plaintiff.\textsuperscript{102}

\textsuperscript{101}Proximate cause is comprised of two elements: cause in fact and foreseeability. \textit{See} Union Pump Co. v. Allbritton, 898 S.W.2d 773, 775 (Tex. 1995); Nixon v. Mr. Property Management Co., 690 S.W.2d 546, 549 (Tex. 1985). "Cause in fact" means the act or omission was a substantial factor in bringing about the injury, and without it, harm would not have occurred." \textit{Travis v. City of Mesquite}, 830 S.W.2d 94, 98 (Tex. 1992). Foreseeability denotes that a person of ordinary intelligence should have anticipated the danger his negligent act created to others. \textit{See} Nixon, 690 S.W.2d at 549-50.

\textsuperscript{102}See Johnson & Johnson Med., Inc. v. Sanchez, 924 S.W.2d 925, 929-30 (Tex. 1996); DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 688 (Tex. 1990).


There are three principal advantages to pleading constructive fraud: (1) constructive fraud may be based upon a breach of fiduciary duty and, unlike actual fraud, does not require proving an intent to defraud, \textit{see} Chien v. Chen, 759 S.W.2d 484, 494-95 (Tex. App.—Austin 1988, no writ); (2) all legal and equitable remedies that are available in fraud actions generally are available in a constructive fraud action, including the remedy of imposing a constructive trust, \textit{see id.} at 494 n.6; and (3) punitive damages, in addition to actual damages, are available when the defendant is guilty of willful or malicious conduct, above and beyond the constructive fraud itself, \textit{see generally infra} notes 180-184 and accompanying text.

A party relying on the existence of a fiduciary relationship bears the burden of proving its existence; however, once the party establishes this relationship, the burden shifts to the alleged fiduciary to establish the fairness of the transaction. \textit{See} Fitz-Gerald v. Hull, 237 S.W.2d 256, 261 (Tex. 1951); \textit{see also} Chien, 759 S.W.2d at 495 ("All transactions between the fiduciary and his principal are presumptively fraudulent and void, which is merely to say that the burden lies on the fiduciary to establish the validity of any particular transaction in which he is involved."). If "the relationship between the parties is a 'fiduciary relationship,' as a matter of fact or of law, the law imputes to the relationship \textit{additional and higher} duties and their breach may constitute a fraud as well." \textit{Id}. However, "subjective trust alone is not enough to transform an arms-length" relationship into a fiduciary one sufficient to support constructive fraud. Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 595 (Tex. 1992); Garrison Contractors, Inc. v. Liberty Mut. Ins. Co., 927 S.W.2d 296, 301 (Tex. App.—El Paso 1996, writ granted).

Another potentially useful aspect of pleading constructive fraud based on the breach of fiduciary duty is that a third party who "knowingly participates in the breach of duty of a fiduci-
In order to constitute actionable fraud, the representation or omission complained of "must concern a material fact as distinguished from a mere matter of opinion, judgment, probability or expectation." A fact is "material" if "a reasonable person would attach importance to and would be induced to act on the information in determining his choice of actions in the transaction in question." Where no confidential relationship exists between the parties, a mere expression of an opinion . . . that proves to be incorrect or false generally is not considered to be a misrepresentation of a material fact upon which one may rely. Moreover, statements which the defendant expressly represents he made based on the information provided by other sources do not constitute actionable fraud.

Representations of fact regarding the as-yet unrealized effect of a transaction or occurrence may give rise to a fraud claim. Likewise, "an expression of an opinion as to the happening of a future event may constitute fraud and deceive where the speaker purports to have special knowledge as to facts that will occur or exist in the future." For example, misrepresentations made by an agent of an issuer or seller regarding the anticipated

ary...becomes a joint tortfeasor with the fiduciary and is liable as such." Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 514 (Tex. 1942).


103Beneficial Personnel Servs. of Tex., Inc. v. Rey, 927 S.W.2d 157, 168 (Tex. App.—El Paso 1996) (quoting American Med. Int’l, Inc. v. Giurintano, 821 S.W.2d 331, 338 (Tex. App.—Houston [14th Dist.] 1991, no writ)), vacated on other grounds, 938 S.W.2d 717 (Tex. 1997); see also Manges v. Astra Bar, Inc., 596 S.W.2d 605, 611 (Tex. Civ. App.—Corpus Christi 1980, writ ref’d n.r.e.) ("In order to show materiality, proof must be made that the misrepresentation induced the complaining party to act.") (citing Sawyer v. Pierce, 580 S.W.2d 117, 124 (Tex. Civ. App.—Corpus Christi 1979, writ ref’d n.r.e.). This standard differs from that applied to causes of action under the Texas Securities Act. See discussion infra note 198 and accompanying text.

104Ryan, 496 S.W.2d at 210.

105See Boles v. Aldridge, 175 S.W. 1052, 1053 (Tex. 1915); Ratcliff v. Trenholm, 596 S.W.2d 645, 651 (Tex. Civ. App.—Tyler 1980, writ ref’d n.r.e.).

106See Maness, 489 S.W.2d at 664 (finding that evidence in the record that all three defendants told plaintiff that after withdrawing $200,000 there would still be $200,000 to $250,000 remaining in the business’ account raised a jury issue of fraud).

107Ratcliff, 596 S.W.2d at 651 (citing Russell v. Industrial Transp. Co., 251 S.W. 1034 (Tex. Comm’n App. 1923, holding approved), aff’d on rehearing, 113 Tex. 441, 258 S.W. 462 (1924)); City of Houston v. Howe & Wise, 373 S.W.2d 781, 789 (Tex. Civ. App.—Houston 1963, writ ref’d n.r.e.).
THE SKY IS STILL BLUE IN TEXAS

return on a particular stock—even if stated as an opinion—may give rise to a fraud claim.\textsuperscript{109}

A defendant’s failure to perform a future act may be fraud if she had no intent to perform the act at the time she made the representation.\textsuperscript{110} However, a defendant’s mere failure to perform a future act alone does not prove fraudulent intent.\textsuperscript{111} Rather, failure to perform is “a circumstance to be considered with other facts to establish intent.”\textsuperscript{112}

2. Negligent Misrepresentation

In addition to liability for misrepresentations made knowingly, Texas law also recognizes liability for negligent misrepresentations in the context of securities offerings and sales. Texas courts follow the rule of section 552 of the Restatement (Second) of Torts, which provides that:

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

\textsuperscript{109}See Wink Enters. v. Dow, 491 S.W.2d 451, 453 (Tex. Civ. App.—El Paso 1973, writ ref’d n.r.e.).


While a party’s intent is determined at the time the party made the representation, it may be inferred from the party’s subsequent acts after the representation is made. Intent is a fact question uniquely within the realm of the trier of fact because it so depends upon the credibility of the witnesses and the weight to be given to their testimony.

. . . . Since intent to defraud is not susceptible to direct proof, it invariably must be proven by circumstantial evidence. “Slight circumstantial evidence” of fraud, when considered with the breach of promise to perform, is sufficient to support a finding of fraudulent intent.

 Courts have held a party’s denial that he ever made a promise is a factor showing no intent to perform when he made the promise. No pretense of performance by the defendant has also been held to be a factor showing lack of intent.

\textsuperscript{111}Schindler, 841 S.W.2d at 854; Spoljaric, 708 S.W.2d at 435; Figueroa v. West, 902 S.W.2d 701, 707 (Tex. App.—El Paso 1995, no writ).

\textsuperscript{112}Spoljaric, 708 S.W.2d at 435.
reasonable care or competence in obtaining or communicating the information.\textsuperscript{113}

The Restatement rule imposes a duty not to negligently supply false information to others for use in their business transactions.\textsuperscript{114}

A plaintiff alleging negligent misrepresentation must plead and prove that: (1) the defendant made a representation or omission in the course of his business, or in a transaction in which the defendant had a pecuniary interest, (2) which was both false and "for the guidance of others in their business"; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffered pecuniary loss by justifiably relying on the representation.\textsuperscript{115}

Because establishing liability for negligent misrepresentation requires a lower fault threshold than proving the intentional tort of fraud, the claim is not

\textsuperscript{113}Restatement (Second) of Torts § 552(1) (1977); see Lutheran Bhd. v. Kidder Peabody & Co., 829 S.W.2d 300, 309 (Tex. App.—Texarkana), vacated as moot, 840 S.W.2d 384 (Tex. 1992) (citing Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co., 715 S.W.2d 408, 411 (Tex. App.—Dallas 1986, writ ref'd n.r.e.)); Shatterproof Glass Corp. v. James, 466 S.W.2d 873, 878 (Tex. Civ. App.—Fort Worth 1971, writ ref'd n.r.e.).


Under a claim of negligent misrepresentation, the plaintiff must prove "justifiable reliance" on the misrepresentation. Geosearch, Inc. v. Howell Petroleum Corp., 819 F.2d 521, 526 (5th Cir. 1987) (applying Texas law); see also Baskin v. Mortgage & Trust, Inc., 837 S.W.2d 743, 747-48 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (holding that summary judgment on negligent misrepresentation claim appropriate in the absence of proving detrimental reliance). This requirement has two aspects: (1) the plaintiff must have in fact relied upon the misrepresentation; and (2) such reliance must have be justifiable given the plaintiff's intelligence and experience. See Clardy Mfg. Co. v. Marine Midland Business Loans, Inc., 88 F.3d 347, 358 (5th Cir. 1996). In short, the plaintiff cannot be negligent in relying on the misrepresentation. See id.

For example, a representation regarding one party's bargaining posture (e.g., an offer is non-negotiable, an offer is the best price, no better offers exist) made before or during negotiation of a contract cannot form the basis of a negligent misrepresentation claim because it is not justifiable for the plaintiff to rely on such assertions. See Keasler v. Natural Gas Pipeline Co., 569 F. Supp. 1180, 1187 (E.D. Tex. 1983), aff'd, 741 F.2d 1380 (5th Cir. 1984); Marburger v. Seminole Pipeline Co., 957 S.W.2d 82, 86-87 (Tex. App.—Houston [14th Dist.] 1997, pet. denied).
subject to certain recognized limits. A defendant may be liable only for negligent misrepresentation to the person or class of persons whom the maker of the representation intended to benefit or whom the defendant may have foreseeably expected to rely on the information.\footnote{See Blue Bell, 715 S.W.2d at 413; Cook Consultants, Inc. v. Larson, 700 S.W.2d 231, 234 (Tex. App.—Dallas 1995, writ ref'd n.r.e.); see also Geosearch, 819 F.2d at 524.}

Moreover, the recipient of the false information must use it in a transaction of which the maker is aware or intends to influence.\footnote{The defendant may be under a legal or contractual duty to supply the information, but need not be. If the defendant undertakes to supply the information, “[i]t is well settled that even though one does not have a duty to act, if one acts voluntarily, he must do so with due care and is generally liable for negligence.” Great Am. Mortgage Investors v. Louisville Title Ins. Co., 597 S.W.2d 425, 430 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.); accord Hermann Hosp. v. National Std. Ins. Co., 776 S.W.2d 249, 253 (Tex. App.—Houston [1st Dist.] 1989, writ denied).}

Interestingly, for a negligent misrepresentation claim, neither the Restatement rule nor relevant authority require that the misrepresentation be “material” in the sense required for a showing of fraud.\footnote{See Geosearch, 819 F.2d at 524.}

However, negligent omission claims appear to require proof of materiality.\footnote{Compare supra note 113, with supra notes 99-100 and accompanying text (discussing materiality requirement for common law fraud claims). Both the TSA and section 27.01 of the Business and Commerce Code also require materiality, though the standard under the TSA differs from that under either common law or section 27.01. Compare discussion infra note 198 and accompanying text (TSA) with discussion supra notes 103-109 and accompanying text (common law fraud) and discussion infra notes 286-288 and accompanying text (section 27.01).}

3. Defenses to Fraud and Negligent Misrepresentation\footnote{See Lutheran Bhd., 829 S.W.2d at 306, vacated on other grounds, 840 S.W.2d 384 (Tex. 1992) ("[L]iability . . . for negligent misrepresentation may be based, not only on a false statement, but on omissions to state a material fact necessary to make other statements not misleading.").}

Common law recognizes a number of affirmative defenses to claims of fraud and negligent misrepresentation.

\begin{itemize}
  \item \textbf{a. Limitations}
  \end{itemize}

The statute of limitations for common law fraud claims is four years.\footnote{Some of these defenses may be available to a party defending a claim of liability under section 33 of the Texas Securities Act, Tex. Rev. Civ. Stat. Ann. art. 581-33A(2), B, C, F (Vernon Supp. 1998). See discussion infra parts IV.B, D.}

Claims of negligent misrepresentation are subject to a two-year limitations
A cause of action for fraud accrues when the defendant perpetrates the fraud or, if the defendant conceals the fraud, when the plaintiff discovers the fraud or should have discovered the fraud through the exercise of reasonable diligence. Both fraud and negligent misrepresentation claims are subject to tolling by operation of the discovery rule, as well as


124 A cause of action generally accrues “when the wrongful act effects an injury, regardless of when the plaintiff learned of such injury.” Moreno v. Sterling Drug, Inc., 787 S.W.2d 348, 351 (Tex. 1990). The discovery rule, an exception to this general rule, “tolls the running of the limitations period until the time the injured party discovers or through the use of reasonable care and diligence should have discovered the injury.” Enterprise-Laredo Assocs. v. Hachar’s, Inc., 839 S.W.2d 822, 837 (Tex. App.—San Antonio), writ denied per curiam, 843 S.W.2d 476 (Tex. 1992). The plaintiff asserting the discovery rule must affirmatively plead it to gain its benefits. See Woods, 769 S.W.2d at 517-18.

The Woods Court explained the nature and origin of the discovery rule:

[T]he discovery rule is a plea in confession and avoidance. A plea in confession and avoidance is one which avows and confesses the truth in the averments of fact in the petition, either expressly or by implication, but then proceeds to allege new matter which tends to deprive the facts admitted of their ordinary legal effect, or to obviate, neutralize, or avoid them. This most closely describes the function of the discovery rule, which asserts that while the statute of limitation may appear to have run, giving rise to that appearance should not control.

A party seeking to avail itself of the discovery rule must therefore plead the rule, either in its original petition or in an amended or supplemental petition in response to defendant’s assertion of the defense as a matter of avoidance. A defendant who has established that the suit is barred cannot be expected to anticipate the plaintiff’s defenses to that bar. A matter in avoidance of the statute of limitations that is not raised affirmatively by the pleadings will, therefore, be deemed waived. The party seeking to benefit from the discovery rule must also bear the burden of proving and securing favorable findings thereon. The party asserting the discovery rule should bear this burden, as it will generally have greater access to the facts necessary to establish that it falls within the rule.

Id. at 517-18 (citations omitted); accord Pitman v. Lightfoot, 937 S.W.2d 496, 509-10 (Tex. App.—San Antonio 1996, writ denied).

Nonetheless, “[t]he discovery rule does not excuse a party from exercising reasonable diligence in protecting its own interests.” Pitman, 937 S.W.2d at 510; see Enterprise-Laredo, 839 S.W.2d at 838. The rule “expressly mandates the exercise of reasonable diligence to discover facts of negligence or omission.” Pitman, 937 S.W.2d at 510; see Enterprise-Laredo, 839 S.W.2d at 838. The plaintiff has the burden to establish the rule’s applicability. See Woods, 769 S.W.2d at 518; Hachar’s, 839 S.W.2d at 838; see also Arroyo Shrimp Farm, Inc. v. Hung
by the defendant’s fraudulent concealment of facts essential to the plaintiff’s awareness of his claims.\footnote{Like the discovery rule, fraudulent concealment is an affirmative response to the defense of limitations on which the plaintiff bears the burden of proof. See Borderlon v. Peck, 661 S.W.2d 907, 908-09 (Tex. 1983); Weaver v. Witt, 561 S.W.2d 792, 793 (Tex. 1977); Texas Gas Exploration Corp. v. Fluor Corp., 828 S.W.2d 28, 32 (Tex. App.—Texarkana 1991, writ denied). Fraudulent concealment explains why the plaintiff did not discover or could not reasonably have discovered the damage or injury of which she now complains. See Borderlon, 661 S.W.2d at 909.}

Shrimp Farm, Inc., 927 S.W.2d 146, 153-54 (Tex. App.—Corpus Christi 1996, no writ) (citing Thigpen v. Locke, 363 S.W.2d 247 (Tex. 1962); Laughlin v. FDIC, 657 S.W.2d 477, 482 (Tex. App.—Tyler 1983, no writ)) (“A person must exercise reasonable ordinary care for the protection of his own interests and discover the existence of fraud if he has knowledge of facts that would put a reasonably prudent person on inquiry.”). Whether the plaintiff used reasonable diligence is generally a question of fact. Pitman, 737 S.W.2d at 510. Only when the evidence is such that reasonable minds could not differ as to its effect does it become a question of law. See Enterprise-Laredo, 839 S.W.2d at 838; Wakefield v. Bevly, 704 S.W.2d 339, 346 (Tex. App.—Corpus Christi 1985, no writ).

Fraudulent concealment is based upon the doctrine of equitable estoppel. See Borderlon, 661 S.W.2d at 908. In the proper case, a plaintiff may invoke fraudulent concealment to estop a defendant from relying on the statute of limitations as a defense to the plaintiff’s claim. See Computer Assocs. Int’l, Inc. v. Altai, Inc., 918 S.W.2d 453, 456 (Tex. 1996); Borderlon, 661 S.W.2d at 908. However, the plaintiff’s failure to timely file suit “must be unmixed with any want of diligence on the plaintiff’s part.” Villages of Greenbriar v. Torres, 874 S.W.2d 259, 264 (Tex. App.—Houston [1st Dist.] 1994, writ denied); see also Leonard v. Eskew, 731 S.W.2d 124, 129 (Tex. App.—Austin 1987, writ ref’d n.r.e.).

Estoppel prevents a “defendant from relying on limitations as an affirmative defense when the defendant is under a duty to make a disclosure but fraudulently conceals the existence of the cause of action from [the plaintiff].” Borderlon, 661 S.W.2d at 908; see Estate of Stonecipher v. Estate of Butts, 591 S.W.2d 806, 809 (Tex. 1979); Nichols v. Smith, 507 S.W.2d 518, 519 (Tex. 1974); Sherman v. Sipper, 137 Tex. 85, 152 S.W.2d 319, 321 (1941); Thompson v. Barnard, 142 S.W.2d 238, 241 (Tex. Civ. App.—Waco 1940), aff’d, 138 Tex. 277, 158 S.W.2d 486 (1942). The estoppel effect ends when the plaintiff learns of facts or circumstances that would lead a reasonably prudent person to inquire about and thereby discover the concealed cause of action. See Borderlon, 661 S.W.2d at 909; Mooney v. Harlin, 622 S.W.2d 83, 85 (Tex. 1981); Leeds v. Cooley, 702 S.W.2d 213, 215 (Tex. App.—Houston [1st Dist.] 1985, writ ref’d n.r.e.). “Knowledge of such facts is in law equivalent to knowledge of the cause of action.” Borderlon, 661 S.W.2d at 909.

A plaintiff “must show that the defendant had actual knowledge that a wrong occurred and that [the defendant acted with] a determined purpose to conceal the wrong.” Enterprise-Laredo, 839 S.W.2d at 837; Baskin v. Mortgage & Trust, Inc., 837 S.W.2d 743, 746 (Tex. App.—Houston [14th Dist.] 1992, writ denied); Leeds, 702 S.W.2d at 215. Put another way, to invoke fraudulent concealment, a plaintiff:

must prove that [the defendant made] (1) a false representation or concealment of a material fact (2) made with knowledge or the means of knowledge of the real facts (3)
b. Plaintiff's Sophistication or Knowledge

A common defense to claims of securities fraud (and other breeds of fraud, as well)—whether at common law or pursuant to statute—is the relative sophistication of the allegedly misleading party and the allegedly misled party. Texas courts may consider sophistication as evidence of reliance, but will not foreclose a plaintiff's recovery as a matter of law simply because she is a "sophisticated" or "experienced" investor.\(^{126}\) As the Texarkana Court of Appeals explained:

The fact that investors are sophisticated and experienced in high risk and speculative investments does not preclude, as a matter of law, their recovery for fraudulent misrepresentations. Rather, the investors' sophistication and experience are material evidence on the issue of reliance. If an investor is sufficiently sophisticated and experienced, that may be evidence that he did not rely on the seller's representations but on his own expertise. The degree of sophistication is evidence for the trier of fact to consider in deciding the issue of reasonable or justifiable reliance.\(^{127}\)

c. Intervening Cause

A plaintiff's recovery of damages for fraud or negligence depends on the plaintiff's ability to establish that the defendant's act or omission proximately caused the plaintiff's losses.\(^{128}\) If a defendant's act or omission sets in motion "a natural and unbroken chain of events [leading] di-

---


\(^{127}\)Id.

\(^{128}\)See supra notes 101-102 and accompanying text.
rectly and proximately to a reasonably foreseeable injury or result," the act or omission is a "proximate cause" of the result or injury.  

An "independent intervening cause," or "new and independent cause," is an act or omission of a separate and independent person or entity that destroys the causal connection between the defendant's act or omission and the plaintiff's injury, and thereby becomes the immediate cause of the plaintiff's injury. In other words, some independent force, rather than the defendant's fraud or negligence, is legally responsible for the plaintiff's injury. However, an intervening cause that is reasonably foreseeable by the defendant does not break the chain of causation between the defendant's fraud or negligence and the injury complained of nor does it relieve the defendant of liability for such injury.

d. Estoppel

Estoppel prevents a party from disavowing his conduct that "induced another to act detrimentally in reliance upon it." Estoppel requires a defendant to establish that (1) the plaintiff made a false representation or concealment of material fact, (2) with knowledge, actual or constructive, of the falsity or materiality thereof, (3) with the intention that the defendant should act on this misrepresentation or material concealment, (4) that the defendant had no knowledge or way to obtain knowledge of the real facts, and (5) the defendant acted or relied on the representation or concealment.

129 Hart v. Van Zandt, 399 S.W.2d 791, 793 (Tex. 1965) (quoting Porter v. Puryear, 153 Tex. 82, 262 S.W.2d 933, 936 (1953), judgment set aside on other grounds, 264 S.W.2d 689 (Tex. 1954)); see Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 817 (Tex. 1997) ("[A] plaintiff's recovery of damages is limited . . . by the defendant's . . . evidence of intervening causes.").


131 See Phoenix Refining, 81 S.W.2d at 61.


to her detriment.\textsuperscript{135} A defendant asserting estoppel must come to the court with “clean hands.”\textsuperscript{136}

e. Laches

Laches is an equitable alternative to limitations.\textsuperscript{137} In order to invoke laches, a defendant must prove that (1) the plaintiff unreasonably delayed asserting legal or equitable rights and (2) the defendant made a “good faith

\textsuperscript{135}See Gulbenkian v. Penn, 252 S.W.2d 929, 932 (Tex. 1952); see Villages of Greenbriar v. Torres, 874 S.W.2d 259, 264 (Tex. App.—Houston [1st Dist.] 1994, writ denied); see also Kuehnheofer v. Welch, 893 S.W.2d 689, 692 (Tex. App.—Texarkana 1995, writ denied) (noting that the essential elements of estoppel are (1) a misrepresentation (2) upon which the party relied (3) to the party’s detriment). These elements are similar to the elements of common law fraud, see discussion supra part IV.A.1, against which estoppel may serve as a defense.

\textsuperscript{136}See Regional Properties, Inc. v. Financial & Real Estate Consulting Co., 752 F.2d 178, 182 (5th Cir. 1985) (applying Texas law). Estoppel bears a close resemblance to the equitable defenses of laches, see discussion infra part IV.A.3.e, ratification, see discussion infra part IV.A.3.f, waiver, see discussion infra part IV.A.3.h, and is a not-too-distant cousin of unclean hands and in pari delicto, see discussion infra part IV.A.3.g. All of these defenses are, to some extent, “grounded in the principle that a party with full knowledge of facts which entitle him to rescind a contract will be barred from asserting his right where he fails to act promptly upon this right to the detriment of another.” Regional Properties, 752 F.2d at 182.

Under the doctrine of laches, prejudice may result from a party’s unreasonable delay in enforcing rights of which he has or should have had knowledge. See City of Fort Worth v. Johnson, 388 S.W.2d 400, 403 (Tex. 1964); Culver v. Pickens, 142 Tex. 87, 176 S.W.2d 167, 170 (1943); Sterigio v. Forrest Place Homeowners’ Association, Inc., 651 S.W.2d 396, 401 (Tex. App.—Dallas 1983, writ ref’d n.r.e.). Similarly, a party may be estopped from asserting a right where, with actual or constructive knowledge of facts affecting his rights, the party leads another by his words or conduct to believe that he will acquiesce in the other’s conduct. See Champlin Oil & Refining Co. v. Chastain, 403 S.W.2d 376, 385 (Tex. 1965). Finally, a waiver of rights may result where a party demonstrates intentional relinquishment of rights of which the party has full knowledge. See Cattle Feeders, Inc. v. Jordan, 549 S.W.2d 29, 33 (Tex. Civ. App.—Corpus Christi 1977, no writ).

\textit{Id.} at 182-83. However, these equitable defenses, “cannot be successfully asserted . . . if the defendant comes to court with unclean hands.” \textit{Id.} at 183. See discussion infra part IV.A.3.g. “An equitable defense cannot be used to reward inequities nor to defeat justice.” \textit{Regional Properties}, 752 F.2d at 183 (citing Westworth Village v. Mitchell, 414 S.W.2d 59, 60 (Tex. Civ. App.—Fort Worth 1967, writ ref’d n.r.e.).

\textsuperscript{137}See Lawrence v. Lawrence, 911 S.W.2d 443, 449 (Tex. App.—Texarkana 1995, writ denied).
change of position” to the defendant’s detriment because of the delay.\textsuperscript{138} Delay alone is not sufficient to give rise to laches.\textsuperscript{139} The defendant must be injured or prejudiced by the plaintiff’s delay.\textsuperscript{140} 

As a general rule, laches is unavailable when the controversy is one to which a statute of limitations applies.\textsuperscript{141} Only in exceptional circumstances may laches bar a claim in a period shorter than that established by an applicable statute of limitations.\textsuperscript{142} 

A defendant asserting laches must come to the court with “clean hands.”\textsuperscript{143}

\textit{f. Ratification}

Ratification is “the adoption or confirmation, by one with knowledge of all material facts, of a prior act which did not then legally bind that person and which that person had the right to repudiate.”\textsuperscript{144} In order to prove rati-

\bibitem{138} Rogers v. Ricane Enters., 772 S.W.2d 76, 80 (Tex. 1989); see City of Fort Worth v. Johnson, 388 S.W.2d 400, 403 (Tex. 1964); Miller v. Sandvick, 921 S.W.2d 517, 524 (Tex. App.—Amarillo 1996, writ denied).

\bibitem{139} See Lawrence, 911 S.W.2d at 448; Keown v. Meriwether, 371 S.W.2d 56, 58 (Tex. Civ. App.—Beaumont 1963, writ ref’d n.r.e.).

\bibitem{140} See Lawrence, 911 S.W.2d at 449; Murray v. Murray, 611 S.W.2d 172, 173 (Tex. Civ. App.—El Paso 1981, no writ).


\bibitem{142} See, e.g., Conrads v. Kasch, 26 S.W.2d 732, 737-38 (Tex. Civ. App.—Austin), writ ref’d per curiam, 31 S.W.2d 630 (Tex. 1930); see generally 2 ROY W. MCDONALD, TEXAS CIVIL PRACTICE § 9:55 (1992).

\bibitem{143} See discussion supra note 136; discussion infra part IV.A.3.g.

\bibitem{144} Enscher Corp. v. Rebich, 925 S.W.2d 75, 84 (Tex. App.—Tyler 1996, writ dism’d by agr.); see Vessels v. Anschutz Corp., 823 S.W.2d 762, 764 (Tex. App.—Texarkana 1992, writ denied). Ratification usually only applies to the adoption of acts done on behalf of the alleged ratifier and not to the conduct of some other party to the transaction other than the ratifier’s representative. See Horton v. Robinson, 776 S.W.2d 260, 267 (Tex. App.—El Paso 1989, no writ); Buffalo Savs. & Loan Ass’n v. Trumix Concrete Co., 641 S.W.2d 650, 653 (Tex. App.—Corpus Christi 1982, no writ); Rhodes, Inc. v. Duncan, 623 S.W.2d 741, 744 (Tex. App.—Houston [1st Dist.] 1981, no writ); Herider Farms-El Paso, Inc. v. Criswell, 519 S.W.2d 473, 477 (Tex. Civ. App.—El Paso 1975, writ ref’d n.r.e.).

Ratification relates closely to waiver, see discussion infra part IV.A.3.h, especially with respect to claims of fraud or fraudulent inducement to contract:

Tao argued that, since Hung assigned the contract for sale of the land to Hung Shrimp Farm after any alleged misrepresentations by Tao were made, and since Hung had full knowledge of the alleged misrepresentations at the time he assigned the contract, he effectively accepted the conditions of the contract and waived any fraud.
fication, a defendant must show that the plaintiff (1) had full knowledge of the defendant’s allegedly fraudulent or negligent acts at the time of ratification and (2) nevertheless intentionally chose to ratify those acts in spite of the alleged fraud or negligence.\(^{145}\)

Ratification frequently involves a principal adopting acts committed or agreements made on the principal’s behalf by the principal’s actual or alleged agents. For example, “[r]atification occurs when a principal, though he had no knowledge originally of an unauthorized act of his agent, retains the benefits of the transaction after acquiring full knowledge.”\(^{146}\) However, there are exceptions—namely: (a) when the principal has an obligation to

claims he might have had as a result of the misrepresentations. Tao cited *Russell v. French & Associates, Inc.*, 709 S.W.2d 312, 317 (Tex. App.—Texarkana 1986, writ ref’d n.r.e.), in his motion as authority for this argument.

... Tao notes that, in order to prove ratification or waiver, he must show that Hung, after obtaining full knowledge of the fraud, either (1) continued to accept benefits under the transaction or (2) conducted himself so as to recognize the transaction as binding. LSR Joint Venture No. 2 v. Callewart, 837 S.W.2d 693, 699 (Tex. App.—Dallas 1992, writ denied); see *Spangler v. Jones*, 797 S.W.2d 125, 131 (Tex. App.—Dallas 1990, writ denied). Tao also notes that ratification or waiver of fraud has been found where a plaintiff undertook to investigate a matter himself and was able to investigate without hindrance from the defendant. Laughlin v. FDIC, 657 S.W.2d 477, 483 (Tex. App.—Tyler 1983, no writ); Mann v. Rugel, 228 S.W.2d 585, 587 (Tex. Civ. App.—Dallas 1950, no writ).

*Arroyo Shrimp Farm, Inc.* v. *Hung Shrimp Farm, Inc.*, 927 S.W.2d 146, 151-52 (Tex. App.—Corpus Christi 1996, no writ). Ratification is also closely related to estoppel. See discussion *supra* part IV.A.3.d.

\(^{145}\) *Arroyo Shrimp Farm, 927 S.W.2d at 153; see Rourke v. Garza*, 530 S.W.2d 794, 805 (Tex. 1975); Texacadian Fuels, Inc. v. Lone Star Energy Storage, Inc., 896 S.W.2d 233, 237 (Tex. App.—Houston [1st Dist.] 1995), *vacated on other grounds*, 922 S.W.2d 549 (Tex. 1996); *LSR Joint Venture No. 2*, 837 S.W.2d at 699; *Vessels*, 823 S.W.2d at 764.


With respect to the acts or omissions of an agent allegedly on behalf of her principal(s), “[t]he ratification or other affirmance by the principal of an unauthorized act done by an agent acting in excess of his power to bind the principal releases the agent from liability in damages to the principal for having violated a duty to him.” RESTATEMENT (SECOND) OF AGENCY § 416 (1958), *cited in* *Spangler v. Jones*, 861 S.W.2d 392, 394 (Tex. App.—Dallas 1993, writ denied).
affirm the act in order to protect his own interests; or (b) when the agent causes the principal to ratify the act through misrepresentation or duress.\textsuperscript{147}

An express ratification is not necessary; any act that impliedly recognizes the existence of the contract or any conduct inconsistent with an intention of avoiding it has the effect of waiving the right of rescission.\textsuperscript{148} Implied ratification "may be proven by silence in the face of knowledge."\textsuperscript{149} "The critical factor in determining whether a principal has ratified an unauthorized act by his agent is the principal’s knowledge [of the facts of] the transaction and his actions in light of such knowledge."\textsuperscript{150}

\section{g. Unclean Hands and In Pari Delicto}

To obtain equity, a plaintiff must come into court with clean hands.\textsuperscript{151} That is to say: "[a] court acting in equity will refuse to grant relief to a plaintiff who has been guilty of unlawful or inequitable conduct with regard to the issue in dispute."\textsuperscript{152}

The affirmative defense of unclean hands is available to a defendant who has suffered some "serious, uncorrectable harm" as a consequence of

\begin{itemize}
\item \textsuperscript{147}See RESTATEMENT (SECOND) OF AGENCY § 416(a)-(b); \textit{Spangler}, 861 S.W.2d at 395-96. Moreover,
\item \textsuperscript{148}See Rosenbaum v. Texas Bldg. & Mortgage Co., 140 Tex. 325, 167 S.W.2d 506, 508 (1943).
\item \textsuperscript{149}\textit{Pitman}, 937 S.W.2d at 523 (citing BancTEXAS Allen Parkway v. Allied Am. Bank, 694 S.W.2d 179, 182 (Tex. App.—Houston [14th Dist.] 1985, no writ)) (emphasis omitted).
\item \textsuperscript{150}\textit{Land Title Co.}, 609 S.W.2d at 756.
\item \textsuperscript{151}See Omohundro v. Matthews, 341 S.W.2d 401, 410 (Tex. 1960); Wynne v. Fischer, 809 S.W.2d 264, 267 (Tex. App.—Dallas 1991, writ denied); Grohn v. Marquardt, 657 S.W.2d 851, 855 (Tex. App.—San Antonio 1983, writ ref’d n.r.e.).
\item \textsuperscript{152}\textit{Wynne}, 809 S.W.2d at 267; \textit{see Grohn}, 657 S.W.2d at 855; Munzenrieder & Assoecs. v. Daigle, 525 S.W.2d 288, 291 (Tex. Civ. App.—Beaumont 1975, no writ).
\end{itemize}
the plaintiff's own un equitable conduct.\textsuperscript{153} The defendant may assert unclean hands to bar recovery by a plaintiff whose conduct, in connection with the same matter or transaction on which the plaintiff sues, was “unconscientious or unjust, or marked by a want of good faith, or has violated principles of equity and righteous dealing.”\textsuperscript{154} “The ‘clean hands’ doctrine in its purest form also provides that the defendant must show injury suffered as a result of the plaintiff’s conduct.”\textsuperscript{155} A defendant who complains that the plaintiff has unclean hands because of the plaintiff’s “conduct in the transaction out of the litigation arose, or with which it is connected, must show that [the defendant] himself,” and not some third person, suffered from the plaintiff’s conduct.\textsuperscript{156} A defendant may not prevail on an unclean hands defense if the plaintiff’s “unlawful or inequitable conduct is merely collateral to her cause of action.”\textsuperscript{157} Likewise, a defendant may not assert unclean hands for the purpose of “obtaining the benefit of, or shielding himself from the results of his own fraud, . . . [or] his own dereliction of duty, violation of law, wrongful act, or other inequitable conduct in the transaction in question.”\textsuperscript{158} A corollary of the doctrine of unclean hands is the in pari delicto defense, which, in a case of equal or mutual fault, prevents a plaintiff from recovering from the defendant.\textsuperscript{159}


\textsuperscript{154}Ligon v. E.F. Hutton & Co., 428 S.W.2d 434, 437 (Tex. Civ. App.—Dallas 1968, writ ref’d n.r.e.).

\textsuperscript{155}Wynne, 809 S.W.2d at 267; Right to Life Advocates, Inc. v. Aaron Women’s Clinic, 737 S.W.2d 564, 571 (Tex. App.—Houston [14th Dist.] 1987, writ denied); Grohn, 657 S.W.2d at 855.

\textsuperscript{156}Omoohundo v. Matthews, 341 S.W.2d 401, 410 (Tex. 1960); see Gillen, 624 S.W.2d at 263.

\textsuperscript{157}Davis v. Grammer, 750 S.W.2d 766, 768 (Tex. 1988); see Grohn, 657 S.W.2d at 855.


\textsuperscript{159}See Pinter v. Dahl, 486 U.S. 622, 632-33 (1988); Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985). In Bateman Eichler, the U.S. Supreme Court held that the in pari delicto defense may operate as a bar to private causes of action for damages under the federal securities laws. See id. at 310-11. The Bateman Eichler test requires that the plaintiff “be an active, voluntary participant in the unlawful activity that is the subject of the suit.” Pinter, 486 U.S. at 636; accord Banc One Capital Partners Corp. v. Kneipper, 67 F.3d 1187, 1197 (5th Cir. 1995). The Kneipper court stated:
Texas courts have held that both the unclean hands and in pari delicto defenses are applicable against allegations of securities fraud, even in cases where the plaintiff seeks damages rather than equitable relief.

h. Waiver

Waiver can be asserted against a party "who intentionally relinquishes a known right or engages in intentional conduct inconsistent with claiming that right." The elements of waiver are: "(1) an existing right, benefit, or advantage; (2) a knowledge, actual or constructive, of its existence; and (3) an actual intention to relinquish it (which can be inferred from conduct)." Waiver is a voluntary act and implies that the waiving party elected "to dispense with something of value or to forego some advantage which might have been demanded or insisted upon."

The test under Texas law for determining whether the in pari delicto defense applies does not appear to be contrary. Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146 (1947) (stating that the rule's application is a matter of public policy). One test relied on by Texas courts "is whether the plaintiff requires any aid from the illegal transaction to establish his case." Id. 199 S.W.2d at 151; see also Plumlee v. Paddock, 832 S.W.2d 757, 759 (Tex. App.—Fort Worth 1992, writ denied) ("C]ourts have required parties who wish to recover on an illegal contract prove their case without reliance on their own illegal act."). In determining "whether the plaintiff requires any aid from the illegal transaction to establish his case," it is "necessary to bear in mind the rule that if a party can show a complete cause of action without being obliged to prove his own illegal act, although said illegal act may appear incidentally and may be important in explanation of other facts in the case, he may recover." Norman v. B.V. Christie & Co., 363 S.W.2d 175, 177-78 (Tex. Civ. App.—Houston 1962, writ ref'd n.r.e.) (citations omitted). It is not enough for the jury to conclude that the investors were active participants in some wrongdoing with the defendants. Rather, the wrongdoing must be the same wrongdoing for which the investors are seeking to recover damages.

Kneipper, 67 F.3d at 1197.


161See Kuehnert, 412 F.2d at 704.


163Vessels v. Anschutz Corp., 823 S.W.2d 762, 765 (Tex. App.—Texarkana 1992, writ denied). Waiver relates closely to both estoppel, see discussion supra part IV.A.3.d, and ratification, see discussion supra part IV.A.3.f.

164El Paso Dev. Co. v. Berryman, 769 S.W.2d 584, 589 (Tex. App.—Corpus Christi 1989, writ denied); see Bluebonnet Oil & Gas Co. v. Panuco Oil Leases, Inc., 323 S.W.2d 334, 338 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.).
Waiver may be express or implied. A party’s express renunciation of a known right can establish waiver.\textsuperscript{165} Silence or inaction, for so long a period as to show an intention to yield the known right, is also enough to prove waiver.\textsuperscript{166} However, a presumption exists against waiver.\textsuperscript{167} Therefore, in the absence of an express renunciation of a known right, Texas courts do not presume or imply a waiver that is contrary to the intention of a party unless the conduct of that party has prejudicially misled the other party into an honest belief that the first party intended to assent to the waiver.\textsuperscript{168}

---

One of the most interesting questions involving waiver is whether future rights are waivable. For example,

parties may agree to exempt one another from future liability for negligence so long as the agreement does not violate the constitution, a statute, or public policy. See Allright, Inc. v. Elledge, 515 S.W.2d 266, 267 (Tex. 1974); Crowell v. Housing Auth’y of the City of Dallas, 495 S.W.2d 887, 889 (Tex. 1973); Derr Construction Co. v. City of Houston, 846 S.W.2d 854, 859 (Tex. App.—Houston [14th Dist.] 1992, no writ); Interstate Fire Ins. Co. v. First Tape, Inc., 817 S.W.2d 142, 145 (Tex. App.—Houston [1st Dist.] 1991, writ denied). When the parties to the contract are private entities bargaining “from positions of substantially equal strength, the agreement is ordinarily enforced.” Crowell, 495 S.W.2d at 889; see Elledge, 515 S.W.2d at 267; First Tape, 817 S.W.2d at 145. If one party is so disadvantaged that it is essentially forced to agree to an exculpatory provision, a court will declare that provision void. See Elledge, 515 S.W.2d at 267-68; Crowell, 495 S.W.2d at 889.


\textsuperscript{165}See Alford, Meroney & Co. v. Rowe, 619 S.W.2d 210, 213 (Tex. Civ. App.—Amarillo 1981, writ ref’d n.r.e.).

\textsuperscript{166}See id.; Self v. Kinder, 474 S.W.2d 632, 634 (Tex. Civ. App.—San Antonio 1971, writ ref’d n.r.e.).


\textsuperscript{168}See Enscher Corp. v. Rebich, 925 S.W.2d 75, 82 (Tex. App.—Tyler 1996, writ dism’d by agr.); Berryman, 769 S.W.2d at 589-90; Lewis v. Smith, 198 S.W.2d 598, 601 (Tex. Civ. App.—Fort Worth 1946, writ dism’d). For example, acts done in affirmance of a contract do not necessarily waive the actor’s right to sue for fraudulent inducement. See Arroyo Shrimp Farm, Inc. v. Hung Shrimp Farm, Inc., 927 S.W.2d 146, 154 (Tex. App.—Corpus Christi 1996, no writ); Andrews v. Powell, 242 S.W.2d 656, 661 (Tex. Civ. App.—Texarkana 1951, no writ). Moreover, it is well-settled that, “even though a party may have once waived a contract right in the past, it may enforce that right in the future by giving notice of its intention to do so.” Transwestern Pipeline, 809 S.W.2d at 592-93 (citing A.L. Carter Lumber Co. v. Saide, 140 Tex.
In determining if waiver has, in fact, occurred, the court must examine the acts, words, or conduct of the parties, and whether the allegedly waiving party has "unequivocally manifested" an intent to no longer assert the right.\textsuperscript{169}

As with estoppel and laches, a defendant may not successfully assert waiver unless the defendant "comes to the court with clean hands."\textsuperscript{170}

\textit{i. Disclaimer}

A disclaimer stating that the offeror or seller relies solely on someone else for the truth and completeness of the representations protects the offeror or seller only to the extent that the offeror or seller has, in fact, relied on someone else's information.\textsuperscript{171} It will not protect the offeror or seller if the statements are false and the offeror or seller knows they are false, for in that case, since the statement relied upon is false, the offeror or seller becomes a party to the fraud.\textsuperscript{172}

4. Remedies for Fraud and Negligent Misrepresentation

A plaintiff establishing a defendant's common law fraud or negligent misrepresentation may stand on the transaction and recover actual damages, exemplary damages (only if fraud is proven), and prejudgment interest; or, if the circumstances permit, may have the transaction rescinded.

\textit{a. Actual Damages}

Ordinarily, the measure of damages recoverable by a cause of action for fraud or negligent misrepresentation "is the actual amount of the plaintiff's loss that directly and proximately results from the defendant's fraudulent conduct."\textsuperscript{173}

\begin{footnotes}
\item[169] Enterprise-Laredo Assocs. v. Hachar's, Inc., 839 S.W.2d 822, 836 (Tex. App.—San Antonio 1992), \textit{writ denied per curiam}, 843 S.W.2d 476 (Tex. 1992); Marriott Corp. v. Azar, 697 S.W.2d 60, 65 (Tex. App.—El Paso 1985, \textit{writ ref'd n.r.e.}).
\item[170] See discussion supra note 136.
\item[172] \textit{Id.} (citing Ashland Oil, Inc. v. Arnett, 875 F.2d 1271, 1284-85 (7th Cir. 1989)).
\end{footnotes}
i. Compensatory Damages

Under Texas common law, compensatory damages arising from fraud or negligent misrepresentation are measured in two ways: (i) "out-of-pocket" damages, and (ii) "benefit-of-the-bargain" damages.\textsuperscript{174} Out-of-pocket damages measure the difference between the value the buyer paid or otherwise gave to the seller against the value of what the buyer received.\textsuperscript{175} Benefit-of-the-bargain damages measure the difference between the value as represented by the seller and the value received by the buyer.\textsuperscript{176}

Actual damages are those damages recoverable under common law. At common law, actual damages are either "direct" or "consequential." Direct damages are the necessary and usual result of the defendant's wrongful act; they flow naturally and necessarily from the wrong. Direct damages compensate the plaintiff for the loss that is conclusively presumed to have been foreseen by the defendant from his wrongful act.

Consequential damages, on the other hand, result naturally, but not necessarily, from the defendant's wrongful acts. . . . [They] need not be the usual result of the wrong, but must be foreseeable, and must be directly traceable to the wrongful act and result from it.


\textsuperscript{174}Arthur Andersen & Co., 945 S.W.2d at 817; see W.O. Bankston Nissan, Inc. v. Walters, 754 S.W.2d 127, 128 (Tex. 1988); Leyendecker & Assocs. v. Wechter, 683 S.W.2d 369, 373 (Tex. 1984).

\textsuperscript{175}In order to properly compute out-of-pocket damages, the trial court must determine the fair market value of the stock as of the date of the sale or purchase. Quest Med., Inc. v. Aprill, 90 F.3d 1080, 1086-87 (5th Cir. 1996) (applying Texas law). "According to the classic formulation, 'fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.'" United States v. Cartwright, 411 U.S. 546, 551 (1973) (quoting Treas. Reg. § 20.203-1(b)); see also Keefer v. Exxon Co., USA, 32 F.3d 127, 132 (4th Cir. 1994), cert. denied, 513 U.S. 1154 (1995); United States v. Campbell, 897 F.2d 1317, 1322 (5th Cir. 1990); Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enterp., 793 F.2d 1456, 1461 (5th Cir. 1986), cert. denied, 479 U.S. 1034, 1089 (1987). "Where . . . the property to be valued consists of securities traded on a stock exchange, the general rule is that the average exchange price quoted on the valuation date furnishes the most accurate, as well as the most readily ascertainable, measure of fair market value." Amerada Hess Corp. v. Comm'r, 517 F.2d 75, 83 (3d Cir.), cert. denied, 423 U.S. 1037 (1975) (footnote omitted); see also Barry v. Smith (In re New York, N.H. & H. R.R.), 632 F.2d 955, 962-63 (2d Cir.), cert. denied, 449 U.S. 1062 (1980).

\textsuperscript{176}Arthur Andersen & Co., 945 S.W.2d at 817; see Walters, 754 S.W.2d at 128; see Leyendecker & Assocs., 683 S.W.2d at 373. A third measure of damages, applicable in stock conversion cases,
Both measures of damages are determined at the time of sale. The plaintiff bears the burden of proving either or both measure(s) of damages.

ii. Consequential Damages

Consequential damages are recoverable, but only if the defendant’s fraud or negligent misrepresentation is a producing cause of the plaintiff’s loss.

b. Exemplary Damages

Exemplary damages are available to a plaintiff who establishes that he was intentionally defrauded. In light of the 1995 amendments to Chapter

---

is the market value of the stock at the time of the conversion. If the conversion of the stock is attended by fraud, willful wrong, or gross negligence, then the measure of damages is the highest market value between the date of the conversion and the filing of suit.

Apprill, 90 F.3d at 1086 n.6 (citing Patterson v. Wizowaty, 505 S.W.2d 425, 427 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ)); De Shazo v. Wool Growers Cent. Storage Co., 139 Tex. 143, 149, 162 S.W.2d 401, 404 (1942).

Arthur Andersen & Co., 945 S.W.2d at 817; see Leyendecker & Assocs., 683 S.W.2d at 373.

See Walters, 754 S.W.2d at 128.

Arthur Andersen & Co., 945 S.W.2d at 817; see Haynes & Boone v. Bowser Bouldin, Ltd., 896 S.W.2d 179, 182 (Tex. 1995).


See TEX. CIV. PRAC. & REM. CODE ANN. § 41.003(a)(1) (Vernon 1997); e.g., Tilton v. Marshall, 925 S.W.2d 672, 680 (Tex. 1996). For purposes of Chapter 41, “fraud” means any fraud other than constructive fraud.” TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(6).

The Dallas Court of Appeals’ most recent opinion in the well-traveled case of Ellis County State Bank v. Keefer, 936 S.W.2d 683 (Tex. App.—Dallas 1996, no writ), provides a thoughtful treatment of the current state of Texas law regarding punitive or exemplary damages. The court begins by outlining the factors set forth in Alamo National Bank v. Kraus, 616 S.W.2d 908 (Tex. 1981):

When determining whether the punitive damage award is excessive, we consider the following: (1) the nature of the wrong; (2) the character of the conduct involved; (3) the degree of culpability of the wrongdoer; (4) the situation and sensibilities of the
41 of the Texas Civil Practice and Remedies Code, it no longer appears that a plaintiff is entitled to exemplary damages at common law for negligent misrepresentation—even if the defendant’s negligent misrepresentation rises to the level of gross negligence.\textsuperscript{182} 

---

parties; and (5) the extent to which such conduct offends a public sense of justice and propriety.

Keever, 936 S.W.2d at 686. The “nature of the wrong”

refers to the nature of injury or harm caused by the defendant’s actions. Because both “the character of the conduct involved” and “the degree of culpability of the wrongdoer” concern the wrongdoer’s conduct, and because none of the other Kraus factors appear to refer to the nature of the injury, we will address the nature of the wrong as meaning the nature of the injury or harm.

Id. (citing Missouri Pacific R.R. v. Lemon, 861 S.W.2d 501, 522 (Tex. App.—Houston [14th Dist.] 1993, writ dism’d by agr.), and Preston Carter Co. v. Tatum, 708 S.W.2d 23, 24-25 (Tex. App.—Dallas 1986, writ ref’d n.r.e.) (parentheticals omitted)). “The character of the conduct involved and the degree of the wrongdoer’s culpability refer to evidence of the [defendant’s] state of mind, the degree of its conscious indifference, and any malice in its actions.” Keever, 936 S.W.2d at 687 (citing Parker v. Parker, 897 S.W.2d 918, 930 (Tex. App.—Fort Worth 1995, writ denied), and Preston Carter, 708 S.W.2d at 25). “The situation and sensibilities of the parties concerned refers to evidence of such things as remorse, remedial measures, and ability to pay the punitive damages.” Keever, 936 S.W.2d at 688.

\textsuperscript{182}Compare TEX. CIV. PRAC. & REM. CODE ANN. § 41.003 (permitting the recovery of Common law exemplary damages only in cases of “(1) fraud, (2) malice, or (3) wilful act or omission or gross neglect in wrongful death actions” (emphasis added)) with TEX. CIV. PRAC. & REM. CODE ANN. § 41.003 (Vernon Supp. 1995) (permitting the recovery of common law exemplary damages only in cases of (1) fraud, (2) malice, or (3) gross negligence).

“‘Gross negligence’ means more than momentary thoughtlessness, inadvertence, or error of judgment. It means such an entire want of care as to establish that the act or omission was the result of actual conscious indifference to the rights, safety, or welfare of the person affected.” Moriel, 879 S.W.2d at 20 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(5) (Vernon Supp. 1994)). The test for gross negligence contains both an objective and a subjective component. See id. at 21-22. “Objectively, the defendant’s conduct must involve an ‘extreme degree of risk,’...[which] is a function of both the magnitude and the probability of the anticipated injury to the plaintiff.” Moriel, 879 S.W.2d at 22; see also Wal-Mart Stores, Inc. v. Alexander, 868 S.W.2d 322, 326 (Tex. 1993). Subjectively, there must be evidence that the defendant was consciously indifferent to the extreme risk. See Moriel, 879 S.W.2d at 22; Alexander, 868 S.W.2d at 326. The requirement of conscious indifference requires proof that the defendant had actual subjective knowledge of the extreme risk of serious harm. See Moriel, 879 S.W.2d at 22-23. The defendant’s subjective mental state can be shown by direct or circumstantial evidence. See id.
Unless a plaintiff's claim for exemplary damages arises out of one of the criminal or quasi-criminal acts identified in Section 41.008(c), Chapter 41 limits exemplary damages awarded against any defendant to an amount equal to the greater of:

(1) (A) two times the amount of economic damages; plus (B) an amount equal to any noneconomic damages found by the jury, not to exceed $750,000; or

(2) $200,000. c. Rescission

A defrauded party has the option to rescind a purchase or sale agreement or transaction, rather than sue for damages, absent some change in circumstances that would make rescission unavailable. A claim for rescis-

---

183 The exemplary damage cap imposed by section 41.008(b) does not apply to a cause of action against a defendant from whom a plaintiff seeks recovery of exemplary damages based on conduct described as a felony in the following sections of the Penal Code if . . . the conduct was committed knowingly or intentionally, [including inter alia, . . . .

(8) Section 32.21 (forgery);

(9) Section 32.43 (commercial bribery);

(10) Section 32.45 (misapplication of fiduciary property or property of financial institution);

(11) Section 32.46 (securing execution of document by deception);

(12) Section 32.47 (fraudulent destruction, removal, or concealment of writing);

(13) Chapter 31 (theft) the punishment level for which is a felony of the third degree or higher;

TEX. CIV. PRAC. & REM. CODE ANN. § 41.008(c) (Vernon 1997). For purposes of section 41.008, "intentionally" and "knowingly" have the same meanings assigned those terms in sections 6.03(a) and (b) of the Texas Penal Code." Id. § 41.008(d).


185 See Swanson v. Schlumberger Tech. Corp., 895 S.W.2d 719, 740 (Tex. App.—Texarkana 1994), rev'd on other grounds, 959 S.W.2d 171 (Tex. 1997). By the same token, "[w]hen a person is fraudulently induced to enter into a contract and has sustained damages thereby, he may stand on the contract and bring an action to recover those damages. . . . Rescission is not a prerequisite to such an action." Id. at 742-43 (citing Santa Maria Water Control & Improvement Dist. v. Towery Equip. Co., 241 S.W.2d 755 (Tex. Civ. App.—El Paso 1951, no writ)). A plaintiff must specifically plead and pray for rescission. See Argee Corp. v. Solis, 932 S.W.2d 39, 66 (Tex. App.—Beaumont 1995), rev'd on other grounds, 951 S.W.2d 384 (Tex. 1997); Burnett v.
sion is equitable in nature and is predicated on negating or "undoing" the agreement or transaction of which the plaintiff complains.\textsuperscript{186} Rescission returns the parties to their respective conditions as if no agreement had ever existed or no transaction had ever occurred.\textsuperscript{187} When an agreement or transaction is rescinded, "it is annulled and abrogated and the rights of the parties under it are extinguished."\textsuperscript{188}

As a condition precedent to the granting of rescission, the plaintiff must either (1) restore, or offer to restore, to the defendant any consideration received by plaintiff in the transaction,\textsuperscript{189} or (2) persuade the court "that there are special equitable considerations that obviate the need for the par-


Common grounds supporting rescission include:

1. incapacity, see, \emph{e.g.}, Kargar v. Sorrentino, 788 S.W.2d 189, 191 (Tex. App.—Houston [14th Dist.] 1990, no writ);
2. duress, \emph{see, e.g.}, First Texas Savs. Ass’n v. Dicker Ctr., Inc., 631 S.W.2d 179, 184 (Tex. App.—Tyler 1982, no writ);
3. fraud, \emph{see, e.g.}, Saenz v. Fidelity & Guar. Ins. Underwriters, 925 S.W.2d 607, 612 (Tex. 1996);
4. undue influence, \emph{see, e.g.}, Wils v. Robinson, 934 S.W.2d 774, 779-80 (Tex. App.—Houston [14th Dist.] 1996), \emph{vacated on other grounds}, 938 S.W.2d 717 (Tex. 1997);
5. mutual mistake, \emph{see, e.g.}, de Monet v. PERA, 877 S.W.2d 352, 356-57 (Tex. App.—Dallas 1994, no writ); Great Am. Ins. Co. v. North Austin Mun. Util. Dist. No. 1, 902 S.W.2d 488, 499-500 (Tex. App.—Austin 1993) \emph{aff’d in part, rev’d in part on other grounds}, 908 S.W.2d 415 (Tex. 1995); and
6. breach of a fiduciary relationship, \emph{see, e.g.}, Miller v. Miller, 700 S.W.2d 941, 945 (Tex. App.—Dallas 1985, writ ref’d n.r.e.).

\emph{See generally} 10 TEX. JUR. 3d Cancellation and Reformation of Instruments § 1 et seq. (1997).

\textsuperscript{186} \emph{See generally} American Apparel Prods., Inc. v. Brabs, Inc., 880 S.W.2d 267, 270 (Tex. App.—Houston [14th Dist.] 1994, no writ); Ferguson v. DRG/Colony North, Ltd., 764 S.W.2d 874, 887 (Tex. App.—Austin 1989, writ denied).

\textsuperscript{187} \emph{See generally} American Apparel Products, 880 S.W.2d at 270; Lowrey v. University of Texas Med. Branch at Galveston, 837 S.W.2d 171, 174 (Tex. App.—El Paso 1992, writ denied).

\textsuperscript{188} \emph{Ferguson}, 764 S.W.2d at 887 (quoting Tuttlebee v. Tuttlebee, 702 S.W.2d 253, 257 (Tex. App.—Corpus Christi 1985, no writ)); \emph{accord} \emph{American Apparel Products}, 880 S.W.2d at 270.

\textsuperscript{189} \emph{See Texas Employers Ins. Ass’n v. Kennedy}, 135 Tex. 486, 143 S.W.2d 583, 585 (1940); Freyer v. Michels, 360 S.W.2d 559, 562 (Tex. Civ. App.—Dallas 1962, writ dism’d).
ties to be in the status quo. In addition, the plaintiff must show that she has no adequate remedy at law.

d. Prejudgment Interest

Prejudgment interest is recoverable in cases involving fraud or negligent misrepresentation.

e. Attorneys’ Fees and Costs

Texas plaintiffs generally cannot recover attorneys’ fees and costs as actual damages for common law fraud or negligent misrepresentation.

---


In Cavnar v. Quality Control Parking, Inc., 696 S.W.2d 549, 554 (Tex. 1985), the Supreme Court held that a trial court may award prejudgment interest under principles of equity when no statute authorizes prejudgment interest. Under Cavnar, if the trial court decides to award equitable prejudgment interest, the prejudgment interest rate is the same as for post-judgment interest—the rate set out in section 2 of Article 5069-1.05 of the Texas Revised Civil Statutes, TEX. REV. CIV. STAT. ANN. art. 5069-1.05(2) (Vernon Supp. 1997) (repealed 1997) (current version of the statute can be found at TEX. Fn. CODE § 304.003, .006 (Vernon 1997))—and interest begins to accrue commencing six months after the occurrence of the incident giving rise to the cause of action and continues to accrue until the date that judgment is rendered. See Cavnar, 696 S.W.2d at 554-55.

Prejudgment interest is not recoverable on additional or exemplary damages. See, e.g., Vail v. Texas Farm Bureau Mut. Ins. Co., 754 S.W.2d 129, 137 (Tex. 1988) (citing Cavnar, 969 S.W.2d at 555)); Cain v. Pruett, 935 S.W.2d 152, 158 (Tex. App.—Dallas 1996, no writ). Nor is prejudgment interest recoverable, when applicable, on attorneys’ fees awarded. See Hervey v. Passero, 658 S.W.2d 148, 148-49 (Tex. 1983); Cain, 938 S.W.2d at 158.

193 See Kneip v. UnitedBank-Victoria, 774 S.W.2d 757, 759 (Tex. App.—Corpus Christi 1989, no writ); Kilgore Fed. Savs. & Loan Ass’n v. Donnelly, 624 S.W.2d 933, 938 (Tex. App.—Tyler 1981, writ ref’d n.r.e.).

A plaintiff seeking to recover attorneys’ fees, must prevail on a claim for which attorneys’ fees are recoverable. See Spangler v. Jones, 861 S.W.2d 392, 397 (Tex. App.—Dallas 1993, writ denied); e.g., Mullins v. Mullins, 889 S.W.2d 550, 554 (Tex. App.—Houston [14th Dist.] 1994, writ denied) (permitting recovery of fees in suit upon written contract). Attorneys’ fees are not recoverable in Texas unless allowed by statute or by contract. See Dallas Cent. Appraisal Dist. v. Seven Inv. Co., 835 S.W.2d 75, 77 (Tex. 1992); Jackson v. Biotectronics, Inc., 937 S.W.2d 38, 44 (Tex. App.—Houston [14th Dist.] 1996, no writ); City of Grand Prairie v. Sisters of Holy
Attorneys' fees and costs may, however, be recovered as one component of an exemplary damage award based on fraud.\textsuperscript{194}

B. Liability Under the Texas Securities Act\textsuperscript{195}

1. Liability of an Offeror or Seller

Irrespective of the exemptions contained in sections 5 and 6 of the TSA,\textsuperscript{196} section 33A(2) imposes liability on those who offer to sell or sell securities by means of (1) an untrue statement of material fact, or (2) an omission of a material fact necessary to make the statements made, in light of the circumstances in which they were made, not misleading.\textsuperscript{197}

\begin{flushleft}

Chapter 38 of the Texas Civil Practice and Remedies Code provides that a party may recover reasonable attorneys' fees for a claim based upon, \textit{inter alia}, a sworn account, an oral or written contract, services rendered, labor performed, or materials furnished. \textit{See} TEX. CIV. PRAC. \\ & REM. CODE § 38.001(1)-(3), (7) & (8) (Vernon 1997); \textit{Jackson}, 937 S.W.2d at 44; Atlantic Richfield Co. v. Long Trusts, 860 S.W.2d 439, 449-50 (Tex. App.—Texarkana 1993, writ denied). In addition, attorneys' fees are specifically provided for in other statutes—notably, the Texas Deceptive Trade Practices Act, \textit{see} TEX. BUS. \\ & COM. CODE ANN. § 17.50(d) (Vernon Supp. 1998), section 27.01 of the Texas Business and Commerce Code, \textit{see} TEX. BUS. \\ & COM. CODE ANN. § 27.01(e) (Vernon 1987), and, at the court's discretion, the Texas Securities Act, \textit{see} TEX. REV. CIV. STAT. ANN. art. 581-33D(7) (Vernon Supp. 1998).


\textit{The discussion here and elsewhere in this Article focuses solely on civil liability for violations of the applicable provisions of the Texas Securities Act. \textit{See also supra} part III and infra part V.D. However, the TSA also imposes criminal liability on any person who, \textit{inter alia}, (1) engages in fraudulent practices in the sale of securities, (2) knowingly makes false or misleading statements in any document (including a prospectus) filed with the Securities Commissioner, or (3) knowingly makes any false statement or representation concerning the registration of any security subject to the TSA. \textit{See} TEX. REV. CIV. STAT. ANN. art. 581-29C, 29E & F, respectively.}

\textit{See} TEX. REV. CIV. STAT. ANN. art. 581-5, -6.

\textit{See} TEX. REV. CIV. STAT. ANN. art. 581-33A(2); Anderson v. Vinson Exploration, Inc., 832 S.W.2d 657, 661-62 (Tex. App.—El Paso 1992, writ denied). Section 33A(2) parallels section 12(2) of the 1933 Securities Act, codified as amended (by PSLRA) at 15 U.S.C.A. § 77l(a)(2) (West 1997). \textit{See Steinberg, supra} note 2, at 1098; \textit{see also} TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. ("Changes have been made from old § 33A(2) which bring this provision closer to [15 U.S.C.A. § 77l(a)(2)].") Section 77l(a)(2) provides, in relevant part:

Any person who—

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate com-
\end{flushleft}
a. Establishing a Section 33A(2) Claim

For purposes of the TSA,

[a]n omission or misrepresentation is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding to invest. An investor is not required to prove that he would have acted differently but for the omission or misrepresentation. . . . [T]he focus under the Texas Securities Act is on the conduct of the seller or issuer of securities, i.e., whether they made a material misrepresentation, not on the conduct of individual buyers. 198

15 U.S.C.A. § 77l(a)(2) (West 1997). The language of section 33A(2) also similar to that of SEC Rule 10b-5(b), promulgated under section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C.A. § 78j(b). The rule declares it illegal “[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

198Weatherly v. Deloitte & Touche, 905 S.W.2d 642, 649 (Tex. App.—Houston [14th Dist.] 1995, writ dism’d w.o.j.) (citations omitted). By comparison, in the context of a common law fraud or negligent misrepresentation action, or an action brought pursuant to section 27.01 of the Texas Business and Commerce Code, the test of materiality is whether the plaintiff would have signed the contract or made the purchase if the defendant had not made the material misrepresentations or omissions. See, e.g., Adickes v. Andreoli, 600 S.W.2d 939, 946 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ dism’d w.o.j.) (citing H.W. Broaddus Co. v. Binkley, 126 Tex. 374, 88 S.W.2d 1040 (1936)). Under Rule 10b-5, “the test of materiality is ‘whether a reasonable man would attach importance to the fact misrepresented in determining his course of action.’ ” Wheat v. Hall, 535 F.2d 874, 876 (5th Cir. 1976) (quoting John R. Lewis, Inc. v. Newman, 446 F.2d 800, 804 (5th Cir. 1971)).
Whether a particular representation or omission is material is a question of fact. In *Sibley v. Horn Advertising, Inc.*, the Dallas Court of Appeals considered the following defense to plaintiff's claims that defendant failed to perform under a stock subscription agreement:

Defendant's answer alleges the following omissions of material facts:

(1) the failure to give Defendant any written or oral information concerning the company's operation, scope and nature of business; (2) the failure to give Defendant any written or oral information concerning the financial status of the corporation; (3) failure to inform Defendant that the corporation was solvent at the time of its offer of the securities to Defendant; (4) failure to disclose to Defendant the fact that the corporation had offered and sold similar securities issued by it to other individuals besides the Defendant, when in fact Plaintiff's assignee (sic) had sold to at least eight or nine different individuals securities issued by the corporation similar to those described in the alleged subscription agreement in question; (5) failure to disclose to Defendant the terms upon which such third parties purchased or agreed to purchase the corporation's securities; and (6) failure to disclose that said parties who purchased or agreed to purchase securities of the corporation included both residents of Texas and non-residents of Texas.

Defendant does not allege, nor does he point out here, any statement made to him that was rendered misleading because of absence of information alleged to have been omitted. We do not see how any of the facts alleged to have been omitted would have served to prevent a misleading interpretation of the information given. The "confidential memorandum," if Defendant saw it, cannot be considered misleading in this respect because it provides most of the information alleged to have been omitted. It shows that the business was an entirely new and speculative venture, describes the plan of operation, and explains that it is to be financed by issuance of 40,000 shares of

---

199See Bodovsky v. Texoma Nat'l Bank, 584 S.W.2d 868, 873 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.); see, e.g., Anderson, 832 S.W.2d at 663.

stock at $1.00 per share with an agreement of the subscribers to loan to the corporation $4,000 for each 2,000 shares purchased. On the basis of the evidence before us we hold that none of the matters alleged in the answer is shown as a matter of law to be an "omission to state a material fact necessary in order to make the statements made not misleading" within [section] 33.201

A person who "offers or sells" a security is not limited to those who pass title.202 The TSA defines "sell" as any act by which a sale is made, including a solicitation to sell, an offer to sell, or an attempt to sell.203 Section 33A(2) applies if the defendant was any "link in the chain of the selling process."204

Unlike common law fraud and negligent misrepresentation,205 statutory stock fraud under section 27.01 of the Texas Business and Commerce Code,206 and Rule 10b-5,207 section 33A(2) does not require that the buyer

\footnotesize

201 Sibley, 505 S.W.2d at 420-21.
205 See Schlumberger Tech. Corp. v. Swanson, 959 S.W.2d 171, 181 (Tex. 1997); supra parts IV.A.1 & IV.A.2.
206 See Granader v. Mcbee, 23 F.3d 120, 123 (5th Cir. 1994); infra part IV.C.1.
207 The elements of a cause of action under section 10(b) of the 1934 Act and Rule 10b-5 are: (1) a misrepresentation or omission (2) of a material fact, (3) made knowingly or without knowledge of the truth thereof (4) by a person who owes the plaintiff a duty to disclose, (5) on which the plaintiff relied, (6) resulting in damage to the plaintiff. See Paracor Fin., Inc. v. General Elec. Capital Corp., 96 F.3d 1151, 1157 (9th Cir. 1996). To these widely-accepted elements, the Fifth Circuit has added the due diligence requirement which is satisfied as long as the plaintiff has not acted with knowledge or in reckless disregard of the truthfulness of the defendant’s misrepresentation or omission. See Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1122 (5th Cir. 1980); Dupuy v. Dupuy, 551 F.2d 1005, 1020 (5th Cir. 1977). In essence, the Fifth Circuit requires that a plaintiff’s reliance on the defendant’s material misrepresentation be “justifiable,” see, e.g., Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990)—a requirement shared by other circuits as well, see, e.g., Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983). However, where a plaintiff alleges a fraudulent omission, “positive proof of reliance is not a prerequisite to recovery.” Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972); accord Burke v. Jacoby, 981 F.2d 1372, 1379 (2d Cir. 1992). Rather, a plaintiff seeking to recover damages caused by a material omission need only demonstrate that “the omission created a material misimpression regarding the facts at issue.” Grandon v. Merrill
prove reliance on the seller's misrepresentation or omission. Nor does section 33A(2) require proof of scienter—that is, proof that the defendant knew the representation was false or made it without regard to its truth or falsity—as is required to show common law fraud, a Rule 10b-5 violation, and, to a lesser extent, a section 12(2) violation. Furthermore, section 33A(2) does not require any duty to dis-


More akin to a section 33A(2) plaintiff, a plaintiff suing under section 12(2) of the 1933 Act need only prove (1) an offer or sale of a security, (2) by the use of any means of interstate commerce, (3) through a prospectus or oral communication (4) which includes an untrue statement of material fact or omits to state a material fact, (5) that plaintiff did not know to be false. Gridley v. Sayre & Fisher Co., 409 F. Supp. 1266, 1272-73 (D.S.D. 1976); see 15 U.S.C.A. § 77t(a)(2) (West 1997); Cook v. Avien, Inc., 573 F.2d 685, 693 (1st Cir. 1978); Thiele v. Shields, 131 F. Supp. 416, 419 (S.D.N.Y. 1955). The section 12(2) "[d]efendant bears the burden of proving that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." Gridley, 409 F. Supp. at 1273; see Thiele, 131 F. Supp. at 419. Reliance is not an element of a section 12(2) claim. See Metromedia Co. v. Fugazy, 983 F.2d 350, 361 (2d Cir. 1992); Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir. 1980); Gridley, 409 F. Supp. at 1273.

See Weatherly v. Deloitte & Touche, 905 S.W.2d 642, 648-49 (Tex. App.—Houston [14th Dist.] 1995, writ dism’d w.o.j.); Anheuser-Busch Cos. v. Summit Coffee Co., 858 S.W.2d 928, 936 (Tex. App.—Dallas 1993, writ denied), vacated on other grounds, 514 U.S. 1001 (1995); Rio Grande Oil, 539 S.W.2d at 921; see also Granader, 23 F.3d at 123. But cf. Nicholas v. Crocker, 687 S.W.2d 365, 368 (Tex. App.—Tyler 1984, writ ref’d n.r.e.) (construing section 33A(2) to require that the alleged misrepresentation relate to the security and “induce [] the purchase thereof” for purposes of holding that misrepresentations made after the purchase do not support a recovery under section 33A(2)).


See supra part IV.A.1. Common law negligent misrepresentation does not require proof of scienter because, if scienter were present, defendant’s actions would be fraudulent, not negligent. See generally supra part IV.A.2. Nor does section 27.01 require proof of scienter. See infra part IV.C.1.


See SEC v. Softpak, Inc., 958 F. Supp. 846, 859-60 (S.D.N.Y. 1997); see also Ernst & Ernst, 425 U.S. at 208-09 (discussing section 12(2) as supporting recovery for negligent conduct); Gasner v. Board of Supervisors, 103 F.3d 351, 356 (4th Cir. 1987) (comparing elements of a Rule 10b-5 claim with those of a section 12(2) claim). While scienter is an element of the prima facie case under Rule 10b-5, the defendant’s state of mind under section 12(2) comes into play only if the affirmative defense of reasonable care is raised. See Ernst & Ernst, 425 U.S. at
close on the part of the offeror or seller in order for an omission of material fact to be actionable, but rather implies such a duty in every securities offering or sale.\textsuperscript{214} However, section 33A(2) does require that an alleged misrepresentation occur prior to the plaintiff’s purchase of the securities in question.\textsuperscript{215}

\textsuperscript{214}Section 33A(2) liability exists or does not exist regardless of whether the security in question is subject to registration under the TSA. See Russell v. French & Assocs., 709 S.W.2d 312, 314 (Tex. App.—Texarkana 1986, writ ref’d n.r.e.) (citing Vick v. George, 671 S.W.2d 541, 551 (Tex. App.—San Antonio 1983), rev’d on other grounds, 686 S.W.2d 99 (Tex. 1984)). On the other hand, in Paracor Finance, Inc. v. General Electric Capital Corp., 96 F.3d 1151, 1157 (9th Cir. 1996), the court stated:

“Rule 10b-5 is violated by nondisclosure only when there is a duty to disclose.” Jett v. Sunderman, 840 F.2d 1487, 1492 (9th Cir. 1988). “[T]he parties to an impersonal market transaction owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other.” Id. at 1493 (citing Chiarella v. United States, 445 U.S. 222, 232... (1980)). A number of factors are used to determine whether a party has a duty to disclose: (1) the relationship of the parties, (2) their relative access to information, (3) the benefit that the defendant derives from the relationship, (4) the defendant’s awareness that the plaintiff was relying upon the relationship in making his investment decision, and (5) the defendant’s activity in initiating the transaction. See Jett, 840 F.2d at 1493.

Id.

\textsuperscript{215}Section 33A(2)

renders a defendant liable to a plaintiff if the defendant sells a security “... by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made not misleading...” (Emphasis supplied.) We construe this statute to mean that in order for the plaintiff/buyer to prevail, he must introduce evidence that the untrue statements relate to the security purchased and induced the purchase thereof. Thus untrue statements made about a security by a seller to the buyer thereof at a time when the buyer has already purchased the security are not the “means” by which the security was sold. It follows then, that if a buyer was not induced to purchase a security by an untrue statement made after the purchase, he could not have been misled thereby, and no further statements respecting such security are required to explain the original statement so made under the provisions of the above statute.

Nicholas v. Crocker, 687 S.W.2d 365, 368 (Tex. App.—Tyler 1984, writ ref’d n.r.e.); accord Calpetco 1981 v. Marshall Exploration, Inc., 989 F.2d 1408, 1419 n. 24 (5th Cir. 1993) (citing Nicholas and noting that section 33A(2) “has been construed to mean that the alleged misrepresentation must relate to the security and ‘induce[ ] the purchase thereof’”). In Nicholas, the court held that a buyer of an interest in oil and gas wells failed to establish a violation of section
b. Section 33A(2) Defenses

i. Standing

Section 33A(2)'s protection, like that of section 33A(1),²¹⁷ extends only to buyers—persons who did not buy the security thus lack standing to sue the person who offered or sold it.²¹⁸

ii. Limitations

A plaintiff must bring a section 33A(2) claim within three years of the date on which the plaintiff knew, or should have known through the exercise of reasonable diligence,²¹⁹ of the existence of her claim, but in any case

---

³³A(2) because he did not show the seller's representations were made before the sale. See Nicholas, 687 S.W.2d at 368.

²¹⁶In addition to the statutory defenses discussed here, one or more of the common law affirmative defenses discussed in part IV.A.3, supra, might be available to a section 33A(2) defendant. But see Insurance Co. of N. Am. v. Morris, 928 S.W.2d 133, 154 (Tex. App.—Houston [14th Dist.] 1996, writ granted) (holding that neither estoppel nor ratification are available under the TSA); Mayfield v. Troutman, 613 S.W.2d 339, 344 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.) (holding that ratification is not a defense to an action for fraud under the TSA); Riggs v. Riggs, 322 S.W.2d 571, 574 (Tex. Civ. App.—Dallas 1959, no writ) (holding that laches are unavailable under the TSA); supra part III.D.3 (discussing statutory restrictions on waiver of TSA claims). See generally Stinner, supra note 133 (discussing the viability of estoppel and in pari delicto defenses under state blue sky laws).

²¹⁷See supra part III.E.1.

²¹⁸See, e.g., Anderson v. Vinson Exploration, Inc., 832 S.W.2d 657, 662 (Tex. App.—El Paso 1992, writ denied); see also Ratner v. Sioux Natural Gas Corp., 770 F.2d 512, 517 (5th Cir. 1985) (holding that non-purchasers lack standing to sue under either section 33A(2) or section 12(2) of the 1933 Act because both provisions “by their terms impose liability on any person who ‘offers or sells’ a security by fraudulent means, but their protection extends only to purchasers”). See generally supra notes 77-78.

²¹⁹The plaintiff need not have actual knowledge of fraud for the limitations period to begin to run. See supra note 80; Jensen v. Snellings, 841 F.2d 600, 607 (5th Cir. 1988). Rather, “[t]he requisite knowledge that a plaintiff must have to begin the running of the limitations period ‘is merely that of the facts forming the basis of his cause of action,’... not that of the existence of the cause of action itself.” Jensen, 841 F.2d at 606 (quoting Vigman v. Community Nat'l Bank & Trust Co., 635 F.2d 455, 459 (5th Cir. 1981)); see also Azalea Meats, Inc. v. Muscat, 386 F.2d 5, 9 (5th Cir. 1967). Accordingly, a plaintiff who has discovered facts which would require a reasonable person to inquire further has an affirmative duty to make diligent inquiry to discover fraud. Jensen, 841 F.2d at 607; Corwin v. Marney, Orton Invs., 843 F.2d 194, 197 (5th Cir. 1988); Vigman, 635 F.2d at 459.

In Reed, the court explained the standard of reasonable diligence:
no more than five years after the purchase or sale occurred, even if the plaintiff had not yet discovered her claim, or within one year after the plaintiff properly rejected a rescission offer tendered by the defendant pursuant to the terms of Section 331, whichever period expires on the earliest date.\(^{220}\)

iii. Other Statutory Defenses

Unlike a section 33A(1) defendant, whose only statutory defense is limitations,\(^{221}\) a section 33A(2) defendant has two additional statutory defenses. First, a seller or offeror is not liable under the TSA if he can prove that the buyer actually knew of the untruth or omission.\(^{222}\) The burden is not on the plaintiff to prove his lack of knowledge or his diligence in seeking to determine the truthfulness of the defendant’s misrepresentation.

Courts apply an objective standard to determine whether a plaintiff has satisfied his duty to exercise reasonable diligence to discover fraud. Under this standard, a plaintiff must diligently pursue discovery of the claim. A potential plaintiff is not permitted a "leisurely discovery of the full details of an alleged scheme," nor are investors "free to ignore 'storm warnings' which would alert a reasonable investor to the possibility of fraudulent statements or omissions in his securities transaction." An investor who has learned of facts which would cause a reasonable person to inquire further must proceed with a reasonable and diligent investigation and is charged with the knowledge of all facts such an investigation would have disclosed.

Reed v. Prudential Sec., Inc., 875 F. Supp. 1285, 1289 (S.D. Tex. 1995), aff'd, 87 F.3d 311 (5th Cir. 1996) (quoting Jensen, 841 F.2d at 607) (citations omitted). For example, numerous courts have held that a sharp drop in the price of stock triggers an investor's duty to make diligent inquiry to discover the existence of possible fraud. See id.

\(^{220}\)TEX. REV. CIV. STAT. ANN. art. 581-33H(2), 581-33I (Vernon 1964 & Supp. 1998); Williams v. Khalaf, 802 S.W.2d 651, 655 n.3 (Tex. 1990); Pitman v. Lightfoot, 937 S.W.2d 496, 528 (Tex. App.—San Antonio 1996, writ denied); see TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. "[A]rticle 581-33H clearly provides an optimum limitations period of five years for securities fraud claims, and this limitations period is measured from the date of the 'purchase or sale,' not the date of the agreement." Pitman, 937 S.W.2d at 529.

By comparison, claims under section 12(2) of the 1933 Securities Act, section 10(b) of the 1934 Securities Exchange Act, or Rule 10b-5 must be brought no more than three years after the cause of action accrued, but in any case within one year of the date on which plaintiff discovered, or in the exercise of reasonable diligence should have discovered, the existence of her claim. See 15 U.S.C. § 77m (1994) (limitations for section 12(2) claim); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 (1991) (limitations for section 10(b) or Rule 10b-5 claim); Topalian v. Ehrman, 954 F.2d 1125, 1135 (5th Cir.), cert. denied, 506 U.S. 825 (1992); Reed, 875 F. Supp. at 1288.

\(^{221}\)See supra part III.E.2.

\(^{222}\)TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (Vernon Supp. 1998).
or omission; rather, the defendant must prove the plaintiff's actual knowledge.\textsuperscript{223} It is not a defense to a section 33A(2) claim "that the defrauded person might have discovered the truth by the exercise of ordinary care."\textsuperscript{224}

Second, section 33A(2) excuses a defendant from liability for a material misrepresentation or omission if the defendant can show that it did not, and could not by the exercise of reasonable care and diligence,\textsuperscript{225} know of the untruth or omission.\textsuperscript{226} For example, a dealer who makes all reasonable efforts to get complete and accurate information about a company whose

\textsuperscript{223}See Summers v. WellTech, Inc., 935 S.W.2d 228, 234 (Tex. App.—Houston [1st Dist.] 1996, no writ) (holding that the buyer "had no duty of due diligence; the statute merely requires proof of a misrepresentation by the seller").

\textsuperscript{224}Summers, 935 S.W.2d at 234; see also TEX. REV. CIV. STAT. ANN. art. 581-33A(2).

\textsuperscript{225}As for what constitutes "reasonable care," the commentary to section 33 advises:

Reasonable care is a question of fact to be determined by taking into account all the circumstances. Illustrative of the factors which may be relevant are:

1. The relationship of the parties,
2. Their respective knowledge of information about the security in the transaction,
3. Their relative sophistication and access to such information,
4. Their respective expectations of benefit from the transaction,
5. Whether the untruth or omission was in a document prepared for use in the purchase or sale of the security, and
6. Such other factors as whether the defendant:
   1. Was the issuer of the security
   2. Was an underwriter of the security in the transaction or in the 40 days before the transaction
   3. Was a dealer or salesman (as distinct from an ordinary investor)
   4. Was a principal or agent in the transaction
   5. Published a recommendation for the purchase or sale of the security
   6. Solicited the purchase or sale
   7. Reasonably relied on an official offering statement of the United States, District of Columbia, or a state or municipal corporation or political subdivision thereof or a public agency or instrumentality of any of the foregoing which was the issuer of the security
   8. Reasonably relied on information purporting to be made on the authority of an expert (other than himself).

TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.

\textsuperscript{226}See id. art. 581-33A(2). This defense is not available to an issuer of securities, other than a governmental issuer, if the untruth or omission appears (1) in a prospectus required by section 7, or (2) in any writing prepared and delivered by an issuer as part of the sale. See id.; Cure v. Sussman, 795 S.W.2d 804, 806 (Tex. App.—Houston [14th Dist.] 1990, writ denied). Section 33B affords the same defense, without the restrictions. See infra part IV.B.2.b.i. To date, there is no published opinion of any Texas court considering the "reasonable care" defense to a claim brought pursuant to either section 33A(2) or 33B.
security he sells to a customer, should not be liable to the customer if there is information the dealer fails to get, or gets in an inaccurate form.\footnote{See Tex. Rev. Civ. Stat. Ann. art. 581-33 cmt. This "reasonable care" defense is intended to be available to three classes of defendants:}

\subsection*{c. Remedies for Violations of Section 33A(2)}

In addition to those remedies available at common law or in equity,\footnote{See id. The commentary to section 33 further advises that this provision is aimed particularly at private placement memoranda and other material used in the sale of a security. But ordinary annual, quarterly and other reports to shareholders, proxy statements, and similar communications are subject to the reasonable care defense unless shown by the plaintiff to have been "prepared and delivered by the issuer in a sale of a security." This is a fact question. Oral communications are also eligible for the defense. It will not be an easy defense for an issuer to establish, since there are few things about itself it does not know, and even fewer it could not reasonably discover.} section 33D affords a successful section 33A(2) plaintiff the following remedies.

\begin{itemize}
\item[(1)] Municipal issuers, as defined in section 6A, in all situations;
\item[(2)] All other issuers, except with respect to\begin{itemize}
\item[(a)] untruths or omissions in a prospectus required to be filed pursuant to Section 7, and/or
\item[(b)] untruths or omissions in a writing prepared and delivered by the issuer in the sale of a security; and
\end{itemize}
\item[(3)] All other defendants—e.g., dealers (except as to securities of which they are issuers), salespersons, and an issuer’s officers and directors, in all situations.
\end{itemize}

\footnote{See Tex. Rev. Civ. Stat. Ann. art. 581-33M. Nonetheless, while a plaintiff may elect to sue, e.g., under both the TSA and common law, “[i]t is axiomatic . . . that an aggrieved party is entitled to but one recovery for the same loss.” Vick v. George, 671 S.W.2d 541, 551 (Tex. App.—San Antonio 1983), rev’d on other grounds, 686 S.W.2d 99 (Tex. 1984).}

While the TSA makes clear that its remedies are not exclusive of those available at common law or in equity, it is less clear whether the various remedies provided by the TSA are exclusive of one another. For example, section 33A(2) provides that a buyer “may sue either at law or in equity for rescission, or for damages if the buyer no longer owns the security.” Tex. Rev. Civ. Stat. Ann. art. 581-33A(2). The parallel provision of the 1933 Securities Act provides that a buyer “may sue either at law or in equity . . . to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.” 15 U.S.C.A. § 77l(a)(2) (West 1997).
In *Lutheran Brotherhood v. Kidder Peabody & Co.*, 829 S.W.2d 300 (Tex. App.—Texarkana), *vacated on other grounds*, 840 S.W.2d 384 (Tex. 1992), the court of appeals held:

Defendant also contends that plaintiffs cannot recover damages under the Texas Securities Act, but may only obtain rescission since they still own the securities. The Act does state that the buyer "may sue at law or in equity for rescission, or for damages if the buyer no longer owns the security." We are of the opinion that the statute did not intend to limit the buyer to rescission only if he still owns the security, but that it used the phrase "if the buyer no longer owns the security" simply to emphasize that the buyer did not lose his right of action for damages if he no longer owned the security. Any other construction would render meaningless the phrase in the statute that the buyer may sue "at law or in equity," because rescission is exclusively an equitable remedy.

*Id.* at 307. However, the *Lutheran Brotherhood* court recognized that "[t]here is authority to the contrary, however, indicating that the buyer may sue only for rescission if he still owns the security." *Id.* (citing, *inter alia*, *Randall v. Loftsgaarden*, 478 U.S. 647 (1986), and *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028 (2d Cir. 1979)).

Two recent cases have cast their votes for exclusivity. In both *Summers v. WellTech, Inc.*, 935 S.W.2d 228 (Tex. App.—Houston [1st Dist.] 1996, no writ), and *Anheuser-Busch Cos. v. Summit Coffee Co.*, 858 S.W.2d 928 (Tex. App.—Dallas 1993, writ denied), *vacated on other grounds*, 514 U.S. 1001 (1995), the courts of appeals held that buyers who still owned the stock at the time they brought suit could only sue for rescission, not damages. *See Summers, 935 S.W.2d at 231-32; Anheuser-Busch, 858 S.W.2d at 939.*

Regarding the federal securities law, rescission is generally an exchange meant to return the parties to a status quo, and can only take place if the purchaser returns the stock he received. The plaintiff is given no choice of remedy. If he owns the stock, he is entitled to rescission but not damages. If he no longer owns the stock, he is entitled to damages but not rescission. *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1035 (2d Cir. 1979). The statute prescribes the remedy of rescission except where the defrauded buyer no longer owns the security, in which case he is entitled to a recissionary measure of damages. *Randall v. Loftsgaarden*, 106 S. Ct. 3142, 3148-49 (1986).

*By* enabling the victims of... fraud to demand rescission upon tender of the security, Congress shifted the risk of an intervening decline in the value of the security to defendants, whether or not that decline was actually caused by the fraud. *Id.* at 659. The plaintiff buyer is entitled to rescission whether or not the misrepresentations caused the bankruptcy of the business. *See Casella v. Webb*, 883 F.2d 805, 808-09 (9th Cir.1989).

.. .

Our reading of the controlling federal cases indicates that restoration of the status quo ante is not a binding prerequisite to the remedy of rescission. The United States Supreme Court has expressed the opinion that restoration of the status quo is only one goal sought to be served by the remedy of rescission. Moreover, the Court indicated that the concern is with restoration of the plaintiff's position, not necessarily the de-
THE SKY IS STILL BLUE IN TEXAS

1998]

i. Rescission

A successful section 33A(2) plaintiff who still owns the securities is entitled to have the transaction rescinded and to recover, upon making a tender of the security (or a security of the same class and series), "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the amount of any income he received on the security."^{229}

ii. Statutory Damages

A successful section 33A(2) plaintiff who no longer owns the securities at issue may recover "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the value of the security at the time he disposed of it plus the amount of any income he received on the security."^{230}

One significant difference between section 33 of the TSA and common law claims or statutory claims under section 27.01 of the Texas Business and Commerce Code is the availability of exemplary damages. Exemplary

---

fendant's. Randall v. Lofisgarden, 106 S. Ct. at 3151. Thus, the federal statute shifts risk of any decline in the security's value to the defendant.

Anheuser-Busch, 858 S.W.2d at 939; accord Summers, 935 S.W.2d at 233 (concluding, with respect to the rescission remedy afforded by the TSA, that "the main concern of courts should be to restore the plaintiff to the status quo [ante], not necessarily the defendant").

The Lutheran Brotherhood court, cognizant of this split in authority, offered the following "middle ground" position: "[P]laintiffs can sue defendant, as a seller, for rescissionary damages under the Texas Securities Act, and for damages under their other [non-Article 581] causes of action." Lutheran Brotherhood, 829 S.W.2d at 307 (citations omitted).

Common law appears to be more flexible: "When a person is fraudulently induced to enter into a contract and has sustained damages thereby, he may stand on the contract and bring an action to recover those damages ... Rescission is not a prerequisite to such an action." Swanson v. Schlumberger Tech. Corp., 895 S.W.2d 719, 742-43 (Tex. App.—Texarkana 1994), rev'd on other grounds, 959 S.W.2d 171 (Tex. 1997) (citing Santa Maria Water Control & Improvement Dist. v. Towery Equip. Co., 241 S.W.2d 755 (Tex. Civ. App.—El Paso 1951, no writ)).

For sake of argument, this Article presumes that statutory rescission is the sole TSA remedy available to a plaintiff who still owns the securities in question (or, in the case of a suit by a seller, the defendant still owns the securities in question), and that damages are available only to TSA plaintiffs who no longer own the securities in question (or, in the case of a suit by a seller, to plaintiffs whose defendant no longer owns the securities in question).

^{229}TEX. REV. CIV. STAT. ANN. art. 581-33D(1). "Consideration paid" under section 33D(1) includes any commissions paid by the buyer. See id. art. 581-33 cmt.

^{230}Id. art. 581-33D(3). "Consideration paid" under section 33D(3), likewise, includes any commissions paid by the buyer. See id. art. 581-33 cmt.
damages are available at common law to a plaintiff who establishes that he was intentionally defrauded.\textsuperscript{231} Section 27.01 authorizes exemplary damages against persons who make or benefit from false representations or false promises with actual awareness of their falsity.\textsuperscript{232} The TSA, however, does not provide for exemplary damages.\textsuperscript{233}

iii. Prejudgment Interest

Section 33D explicitly includes "interest thereon at the legal rate" as an element of a plaintiff's recovery for a violation of section 33A(2), whether the plaintiff is suing for rescission or for damages.\textsuperscript{234}

iv. Attorneys' Fees and Costs

Regardless of whether a plaintiff sues under section 33A(2) seeking damages or rescission, she is entitled to recover her costs of court;\textsuperscript{235} and, if the court finds that such a recovery would be equitable in the circumstances, she may also recover her reasonable attorneys' fees.\textsuperscript{236}

v. Injunctive Relief

As previously discussed,\textsuperscript{237} injunctive relief is not available to a private plaintiff suing under the TSA.

2. Liability of a Buyer

Irrespective of the exemptions contained in sections 5 and 6 of the TSA,\textsuperscript{238} a defendant who offers to buy or buys securities "by means of an

\textsuperscript{231}See supra note 181. However, misrepresentations made negligently, rather than fraudulently, will not support exemplary damages. See supra note 182 and accompanying text.

\textsuperscript{232}See infra notes 315-316.

\textsuperscript{233}See supra note 87. Exemplary damages are, likewise, unavailable to plaintiffs who successfully prosecute a claim under section 12(2) of the 1933 Securities Act, see Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 697 (5th Cir. 1971); see also Hunt v. Miller, 908 F.2d 1210, 1216 n.13 (4th Cir. 1990), or under section 10(b) of the 1934 Securities Exchange Act, or Rule 10b-5 promulgated thereunder, see 15 U.S.C. § 78bb(a) (1995); Hunt, 908 F.2d at 1216 n.13; Green v. Wolf Corp., 406 F.2d 291, 302-03 (2d Cir. 1968). However, section 78bb(a) does not prevent a plaintiff from recovering exemplary damages on a pendent state-law claim. See Hunt, 908 F.2d at 1216 n.13; Young v. Taylor, 466 F.2d 1329, 1337-38 (10th Cir. 1972).

\textsuperscript{234}TEX. REV. CIV. STAT. ANN. art. 581-33D(1), (2). Prejudgment interest is also recoverable in cases involving common law fraud or negligent misrepresentation. See supra note 192.

\textsuperscript{235}See TEX. REV. CIV. STAT. ANN. art. 581-33D(6).

\textsuperscript{236}See id. art. 581-33D(7). For a discussion of the factors Texas courts may consider in deciding whether to award attorneys' fees pursuant to section 33D(7), see supra note 90.

\textsuperscript{237}See supra part III.F.6.
HeinOnline -- 50 Baylor L. Rev. 161 1998

1998] THE SKY IS STILL BLUE IN TEXAS 161

untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, is liable to the person selling the security to him.”

By imposing liability on any person who offers to buy or buys a security by means of a material misrepresentation or omission, section 33B expands the scope of the TSA beyond that of both section 27.01 of the Texas Business and Commerce Code and federal securities law.

a. Establishing a Section 33B Claim

The TSA does not define “offers to buy or buys.” However, the commentary to article 581-33B states that the provision is to be construed similarly to article 581-33A. The TSA defines “sale,” “offer for sale,” or “sell” to “include every disposition, or attempt to dispose of a security for value,” as well as any act by which a sale is made, including a solicitation to sell, an offer to sell, or an attempt to sell. By analogy, the terms “offer to buy” or “buy,” as used in section 33B, should “include every acquisition of, or attempt to acquire, a security for value.”

Section 33B renders a buyer liable only if he buys or offers to buy a security by means of an untrue statement or omission. The Tyler Court of Appeals has held that the parallel wording of section 33A(2) requires the defrauded buyer to prove that the untrue statements related to the security and induced the purchase; thus, the untrue statements must have been made

---

239 Id. art. 581-33B (Vernon Supp. 1998).
242 See Tex. Rev. Civ. Stat. art. 581-33 cmt. (“The phrase ‘offers to buy or buys’ is to be construed like the corresponding phrase for sales in §§ 33A(1) and 33A(2).”). As previously discussed, section 33A(2) applies if the defendant was any link in the chain of the selling process. See supra note 204. Thus, one who “offers to buy or buys” a security should not be limited to those who acquire title. See supra notes 202-204.
244 Pitman v. Lightfoot, 937 S.W.2d 496, 531 (Tex. App.—San Antonio 1996, writ denied).
before the sale occurred. Given the statutory directive that sections 33A and 33B are intended to be construed similarly, the San Antonio Court of Appeals has held that section 33B requires an allegedly defrauded seller to prove that the alleged untruth or material omission related to the security and induced the sale thereof.

243 See Nicholas v. Crocker, 687 S.W.2d 365, 368 (Tex. App.—Tyler 1984, writ ref’d n.r.e.); supra note 215.

244 See Pitman, 937 S.W.2d at 531. In Pitman:

[i]n the only allegations regarding statutory securities fraud are found in paragraph ten of the appellees’ amended petition:

The Control Group agreed (and if not, fraudulently offered and misrepresented to FIELDS and LIGHTFOOT) to purchase Fields’ and Lightfoot’s shares of CROWN stock for Ten Dollars ($10.00) per share. FIELDS and LIGHTFOOT relied on that agreement and representation. Each member of the Control Group, CROWN, and each Trustee, directly or indirectly, with intent to deceive or disregard or reckless disregard for the truth, aided in the misrepresentations regarding the purchase. Further, CROWN and each Trustee who directly or indirectly controlled the Control Group, were aware of the agreements to purchase, and failed to ensure that the purchase price be paid. Because the purchase was not consummated as represented, the acts and failures to act by CROWN, the Control Group, and the Trustees directly and proximately caused damages to FIELDS and LIGHTFOOT.

[T]here is simply no evidence there were any untrue statements or omissions regarding the stock itself. We recognize that a person who offers to buy or buys a security by means of any untrue statement of a material fact may be liable to the person selling the security who does not know of the untruth. Similarly, liability may be imposed on a buyer who fails to state a material fact that is necessary to prevent other statements from being misleading in light of the circumstances under which they were made. In the present case, however, the evidence does not show a violation of the Texas Securities Act, but simply a breach of contract. The evidence alluded to by the appellees concerns how they were to be paid for the stock and the fact they were continually told after the sale that it would go through—not evidence of an untrue statement or material omission relating to the stock itself at the time of purchase. Simply offering to purchase stock and then failing to pay for it does not amount to an untrue or material omission, nor can omissions which occur only after the sale be the “means” by which a purchaser “offers to buy or buys” the security. To hold otherwise would transform every breach of contract involving a sale of securities into a statutory violation, a result certainly not intended by the Texas Legislature when it drafted article 33B. We therefore hold, as a matter of law, that Fields has not established a violation of article 33B of the Texas Securities Act.

Id. at 531-32 (citations omitted).
b. Section 33B Defenses

i. Limitations

A plaintiff must bring a section 33B claim within three years of the date on which the plaintiff knew or should have known of the existence of the claims.\textsuperscript{248} However, the plaintiff must sue no more than five years after the sale occurred, even if the plaintiff had not yet discovered her claim, or within one year after the plaintiff properly rejected a rescission offer tendered by the defendant pursuant to section 33I, whichever period expires earlier.\textsuperscript{249}

ii. Other Statutory Defenses

A section 33B defendant has two additional statutory defenses. A buyer will not be liable under the TSA if he proves that either "(a) the seller knew of the untruth or omission, or (b) [the buyer] did not know, and in the exercise of reasonable care could not have known, of the untruth or omission."\textsuperscript{250} As is true for a section 33A(2) claim, the burden is on the defendant to prove the plaintiff's actual knowledge or the defendant's own reasonable care and diligence.\textsuperscript{251}

c. Remedies for Violations of Section 33B

Section 33D affords a successful section 33B plaintiff the following remedies:

i. Rescission

If the section 33B defendant still owns the securities, the plaintiff is entitled to have the transaction rescinded and to recover "the security (or a security of the same class and series) upon a tender of (a) the consideration he received for the security plus interest thereon at the legal rate from the

\textsuperscript{247}In addition to the statutory defenses discussed here, one or more of the common law affirmative defenses discussed in supra part IV.A.3, might be available to a section 33B defendant, subject to the exceptions identified in supra note 216 and supra part III.E.3. Section 33B affords the same statutory defenses as section 33A(2).

\textsuperscript{248}See TEX. REV. CIV. STAT. ANN. art. 581-33H(3) (Vernon Supp. 1998); see supra note 219.

\textsuperscript{249}See supra note 220.

\textsuperscript{250}TEX. REV. CIV. STAT. ANN. art. 581-33B. See supra part IV.B.1.b.iii for a discussion of these defenses.

\textsuperscript{251}See supra notes 223-227 and accompanying text.
date of receipt by him, less (b) the amount of any income the buyer received on the security.\textsuperscript{252}

ii. Statutory Damages

If the defendant no longer owns the securities at issue, a successful section 33B plaintiff “shall recover (a) the value of the security at the time of sale plus the amount of any income the buyer received on the security, less (b) the consideration paid the seller for the security plus interest thereon at the legal rate from the date of payment to the seller.”\textsuperscript{253} Section 33B does not provide for exemplary damages.\textsuperscript{254}

iii. Prejudgment Interest

Unlike a successful section 33A(1) or 33A(2) plaintiff, a successful section 33B plaintiff is not entitled, by the terms of the statute, to recover prejudgment interest. Rather, in a rescission case, any prejudgment interest is tendered by the plaintiff to the defendant as part of the statutory consideration for return of the securities,\textsuperscript{255} and in a damages case, any prejudgment interest is credited to the defendant against the plaintiff’s recovery.\textsuperscript{256}

iv. Attorneys’ Fees and Costs

Regardless of whether a section 33B plaintiff sues for damages or rescission, he is entitled to recover his court costs;\textsuperscript{257} and, if the court finds that such a recovery would be equitable in the circumstances, he may also recover reasonable attorneys’ fees.\textsuperscript{258}

\textsuperscript{252}TEX. REV. CIV. STAT. ANN. art. 581-33D(2); see Pitman v. Lightfoot, 937 S.W.2d 496, 530 (Tex. App.—San Antonio 1996, writ denied). “Consideration” received in section 33D(2) is net of any commissions paid by the seller. TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.

\textsuperscript{253}TEX. REV. CIV. STAT. ANN. art. 581-33D(4); see Pitman, 937 S.W.2d at 530-31. “Consideration” paid in section 33D(4) is, likewise, net of any commissions paid by the seller. TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.

\textsuperscript{254}See supra note 87.

\textsuperscript{255}See supra note 87.

\textsuperscript{256}See id. art. 581-33D(4).

\textsuperscript{257}See id. art. 581-33D(6).

\textsuperscript{258}See id. art. 581-33D(7). For a discussion of the factors Texas courts may consider in deciding whether to award attorneys’ fees pursuant to section 33D(7), see supra note 90.
3. Liability of a Non-Selling Issuer

The TSA also holds any issuer\textsuperscript{259} of securities who registers under section 7A, 7B, or 7C of the TSA,\textsuperscript{260} or under section 6 of the 1933 Securities Act,\textsuperscript{261} liable for any untrue statements of material fact or material omissions:

If the prospectus required in connection with the registration contains, as of its effective date, an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the issuer is liable to a person buying the registered security, who may sue either at law or in equity for rescission or for damages if the buyer no longer owns the securities.\textsuperscript{262}

\textsuperscript{259}The TSA defines “issuer” to “mean and include every company or person who proposes to issue, has issued, or shall hereafter issue any security.” \textsc{Tex. Rev. Civ. Stat. Ann.} art. 581-4G (Vernon 1964).

\textsuperscript{260}See \textit{supra} part III for a discussion of the registration provisions of the TSA.

\textsuperscript{261}15 U.S.C. § 77f (1994). The relevant portion of section 6 reads:

Any security may be registered with the Commission under the terms and conditions hereinafter provided, by filing a registration statement in triplicate, at least one of which shall be signed by each issuer, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting officer, and the majority of its board of directors or persons performing similar functions (or, if there is no board of directors or persons performing similar functions, by the majority of the persons or board having the power of management of the issuer), and in case the issuer is a foreign or Territorial person by its duly authorized representative in the United States; except that when such registration statement relates to a security issued by a foreign government, or political subdivision thereof, it need be signed only by the underwriter of such security. Signatures of all such persons when written on the said registration statements shall be presumed to have been so written by authority of the person whose signature is so affixed and the burden of proof, in the event such authority shall be denied, shall be upon the party denying the same. The affixing of any signature without the authority of the purported signer shall constitute a violation of this subchapter. A registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered.

\textit{Id.} § 77f(a).

Section 33C has no direct counterpart in federal securities law but is “similar in effect”\(^{263}\) to section 11 of the 1933 Securities Act.\(^{264}\) Section 33C broadens the reach of section 33A(2), since an issuer who registers its outstanding securities for sale by someone else—typically a person in control of the issuer—is not a seller and is, therefore, not liable under section 33A(2) for an untruth or omission.\(^{265}\)

a. The Scope of Section 33C

Section 33C liability only encompasses material untruth or omission in a prospectus given to investors pursuant to section 9C of the TSA,\(^{266}\) or a parallel federal provision.\(^{267}\) Section 33C is justified by the “great importance of the registration-prospectus process in disclosing information for investor decisions, and the issuer’s ideal position for obtaining and presenting such information about itself.”\(^{268}\)

\(^{263}\)Id. art. 581-33 cmt.

\(^{264}\)15 U.S.C.A. § 77k (West 1997). Section 11 casts a wider net than section 33C, allowing a plaintiff who purchased a security for which the registration statement contained a material misstatement or omission to sue the issuer, as well as, subject to certain conditions and exemptions, and provided that the plaintiff did not know of the untruth or omission at the time she purchased the securities in question:

(1) every person who signed the registration statement;
(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;
(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;
(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him; [and]
(5) every underwriter with respect to such security.

Id. § 77k(a)(1)-(5). The defendant seeking to avoid section 11 liability bears the burden of proving the plaintiff’s prior knowledge of the untruth or omission. See id. § 77k(a); In re The Gap Stores Sec. Litig., 79 F.R.D. 283, 297 (N.D. Cal. 1978).

\(^{265}\)TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.

\(^{266}\)Id. art. 581-9C.

\(^{267}\)Id. art. 581-33 cmt. For example, 15 U.S.C. §§ 77e(b) and 77j (1994).

\(^{268}\)TEX. REV. CIV. STAT. ANN. art. 581-33 cmt.
Section 33C does not exhaust an issuer’s liabilities.\textsuperscript{269} For example: (1) an issuer who registers its own securities for sale may also be liable under section 33A(2);\textsuperscript{270} (2) an issuer who should register but does not may be liable under section 33A(1);\textsuperscript{271} or (3) a non-selling issuer may also be liable under section 33F for any violation of a seller if the issuer is in control of the seller or materially aids the seller.\textsuperscript{272}

\textit{b. Section 33C Defenses}\textsuperscript{273}

\textbf{i. Limitations}

A plaintiff must bring a section 33C claim within three years of the date on which the plaintiff knew, or should have known through the exercise of reasonable diligence,\textsuperscript{274} of the existence of her claim, or within one year after the plaintiff properly rejected a rescission offer tendered by the defendant pursuant to the terms of section 33I, whichever period expires on the earliest date.\textsuperscript{275} In any case, however, a plaintiff may not bring a section 33C claim more than five years after the sale occurred, regardless of whether the plaintiff had or had not yet discovered her claim.\textsuperscript{276}

\textbf{ii. Other Statutory Defense}

An issuer will not be liable under the TSA, if the issuer sustains its burden of proving that the buyer knew of the untruth or omission.\textsuperscript{277} As with sections 33A(2) and 33B,\textsuperscript{278} the defendant must prove the plaintiff’s actual knowledge.\textsuperscript{279}

\textsuperscript{269}See generally id.
\textsuperscript{270}Id. art. 581-33A(2); see supra part IV.B.1.
\textsuperscript{271}TEX. REV. CIV. STAT. ANN. art. 581-33A(1); see supra part III.
\textsuperscript{272}TEX. REV. CIV. STAT. ANN. art. 581-33F; see infra part IV.D.1-2.
\textsuperscript{273}In addition to the statutory defenses discussed here, one or more of the common law affirmative defenses discussed in supra part IV.A.3, might be available to a section 33B defendant, subject to the exceptions identified in supra note 216 and supra part III.E.3.
\textsuperscript{274}See supra note 219.
\textsuperscript{275}TEX. REV. CIV. STAT. ANN. art. 581-33H(2); see supra note 220.
\textsuperscript{276}TEX. REV. CIV. STAT. ANN. art. 581-33H(2).
\textsuperscript{277}See TEX. REV. CIV. STAT. ANN. art. 581-33C(2); see supra note 222.
\textsuperscript{278}See supra parts IV.B.1.b.ii and IV.B.2.b.ii, respectively.
\textsuperscript{279}See supra notes 223-224 and 251.
c. Remedies for Violations of Section 33C

Section 33D affords a successful section 33C plaintiff the following remedies.

i. Rescission

A successful section 33C plaintiff who still owns the securities may have the transaction rescinded and recover, upon tender of the security (or a security of the same class and series), "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the amount of any income he received on the security. . . ."280

ii. Statutory Damages

A successful section 33C plaintiff who no longer owns the securities at issue may recover "(a) the consideration he paid for the security plus interest thereon at the legal rate from the date of payment by him, less (b) the value of the security at the time he disposed of it plus the amount of any income he received on the security."281 In any event, "[f]or a buyer suing under Section 33C, the consideration he paid shall be deemed the lesser of (a) the price he paid and (b) the price at which the security was offered to the public."282

iii. Prejudgment Interest

281. Id. art. 581-33D(3). "Consideration paid" under section 33D(3), likewise, includes any commissions paid by the buyer. Id. art. 581-33 cmt.
282. Id. art. 581-33D(5).

New par. (5), which applies only to § 33C suits against non-selling issuers that register, keeps the issuer from being liable for more than the public price of the registered offering to a plaintiff who bought the registered security in the aftermarket at a higher price. Example: X makes a secondary offering of Y Co. shares owned by him, at $10 a share, and the shares trade at a premium in the aftermarket, where P buys them at $12. The most that P can recover from Y Co. for a defective registration statement is $10, although he may recover $12 from the person selling to him if that person has violated § 33A(2). The reasons for limiting the recovery against the issuer (Y Co.) are that the issuer is not the seller, gets none of the proceeds, and should not bear the risk of an aftermarket move. Of course, nothing gives a plaintiff the right to more than one recovery for the same loss.

Id. art. 581-33 cmt.
Section 33D explicitly includes "interest thereon at the legal rate" as an element of a plaintiff's recovery for a violation of section 33C, whether the plaintiff is suing for rescission or for damages.²⁸³

iv. Attorneys’ Fees and Costs

Regardless of whether a plaintiff sues under section 33C seeking damages or rescission, the plaintiff may recover costs of court;²⁸⁴ and, if the court finds that such a recovery would be equitable in the circumstances, the plaintiff may also recover reasonable attorneys’ fees.²⁸⁵

C. Liability Under the Texas Business and Commerce Code

Section 27.01 of the Texas Business and Commerce Code provides a cause of action for (1) a false representation of a past or existing material fact, or a false promise to perform some material act made with the intention not to fulfill it, (2) made to induce a person to enter into a contract to purchase stock, and (3) relied upon by that person in entering into the contract to purchase stock.²⁸⁶

1. Requisites of Section 27.01 Liability

The elements of common law fraud,²⁸⁷ including reliance and materiality, are essentially the same as those for statutory stock fraud.²⁸⁸ However, unlike its common law counterpart, section 27.01 does not require that the person making the false representation knew of its falsity at the time that

²⁸³Id. art. 581-33D(1), (3).
²⁸⁴See id. art. 581-33D(6).
²⁸⁵See id. art. 581-33D(7). For a discussion of the factors Texas courts may consider in deciding whether to award attorneys’ fees pursuant to section 33D(7), see supra note 90.
²⁸⁶Tex. Bus. & Com. Code Ann. § 27.01(a) (Vernon 1987). While section 27.01 uses the term “stock,” rather than “securities” as used in the TSA, it is unlikely that a Texas court would find a particular device to be “stock,” and thus subject to section 27.01, but not a “security,” and thus subject to the TSA. Whether the converse is true is somewhat less clear; this author located no reported cases which denied the applicability of section 27.01 to a device covered by sections 33A(2), 33B, or 33C of the TSA.
²⁸⁷The elements of common law fraud are that the defendant: (1) made a material misrepresentation, (2) which was false, (3) that he either knew was false when made or that he made without knowledge of the truth, (4) he intended the person to whom he made the misrepresentation to act upon it, (5) that person relied upon the misrepresentation, and (6) such reliance caused injury to this person. See Johnson & Johnson Med., Inc. v. Sanchez, 924 S.W.2d 925, 929-30 (Tex. 1996); DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 688 (Tex. 1990). See generally supra part IV.A.1.
²⁸⁸See Bykowski v. Pulte Home Corp., 950 F.2d 1046, 1050 (5th Cir. 1992).
she made the representation. Section 27.01, in essence, codifies common law fraud in the context of stock and real estate dealings but relieves the plaintiff of the need to establish scienter in order to recover actual damages, attorneys’ and expert witness fees, and costs. Moreover, a plaintiff who can prove scienter has the opportunity to seek exemplary damages that are not allowed under the Texas Securities Act (the other statutory basis for suing for stock fraud). Notwithstanding the fact that a section 27.01 plaintiff need not prove scienter, section 27.01 is “penal in nature and must be strictly construed.”

To succeed on a section 27.01 claim, a plaintiff’s reliance on the defendant’s fraudulent conduct “must be justifiable as well as actual.” “Such justifiability is determined by inquiring whether—‘given a fraud plaintiff’s individual characteristics, abilities, and appreciation of facts and circumstances at or before the time of the alleged fraud—it is extremely unlikely that there is actual reliance on the plaintiff’s part.’” In addition to proving justifiable reliance, a section 27.01 plaintiff must prove that the misrepresentation or omission was material.

A section 27.01 plaintiff must also show “[s]ome pecuniary injury” as a result of the defendant’s fraud.

The injury or damage suffered as a result of the fraud need not be measured in money, but it is sufficient if the de-

---

289 Compare TEX. BUS. & COM. CODE ANN. § 27.01(a) and Swanson v. Schlumberger Tech. Corp., 895 S.W.2d 719, 732 (Tex. App.—Texarkana 1994), rev’d on other grounds, 959 S.W.2d 171 (Tex. 1997) with Sanchez, 924 S.W.2d at 929-30.
290 Section 27.01 does not extinguish a plaintiff’s right to seek recovery for common law fraud or misrepresentation, nor does it provide an exclusive remedy for causes of action based upon fraud in a transaction involving stock. See Ratcliff v. Trenholm, 596 S.W.2d 645, 651 (Tex. Civ. App.—Tyler 1980, writ ref’d n.r.e.); Sherrod v. Bailey, 580 S.W.2d 24, 28 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref’d n.r.e.).
291 See TEX. BUS. & COM. CODE ANN. § 27.01(b).
292 Compare § 27.01(c) with TEX. REV. CIV. STAT. ANN. art. 581-33D; see also supra note 87 and accompanying text.
293 Ratcliff, 596 S.W.2d at 650 (citing Westcliff Co. v. Wall, 267 S.W.2d 544 (Tex. 1954)); accord Bykowicz, 950 F.2d at 1050.
294 Bykowicz, 950 F.2d at 1050 (quoting Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990)).
295 Id. (quoting Haralson, 919 F.2d at 1026, and citing General Motors Corp., Pontiac Motor Div. v. Courtesy Pontiac, Inc., 538 S.W.2d 3, 6 (Tex. Civ. App.—Tyler 1976, no writ)).
296 See Bykowicz, 950 F.2d at 1051 (citing Haralson, 919 F.2d at 1030).
frauded party has been induced to incur legal liabilities or obligations different from those contracted for or represented. The amount of the damage is immaterial, provided it is substantial. It is not necessary to his cause of action that the complaining party show that he has suffered pecuniary injury at the time of the trial provided the facts show he will suffer such injury unless the contract is cancelled.\(^{298}\)

Section 27.01 is narrower than either common law fraud or liability under the TSA. For example, a defendant may be liable under the TSA and for common law fraud or negligent misrepresentation based on an omission of material fact necessary to make other statements not misleading, as well as on a false statement.\(^{299}\) In contrast, section 27.01, by its terms, does not encompass omissions,\(^{300}\) nor does section 27.01 protects securities sellers from fraud by buyers.\(^{301}\)

2. Section 27.01 Defenses

A plaintiff must bring a claim under section 27.01 within four years of the date on which the claim accrued.\(^{302}\) An action for fraud accrues when the defendant perpetrates the fraud, or, if he conceals the fraud, when the plaintiff discovers, or through the exercise of reasonable diligence should have discovered, the fraud.\(^{303}\) The discovery rule applies to an action under section 27.01, as well as to claims of common law fraud and negligent misrepresentation,\(^{304}\) as does the doctrine of fraudulent concealment.\(^{305}\)


\(^{300}\) \textit{See} TEX. BUS. & COM. CODE ANN. § 27.01(a) (Vernon 1987).

\(^{301}\) \textit{Compare id. with} TEX. REV. CIV. STAT. ANN. § 581-33B (statutory fraud by a buyer).

\(^{302}\) \textit{See} Pooley v. Seal, 802 S.W.2d 390, 393 (Tex. App.—Corpus Christi 1990, writ denied). The same four-year period applies to claims of common law fraud. See Williams v. Khalaf, 802 S.W.2d 651, 658 (Tex. 1990).

\(^{303}\) \textit{See} Woods v. William M. Mercer, Inc., 769 S.W.2d 515, 517 (Tex. 1988); \textit{Pooley}, 802 S.W.2d at 393.

\(^{304}\) \textit{See} Pooley, 802 S.W.2d at 393; \textit{supra} note 124 and accompanying text.
Like section 33A(1) of the Texas Securities Act, section 27.01 contains no statutory defenses. However, unlike section 33A(1), which is, in essence, a strict liability statute, section 27.01 is a codification of common law fraud (absent the scienter requirement). Because of this, the various defenses to common law fraud should be equally available to a section 27.01 defendant.

3. Section 27.01 Remedies

The remedies available to a plaintiff suing under section 27.01 include all remedies available to a plaintiff suing for common law fraud—including actual damages, exemplary damages, rescission, and prejudgment interest—plus attorneys’ fees and costs.

a. Actual Damages

Section 27.01 provides for actual damages against any person making a false representation or false promise, as defined in section 27.01(a), as well as “[a]ny person who (1) has actual awareness of the falsity of a representation or promise made by another person, (2) fails to disclose the falsity of the representation or promise to the person defrauded, and (3) benefits from the false representation or promise.”

Section 27.01 does not define actual damages. In the absence of such a statutory definition, Texas courts generally look to the common law for guidance. The measure of damages recoverable under section 27.01, therefore, should be the same as that under a claim of common law fraud.

---

306TEX. REV. CIV. STAT. ANN. art. 581-33A(1) (Vernon Supp. 1998); see supra part III.E.
307See supra part IV.C.1.
308See supra part IV.A.3.
309See TEX. BUS. & COM. CODE ANN. § 27.01(b), (c) (Vernon 1987).
310See id. § 27.01(b).
311"Actual awareness may be inferred where objective manifestations indicate a person acted with actual awareness." ld. § 27.01(c).
312ld. § 27.01(d); see infra part IV.D.3.
b. Exemplary Damages

In the event that a defendant who made a false representation or false promise, as defined in section 27.01(a), also did so "with actual awareness of the falsity thereof," that defendant may be liable for exemplary damages.\textsuperscript{315} Likewise, any person "who (1) has actual awareness of the falsity of a representation or promise made by another person, (2) fails to disclose the falsity of the representation or promise to the person defrauded, and (3) benefits from the false representation or promise," may be liable for exemplary damages.\textsuperscript{316}

c. Rescission

As with a plaintiff suing for common law fraud and negligent misrepresentation in connection with a securities purchase or sale, and certain plaintiffs suing under the TSA, a section 27.01 plaintiff may seek to have the securities contract rescinded, provided she can establish "[s]ome pecuniary injury" as a result of the fraud.\textsuperscript{317}

d. Prejudgment Interest

Prejudgment interest is recoverable in cases involving statutory securities fraud.\textsuperscript{318}

e. Attorney's Fees and Costs

Section 27.01 also obligates any person found to have violated the section to pay the plaintiff's "reasonable and necessary attorney's fees, expert witness fees, costs for copies of depositions, and costs of court."\textsuperscript{319}

\textsuperscript{315}TEX. BUS. \& COM. CODE ANN. § 27.01(c). See supra part IV.A.4.b for a discussion of exemplary damages recoverable for common law fraud. Recall that the TSA does not permit the recovery of exemplary damages. See supra note 87.

\textsuperscript{316}Id. § 27.01(d). Note that this second class of defendants includes persons other than the person who actually made the material misrepresentation or omission. See infra part IV.D.3 for more discussion of secondary liability under section 27.01.


\textsuperscript{319}TEX. BUS. \& COM. CODE ANN. § 27.01(e). For a discussion of the factors Texas courts may consider in awarding "reasonable and necessary" attorneys' fees, see supra note 90.
D. Secondary Liability for Securities Violations

In addition to, or in lieu of, suing the primary violators of the various common law and statutory provisions already discussed, a plaintiff may elect to pursue one or more persons or entities for whom, or under whose supervision or control, a primary violator worked. The plaintiff may hold these so-called “secondary violators” jointly and severally liable with a primary violator by means of specific provisions of the TSA or section 27.01, as well as by means of common law respondeat superior, principal-agent, or conspiracy theories.

1. Control Person Liability for Violations of the TSA

Control person liability is a statutorily created doctrine that expands on the common law theories of respondeat superior, agency, and conspiracy\textsuperscript{320} to create an additional avenue of secondary liability for violation of federal and state securities laws.\textsuperscript{321} One rationale for control person liability is that “a control person is in a position to prevent the violation and may be able to compensate the injured investor when the primary violator (e.g., a corporate issuer which has gone bankrupt) is not.”\textsuperscript{322}

\textsuperscript{320}See infra parts IV.D.4 & 5.


\textsuperscript{322}TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. This expansive reading of control person liability supports extending its reach in a securities fraud action to encompass non-statutory causes of action as well. For example, the TSA does not expressly restrict the imposition of control person liability to parties who controlled a person who was himself liable under section 33. Instead, the TSA states that a control person is “liable under Section 33A ... to the same extent as if he were the seller, buyer, or issuer.” Id. art. 581-33F(1). By contrast, imposition of control person liability under the federal securities laws derives from the existence of a primary violation of section 10(b) of the 1934 Act or sections 11 or 12 of the 1933 Act. See, e.g., Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1021 n.8 (5th Cir. 1996); Dennis v. General Imaging, Inc., 918 F.2d 496, 509 (5th Cir. 1990); see also, e.g., Professional Serv. Indus., Inc. v. Kimbrell, 834 F. Supp. 1289, 1305 (D. Kan. 1993) (requiring an underlying violation of section 10(b) of the 1934 Act to impose control person liability); Rand v. M/A-Com, Inc., 824 F. Supp. 242, 264 (D. Mass. 1992) (same); Steiner v. Tektronix, Inc., 817 F. Supp. 867, 885 (D. Or. 1992) (requiring a primary violation of the federal securities laws for the imposition of control person liability); Maywalt v. Parker & Parsley Petroleum Co., 808 F. Supp. 1037, 1053-54 (S.D.N.Y. 1992) (noting that control person liability is derivative and cannot exist in the absence of a primary

HeinOnline -- 50 Baylor L. Rev. 174 1998
Section 33F(1) of the TSA, provides that "[a] person who directly or indirectly controls a seller, buyer, or issuer of a security is liable under section 33A ... jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer." The TSA's control person liability parallels that provided for in both the section 15 of the 1933 Securities Act and section 20 of the 1934 Securities Exchange Act, and is modeled after those parallel federal provisions. Control violation of the acts); Brown v. Hutton Group, 795 F. Supp. 1317, 1324-25 (S.D.N.Y. 1992) (requiring a primary violation of securities laws by the controlled party before imposing secondary liability). This is consistent with the statutory language limiting control person liability to the situation where the control person "controls any person liable" under the federal securities laws. See infra notes 324-325. Because the federal securities acts require a violation of sections 11 or 12 of the 1933 Act or section 10(b) of the 1934 Act for the imposition of control person liability, control person liability under the federal securities acts cannot derive from an underlying common law cause of action.


324Every person who, by or through stock ownership, agency, or otherwise, . . . controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person . . . is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.


325Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Id. § 78t(a). The Fifth Circuit has held that section 15 of the 1933 Act and section 20(a) of the 1934 Act, despite somewhat different wording, are analogous provisions susceptible to similar interpretation. See Pharo v. Smith, 621 F.2d 656, 672-73 (5th Cir.), modified on other grounds, 625 F.2d 1226 (5th Cir. 1980).


In the wake of the Private Securities Litigation Reform Act of 1995, see supra part II.B, joint and several liability for control persons under federal law may now be available only if the control person "knowingly committed a violation of the securities laws." 15 U.S.C.A. § 78u-4(g)(2)(A) (West 1997). Compare id. with 15 U.S.C. §§ 77o & 78t(a) (1994). In the absence of a knowing violation, federal law may afford a plaintiff only proportionate liability against a con-
person liability under section 33F(1) encompasses primary violations of sections 33A(1), 33A(2), 33B, and 33C.

A plaintiff seeking to hold a control person liable need not sue the primary violator in order to do so.\textsuperscript{327} Section 33F "provides for joint and several liability, and does not require a plaintiff to seek affirmative relief against the controlled entity [or person] before such relief may be sought from a control person."\textsuperscript{328}

\textit{a. Who or What is a "Control Person?"}

"Control," in section 33F, "is used in the same broad sense as in federal securities law. . . . Depending on the circumstances, a control person might include an employer, an officer or director, a large shareholder, a parent company, and a management company."\textsuperscript{329} "The burden of establishing control is on the plaintiff."\textsuperscript{330}

As a general rule under federal law, to which Texas courts look for guidance in interpreting and applying the TSA,\textsuperscript{331} a plaintiff seeking to establish the requisite degree of control should plead and prove that the defendant (1) exercised active control over the day-to-day affairs of the controlled person or entity and (2) had the power to control and influence the particular transactions that gave rise to the underlying securities violations.\textsuperscript{332} Significantly, while the plaintiff must show that the alleged control person. See Shu, \textit{supra} note 321, at 569; Steinberg & Olive, \textit{supra} note 31, at 349-50. If this proposition proves correct, the TSA could now afford a Texas plaintiff greater relief than its federal progenitors.


\textsuperscript{328}Id.

\textsuperscript{329}TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. (citing 17 C.F.R. § 230.405(f)). SEC Rule 405 defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405(f) (1997); see \textit{Pharo}, 621 F.2d at 670.

For an excellent recent discussion of control person liability under federal securities law, discussing, inter alia, the likely outcome of a control-person analysis under a number of sample fact patterns, see Loftus C. Carson, II, \textit{The Liability of Controlling Persons Under the Federal Securities Acts}, 72 NOTRE DAME L. REV. 263 (1997).

\textsuperscript{330}G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 957-58 (5th Cir. 1981); see Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1119-20 (5th Cir. 1980).

\textsuperscript{331}See \textit{supra} note 3.

\textsuperscript{332}See, \textit{e.g.}, Abbott v. Equity Group, Inc., 2 F.3d 613, 619-20 (5th Cir. 1993); Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985). Thus, for example, in \textit{G.A. Thompson}, the Fifth
trol person *possessed* the power to control or influence the challenged transaction, the plaintiff need not show that the alleged control person *exercised* that power in the particular instance at bar.\(^{333}\) Indeed, control person liability may also arise from a party’s failure to supervise or even from inaction.\(^{334}\)

In *Busse v. Pacific Cattle Feeding Fund #1, Ltd.*,\(^{335}\) the court found that the individual defendant, who was both the majority shareholder and a director of the alleged wrongdoer, was a “control person” within the meaning of section 33F(1).\(^{336}\) However, the *Busse* court went further, recognizing that a person who was *either* a major shareholder or a director would also qualify as a “control person.”\(^{337}\)

Section 33F(1) does not require the plaintiff to prove that the control person acted with any requisite scienter—that is, the control person need not have knowledge of the underlying violations or reckless disregard for the truthfulness of the primary violator’s acts or omissions.\(^{338}\) If the plaintiff can prove that the controlled person violated one of the identified sec-

---

\(^{333}\) See, e.g., *G.A. Thompson & Co.*, 636 F.2d at 958 (noting that neither 17 C.F.R. § 230.405(f), see supra note 329, nor 15 U.S.C.A. § 78t(a), see supra note 325, “appears to require participation [by the control person] in the wrongful transaction” and, as a consequence, “Fifth Circuit case law appears to follow the plain meaning of the statute in this respect.”); *Metge*, 762 F.2d at 631. But see, e.g., *In re Browning-Ferris Indus. Inc. Sec. Litig.*, 876 F. Supp. 870, 911 (S.D. Tex. 1995) (requiring the plaintiff to demonstrate that the alleged control person actually participated in or induced the alleged primary violation).

\(^{334}\) See Kersh v. General Council of the Assemblies of God, 804 F.2d 546, 550 (9th Cir. 1986); *G.A. Thompson & Co.*, 636 F.2d at 959.

\(^{335}\) 96 S.W.2d 807 (Tex. App.—Texarkana 1995, writ denied).

\(^{336}\) Id. at 815.

\(^{337}\) See id.; TEX. REV. CIV. STAT. ANN. art. 581-33F cmt. (Vernon Supp. 1998) (majority stockholder); Salit v. Stanley Works, 802 F. Supp. 728, 734-35 (D. Conn. 1992) (director). By contrast, the Fifth Circuit appears to have rejected the notion that, at least under federal law, merely holding the position of director or officer establishes “control.” See *Dennis v. General Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990).

\(^{338}\) Compare *TEX. REV. CIV. STAT. ANN. art. 581-33F(1) and Busse*, 896 S.W.2d at 815 *with* *TEX. REV. CIV. STAT. ANN. art. 581-33F(2) (requiring proof of actual knowledge or reckless disregard in order to establish aider and abettor liability under the TSA); and, e.g., *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 961 & n.32 (5th Cir. 1981) (adopting “severe recklessness” test for establishing sufficient sciente for Rule 10b-5 violation). *See generally* cases cited supra notes 210-213 and accompanying text.
tions of the TSA and that the defendant was a “control person” under the statute, then judgment against the defendant will be proper, in the absence of a viable affirmative defense.\(^{339}\)

b. **Defenses to Control Person Liability**

Section 33F(1) provides a statutory defense for a control person who pleads and proves that “he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.”\(^{340}\) Presumably, the defense afforded a primary violator by sections 33A(2), 33B, and 33C—namely, the plaintiff’s knowledge of the untruth or omission—is also available to a control person being sued as secondarily liable for a primary violation of one of those provisions.\(^{341}\) In addition, under federal law, to which Texas courts look for guidance in interpreting and applying the TSA,\(^{342}\) a control person may defend the assertion of liability by proof that she “acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.”\(^{343}\)

\(^{339}\)Id.

\(^{340}\)TEX. REV. CIV. STAT. ANN. art. 581-33F(1).

\(^{341}\)See id. art. 581-33 cmt. (noting that “[t]he reasonable care factors discussed for § 33A(2) are equally applicable” with respect, at least, to control person liability).

\(^{342}\)See supra note 3.

\(^{343}\)15 U.S.C. § 78t(a) (1994). Exactly what constitutes “good faith” under federal law has been the subject of much debate, and considerable disagreement among (and even within) the circuits. For example, in *Paul F. Newton & Co. v. Texas Commerce Bank*, the court set forth the following “good faith” inquiry: Did the control person “fail[] to establish, maintain or diligently enforce a proper system of supervision and control?” 630 F.2d 1111, 1120 (5th Cir. 1980) (citing *Cameron v. Outdoor Resorts of Am., Inc.*, 608 F.2d 187, 194-95 (5th Cir. 1979), *modified on rehearing*, 611 F.2d 105 (5th Cir. 1980)). If the answer was “yes,” then the defendant was unable, as a matter of law, to establish good faith. *See id.*

In *G.A. Thompson & Co., Inc. v. Partridge*, the court found that “there are factual situations where the above standard makes little sense,” and observed that “[t]he test of whether the controlling person has done enough to prevent the violation depends on what he could have done under the circumstances.” 636 F.2d at 959. In the case before the court

Presley was a controlling person of Lincoln which was liable due to Partridge’s acts. Presley could not have supervised Partridge; Presley probably could not have effectively established a system which would have done so. But Presley could have done other things. Presley could have exercised his power in the day-to-day administrative matters to minimize the chance of a 10b-5 violation by Partridge. Presley also could have used his power to influence Partridge or to attempt to monitor Partridge’s acts and act appropriately where Partridge had erred.

*Id.*
Turning from what the control person must do—in addition to or in lieu of establishing, maintaining, and diligently enforcing a proper system of control—to the state of mind with which he or she must fail to do the foregoing, the Fifth Circuit wrote:

The Supreme Court has spoken on the meaning of good faith. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976), the Court gives the controlling person section as an example of a provision of the 1934 Act which “contains a state-of-mind condition requiring something more than negligence.” *Ernst* at 209 n.28, 96 S. Ct. at 1838-39 & n.28.

*Ernst* thus makes clear that a negligence standard is inappropriate. The question then becomes: is recklessness sufficient to give rise to liability? The Third Circuit, in *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880[, 885] (3d Cir. 1975), requires that the plaintiff prove the controlling person’s “culpable participation.” See also *Gordon v. Burr*, 506 F.2d 1080[, 1085-86] (2d Cir. 1974); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761[, 779] (3d Cir. 1976). Culpable participation is further defined, in the case of inaction, as the intentional furthering of the fraud or preventing of its discovery. *Rochez*, 527 F.2d at 890. On the other hand, the Fourth Circuit, in *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388[, 394-95] (4th Cir. 1979), notes that under *Ernst* the good faith standard requires more than negligence, then *Carpenter* holds that in addition to intentional furthering of the fraud a failure to supervise can give rise to liability, thus implying that recklessness can be enough. Although the Fifth Circuit cases neither discuss *Ernst* nor distinguish their test from intentional violations, they [the cases] should probably be read as is *Carpenter*, since liability based on a failure to supervise suggests recklessness (or negligence in other contexts), not intent.

We hold the recklessness standard appropriate. As noted, Fifth Circuit precedent is most consistent with such a holding. Other factors also indicate recklessness should be enough. It would be anomalous to require intent under the controlling person doctrine, while holding noncontrolling persons liable for severe recklessness. See *Securities & Exchange Commission v. Southwest Coal & Energy Co.*, 624 F.2d 1312[, 1321 & n.17] (5th Cir. 1980); *Croy v. Campbell*, 624 F.2d 709[, 715] (5th Cir. 1980). Furthermore, what would be the purpose of the controlling person provision if intent were required—the provision would hardly make anyone liable who would not be so otherwise. Admittedly, the shift of the burden of proof to the defendant would make the controlling person provision somewhat meaningful, but not significantly so. Under our holding, the degree of recklessness required for liability under the controlling person doctrine is less than for noncontrolling persons under *Southwest Coal* and *Croy*, which spoke of a severe form of recklessness. This difference makes the addition of the controlling person provision more meaningful. Finally, had Congress meant to require intentional misdoing, we assume it would have done so explicitly.

We hold therefore that the burden on the controlling person is to establish that he did not act recklessly in inducing, either by his action or his inaction, the “act or acts constituting the violation” of 10b-5[,] or, in the terms used *supra*, . . . in failing to do what he could have done to prevent the violation.

*Id.* at 959-60 (footnotes and parentheticals omitted).
Once a plaintiff establishes that the defendant is a control person, the defendant bears the burden of pleading and proving these affirmative defenses.\textsuperscript{344}

c. Remedies for Violations of Section 33F(1)

Because secondary liability under section 33F(1) presumes a primary violation of section 33A, 33B, or 33C, a successful section 33F(1) plaintiff has the same remedies against a control person as the plaintiff would have if the control person were a primary violator. Thus:

(1) if the plaintiff is a buyer who still owns the securities in question, the plaintiff may obtain rescission and the rescissionary damages set forth in section 33D(1);\textsuperscript{345} or

(2) if the plaintiff is a buyer who no longer owns the securities in question, the plaintiff may recover the statutory damages set forth in section 33D(3);\textsuperscript{346} or

(3) if the plaintiff is a seller, and the buyer still owns the securities in question, the plaintiff may obtain rescission and the rescissionary damages set forth in section 33D(2);\textsuperscript{347} or

(4) if the plaintiff is a seller, and the buyer no longer owns the securities in question, the plaintiff may recover the statutory damages set forth in section 33D(4).\textsuperscript{348}

And, in any event, a prevailing plaintiff may recover its costs and, in the discretion of the trial court, its reasonable attorney’s fees.\textsuperscript{349}


\textsuperscript{345}See TEX. REV. CIV. STAT. ANN. art. 581-33D(1) (Vernon Supp. 1998); \textit{see supra} parts III.E.1, IV.B.1.c.i & IV.B.3.c.i.

\textsuperscript{346}See TEX. REV. CIV. STAT. ANN. art. 581-33D(3); \textit{see supra} parts III.E.2, IV.B.1.c.ii & IV.B.3.c.i.

\textsuperscript{347}See TEX. REV. CIV. STAT. ANN. art. 581-33D(2); \textit{see supra} part IV.B.2.c.i.

\textsuperscript{348}See TEX. REV. CIV. STAT. ANN. art. 581-33D(4); \textit{see supra} part IV.B.2.c.ii.

\textsuperscript{349}See TEX. REV. CIV. STAT. ANN. art. 581-33D(6)-(7). For a discussion of the factors Texas courts may consider in deciding whether to award attorneys’ fees pursuant to section 33D(7), see \textit{supra} note 90. And, of course, a section 33F(1) plaintiff may not recover exemplary damages in any case. \textit{See supra} note 87.
2. Aiding and Abetting Liability for Violations of the Texas Securities Act

Article 581-33F(2) imposes joint and several liability on anyone who "directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security."\footnote{TEX. REV. CIV. STAT. ANN. art. 581-33F(2); see, e.g., Insurance Co. of N. Am. v. Morris, 928 S.W.2d 133, 153 (Tex. App.—Houston [14th Dist.] 1996, writ granted).}

Neither the 1933 Act nor the 1934 Act contains a provision similar to section 33F(2). As a consequence, the U.S. Supreme Court has held that no private cause of action exists for aiding and abetting a violation of section 10(b) and Rule 10b-5.\footnote{See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994); see also supra part II.A. See generally Steven A. Mectre, Textualist Statutory Interpretation Kills Section 10(b) "Aiding and Abetting" Liability, 63 DEF. COUNS. J. 58 (1996); Steinberg, Ramifications, supra note 1, at 491-501 (chronicling the Supreme Court’s adherence to "strict statutory construction" in section 10(b) and Rule 10b-5 cases, beginning, prominently, with Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), and culminating in Central Bank of Denver).} The Fifth Circuit has followed suit.\footnote{See, e.g., Melder v. Morris, 27 F.3d 1097, 1104 n.9 (5th Cir. 1994).} While Texas courts do look to federal decisions for guidance on securities matters,\footnote{See cases cited supra note 3.} because the Central Bank of Denver Court specifically found that no private cause of action existed because the 1934 Act contained no language providing one\footnote{See Central Bank of Denver, 511 U.S. at 191.} and because the TSA does contain such language, a Texas court applying section 33F(2) is not bound by Central Bank of Denver. Moreover, the TSA’s extension of aider and abettor liability to those who act with “reckless disregard” means that the statute’s reach exceeds that of pre-Central Bank of Denver federal law.\footnote{See Akin v. Q-L Invs., Inc., 959 F.2d 521, 532 (5th Cir. 1992). For excellent, albeit pre-Central Bank of Denver, discussions of aider and abettor liability in theory and practice, see Alan R. Bromberg & Lewis D. Lowenfels, Aiding and Abetting Securities Fraud: A Critical Examination, 52 ALB. L. REV. 637 (1988), and Don J. McDermott, Jr., Note, Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions, 62 TEX. L. REV. 1087 (1984).}

a. Requisites of Aider and Abettor Liability

As a general principle, a plaintiff establishes aider and abettor liability by proving that:

(1) a primary violation of the securities laws occurred;
the alleged aider "had 'general awareness' of its role in the violation;"

(3) the alleged aider rendered "substantial assistance" to the primary violator in achieving the primary violation; and

(4) the alleged aider

(a) intended to deceive or defraud the plaintiff; or

(b) acted with reckless disregard for the truth of the representations made by the primary violator.\(^{356}\)

In *Insurance Company of North America v. Morris*,\(^{357}\) a surety (INA) sued several defendants (the Investors) for failing to repay notes because such failure caused INA to make good on its bond.\(^{358}\) As a defense to repayment, the Investors alleged that INA had materially aided and abetted the promisee of the notes (Commonwealth) in violating the TSA in connection with the sale of certain limited partnership interests, in partial payment of which the defendants undertook the notes.\(^{359}\) At trial, the jury found the notes unenforceable because Commonwealth procured them in violation of the TSA and awarded the Investors damages against INA for aiding and abetting Commonwealth.\(^{360}\) On appeal, the court found ample evidence to uphold the jury's finding that INA aided and abetted Commonwealth in a violation of the TSA:

Professor Raymond Britton, the Investors' expert, testified that both the failure to disclose . . . and failure to adequately disclose the poor performance of past Commonwealth programs to the Investors were violations of the TSA. He also opined that INA materially aided Commonwealth in reckless disregard for the truth and the law. INA failed to ensure its agents acting in Texas were licensed. INA took an active role in formulating, marketing, and promoting the transaction. INA's underwriting, including evaluation of the merits of programs, the use of

\(^{356}\) Abbott v. Equity Group, Inc., 2 F.3d 613, 621 (5th Cir. 1993). See generally Lowenfels & Bromberg, *supra* note 13, at 4-11. Note that the test stated here differs from that set forth in either Abbott or Lowenfels & Bromberg because the TSA permits the imposition of aider and abettor liability against both those who knowingly render aid to a primary violator and those who do so with reckless disregard for the truthfulness of the primary violator's acts or omissions. See *Central Bank of Denver*, 511 U.S. at 191.

\(^{357}\) 928 S.W.2d 133 (Tex. App.—Houston [14th Dist.] 1996, writ granted).

\(^{358}\) See id. at 141-42.

\(^{359}\) See id. at 140.

\(^{360}\) See id. at 142, 153.
its name as a marketing tool, and the financing through use of surety bonds were critical to the success of the programs... Burgess, as vice-president of Phillips [the agency that approached INA to underwrite the surety bonds], discovered the Meatte injunction during his due diligence for INA. Ace also knew of the injunction, and was both INA's statutory agent and its agent through apparent authority. INA should have ensured the Meatte injunction was disclosed in the PPMs for the Overlord programs as it had been for earlier programs.361

b. Defenses to Aider and Abettor Liability

Section 33F(2) provides a statutory defense for an aider and abettor who pleads and proves "that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist."362 The defense afforded a primary violator by sections 33A(2), 33B, and 33C—namely, plaintiff's knowledge of the untruth or omission—presumably is also available to an alleged aider or abettor being sued as secondarily liable for a primary violation of one of those provisions.363 However, there exists, as yet, no statutory or other authority supporting or rebutting that presumption.

c. Remedies for Violations of Section 33F(2)

Because secondary liability under section 33F(2) presumes a primary violation of section 33A, 33B, or 33C, a successful section 33F(2) plaintiff

361Id. at 153. To date, Morris is the sole published opinion squarely addressing liability under section 33F(2). Three other cases, Weatherly v. Deloitte & Touche, 905 S.W.2d 642, 649-50 (Tex. App.—Houston [14th Dist.] 1995, writ dism'd w.o.j.), Marshall v. Quinn-L Equities, Inc., 704 F. Supp. 1384, 1391 (N.D. Tex. 1988), and In re Taxable Municipal Bonds Litig., Civ. A. Nos. 90-4724G, 90-4725G, 1992 WL 346299, at *2-3 (E.D. La. Nov. 12, 1992), refer to claims under section 33F(2). However, Weatherly merely assesses the prima facie viability of certain allegations for the purpose of ruling on a request for class certification, see 905 S.W.2d at 649-50, Marshall merely withholds ruling on a motion to dismiss claims under section 33F(2) pending further briefing, see 704 F. Supp. at 1391, and Municipal Bonds lumps its section 33F(2) analysis with its analysis of plaintiffs' aider and abettor claims under section 10(b) of the 1934 Act, see 1992 WL 346299, at *2-3. In light of the Fifth Circuit's recognition in Akin v. Q-L Investments, Inc., 959 F.2d 521 (5th Cir. 1992), that the reach of section 33F(2) exceeds that of pre-Central Bank of Denver federal law, see id. at 532, this latter treatment is no longer proper.

363See generally sources cited supra notes 222-224 and accompanying text.
is entitled to the same remedies against an aider or abettor as the plaintiff would recover if the aider or abettor were a primary violator. Thus:

1. if the plaintiff is a buyer who still owns the securities in question, plaintiff will be entitled to rescission and the rescissionary damages set forth in section 33D(1);\textsuperscript{364} or

2. if the plaintiff is a buyer who no longer owns the securities in question, plaintiff will be entitled to the statutory damages set forth in section 33D(3);\textsuperscript{365} or

3. if the plaintiff is a seller, and the buyer still owns the securities in question, plaintiff will be entitled to rescission and the rescissionary damages set forth in section 33D(2);\textsuperscript{366} or

4. if the plaintiff is a seller, and the buyer no longer owns the securities in question, plaintiff will be entitled to the statutory damages set forth in section 33D(4).\textsuperscript{367}

And, in any event, plaintiff will be entitled to recover its costs and, in the discretion of the trial court, its reasonable attorney’s fees.\textsuperscript{368}

3. Statutory Secondary Liability for Violations of Section 27.01

In addition to the secondary liability provisions of section 33F, section 27.01 of the Texas Business and Commerce Code also provides for secondary liability.

a. Secondary Liability Under Section 27.01(d)

The secondary liability provision in section 27.01 does not require either “control” or “material assistance.” Rather, all that Section 27.01 requires is that the third party (1) have knowledge of the false representation or promise made by the primary violator, (2) fail to disclose the falsity to the plaintiff, and (3) benefit from the false representation or promise.\textsuperscript{369} A person who satisfies these three requisites is liable to the plaintiff for the fraud committed by the primary violator as well as for exemplary dam-


\textsuperscript{368}See Tex. Rev. Civ. Stat. Ann. art. 581-33D(6)-(7). For a discussion of the factors Texas courts may consider in deciding whether to award attorneys’ fees pursuant to section 33D(7), see supra note 90. And, of course, a section 33F(2) plaintiff is not entitled to recover exemplary damages in any case. See supra note 87.

ages. \textsuperscript{370} "Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness." \textsuperscript{371}

b. Section 27.01(d) Remedies

The remedies available to a plaintiff suing under section 27.01(d) are the same as those for a section 27.01(a) plaintiff—namely, actual damages, exemplary damages, prejudgment interest, rescission, attorneys’ and expert witness’ fees, and costs. \textsuperscript{372}


In addition to control person liability, liability for aiding and abetting, and statutory secondary liability under section 27.01, a plaintiff may seek to impose secondary liability for statutory securities violations using the common law theories of agency and respondeat superior. \textsuperscript{373} And, in any

\textsuperscript{370}See id. Because a person who satisfies the requisites of section 27.01(d) commits (vicariously) the primary violation, she is also liable to the plaintiff as if she had committed the primary violation. Therefore, in addition to the liability for exemplary damages that is specifically mentioned in section 27.01(d), she is also liable for actual damages, as permitted by section 27.01(b). \textit{Id.} \S 27.01(b).

\textsuperscript{371}Id. \S 27.01(d).

\textsuperscript{372}See supra part IV.C.3.

\textsuperscript{373}See, e.g., Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1118-19 (5th Cir. 1980); accord Cook v. Goldman, Sachs & Co., 726 F. Supp. 151, 155 (S.D. Tex. 1989). The majority of circuits, including the Fifth Circuit, have held that common law principles of agency and respondeat superior exist as alternative methods of imposing secondary liability for violations of the federal securities laws. See, e.g., Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1576-77 (9th Cir. 1990); Commerford v. Olson, 794 F.2d 1319, 1322-23 (8th Cir. 1986); \textit{In re Atlantic Fin. Mgmt., Inc.}, 784 F.2d 29, 32-35 (1st Cir. 1986); Henricksen v. Henricksen, 640 F.2d 880, 887-88 (7th Cir. 1981); Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705, 716 (2d Cir. 1980); \textit{Paul F. Newton & Co.}, 630 F.2d at 1118-19; Holloway v. Howerdd, 536 F.2d 690, 694-95 (6th Cir. 1976). A minority of circuits (or panels) have, however, rejected the application of these common law principles of liability for violations of federal securities law. See, e.g., Hattruck v. Edward D. Jones & Co., 750 F.2d 767, 777 (9th Cir. 1984); Rochez Bros., Inc. v. Rhoades, 527 F.2d 880, 884-86, 891 (3d Cir. 1975). See generally Shu, supra note 321, at 569-74 (discussing the viability of respondeat superior and agency claims pre- and post-\textit{Central Bank of Denver}).

As the \textit{Paul F. Newton & Co.} court explained:

The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively. The legislative history of \S\S 15 and 20(a) demonstrates that Congress enacted those sections to address the specific evil of persons seeking to evade liability under the acts by organizing "dummies," that, acting under their control, would commit the prohibited acts. That history does not reflect any congressional intent to restrict secondary liability for violations of the acts to the con-
trolled persons formula set out in §§ 15 and 20(a). Section 28 of the Securities Exchange Act, by expressly making the rights and liabilities imposed by the Act cumulative of any existing at law or in equity, evinces a contrary congressional intent.

Limiting secondary liability under the 1934 Act to that liability provided by § 20(a) would contradict the pervasive application of agency principles in nearly all other areas of the law. In the specific factual context confronting us, which concerns the liability of a brokerage firm for the acts of its registered representative, such a rule would enable the brokerage firm to escape liability under the reasoning of some circuits merely by showing that it did not "culpably participate" in fraud committed by its employee. To allow a brokerage firm to avoid secondary liability simply by showing ignorance, purposeful or negligent, of the acts of its registered representative contravenes Congress's intent to protect the public, particularly unsophisticated investors, from fraudulent practices. At least with respect to the initial choice of a broker, most investors rely upon the reputation and prestige of the brokerage firm rather than the individual employees with whom they might deal. Such firms should be held accountable if employees they select utilize the firm's prestige to practice fraud upon the investing public.

The Third Circuit's rule in Rochez Brothers, and the reasoning underlying it, could produce unfair results depending upon the nature of the brokerage firm with which the aggrieved investor dealt. For example, the Third Circuit would impose liability upon a corporate firm whose officer or employee commits violations of the securities acts while acting "(1) in the course of his employment, and (2) for the benefit of the corporation." Yet the Third Circuit rule appears to reject a finding of liability where all the facts are the same except that the violations were committed by an employee of a partnership. In the absence of any clear expression of Congress's intent, we decline to construe § 20(a) in such a manner.

[Common law agency principles ... do] not expose corporations, employers, and other such potential defendants to strict liability for all acts of their agents or cause them to become insurers of their agent's actions. The familiar requirements of agency that the agent act within the course and scope of his employment and that he act within his actual or apparent authority serve to restrict the scope of the principal's liability. It is consistent with the remedial purpose of the federal securities acts to require a brokerage firm that provides an employee with the means to carry out fraudulent practices to pay damages to a victim of those practices when the employee has chosen acts within the course and scope of his employment.

Paul F. Newton & Co., 630 F.2d at 1118-19 (citations omitted).

The United States Supreme Court has not yet addressed this issue. However, some commentators believe that Central Bank of Denver undermines the viability of common law vicarious liability theories for the same reason that it eliminates essentially common law aider and abettor liability—because the federal statutes make no specific provision for such claims. See Steinberg, Ramifications, supra note 1, at 501-02; Lisa Klein Wager & John E. Failla, Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.—The Beginning of an End, or Will Less Lead to More?, 49 BUS. LAW. 1451, 1462-63 (1994); see also ESU Montgomery County, Inc. v. Montenay Int'l Corp., 1996 WL 22979, at *3 (S.D.N.Y. Jan. 23, 1996) (concluding that Central Bank of Denver forecloses respondent superior liability for violations of federal securities law).
event, secondary liability under these common law theories should be available to a plaintiff alleging common law fraud or negligent misrepresentation.

a. Liability of an Agent

An agent is one who is authorized by a principal to transact business or manage some affair on the principal’s behalf and subject to the principal’s control.\textsuperscript{374} As a general rule, an agent acting within the scope of his authority\textsuperscript{375} may neither benefit from nor be held liable for contracts made

\textit{But see} Shu, supra note 321, at 573 (concluding that respondent superior liability may survive \textit{Central Bank of Denver}). No Texas state court—pre- or post-\textit{Central Bank of Denver}\textemdash has addressed the applicability of common law agency or respondent superior to violations of the Texas Securities Act or section 27.01 of the Texas Business and Commerce Code.

\textsuperscript{374}See Bhalli v. Methodist Hosp., 896 S.W.2d 207, 210 (Tex. App.—Houston [1st Dist.] 1995, writ denied); Spangler v. Jones, 861 S.W.2d 392, 396 (Tex. App.—Dallas 1993, writ denied); Ross v. Texas One Partnership, 796 S.W.2d 206, 210 (Tex. App.—Dallas 1990), \textit{writ denied per curiam}, 806 S.W.2d 222 (Tex. 1991); Green v. Hannon, 369 S.W.2d 853, 856 (Tex. Civ. App.—Texarkana 1963, writ ref’d n.r.e.); \textit{RESTATEMENT (SECOND) OF AGENCY} § 15 & cmts. a & b (1958). Both the principal and the agent may be a natural person, groups of natural persons such as partnerships, or a legal entity such as a corporation. \textit{RESTATEMENT (SECOND) OF AGENCY} § 1(1) cmt. a.

The party asserting the agency relationship has the burden of proving its existence. \textit{Bhalli}, 896 S.W.2d at 210; \textit{Spangler}, 861 S.W.2d at 396-97; Glendon Invs., Inc. v. Brooks, 748 S.W.2d 465, 467 (Tex. App.—Houston [1st Dist.] 1988, writ denied). The existence of the agency relationship may be proven by direct testimony or by circumstantial evidence, such as the relationship of the parties and their conduct concerning the transaction at hand. \textit{Spangler}, 861 S.W.2d at 397; Kirby Forest Indus., Inc. v. Dobbs, 743 S.W.2d 348, 356 (Tex. App.—Beaumont 1987, writ denied).

\textsuperscript{375}Any matters which the principal and agent have agreed that the agent may conduct on the principal’s behalf are within the “scope” of the agent’s “authority.” \textit{See generally} RAPHAEL POWELL, THE LAW OF AGENCY 33 (1952). “A ‘general agent’ is one who is authorized to transact for the principal all of the principal’s business of a particular kind or in a particular place.” \textit{First Nat’l Bank v. Kinabrew}, 589 S.W.2d 137, 145 (Tex. Civ. App.—Tyler 1979, writ ref’d n.r.e.); \textit{RESTATEMENT (SECOND) OF AGENCY} § 3(1). A “special agent” is one who is only authorized to perform specific acts in connection with a particular transaction. \textit{See} Schaff v. Stripling, 265 S.W. 264, 266 (Tex. Civ. App.—Texarkana 1924, writ dism’d w.o.j.); Morgan v. Harper, 236 S.W. 71, 72 (Tex. Comm’n App. 1922, holding approved); \textit{see also} \textit{RESTATEMENT (SECOND) OF AGENCY} § 3(2) (“A special agent is an agent authorized to conduct a single transaction or a series of transactions not involving a continuity of service.”). Although the special agent’s powers are limited relative to the general agent, the special agent, like the general agent, is said to have by implication “all such powers as are necessary and proper as a means of effectuating the purposes for which the agency was created.” \textit{Schaff}, 265 S.W. at 266.
for the benefit of the principal.376 There are, however, exceptions to this rule: (1) where the agent contracts in his own name;377 (2) where the princi-

In addition to "actual" agency, Texas courts have recognized two other theories of vicarious liability in the absence of a formal principal-agent relationship. One of these theories, "agency by estoppel," is based on section 267 of the Restatement (Second) of Agency, which reads:

One who represents that another is his servant or other agent and thereby causes a third party justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.

RESTATEMENT (SECOND) OF AGENCY § 267.

The other theory, "apparent agency," is based on section 429 of the Restatement (Second) of Torts, which reads:

One who employs an independent contract to perform services for another which are accepted in the reasonable belief that the services are being rendered by the employer or by his servants, is subject to liability for physical harm caused by the negligence of the contractor in supplying such services, to the same extent as though the employer were supplying them himself or by his servants.


Agency by estoppel requires proof of the following three elements: (1) a third party has a reasonable belief in an agent's authority; (2) the belief is generated by some holding out by act or neglect of the principal; and (3) the third party justifiably relies on the representation of authority. See Sampson v. Baptist Mémorial Hosp. Sys., 940 S.W.2d 128, 132 (Tex. App.—San Antonio 1996, writ granted); McDuff v. Chambers, 895 S.W.2d 492, 498 (Tex. App.—Waco 1995, writ denied); Lopez v. Central Plains Regional Hosp., 859 S.W.2d 600, 605 (Tex. App.—Amarillo 1993, no writ). Apparent agency requires only two elements: (1) the plaintiff must look to the purported principal, rather than the purported agent, for performance, and (2) the purported principal must "hold out" the purported agent as its agent or employee. See Sampson, 940 S.W.2d at 132. Reliance is not an element of apparent agency. See id. Vicarious liability based on the "agency by estoppel" theory is generally more difficult to prove because the plaintiff must show a representation or holding out and actual reliance. See id. at 133.


377See, e.g., Tinsley, 26 S.W.2d at 947; Vincent Murphy Chevrolet Co. v. Auto Auction, Inc., 413 S.W.2d 474-477-78 (Tex. Civ. App.—Eastland 1967, writ ref'd n.r.e.); Hahn, 364 S.W.2d at 470.
pal is undisclosed;\textsuperscript{378} (3) where the agent is authorized to act as owner of the property;\textsuperscript{379} and (4) where the agent has an interest in the subject matter of the contract.\textsuperscript{380} In these situations, an agent is considered a party to the transaction.\textsuperscript{381}

Irrespective of the scope of the agency, an agent is generally liable for the torts he commits, even if the torts are committed on behalf of the principal.\textsuperscript{382} An agent is not liable, however, for the principal’s torts in which he has not participated.\textsuperscript{383}

\textbf{b. Liability of a Principal}

As a general rule, a principal is liable for the acts of his agent that are within the agent’s authority.\textsuperscript{384} A principal is liable on any contract made

\textsuperscript{378}See, \textit{e.g.}, Heinrichs v. Evins Personnel Consultants, Inc. No. 1, 486 S.W.2d 935, 937 (Tex. 1972); Trailways, Inc. v. Clark, 794 S.W.2d 479, 491 (Tex. App.—Corpus Christi 1990, writ denied); Glendon Invs., 748 S.W.2d at 467.

If the third party with whom the agent is dealing has no notice that the agent is acting for a principal, the principal for whom the agent acts is an “undisclosed principal.” \textit{RESTATEMENT (SECOND) OF AGENCY} \S\ 4(3). If the third party with whom the agent is dealing has notice that the agent is or may be acting for a principal but has no notice of the principal’s identity, the principal for whom the agent is acting is a “partially disclosed principal.” \textit{Id.} \S\ 4(2). The third party’s actual knowledge of the principal as opposed to mere suspicion of the principal’s identity is the test for determining whether the principal was adequately disclosed by the agent. See Lacquement v. Handy, 876 S.W.2d 932, 939 (Tex. App.—Fort Worth 1994, no writ); Southwestern Bell Media, Inc. v. Trepper, 784 S.W.2d 68, 71 (Tex. App.—Dallas 1989, no writ); \textit{A to Z Rental Ctr.}, 714 S.W.2d at 435.

Thus, an agent who wishes to avoid personal liability on a contract has a duty to disclose to the third party both (1) the fact that he is acting in a representative capacity, and (2) the identity of the principal on whose behalf the agent is acting. See Wynne v. Adcock Pipe & Supply, 761 S.W.2d 67, 69 (Tex. App.—San Antonio 1988, writ denied).

\textsuperscript{379}See, \textit{e.g.}, Tinsley, 26 S.W.2d at 947; \textit{Hahn}, 364 S.W.2d at 470.

\textsuperscript{380}See \textit{Hahn}, 364 S.W.2d at 470; \textit{see, e.g.}, Mediacomp, Inc. v. Capital Cities Communication, Inc., 698 S.W.2d 207, 211 (Tex. App.—Houston [1st Dist.] 1985, no writ); \textit{Whataburger}, 642 S.W.2d at 34; Nagle v. Duncan, 570 S.W.2d 116, 117 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ dism’d).

\textsuperscript{381}See \textit{Lacquement}, 876 S.W.2d at 939; \textit{A to Z Rental Ctr.}, 714 S.W.2d at 435.


\textsuperscript{383}See, \textit{e.g.}, Mayflower Inv. Co. v. Stephens, 345 S.W.2d 786, 795 (Tex. Civ. App.—Dallas 1960, writ ref’d n.r.e.); \textit{see also} Light v. Wilson, 663 S.W.2d 813, 815 (Tex. 1983) (Spears, J., concurring).

\textsuperscript{384}See Ames v. Great Southern Bank, 672 S.W.2d 447, 450 (Tex. 1984); Shaw v. Kennedy, Ltd., 879 S.W.2d 240, 245 (Tex. App.—Amarillo 1994, no writ). For a discussion of the scope of an agent’s authority, see \textit{supra} note 375.
within the agent’s authority,\textsuperscript{385} as well as on those contracts (within or without the agent’s authority) that the principal has ratified by subsequent agreement or conduct.\textsuperscript{386} Even when an agent does not disclose the agency

\textsuperscript{385}See, e.g., Collins v. Williamson Printing Corp., 746 S.W.2d 489, 493 (Tex. App.—Dallas 1988, no writ).

\textsuperscript{386}See, e.g., Diamond Paint Co. v. Embry, 525 S.W.2d 529, 535 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref’d n.r.e.).

Ratification is “the adoption or confirmation by a person, with knowledge of all material facts, of a prior act which did not then legally bind him and which he had the right to repudiate, but which, by the ratification, is given retroactive effect as if originally performed by him.” Kunkel v. Kunkel, 515 S.W.2d 941, 948 (Tex. Civ. App.—Amarillo 1974, writ ref’d n.r.e.); see also RESTATEMENT (SECOND) OF AGENCY § 82 cmt. b (1958) (“Ratification is not a form of authorization, but its peculiar characteristic is that ordinarily it has the same effect as authorization; upon ratification the consequences of the original transaction are the same as if it had been authorized . . . .”). By virtue of the ratification, the principal is said to be entitled to the benefits of, as well as the liability involved in, those acts done by his or her agent on the principal’s behalf although the agent acted without authorization. See Buffalo Savs. & Loan Ass’n v. Trumix Concrete Co., 641 S.W.2d 650, 653 (Tex. App.—Corpus Christi 1982, no writ).

Ratification by a principal of his or her agent’s unauthorized acts may be express or implied from the principal’s subsequent course of conduct. See Petroleum Anchor Equip., Inc. v. Tyra, 419 S.W.2d 829, 834 (Tex. 1967); Thermo Prod. Co. v. Chilton Indep. Sch. Dist., 647 S.W.2d 726, 733 (Tex. App.—Waco 1983, writ ref’d n.r.e.); see also RESTATEMENT (SECOND) OF AGENCY § 83 (“Affirmation is either (a) a manifestation of an election by one on whose account an unauthorized act has been done to treat the act as authorized, or (b) conduct by him justifiable only if there were such an election.”). Ratification may occur through acts, conduct or affirmative acquiescence by the principal. See Little v. Clark, 592 S.W.2d 61, 64 (Tex. Civ. App.—Fort Worth 1979, writ ref’d n.r.e.); see also Jamal v. Thomas, 481 S.W.2d 485, 490 (Tex. Civ. App.—Houston [1st Dist.] 1972, writ ref’d n.r.e.) (holding that definition of ratification which, although it did not include “acquiescence,” was nevertheless substantially correct). However, ratification cannot be inferred from acts that the principal had a right to do, independently and without knowledge of the unauthorized transaction under scrutiny. See Texas Pac. Coal & Oil Co. v. Smith, 130 S.W.2d 425, 430 (Tex. Civ. App.—Eastland 1939, writ dism’d judgm’t cor.).

The ratifier may be either a disclosed or an undisclosed principal. See RESTATEMENT (SECOND) OF AGENCY § 87 (“To become effective as ratification, the affirmation must be by the person identified as the principal at the time of the original act or, if no person was then identified, by the one for whom the agent intended to act.”). An agent cannot ratify his or her own unauthorized act. See Murray v. Dobbs, 56 S.W.2d 233, 235 (Tex. Civ. App.—Amarillo 1933, no writ); see also Clubb Testing Serv., Inc. v. Singletary, 395 S.W.2d 956, 959 (Tex. Civ. App.—San Antonio 1965, no writ) (stating that an agent who negotiates contract without authority has no power to ratify it).

There are at least two exceptions to the general rule that a principal becomes liable solely by explicitly or implicitly ratifying an otherwise unauthorized transaction—namely: (a) when the principal is obliged to affirm the act in order to protect his own interests; and (b) when the principal is caused to ratify by the misrepresentation or duress of the agent. See RESTATEMENT
and contracts with a third party in the agent’s own name, the principal generally will be liable on the contract so long as the contract was made within the agent’s authority.\textsuperscript{387} Conversely, the principal will not be liable on a contract executed by an unauthorized agent.\textsuperscript{388}

A principal may also be liable for the tortious conduct of an agent committed within the scope of the agency.\textsuperscript{389} “If an agent is acting within the scope of his general authority, his wrongful act, though unauthorized, will nevertheless subject his principal to liability.”\textsuperscript{390} A principal may even be liable for his agent’s \textit{intentional} torts if the tort occurred within the scope of the authority conferred by the principal on the agent.\textsuperscript{391} Of particular relevance, where an agent is acting for the principal, the principal is

(\textit{Second} of \textit{Agency} § 416(a), (b); Spangler v. Jones, 861 S.W.2d 392, 394 (Tex. App.—Dallas 1993, writ denied). Moreover,

When the agent’s act is for the benefit of the agent or some third party, then the principal does not ratify the acts of the agent by accepting the agreement purportedly entered into on its behalf by the agent.

\begin{itemize}
  \item [	extit{If} the agent’s act is a fraud upon the principal, it is incapable of ratification because no principal would confer an authority to practice a fraud upon itself. As Jones conceded in the first appeal of this case, breach of fiduciary duty subsumes claims of constructive fraud. Thus, when the jury found that Jones breached his fiduciary duty to Spangler, it necessarily found that Jones committed constructive fraud against him, which, as noted in \textit{Herider Farms}, is incapable of being ratified.


\textsuperscript{387} \textit{See} Wynne v. Adcock Pipe & Supply, 761 S.W.2d 67, 69 (Tex. App.—San Antonio 1988, writ denied). The undisclosed principal is liable even though the agent is also liable. \textit{See id.} However, the third party cannot recover from both. \textit{See id.; see also} N. K. Parrish, Inc. v. Southwest Beef Indus. Corp., 638 F.2d 1366, 1369 (5th Cir. 1981); Moody-Seagraves Ranch v. Brown, 69 S.W.2d 840, 844 (Tex. Civ. App.—San Antonio 1934, writ ref’d); Diacomis v. Wright, 20 S.W.2d 139, 140 (Tex. Civ. App.—Dallas 1929), aff’d in part, rev’d in part on other grounds, 34 S.W.2d 806 (Tex. 1931).

\textsuperscript{388} \textit{See} Angroson, Inc. v. Independent Communications, Inc., 711 S.W.2d 268, 271 (Tex. App.—Dallas 1986, writ ref’d n.r.e.).

\textsuperscript{389} \textit{See} Celtic Life Ins. Co. v. Coats, 885 S.W.2d 96, 98 (Tex. 1994); Hedley Feedlot, Inc. v. Weatherly Trust, 855 S.W.2d 826, 837 (Tex. App.—Amarillo 1993, writ denied); Southwestern Bell Tel. Co. v. Wilson, 768 S.W.2d 755, 759 (Tex. App.—Corpus Christi 1988, writ denied).


\textsuperscript{391} \textit{See} Miller v. Towne Servs., Inc., 665 S.W.2d 143, 145 (Tex. App.—Houston [1st Dist.] 1983, no writ).
liable for the agent’s fraud or misrepresentation even if the principal received no benefit from the fraud and misrepresentations within the scope of the agency and even though the principal had no knowledge of the fraud or misrepresentations.\textsuperscript{392}

As a general rule, if the agent acts within the scope of his authority, in good faith, and for the interest of his principal, the agent is presumed to have disclosed all facts that came to his knowledge.\textsuperscript{393} However, the agent’s knowledge is not imputed to the principal when the agent engages in fraudulent conduct.\textsuperscript{394} Furthermore, the knowledge of an agent is not imputed to the principal under circumstances where the agent does not acquire his knowledge in the transaction of his principal’s business.\textsuperscript{395}

A principal cannot escape liability for the acts of his agent by simply saying the agent lacked authority to do the particular act in question.\textsuperscript{396} An agent’s authority is presumed to be coextensive with the business entrusted to his care.\textsuperscript{397}

On the other hand, a principal will not be bound by the wrongful acts of an agent which are performed on behalf of some other person or entity,\textsuperscript{398} unless the principal ratifies the agent’s acts,\textsuperscript{399} or otherwise accepts the benefits thereof.

c. Special Cases: Officers and Directors

An officer or director of a corporation is generally insulated from personal liability for actions performed in the scope of his duties for the corporation.\textsuperscript{400} Without piercing the corporate veil, a corporate officer or di-

\textsuperscript{394}See Mays, 247 S.W. at 846; Kirby, 688 S.W.2d at 168.
\textsuperscript{395}See Taylor v. Taylor, 88 Tex. 47, 29 S.W. 1057, 1058 (1895); accord Triad Contractors, Inc. v. Kelly, 809 S.W.2d 683, 686 (Tex. App.—Beaumont 1991, writ denied); Kirby, 688 S.W.2d at 168.
\textsuperscript{397}See Longoria v. Atlantic Gulf Enters., 572 S.W.2d 71, 77 (Tex. Civ. App.—Corpus Christi 1978, writ ref’d n.r.e.).
\textsuperscript{398}See Kirby, 688 S.W.2d at 167-68.
\textsuperscript{399}See supra note 386 for a discussion of ratification.
\textsuperscript{400}See Portlock v. Perry, 852 S.W.2d 578, 582 (Tex. App.—Dallas 1993, writ denied); see generally Castleberry v. Branscum, 721 S.W.2d 270, 271-72 (Tex. 1986).
rector may, nonetheless, be personally liable for the corporation’s tortious conduct, even though he is acting for the benefit of the corporation, if he knowingly participates in a tortious or fraudulent act of the corporation. Participation in a tortious act of the corporation will render the officer or director personally liable, while mere participation in a breach of a corporate contractual obligation will not. “Participation” has been defined to include instigating, aiding, or abetting the corporation’s tortious conduct.

An officer or director may also be personally liable for the corporation’s tortious actions if he had actual or constructive knowledge of the wrongful acts.

The majority of cases in which an officer or director has been held liable for participation in a corporation’s violations of securities law have arisen when the officer or director actively participated in the fraudulent conduct of the corporation by personally making false representations to a third party. Such conduct constitutes personal participation in a corporate act that will subject the officer to personal liability. An officer’s active participation with the corporation in the commission of other torts such as conversion of property may also subject the officer to liability. Mere inaction by the officer or director generally will not, however, be sufficient to constitute participation unless the officer or director had a duty to act.


402 See Barclay, 686 S.W.2d at 336-37.

403 See Portlock, 852 S.W.2d at 582 (citing Permian Petroleum, 484 S.W.2d at 634); Earthman’s, Inc. v. Earthman, 526 S.W.2d 192, 206 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ).

404 See Portlock, 852 S.W.2d at 582.

405 See, e.g., Commercial Escrow, 778 S.W.2d at 541; Barclay, 686 S.W.2d at 338.

406 See Earthman’s, 526 S.W.2d at 206; Permian Petroleum Co., 484 S.W.2d at 634-35.

407 See Portlock, 852 S.W.2d at 582 (noting that when there is no duty to perform, acts of omission will not constitute participation for the purpose of imposing liability on an officer or director).

In Portlock, the parents of a patient who died after being administered an improper dosage of chloral hydrate at a diagnostic clinic filed a lawsuit against the clinic, physician, radiological technicians, and the clinic’s president alleging medical malpractice and negligence. See id. at 580. Prior to trial, plaintiffs settled their claims against the physician and non-suited the clinic and the technicians. See id. Plaintiffs, however, pursued their causes of action against the president of the clinic alleging that the president was individually liable as a participant because (1) he was negligent in failing to institute certain policies and procedures and quality control for the
In order for a plaintiff to establish an officer’s or director’s participation in the corporation’s tortious actions, the plaintiff must first prove that the corporation committed tortious acts. This may be established by imputing the liability of an agent or employee to the corporation, because, e.g., the actions of an employee are imputed to the corporation if they were committed in the course and scope of his employment. The agent’s or employee’s actions, thus, become the actions of the corporation. This has been held to be true in the context of securities sales by an agent.

After establishing the tortious actions of the corporation, the plaintiff must prove that the officer or director participated in the wrongful actions. A plaintiff may do so by proving that the officer or director instigated, aided, or abetted the conduct. The actions of the corporation may then form the basis for liability of an officer or director under the participation theory; thus subjecting the officer or director to individual liability for the tortious conduct of the corporation.

Liability of an officer or director on this theory is joint and several with that imposed on the principal for commission of the tortious act. The clinic, and (2) he negligently hired the clinic’s employees. See id. at 582. Plaintiffs contended that this negligence proximately caused their daughter’s death. See id. The trial court found that the president was not individually liable and granted summary judgment against plaintiffs on their claims against the clinic’s president. See id. at 581.

The court of appeals affirmed the trial court’s judgment, finding that the president’s alleged actions were insufficient to subject him to personal liability for the clinic’s actions because he did not administer the drug, he was not present when the drug was administered, and did not otherwise instigate, aid, or abet the alleged tortious conduct. See d. at 582. Further, the court found that the president had no duty to act, and his alleged omissions were insufficient to constitute participation in the corporation’s wrongful actions. See id. The court of appeals did not address whether the president had actual or constructive knowledge of the corporation’s tortious conduct. It appears from the opinion, however, that the president did not have actual or constructive knowledge of the corporation’s tortious conduct because he did not participate in the day-to-day operations of the clinic. See id. at 580, 582.


409See id. at 732.


413See Dorchester Gas Producing Co. v. Harlow Corp., 743 S.W.2d 243, 258-59 (Tex. App.—Amarillo 1987, writ dism’d).
5. Common Law Conspiracy Liability for Securities Fraud

Texas law may also permit a plaintiff to impose secondary liability for statutory securities violations by pleading and proving a civil conspiracy. And, in any event, conspiracy is clearly available to a plaintiff alleging common law fraud or negligent misrepresentation.

A civil conspiracy is a combination by two or more persons to accomplish an unlawful purpose or to accomplish a lawful purpose through unlawful means. In order to establish a conspiracy, the plaintiff must plead and prove that:

1. two or more persons,

2. combined in order to accomplish some objective, to further some purpose, or to pursue some course of action,

3. reached a meeting of the minds on the objective (or purpose) or course of action, and

4. committed one or more unlawful acts or one or more otherwise lawful acts for an unlawful purpose,

5. with the intent of injuring others,

6. proximately resulting in some injury to or loss by the plaintiff.

414 See Duval County Ranch Co. v. Wooldridge, 674 S.W.2d 332, 337 (Tex. App.—Austin 1984, no writ).

415 See Tilton v. Marshall, 925 S.W.2d 672, 681 (Tex. 1996); Schlumberger Well Surveying Corp. v. Nortex Oil & Gas Corp., 435 S.W.2d 854, 856 (Tex. 1968). There is no independent liability for civil conspiracy. See Belz v. Belz, 667 S.W.2d 240, 243 (Tex. App.—Dallas 1984, writ ref’d n.r.e.). Therefore, the alleged conspirators must conspire to do something that is, in and of itself, unlawful. See Tilton, 925 S.W.2d at 681 (“[A] defendant’s liability for conspiracy depends on participation in some underlying tort for which the plaintiff seeks to hold at least one of the named defendants liable.”).

416 This may be trickier than it seems. For instance, a corporation cannot conspire with itself. See Vosko v. Chase Manhattan Bank, N.A., 909 S.W.2d 95, 100 (Tex. App.—Houston [14th Dist.] 1995, writ denied). Similarly, a corporate parent cannot conspire with its wholly-owned subsidiary. See Atlantic Richfield Co. v. Misty Prods., Inc., 820 S.W.2d 414, 420-21 (Tex. App.—Houston [14th Dist.] 1991, writ denied); see also Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771-77, (1984); Johnson v. Hospital Corp. of Am., 95 F.3d 383, 390-93 (5th Cir. 1996) (applying Texas law).

417 See Triplex Communications, Inc. v. Riley, 900 S.W.2d 716, 719-20 (Tex. 1995); Massey v. Armco Steel Co., 652 S.W.2d 932, 934 (Tex. 1983); Schlumberger, 435 S.W.2d at 856-57.

Notice that, unlike a claim of aiding and abetting, a plaintiff pleading conspiracy need not prove that the alleged conspirator “materially aided” (or, in the words commonly used in pre-Central Bank of Denver federal cases, “substantially assisted”) the underlying securities viola-

The mere fact that two or more persons agreed to do (or not do) something does not amount to an actionable civil conspiracy—the parties must have had some unlawful purpose or used some unlawful means.\footnote{See, e.g., Kelly v. Galveston County, 520 S.W.2d 507, 515 (Tex. Civ. App.—Houston [14th Dist.] 1975, no writ). In order to support a finding of conspiracy, the plaintiff must establish "[t]he acts of a conspiracy ... by full, clear, satisfactory, and convincing testimony." Guynn v. Corpus Christi Bank & Trust, 589 S.W.2d 764, 771 (Tex. Civ. App.—Corpus Christi 1979, writ dismiss'd w.o.j.). There must be "more than a scintilla of evidence" as to each element of the alleged conspiracy to avoid judgment as a matter of law that no conspiracy exists. \textit{Id.} That said, the plaintiff need not obtain a separate finding of actionable liability as a prerequisite to establishing conspiracy. \textit{See} Banc One Capital Partners Corp. v. Kneipper, 67 F.3d 1187, 1195 (5th Cir. 1995). A plaintiff may establish conspiracy by proving the elements of wrongful conduct without pleading a separate cause of action for that conduct. \textit{See id.}} Furthermore, conspiracy requires that the alleged conspirator intended to act in furtherance of the conspiracy for the purpose of causing the intended in-
jury. In other words, civil conspiracy requires specific intent—it is not enough that the alleged wrongdoers "intend[ed] to engage in the conduct that resulted in the injury, the alleged conspirators must also have intended the injury." Moreover, the plaintiff's damages must have proximately resulted from the allegedly conspiratorial acts. If the damages complained of were not proximately caused by the alleged conspiracy, the plaintiff's claim of civil conspiracy fails as a matter of law.

Once a conspiracy is found, each co-conspirator is responsible for the action of any co-conspirator which is in furtherance of the unlawful combination. A finding that certain defendants are liable for conspiracy has the effect of making them jointly and severally liable for the underlying tort about which they are conspiring.

Because liability for conspiracy is derivative of other wrongdoing, the measure of damages for conspiracy is dependent upon the measure of damages for the underlying tort or statutory violation. Likewise, the availability and standard for recovering exemplary damages is dependent upon the underlying tort.

---

420 See Firestone Steel Products Co. v. Barajas, 927 S.W.2d 608, 614 (Tex. 1996). The parties must be aware of the harm of the wrongful conduct at the beginning of the wrongful combination or agreement. See id.; Triplex Communications, 900 S.W.2d at 719.

421 See Triplex Communications, 900 S.W.2d at 720 ("The 'gist of a civil conspiracy' is the injury that is intended to be caused."); see also Schlumberger, 435 S.W.2d at 856-58 (reversing court of appeal's finding of conspiracy because there was no evidence of alleged conspirator's "intention to injure"); Traweek v. Larkin, 708 S.W.2d 942, 946 (Tex. App.—Tyler 1986, writ ref'd n.r.e.); Hicks, 564 S.W.2d at 795 (finding no evidence to support the jury's finding of civil conspiracy where there was no evidence, inter alia, of intent to harm).

422 See Massey v. Armco Steel Co., 652 S.W.2d 932, 934 (Tex. 1983); Times Herald Printing Co. v. A.H Belo Corp., 820 S.W.2d 206, 216 (Tex. App.—Houston [14th Dist.] 1991, no writ); Echols, 529 S.W.2d at 844.

423 See, e.g., Ward, 804 S.W.2d at 933; Echols, 529 S.W.2d at 846.

424 See Akin v. Dahl, 661 S.W.2d 917, 921 (Tex. 1983); Berry v. Golden Light Coffee Co., 160 Tex. 128, 327 S.W.2d 436, 438 (1959); Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 474 (Tex. App.—Houston [1st Dist.] 1985, no writ). Furthermore, upon entering the conspiracy one becomes a party to all acts previously or subsequently done by any of the other conspirators in pursuance of the conspiracy. See State v. Standard Oil Co., 130 Tex. 313, 107 S.W.2d 550, 560 (1937); Bourland v. State, 528 S.W.2d 350, 354 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

425 See Akin, 661 S.W.2d at 921; Berry, 327 S.W.2d at 438; Likover, 696 S.W.2d at 474.


E. Pre-Suit Rescission Offers

Unlike the Texas Deceptive Trade Practices Act\footnote{See TEX. BUS. & COM. CODE ANN. § 17.505(a) (Vernon Supp. 1998).} and article 21.21 of the Texas Insurance Code,\footnote{TEX. INS. CODE ANN. art. 21.21, § 16(e) (Vernon Supp. 1998).} a plaintiff seeking to sue for damages or rescission under the Texas Securities Act is not required to afford the defendant the opportunity to make good on the plaintiff's economic damages or rescind the subject transaction before the plaintiff files suit.\footnote{The original version of section 33 did mandate a pre-suit demand: Every sale or contract of sale of any security made in violation of any provision of this Act shall be voidable at the election of the purchaser, who shall be entitled to recover from the seller in an action at law, upon tender to the seller of the security sold, in proper form for transfer, together with the amount of all dividends, interest, and other income and distributions received by the purchaser from or upon such secu-}
However, if a TSA plaintiff does notify an intended defendant of her claims or if an intended defendant becomes aware by other means of the plaintiff’s (more likely, a class of plaintiffs’) grievances, in response to which the defendant makes a qualifying rescission offer under either section 33J (“Requirements of a Rescission Offer to Buyers”) or section 33J (“Requirements of a Rescission Offer to Sellers”), the plaintiff may not sue for the violation which is the subject of the rescission offer unless: (1) she accepts the offer on its terms, but does not receive the consideration promised by the offer; or (2) she rejects the offer in writing within thirty days of its receipt and expressly reserves in the rejection her right to sue.432

The formal requisites of a rescission offer to a buyer or to a seller are set forth in detail in sections 33J and 33J, respectively.433 There is, to date, no published decision of any Texas court—state or federal—which specifically addresses either the validity of a rescission offer made pursuant to either section 33J or 33J, or the consequences, under the current version of

---

433See TEX. REV. CIV. STAT. ANN. art. 581-33J, J.
the TSA, of a defendant's failure to make a rescission offer or a plaintiff's failure to accept one. 434

V. MISCELLANEA

A. A Note About Suing Foreign Issuers and Dealers

The TSA requires any foreign issuer of securities intending to transact business in the state of Texas to consent to service of process via the Securities Commissioner "in any action or proceedings against such issuer arising out of any transaction subject to" the TSA. 435 The TSA further requires that:

Every company organized under the laws of any other state or of any foreign country, or having its principal office therein, and every non-resident individual, shall file with its or his application for registration as a dealer an irrevocable written consent that actions growing out of any transaction subject to this Act may be commenced against the applicant in the proper court of any county of this state in which the cause of action may arise, or in which the plaintiff may reside, by a service of process upon the Commissioner as the applicant's agent. The consent shall stipulate and agree that such service of process shall be taken and held in all courts to be as valid and binding as if due service had been made upon the person or company it-

434 In Prokop v. Kronek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), the court of civil appeals addressed whether or not a buyer's tender of certain shares permitted the buyer to sue for rescission of the sale of other shares issued by the defendant's predecessor-in-interest. The tender in Prokop was not made in connection with a valid rescission offer under Article 581-33(I), nor did it give rise to a valid rescission offer by the issuer of the securities. Moreover, Prokop was decided under the earlier version of Article 581-33 restated in supra note 430. See id. at 267 n.1 (quoting Acts 1957, 55th Leg., p. 344, ch. 170, § 1, amended by Acts 1963, 58th Leg., p. 473, ch. 170, § 12 (current version at TEX. REV. CIV. STAT. ANN. art. 581-33). As such, it provides no instruction. Indeed, the only readily-accessible published source discussing rescission offers under the current version of section 33 is Michelle Rowe, Rescission Offers Under Federal and State Securities Law, 12 J. CORP. L. 383 (1987), which provides a well-written, if somewhat dated, discussion of federal and state law regarding the timing, consideration, disclosure, and procedural aspects of rescission offers and their effect on the parties' relative positions in subsequent litigation.

self according to the laws of this or any other state or foreign country.\textsuperscript{435}

These provisions augment, rather than supplant, the general rules regarding service of process on and personal jurisdiction over a foreign defendant,\textsuperscript{437} to the extent that at least one court of appeals has concluded that “the Texas Securities Act applies if any act in the selling process of securities covered by the Act occurs in Texas.”\textsuperscript{438}

B. A Note About Removal and Jurisdiction

When a plaintiff brings both state claims and federal claims under the 1933 Securities Act in Texas state court, a defendant will have no right to remove the action to federal court.\textsuperscript{439} Claims under section 10(b) of the 1934 Securities Exchange Act, on the other hand, are subject to exclusive federal jurisdiction.\textsuperscript{440}

VI. CONCLUSION

Texas law provides a variety of common law and statutory remedies for persons who have been injured by a material misrepresentation or omission in the context of an offer to sell or buy securities or a sale or purchase of securities. Each of the theories of “primary” securities fraud liability discussed in this Article—namely, (1) common law fraud, (2) common law negligent misrepresentation, (3) violation of section 33A(2), 33B, or 33C of the Texas Securities Act, and (4) violation of section 27.01 of the Texas Business and Commerce Code—has advantages and disadvantages when compared one to another. As an initial matter, the limitations periods for fraud and under section 27.01 is four years,\textsuperscript{441} compared to two years for negligent misrepresentation\textsuperscript{442}—all of which are subject to equitable tolling by operation of the discovery rule or as a consequence of the defendant’s

\textsuperscript{435}See id. art. 581-16.

\textsuperscript{437}Section 27.01 lacks any such jurisdiction-enhancing provisions. Therefore, a section 27.01 plaintiff must still serve process and establish jurisdiction the “old-fashioned” way. See, e.g., Read v. Cary, 615 S.W.2d 296, 298 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.).

\textsuperscript{438}Rio Grande Oil Co. v. State, 539 S.W.2d 917, 921-22 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.). The purchaser need not reside in Texas. See id.


\textsuperscript{440}See id. § 78aa.

\textsuperscript{441}See supra notes 121 and 302.

\textsuperscript{442}See supra note 122.
fraudulent concealment of the plaintiff’s claim.\textsuperscript{443} Claims under the TSA, on the other hand, must be brought within three years of discovery, but in any event no more than five years from the date of sale or purchase.\textsuperscript{444}

And that is just the beginning. Plaintiffs alleging fraud or a violation of section 27.01 may recover exemplary damages unavailable to plaintiffs suing for negligent misrepresentation or under the TSA.\textsuperscript{445} On the other hand, plaintiffs suing under the TSA need not prove that they relied on the defendant’s misrepresentation or omission in order to have the purchase rescinded or to recover damages as permitted by article 581-33, whereas plaintiffs suing for fraud, negligent misrepresentation, or under section 27.01 must establish reliance.\textsuperscript{446} Likewise, plaintiffs suing under the TSA, as well as those suing for negligent misrepresentation or under section 27.01, need not prove the defendant’s knowledge or state of mind at the time of the transaction, whereas a plaintiff suing for fraud must prove that the defendant acted with requisite scienter.\textsuperscript{447}

Successful plaintiffs suing under section 27.01 are statutorily entitled to recover certain costs of suit, including their expert witness’ fees, and their reasonable attorneys’ fees,\textsuperscript{448} whereas successful TSA plaintiffs are only entitled to recover costs, with the recovery of their attorneys’ fees left to the court’s discretion.\textsuperscript{449} Plaintiffs suing for fraud or negligent misrepresentation, by comparison, are generally not entitled to recover attorneys’ fees or costs, although an award of exemplary damages to a successful fraud plaintiff may take into account her attorneys’ fees and costs.\textsuperscript{450}

Each of the theories of “secondary” securities fraud liability discussed in this Article—namely, (1) controlling person liability under section 33F(1) of the TSA, (2) aider and abettor liability under section 33F(2) of the TSA, (3) statutory liability under section 27.01(d) of the Texas Business and Commerce Code, (4) common law agency or respondeat superior, and (5) common law conspiracy—also has advantages and disadvantages when compared one to another. For example, neither control person li-

\textsuperscript{443} See supra notes 303-305; supra part IV.C.2.
\textsuperscript{444} See supra notes 219-220; supra part IV.B.1.b.ii.
\textsuperscript{445} See supra notes 231-233 and accompanying text; supra part IV.B.1.c.ii.
\textsuperscript{446} See supra notes 205-209 and accompanying text.
\textsuperscript{447} See supra notes 210-213 and accompanying text.
\textsuperscript{448} See supra note 319 and accompanying text; TEX. BUS. & COM. CODE ANN. § 27.01(a) (Vernon 1987).
\textsuperscript{449} See supra notes 235-236 and accompanying text; supra part IV.B.1.c.iv.
\textsuperscript{450} See supra notes 193-194 and accompanying text; supra part IV.A.4.e.
ability nor respondeat superior requires scienter, whereas aider and abettor liability, section 27.01(d), and conspiracy require knowledge, or at a minimum reckless disregard. On the other hand, anyone may be subject to liability as an aider and abettor, as a "person with knowledge" under section 27.01(d), or as a co-conspirator, whereas control person liability, agency, and respondeat superior are, by their nature, limited to particular classes of persons or entities, based on their relation to the "primary" violator or to the "primary" violation. And, a plaintiff satisfying section 27.01(d) is, without any further showing, entitled to recover exemplary damages, attorneys' and expert witness' fees, and costs, whereas sections 33F(1) and 33F(2) offer plaintiffs no opportunity to recover exemplary damages or experts' fees, and leave the question of attorneys' fees to the trial court's discretion. Exemplary damages may be recovered by a plaintiff who successfully proves agency, respondeat superior, or conspiracy, but only after showing a requisite mental state.

A plaintiff may pursue any or all of the foregoing state-law remedies in addition to, or in lieu of, the remedies afforded by federal securities law—most notably, the Securities Act of 1933, the Securities Exchange Act of 1934, and the various regulations promulgated by the federal Securities and Exchange Commission pursuant to those Acts. The questions are: would she want to and, more to the point, should she want to? When compared to the avenues opened to securities fraud plaintiffs by federal law, Texas law seems to be more generous—particularly in light of the recent actions of Congress and the Supreme Court discussed at the beginning of this Article.

At the outset, Texas common law, the TSA, and section 27.01 of the Texas Business and Commerce Code, all afford plaintiffs longer limitations periods within which to discover and assert their claims than those provided by federal law. Moreover, the TSA and section 27.01 impose less stringent pleading and proof requirements than their federal counterparts, and plaintiffs suing for common law fraud or under section 27.01

451 See supra note 392 and accompanying text.
452 See supra notes 350, 369-371, and 421 and accompanying text, respectively.
453 See supra note 372 and accompanying text; supra part IV.D.3.b.
454 See supra notes 345-349 and 364-368 and accompanying text; supra part IV.D.1.c., 2.c.
455 See generally supra notes 180-184; supra part IV.A.4.b.
456 See supra notes 121-122, 219-220, and 302, respectively; supra part IV.A.3.a., B.1.b.ii., C.2.
457 See supra notes 205-215 and accompanying text.
have the opportunity to pursue exemplary damages,\textsuperscript{458} which are unavailable under Rule 10b-5, the 1933 Securities Act, or the 1934 Securities Exchange Act.\textsuperscript{459} And, in the aftermath of \textit{Central Bank of Denver},\textsuperscript{460} the only theory of secondary liability that clearly remains viable under federal law is control person liability (available under both the 1933 and 1934 Acts). Aiding and abetting liability is clearly no longer an option for a federal plaintiff,\textsuperscript{461} and it appears that federal courts \textit{will} no longer recognize conspiracy,\textsuperscript{462} and \textit{may} no longer recognize respondeat superior,\textsuperscript{463} claims pleaded in an effort to expand the net of liability to ensnare not only the person or entity who actually made the material misrepresentation or omission, but also those who knew or should have known of the misrepresentation or omission and should have acted to prevent it or to remedy it without the necessity of the plaintiff filing suit.

Finally, and not to be overlooked, the TSA also creates liability for those who offer or sell unregistered securities that are not exempt from the Act’s registration provisions.\textsuperscript{464} In so doing, TSA provides Texas plaintiffs with an option to suing under section 12(1) of the 1933 Securities Act. Moreover, for those plaintiffs who did not purchase their unregistered securities from or in response to an offer made by “any means or instruments of transportation or communication in interstate commerce or of the mails,”\textsuperscript{465} section 33A(1) of the TSA offers plaintiffs an opportunity for relief that is not available under federal law.\textsuperscript{466}

\textsuperscript{458}See supra notes 180-184 and 315-316 and accompanying text; supra part IV.A.4.b., c.3.

\textsuperscript{459}See supra note 232; supra part IV.B.1.c.ii.

\textsuperscript{460}See supra part II.A.

\textsuperscript{461}See id.; supra notes 351-352 and accompanying text; supra part IV.D.2.

\textsuperscript{462}See supra note 428.

\textsuperscript{463}See supra note 373.

\textsuperscript{464}See supra part III.

\textsuperscript{465}See supra note 41; 15 U.S.C. § 77e.

\textsuperscript{466}Cf. Ayers v. Wolfinbarger, 491 F.2d 8, 16 (5th Cir. 1974) (holding that sales of stock in an Alabama financial corporation to Alabama residents did not require registration under section 5 of the 1933 Act, 15 U.S.C.A. § 77e, and therefore could not give rise to liability under section 12(1), id. § 77l(a)(1), where the defendant used no means of interstate commerce to sell the stock).