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SMU Law Review

Volume 32 | Issue 4 Article 1

January 1978

Civil Liability under Texas Securities Act 33 (1977) and Related Claims - Installment 1 - Introduction: Registration and Related Violations

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CIVIL LIABILITY UNDER TEXAS SECURITIES ACT § 33 (1977) AND RELATED CLAIMS*

INSTALLMENT 1—INTRODUCTION; REGISTRATION AND RELATED VIOLATIONS

by

*Alan R. Bromberg***

CONTENTS

 This Article speaks as of July 1, 1978. It includes, with varying degrees of modification, parts of the Comment—1977 Amendment, by the Committee on Securities and Investment Banking of the State Bar of Texas, in TEX. REV. CIV. STAT. ANN. art. 581-33, comment (Vernon Supp. 1978), copyright 1978 by West Publishing Co.; they are used here by permission of the copyright holder.

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ABBREVIATIONS. The abbreviations used in this Article are:

Board: Texas State Securities Board, created by TSA § 2.

BROMBERG: A. BROMBERG, SECURITIES LAW: FRAUD (4 vols. 1977, orig. pub. 1967).

Commissioner: Texas Securities Commissioner; see TSA §§ 2C, 3. I sometimes refer to a position or interpretation of the Commissioner which might more accurately be that of his staff.

Draft: State Bar Committee Drafts of TSA § 33. The drafts are dated as follows, and are collected in the volume Texas Securities Act § 33 (1977), Civil Liabilities, Pre-Legislative and Legislative History (unpublished; in Underwood Law Library, Southern Methodist University):

Draft 1—Jan. 27, 1976
Draft 2—Feb. 23, 1976
Draft 3—Feb. 27, 1976
Draft 4—May 5, 1976
Draft 5—July 7, 1976
Draft 6—July 22, 1976
Draft 7—Sept. 10, 1976
Draft 8—Sept. 18, 1976
Draft 9—Oct. 10, 1976
Draft 10—Oct. 19, 1976
Draft 11—Oct. 27, 1976
Draft 12—Nov. 21, 1976 (final—as enacted).

Loss: L. LOSS, SECURITIES REGULATION (3 vols. 2d ed. 1961, 3 vols. supp. 1969).

1933 Act: see SA.

1934 Act: see SEA.

Part: Part or subpart of this Article, such as Part 5, Part 5.5 or Part 5.5.5.

SA or 1933 Act: Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976).

SEA or 1934 Act: Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976).

Sec. or §: section or subsection of TSA; thus § 33 is TEX. REV. CIV. STAT. ANN. art. 581-33 (Vernon Supp. 1978); § 33A is *id.* art. 581-33A.

SOWARDS & HIRSCH: H. SOWARDS & N. HIRSCH, BUSINESS ORGANIZATIONS—BLUE SKY REGULATION (2 vols. 1977). These are Vol. 11C (Parts 1 and 2) of Z. CAVITCH, BUSINESS ORGANIZATIONS.

State Bar Committee: State Bar of Texas Committee on Securities and Investment Banking. The members during 1975-76 and 1976-77, when the new § 33 was drafted, were: Larry L. Schoenbrun, Chairman, George Slover, Jr., Vice Chairman, Frank Arnold, Michael B. Baker, Hal M. Bateman, Robert L. Blumenthal, Raymond L. Britton, Alan R. Bromberg, Fred W. Burnett, Jr., W. Amon Burton, Jr., C. Robert Butterfield, Robert B. Davis, John E. Dees, Jr., Roderick T. Edens, Jr., Dan A. Fleckman, Joe Ford, Campbell A. Griffin, Jr., S. Tevis Grinstead, Dewuse Guyton, Jr., Richard D. Haynes, Richard M. Hewitt, Thad T. Hutcheson, Jr., Harold F. Kleinman, Ford Lacy, Richard D. Latham, Leon Lebowitz, Michael F. Linz, Robert M. Lofley, Julian M. Meer, Lawrence R. Mehl, Roy W. Mouer, Perry M. Reaves, Sam Rosen, Louis O. Satterfield, Jr., Sander W. Shapiro, David Short, Lawrence Steinberg, Charles H. Still, Wallace M. Swanson, Rice M. Tilley, Jr., Jim A. Watson, Robert F. Watson, Jerry L. Wickliffe, Howard Wolf, Fletcher Yarbrough, Jr., Barney T. Young.

TSA: Texas Securities Act, TEX. REV. CIV. STAT. ANN. arts. 581-1 to -39 (Vernon 1964 & Supp. 1978). TSA also refers to the several predecessors of the present Act, including those cited in notes 14-15 *infra*. Dates are used when necessary to avoid ambiguity.

Uniform Act: Uniform Securities Act. The full text appears in 1 BLUE SKY L. REP. (CCH) ¶¶ 4901-53 (1975); VII MARTINDALE-HUBBELL LAW DIRECTORY 4350 (1978); 7A UNIFORM LAWS ANN. 561-707 (Master ed. 1978), and a pamphlet edition published by the National Commissioners on Uniform State Laws. A reasonably accurate and current list of the adopting states appears in CCH, *supra*, § 4901, and the latest pocket supplement to 7A UNIFORM LAWS ANN.

INTRODUCTION

The great bulk of private securities litigation in recent years has been under the implied liability provisions of federal law.[1] With the United States Supreme Court busy repressing that implied liability,[2] it is time for states to rethink the explicit civil liability provisions in their securities laws and for private litigants to look more closely at the explicit liability provisions in both federal and state law.[3]

In 1977 Texas enacted a major revision of its civil liability provisions—those which create private rights to damages or rescission for fraud or regulatory violations in securities transactions. This Article, which will appear in two or more installments, if I ever finish it, concentrates on the new civil liability § 33 and aims to provide (a) an unofficial legislative history[4] of § 33 as it was hammered out in the State Bar Committee, since, as

1. *See* 1 BROMBERG § 2.5(6), at 45.

2. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (affirming buyer-seller requirement for private suits under antifraud SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1977), and denouncing "vexatious" shareholder suits); Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975) (requiring irreparable injury for the issuance of an injunction—in a private suit by a target of an alleged takeover through market purchases—for violation of the 5% ownership disclosure requirements of SEA § 13(d)); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (requiring intent to deceive, manipulate or defraud for a 10b-5 suit); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977) (exchange offeror has no implied cause of action for damages against a rival offeror under SEA § 14(e), the antifraud statute for tender and exchange offers); Santa Fe Indus. Inc. v. Green, 430 U.S. 462 (1977) (no 10b-5 cause of action for full disclosure Delaware short form merger, regardless of the unfairness of the terms of the merger or the absence of a corporate purpose).

3. I am not the first writer to observe that plaintiffs have apparently overlooked the state securities laws. *See* Wolens, *"Hidden Gold" in the Blue Sky Laws*, 20 Sw. L.J. 578 (1966).

4. *Unofficial Legislative History*. This history consists primarily of the changes in the 12 Drafts of the State Bar Committee proposal, and the reasons for them. They will be given at relevant points in this Article. The Bar Committee has long been active in preparing and recommending securities legislation in Texas. In particular, it prepared the 1963 civil liability amendments and was disappointed in the changes made by the Legislature in the Bar draft. It had better luck, or did a more thorough job, on the 1977 civil liability amendments, which were passed without change in the Legislature.

The 1977 revision got its start in 1974 with the appointment of a study committee on civil liabilities. Actual drafting began with the 1975 appointment of a Subcommittee on Civil Liabilities, whose final membership was Sam Rosen (Chairman), Alan R. Bromberg, John E. Dees, Jr., and Robert F. Watson. Others who served on the subcommittee at various points were Raymond Britton, Fletcher L. Yarbrough, S. Tevis Grinstead, and David Short. In time and by that process which seems to assume that law professors have more available time than other persons, I came to be the chief draftsman for the project. For those inter-

usual in Texas (and most other states), the official legislative history consists of only a few dates, names, and votes,[5] (b) an interpretation and analysis of the new provision in conjunction with other parts of TSA which it cross references,[6] and against the background of prior law, (c) practical advice on litigating the new law, and (d) some consideration of possible implied actions and related claims.[7]

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ested in the time required for an undertaking of this sort, my records show 108.5 hours on the committee's activities in 1976 and 41.2 in 1977, almost all spent on § 33.

Others who played a critical role in the work of the subcommittee, though not formally members, were Roy Mouer, then Securities Commissioner, and Frank Arnold, then Staff Legal Officer of the State Securities Board and now Deputy Commissioner. State Securities Board members H. Grogan Lord, David D. Allen, and W. Gene Goodnight reviewed proposals critically, and had significant influence on the final bill (especially Mr. Allen). While the Board, the Commissioner, and the staff do not customarily support securities legislation proposed by others, the political reality is that their opposition will kill it. So proponents must negotiate to obtain their neutrality.

The full State Bar Committee (named in note ** *supra*) had a number of meetings on the Drafts and made the final decisions. Draft 12 received the approval of the State Bar of Texas board of directors and was submitted to the Legislature with the Bar's formal endorsement. While it was a Bar bill, Draft 12 was written in close consultation with two other interested groups, the Securities Industry Association and the Municipal Advisory Council of Texas. Yet another important group was the informal steering committee that planned and handled the liaison with the Legislature: John E. Dees, Jr., Roy Mouer, Sam Rosen, Larry Schoenbrun, Wade Spilman, Mike Willatt, and Alan R. Bromberg.

5. *Official Legislative History.* The State Bar Committee's Draft 12 was introduced in the 65th Legislature as S.B. 469 by Grant Jones of Taylor and referred to the Committee on Economic Development (Tom Creighton, Chairman). After a hearing, the committee reported favorably on March 10, 1977, with two amendments correcting typographical errors, and attached a Fiscal Note of March 3, 1977, from the Legislative Budget Board, anticipating that there would be no fiscal implication or additional costs to the state from the bill if enacted. On April 13, 1977, the bill was taken up by the Senate for consideration on second reading by a vote of 23 to 6; a proposed amendment to § 33A(2) was defeated 12 to 9 [see discussion under § 33A(2) in a later installment]; the rules were suspended by a vote of 26 to 5 and the bill was passed on third reading with 7 nays. TEX. S.J., 65th Legis., Reg. Sess. 811-12 (April 13, 1977). A companion bill was introduced as H.B. 881 by Pike Powers of Beaumont and referred to the Committee on Financial Institutions (Jerry (Nub) Donaldson, Chairman), which held a hearing and then referred it to a subcommittee (Robert Maloney, Chairman). The subcommittee, by a 3-0 vote, reported favorably to the committee on April 13, 1977. The committee, by a 9-0 vote, reported favorably on the same day. On April 20, 1977, the committee, by a 7-0 vote (with 2 absent), reported favorably on S.B. 469 which had by then passed the Senate. The House Study Group Daily Floor Report (May 5, 1977) included a pro and con analysis of the bill. On May 9, 1977, the bill was passed on second reading with 3 recorded nays and 2 abstentions. TEX. H.R.J., 65th Legis., Reg. Sess. 2502 (May 9, 1977). The next day the bill was passed on third reading. *Id.* at 2578 (May 10, 1977). It was approved by the Governor on May 20, 1977, and became effective Aug. 2, 1977.

6. A chronic problem with TSA is the lack of coordination of its sections and phrases, resulting from bad drafting and repeated piecemeal amendments. Large parts of the present law originated in 1935 Tex. Gen. Laws, ch. 100, at 255, but there have been amendments or formal (but only partially revised) reenactments by more than a dozen legislatures since then, affecting at one time or another, most of the individual sections. The Texas Supreme Court, in a nice understatement, observed that "[t]he Act, considered as a whole, is something less than a model of lucidity in legislative drafting." Flowers v. Dempsey-Tegeler & Co., 472 S.W.2d 112, 114 (Tex. 1971). For a futile effort to get a coherent (and different) statute, see Bromberg, *The Proposed Texas Uniform Securities Act*, 31 TEX. B.J. 1030 (1968).

7. Implied actions and related claims—under federal, Texas, or other state law—may add to plaintiff's arsenal. Also they may illuminate the scope and interpretation of the explicit Texas claims.

Combining claims. Claims under TSA and other Texas statutory and common law can, of

I may seem to speak with several voices in this Article, but I shall try to distinguish them. When I present the State Bar Committee's official position, I will so identify it. When I present my impression or recollection of the committee's sense, I will so identify that. When I present my understanding of the Commissioner's or staff's position, I will so identify that. In all other situations, I speak only for myself, although as one intimately involved in the writing of § 33.

Civil liability has not been a significant feature of state securities law.[8] The traditional state concern in this area has been with government regulation—by licensing, permits, or registration—rather than with private remedies. Kansas, generally regarded as the originator of blue sky law with its 1911 act,[9] did not prescribe civil liability until 1929.[10] California, which probably has the most comprehensive state securities law today, began its blue sky law in 1913,[11] and added civil liability four years later in the form of a declaration that securities sold without the required permit were void.[12] Texas' first securities law,[13] adopted in 1913, had a rudimentary civil liability provision in the form of a suit on a surety bond that a seller of securities was required to file with the Secretary of State as a condition to receiving a permit for the sale.[14] This civil liability provision was

course, be brought together in a Texas court. Federal 1933 Act claims can also be brought in state courts. 1933 Act § 22(a). Claims under the securities laws of another state, such as the Uniform Act, may also be brought in Texas courts in appropriate instances. However, federal 1934 Act claims (including those under the general antifraud provision, SEC 1934 Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1977)) can be brought only in federal courts, 1934 Act § 27, although they may be entertained as defenses in state courts. *See, e.g.*, Southern Brokerage Co. v. Cannarsa, 405 S.W.2d 457 (Tex. Civ. App.—Texarkana 1966, writ ref'd n.r.e.), *cert. denied*, 386 U.S. 1004 (1967).

If plaintiff prefers federal court, because of 1934 Act claims, or broader discovery or class action rules, or other reasons, he can bring his federal securities law claims there under federal question jurisdiction, without regard to amount in controversy. And he can usually combine his state claims growing out of the same conduct, by the doctrine of pendent jurisdiction. *See, e.g.*, UMW v. Gibbs, 383 U.S. 715 (1966); Hurn v. Oursler, 289 U.S. 238 (1933).

8. As a rough indication, SOWARDS & HIRSCH, the only comprehensive treatise on state securities law, devotes only 75 of its 1100-plus text pages to fraud litigation and 42 pages to other private litigation.

9. 1911 Kan. Sess. Laws, ch. 133. For historical sketches of blue sky law, see L. LOSS & E. COWETT, BLUE SKY LAW 1-17 (1958); SOWARDS & HIRSCH § 1.01.

10. 1929 Kan. Sess. Laws, ch. 140, § 17.

11. 1913 Cal. Stats., ch. 353.

12. 1917 Cal. Stats., ch. 352, § 26100. For the interpretation and application of this language, see H. MARSH & R. VOLK, PRACTICE UNDER THE CALIFORNIA CORPORATE SECURITIES LAW OF 1968, at 15-18 (1969).

13. More general histories of Texas securities law appear in Cox, *The Securities Act*, 2 TEX. REV. CIV. STAT. ANN. XIII (Vernon 1953), and Meer, *The Texas Securities Act—1957 Model: Facelift or Forward Look?*, 36 TEXAS L. REV. 429, 436 (1958).

14. 1913 Tex. Gen. Laws, 33d Legis., 1st Called Sess., ch. 32, § 6, at 68-69. The surety bond was in the amount of 10% of the proposed sale, with a $1,000 minimum and $100,000 maximum. The suit authorized was only for misrepresentation of a material fact concerning the stock. An example of a suit on this kind of bond is American Sur. Co. v. Thompson, 38 S.W.2d 576 (Tex. Comm'n App. 1931, holding approved), *rev'g* 23 S.W.2d 820 (Tex. Civ. App.—Texarkana 1930). While there were provisions for replenishing the bond if it was exhausted, they look unworkable.

The main investor-protection feature of the law, beside the required filing with the Texas Secretary of State and his finding "that the sale of stock will be fairly and honestly con-

dropped from the 1923 Act[15] and the 1935 Act,[16] but the omission did not prevent the courts from creating implied civil liabilities by holding that contracts in violation of the acts were void and, therefore, as a matter of public policy, unenforceable[17] or rescindable.[18]

Texas' first general civil liability statute came in 1941, specifying that sales in violation of TSA were voidable at the buyer's election.[19] The 1941 law is quoted in Appendix 3 below. The state's next civil liability provision was enacted in 1963, and was broader in some respects, narrower in others, and considerably more detailed.[20] The 1963 statute is quoted in Appendix 2 below. The more elaborate 1977 provision,[21]—§ 33—is quoted in Appendix 1 below and is the central subject of this Article. Section 33 is also the organizational framework of the Article, which is structured as analyses of the successive subsections of § 33.

The purposes of TSA civil liability have not been articulated by the Texas legislature or courts. But it seems clear that the purposes are (a) to indemnify investors victimized by violations of TSA, (b) correlatively, to deprive violators of proceeds from transactions in violation of TSA, (c) to encourage compliance with the regulatory and disclosure provisions or, correlatively, to deter violations, and (d) to create incentives for private

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ducted, both to the corporation and to the public" was that sales commissions and expenses not exceed 15%. 1913 Tex. Gen. Laws, 33d Legis., 1st Called Sess., ch. 32, § 4, at 68. The quoted language, as well as the expense limit, suggests that the law was aimed primarily at rapacious salesmen rather than rapacious issuers. In any event, this is the first and last time that fairness to the corporation has been a criterion for issuing a securities permit. The expense limit evolved into § 9B, considered in Part 5.3 below.

15. 1923 Tex. Gen. Laws, 38th Legis., 2d Called Sess., ch. 52, at 114-20. A surety bond was required, but for the limited purpose of assuring that the issuer received the proceeds of securities sold. *Id.* ch. 52, § 6.

16. 1935 Tex. Gen. Laws, ch. 100, at 255.

17. Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940) (unregistered plaintiff not entitled to commission for selling oil leases for defendant):

> The statute is strictly penal in nature, and was enacted to protect the interests of the public. While the law does not specifically provide that a contract made in violation of this Act shall be void, yet, when the Act as a whole is read, and the purposes for which it was passed are considered, we think the very letter and spirit of the law is to absolutely prohibit sales of securities not made under the terms of this law . . . . The conclusion is inescapable that a contract made in violation of its terms is not enforcible. Any other construction would nullify the very purpose for which it was enacted.

143 S.W.2d at 200. This principle is codified in § 33K.

18. Smith v. Fishback, 123 S.W.2d 771, 779-80 (Tex. Civ. App.—Texarkana 1938, writ ref'd) (transferors of royalty to trustee for royalty pool corporation to be formed, who were to receive stock of the corporation in exchange, were entitled to have the transfers and contracts cancelled and the cloud removed from their royalties; neither the stock nor the sellers were registered).

19. 1941 Tex. Gen. Laws, ch. 363, § 1, at 593, apparently codifying and expanding Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940), note 17 *supra*, and Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App.—Texarkana 1938, writ ref'd), note 18 *supra*.

20. 1963 Tex. Gen. Laws, ch. 170, § 12, at 478. The changes made in the prior provision, and the reasons for them, are detailed in TEX. REV. CIV. STAT. ANN. art. 581-33, comment (Vernon 1964). The 1963 provision is treated in Bordwine, *Civil Remedies Under the Texas Securities Laws*, 8 HOUS. L. REV. 657 (1971).

21. 1977 Tex. Gen. Laws, ch. 170, § 1, at 344.

enforcement of TSA.[22]

§ 33—CIVIL LIABILITIES

The full text of § 33 (1977) appears in Appendix 1 below. The text of each subsection appears at the head of the discussion of that subsection in this Article. The 1977 revision, compared to the prior or old (1963) law, made—in a balanced way—a number of badly needed changes in civil liabilities. The most important are these:

Investors are given:

(a) The right to recover when they are defrauded sellers, *e.g.*, in tender offers or going private transactions. § 33B. Prior law gave rights only to defrauded buyers.

(b) Relief from the difficult burden of proving that they could not have known of the untruth or omission (required by prior (1963) § 33A).

(c) The right to recover from persons who control a violator, subject to a defense of reasonable ignorance of the violation. § 33F(1). Prior law imposed liability only on "any person who sells," although this phrase was broadly construed.

(d) The right to recover from an issuer who files a false or omissive prospectus with a registration statement for a sale of already outstanding securities by a security holder. § 33C. Prior law apparently imposed no liability.

(e) The right to recover from those who materially aid in a violation if they act with intent to deceive or with reckless disregard. § 33F(2). Prior law imposed liability only if these are "persons who sell."

(f) The right to recover attorneys' fees, if the court finds it equitable, as well as traditional damages. § 33D(7).

Dealers and other defendants are given:

(a) A due diligence defense that they could not have known of the untruth or omission. §§ 33A(2), 33B. The factors to be considered in deciding whether the defense has been established will be discussed under § 33A(2) in a later installment. Prior law was interpreted to deny such a defense.

(b) The right to cut off potential liability for omission or misrepresentation by making a rescission offer with full § disclosure. §§ 33H(2), 33I. Prior law limited cutoffs to technical violations (failure to register, etc.). However, an investor who rejects in writing a rescission offer has a year in which he can sue.

(c) A final statute of limitations on omission or misrepresentation liability. § 33H(2). Prior law apparently was completely open-ended: the statute of limitations was three years from actual or constructive discovery

22. Purposes (a) and (d) are stated in TEX. REV. CIV. STAT. ANN. art. 581-33, comment (Vernon 1964), and in House Study Group Report, note 5 *supra*. At least the latter carries some expression of legislative intent.

of the violation by the plaintiff. This created many problems of stale testimony, lost records, and uncertainty about contingent liabilities. The period for which an investor can speculate on the market at the expense of a violator is reduced to a somewhat reasonable length.

(d) Greater clarity on measure of damages or rescission, and the requirements of a rescission offer. §§ 33D, 33I, 33J.

Overall, investors will have substantial net gains from the new law.

The table below compares the new and old versions of § 33 and briefly indicates the nature of the changes and additions. The text that follows gives more details.

Comparison of New and Old § 33 by Subsection

New (1977)	Old (1963)	Notes on New
§ 33A(1)	§ 33A(1)	No substantive change
§ 33A(2)	§ 33A(2)	Substantive changes
§ 33B	———	New
§ 33C	———	New
§ 33D	§ 33A	Expands and clarifies
§ 33E	———	New
§ 33F	———	New
§ 33G	§ 33B	No change
§ 33H	§ 33C	Substantive changes
§§ 33I-J	§ 33C	Expands and clarifies
§ 33K	§ 33D	No change
§ 33L	§ 33E	No substantive change
§ 33M	§ 33F	No substantive change

§ 33A(1)—Liability of Sellers—Registration and Related Violations

1. *Text, Derivation, and Evolution.* New § 33A(1) reads:

> A. *Liability of Sellers.*
>
> (1) *Registration and Related Violations.* 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.

It is taken without substantive change from the 1963 § 33A(1).[23]

Formal changes were made in § 33A(1) in 1977 when it was made an independent sentence and separated from § 33A(2) to simplify the syntax and highlight the substance. The relief available for both §§ 33A(1) and 33A(2) was moved to § 33D and modified in certain respects which will be discussed under § 33D in a later installment. Apart from these modifica-

23. See note 20 *supra* for history, Appendix 2 below for text.

tions in form, there was no change in § 33A(1) throughout the deliberations of the Bar Committee, except to alter the caption from "technical violations" to "registration and related violations" in order to allay concerns that the former phrase might give defendants advantages by arguing that the charge against them was "only a technical violation."[24]

Both the 1977 and 1963 versions of § 33A(1) derived from Uniform Securities Act § 410(a)(1), which drew from SA § 12(1). Since both those acts are structured quite differently from TSA, the cross references in § 33A(1) have effects that are strikingly different in some respects from those in other acts, as we shall see in the detailed treatment below.

2. *Plaintiffs.*

2.1 *Buyers.* Only buyers of securities can sue under § 33A(1) [or § 33A(2)]. A plaintiff must plead and prove he belongs to that category. "Buyer" is not a defined term in TSA, although a definition can be inferred from the first sentence of the definition of "sale" in § 4E: a buyer is one who acquires a security for value.[25] Who is a buyer will be obvious in most situations, but in a few instances may have to be determined by looking at the economic realities of the transaction, *i.e.*, who acquires the security and gives the value. The person who is a buyer and seller in the same transaction, giving up security *X* in exchange for security *Y*, can sue as a buyer of security *Y* if there has been a violation as to that security.[26] The result should be the same if the exchange takes place in a merger, even though the merger is exempt from registration by § 5G.[27]

2.2 *Sellers?* Sellers can sue for fraud under § 33B. But they cannot sue for anything under § 33A(1); this section is explicitly limited to buyer plaintiffs. Do sellers have implied rights to sue on the kinds of violations for which § 33A(1) gives rights to buyers? Part of the negative answer is that most of the sections cross referenced in § 33A(1) regulate only sellers (and therefore could give rights only to buyers), *e.g.*, § 7 registration of securities, § 9 escrow, expense limit, and prospectus requirements, and § 23A stop-sale orders. A possible exception[28] is § 12, which requires

24. This concern was expressed by then Commissioner-Designate Richard Latham (now Commissioner), and the change was made in Draft 12 after "Technical Violation" was used in Drafts 5-11.

25. Whether § 33B, where buyers are defendants, calls for a broader meaning of buyer, paralleling the broader meaning of seller which can be derived from the later sentences of § 4E (see Parts 3.1-3.2 below), will be discussed under § 33B.

26. *Cf.* Smith v. Fishback, 123 S.W.2d 711, 777 (Tex. Civ. App.—Texarkana 1938, writ ref'd) (oil royalty owners exchanging their royalties for unregistered corporate stock sold by unregistered persons were buyers of stock, and could rescind under prior law which had no explicit civil liability). § 4E, 2d sentence, specifies that a security issued in exchange for value is sold.

27. *See* SEC v. National Sec., Inc., 393 U.S. 453, 464-69 (1969) (merger involves purchase-sale for federal antifraud provisions).

28. *Stop-Advertising Orders for Purchases.* Another possible exception is a § 23B stop-advertising order (see Part 5.7.1 below) for a tender offer or other offer to buy. However, it seems quite clear from its historical context and its language, that § 22 (which is linked to § 23B in ways described below) was intended to control only sale advertising. Its original form, 1938 Tex. Gen. Laws, ch. 100, § 23, at 269, clearly dealt only with sales. The 1955 changes, which produced the substance of the present provision, were intended to authorize

dealer and salesman registration. An unregistered dealer or salesman presumably represents as much a threat to a seller as to a buyer. But it is quite doubtful that a seller has an implied action against such an unregistered buyer.[29] Inhibiting factors are the negative legislative intent manifested by giving the right to buyers while saying nothing about sellers, the serious questions whether buying activity is part of "dealing" or makes one a "dealer,"[30] and the long line of cases holding that TSA is intended to

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additional sale advertising in the form of SEC preliminary prospectuses. 1955 Tex. Gen. Laws, ch. 67, § 23, at 338; Tinsley, *Texas Securities Act*, 18 TEX. B.J. 273, 358-59 (1955). Moreover, all this was years before tender offers became popular in the 1960's. Finally, the language of present § 22 confirms that it applies only to sale advertising (*e.g.*, § 22B applies after registration, which is required only for sales; § 22C deals with underwriters (sellers); § 22D covers SEC 1933 Act filings (which are only for sales), the required legend is limited to sales, and noncomplying use is "deemed a sale punishable"; § 23E invokes exemptions (which apply only to sales). It follows that § 22 does not cover purchase advertising. And it follows that § 23B—which has a common origin with § 22 in 1935 Tex. Gen. Laws, ch. 100, §§ 23 (1st para.) and 24 (2d sent.), at 269 and 272, and is tied to § 22 by identical language describing advertising and by the cross references from §§ 22B and 22D to § 23—does not apply to purchase advertising. Indeed, that is plain on the face of § 23B, which prohibits the use of banned advertising "in connection with any sale or offer of sale." Consequently, there can be no valid § 23B stop-advertising order for purchases, and no implied liability based thereon.

The Commissioner probably disagrees with this analysis. The Board's tender offer rules, dealing wholly with purchase offers, threaten noncompliers with action under (in addition to §§ 25, 29, and 32) § 23, which consists of § 23B just analyzed, § 23A which is even more clearly limited to sale offers, and § 23C which is an information-gathering provision, also clearly confined to sale offers. The Commissioner has issued § 23B stop-advertising orders against persons who seemed to be buyers but in fact probably were sellers. Joe D. Russell dba Trans-World Financial Corp., Tex. State Sec. Board Order No. CP-522 (Aug. 29, 1974), *summarized in* TEX. STATE SEC. BOARD, TEX. MONTHLY SEC. BULL. 2 (Aug. 1974); Al Correa dba Trans-World Financial Corp., *id.* No. CP-523. The ads stated "Unlimited Funds Available for qualified borrowers" and seemed to be offers to lend money and buy securities (*i.e.*, borrowers' notes). However, the advertisers were probably loan brokers seeking advance payment placement fees from borrowers and thus selling some sort of security to the borrowers.

29. The argument for the right would be based not only on the § 12 requirement but on the parallel § 29A which prescribes criminal penalties for selling, offering or "deal[ing] in any other manner" in a security without being registered. "Dealing" would have to include buying for this argument to succeed, and it very likely does not. See note 30 *infra*.

30. *Buying as Dealing.* Parts of the definition of "dealer" in § 4C (which is discussed generally in Part 5.5.3 below) might be construed to consist of buying activities: "soliciting . . . orders for, or undertaking to . . . invite offers for, . . . or dealing in any other manner in any security." More likely, these relate only to selling. Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146, 149-50 (1947) (discussed further in note 31 *infra*) gives the latter construction to identical language in the 1935 Act:

> [T]he Securities Act in all of its many sections makes careful and detailed provision for the registration of dealers in securities, that is, persons engaging in the business of selling securities, and for permits for the issuance of securities, that is, securities issued to be sold,—all for the protection of buyers against sellers.

See also Part 3.1.4 below.

Earlier, the Texas Supreme Court had firmly ruled that one engaged in buying (here a buyer's agent) need not be registered: "Had the Legislature intended to require buyers of securities to register, its intention would, or certainly in a penal Act should, have been manifested more clearly than by the use of the word 'dealing' following particular and specific words all relating to selling." Fowler v. Hults, 138 Tex. 636, 161 S.W.2d 478, 482 (1942), discussed further in note 31 *infra*.

The conclusion that "dealer" refers only to selling activities is, then, strengthened by other parts of the definition, which are unmistakably selling terms. Moreover, the point is aca-

protect buyers, but not sellers.[31]

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demic here, since § 12 unambiguously compels only sellers to register. Thus, a buying dealer is not in violation of the registration requirement. Ergo, his seller has no claim for violation.

Whether "dealer" connotes buying may be significant in terms of the Commissioner's authority to regulate purchases by tender offer. *See* Tex. State Sec. Board Rule XV, Tex. Reg. Nos. 065.15.00.100-.700, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,615 (1978). That point I will not debate in this Article.

31. *Buyer Protection Purpose of TSA.* The courts have consistently said that TSA is intended to regulate sellers and protect buyers. Atwood v. State, 135 Tex. Crim. App. 543, 121 S.W.2d 353, 355 (1938); Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197, 199 (1940). The courts soon added the corollary that TSA is not intended to regulate buyers and protect sellers. Fowler v. Hults, 138 Tex. 636, 161 S.W.2d 478, 481-82 (1942) (buyer's agent need not be registered to collect commission from buyer); see further discussions of *Fowler* in note 62 *infra* and note 30 *supra*; this cause of action arose before the 1941 addition of § 33b (now § 34), discussed below. The court wrote:

> All the provisions of the Act above quoted and referred to [corresponding to present §§ 4C, 7, 12, 13B, 23C, 29A, and 29B] relate to sales and sellers of securities and not to purchasers or buyers. Nowhere in the Act is there any language which might be construed as disclosing an intention to require purchasers of securities to register or to prohibit one from buying securities without registering . . . .

161 S.W.2d at 482. This language was quoted with approval in Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735, 738-39 (1943), discussed in note 66 *infra*. The corollary was repeated after the 1941 addition of § 33b (now § 34) to prohibit unregistered persons from collecting commissions on purchases, thus affording a measure of protection to sellers. Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146, 149 (1947). The case held that a plaintiff alleging partnership with a defendant may maintain a suit to establish an interest in assets acquired in defendant's name (including oil and gas leases) without alleging that either of them is registered as a dealer under what are now §§ 12-15. [The relevance of the defendant being a registered dealer is that some sales to a registered dealer are exempt by what is now § 5H and therefore do not require the seller to be registered. *See, e.g.*, Dunnam v. Dillingham, 345 S.W.2d 314, 318-19 (Tex. Civ. App.—Austin 1961, no writ).] The rationale appears to be that, even if the oil and gas interests were securities, there was no allegation that the partnership was selling them, and thus no need for registration. With respect to the 1941 amendment, the court wrote:

> We do not construe this added section to intend, on account of its use of the words 'sale or purchase of securities' and 'securities so sold or purchased', to work changes in the general purpose of the Act and so to amend it as to require the procuring of permits or licenses by those who buy securities and the registration of securities for the protection of sellers against buyers.

199 S.W.2d at 149; *accord*, Fitz-Gerald v. Hull, 150 Tex. 39, 237 S.W.2d 256, 258 (1951) (joint venture).

Later amendments to TSA have given sellers additional specific protections. The 1973 amendment to § 29C outlawed fraud by buyers. 1973 Tex. Gen. Laws, ch. 97, § 2, at 217. The 1977 amendment to § 33B gave civil remedies to defrauded sellers. A discussion of § 33B will appear in a later installment of this Article. § 32, an earlier provision dating from 1935, and authorizing injunction suits by the Commissioner and the Texas Attorney General against violations, might be construed to protect buyers; it thrice uses the phrase "purchase or sale" but in a welter of words aimed primarily at protecting buyers.

These protections of sellers are probably not enough to tip the balance in favor of giving sellers an implied right to sue unregistered dealers and salesmen. *Cf.* Chesnut v. Coastal Oil & Land Corp., 543 S.W.2d 154, 158 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.), citing Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146 (1947), for the proposition that "the 1941 amendments . . . did not change the general purposes of the Act" and refusing to find that Coastal's purchase of an oil and gas lease 1/4 for itself and 3/4 for plaintiffs was a sale by Coastal to plaintiffs. Hence plaintiffs were not entitled to rescind. The transactions were after the 1973 amendment to § 29C, although the court did not consider it.

It is still clear, as noted in *Fowler* and *Herren, supra*, that § 12 mandates registration only for sellers. Moreover, the 1977 amendments to § 33, which for the first time gave express rights to sellers for fraud (§ 33B) did not give them rights for dealer-salesman nonregistra-

There are other possible § 33A(1) situations in which a seller might like to sue. An issuer (seller) is injured if selling expenses are excessive and might want to sue the underwriter or dealer for violation of the maximum expense limits of § 9B, which are referenced in § 33A(1). However, it seems that the limits are imposed only for the protection of buyers. The caption of § 9 so states: "Protection to Purchasers of Securities." Hence, it is doubtful that a legislative intent to protect issuers by the expense limits could be found. Moreover, issuers can normally protect themselves by contracting for limited expenses, although this will not always be true, especially when the issuer is controlled by the underwriter or dealer.

Other situations can be imagined in which one seller's violations could injure another seller, who might therefore want to sue. In all these instances, it seems unlikely that the courts will find implied rights for sellers—other than for fraud—under an act they have consistently construed to protect only buyers.[32]

Sellers who sell to buyers who violate the tender offer rules—assuming the rules are valid[33]—may well be on a different footing. The rules were presumably adopted for the specific protection of sellers (or recipients of the offer to buy), and there are no express liabilities for tender offers from which to draw negative inferences. However appropriate it may be to recognize implied actions to enforce compliance with the tender offer rules, or express or implied actions for fraud, I remain dubious about damages or rescission based solely on a regulatory violation.[34]

3. *Defendants: Persons Who Sell.* Only a "person who offers or sells" can be sued under § 33A(1) [or § 33A(2)]. A plaintiff must plead and prove that a defendant belongs to this category.[35] Correspondingly, a defendant is liable only to "the person buying from him." In many instances,

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tion under (or parallel to) § 33A, even though § 33A was amended in other respects at the same time. This generates a strong negative implication. I feel sure that no one in the State Bar Committee intended to give sellers the right to sue for such nonregistration.

32. Note 31 *supra*.

33. See the end of note 30 *supra*.

34. There is another obstacle to suit for violation of the tender offer rules. In Simmons v. Danco, Inc., 563 S.W.2d 376 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.), the court held that the Securities Commissioner and the State Securities Board have primary jurisdiction over the rules, and that a private plaintiff (here a competing offeror) cannot sue under them without first "presenting" the matter to the Commissioner and the Board. Accordingly, it was error for a district court to grant Danco (a proposed tender offeror for Contran's shares) a temporary injunction restraining Contran and its controlling shareholder from making a counteroffer for Contran's shares in alleged violation of the tender offer rules. Just how a private plaintiff is to make such a presentation, and what rights he would have to enforce the rules after action (or inaction) by the Commissioner or Board is not indicated.

35. *Entities.* Corporations are civilly liable to the same extent as natural persons. There was once law to the contrary. Dempsey-Tegeler & Co. v. Flowers, 465 S.W.2d 208 (Tex. Civ. App.—Beaumont 1971) (interpreting "person" in old § 33A to exclude "corporations"), criticized in Lebowitz, *Corporations, Annual Survey of Texas Law*, 26 Sw. L.J. 86, 112-21 (1972). But it was reversed, 472 S.W.2d 112 (Tex. 1971), and disavowed by a clarifying amendment of "person" in § 4B. 1971 Tex. Gen. Laws, ch. 235, § 1, at 1085. The emergency clause of that enactment referred to the first *Dempsey* case and "the resulting necessity to confirm that the intent of the Legislature was, and is now, that Section 33 and certain other sections of said [Securities] Act should apply to corporation and other entities as well

it will be obvious who the seller is, *e.g.*, the owner, issuer, or promoter in a face-to-face transaction, whether conducted directly or through agents.[36] But great strain is put on the concept by unusual fact patterns where selling activity is divided among several persons, especially if the primary seller (the ex-owner or issuer) has disappeared across the border or into insolvency so that the suit is against someone else. As the following parts indicate, a very broad definition of "person who sells" (or "seller" for short) prevailed in the pre-1977 law, but the changes made in that year call for a narrower view.

3.1 *Pre-1977 Law.*

3.1.1 *The Judicial Metaphorical Approach (Link in the Chain).* The broad interpretation of seller in pre-1977 law rests primarily on the definition of sale in § 4E and on the decisions construing that language. Section 4E devotes more than 200 words to defining offer and sale, itself an

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as to natural persons." *Id.* § 2. However, corporations remain excluded from the criminal provisions of the Act (§ 29) by the last sentence of § 4B.

Other entities such as partnerships, are presumably as liable as corporations. The legislative intent just quoted seems conclusive. To take full advantage of the joint and several liability of general partners for partnership obligations, TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (Tex. UPA) (Vernon 1970), a plaintiff should normally name and serve as defendants the partnership and each of the general partners. *See* TEX. R. CIV. P. 28; TEX. REV. CIV. STAT. ANN. art. 2033 (Vernon 1964); TEX. REV. CIV. STAT. ANN. art. 2223 (Vernon 1971).

A "common law trust" is included in the definition of "person" but for some mysterious reason, a "trust created or appointed under or by virtue of a last will and testament or by a court of law or equity" is not. § 4B, 2d sentence. The latter kind of trust thus seems to be exempt from any § 33 liability, unless the context can be found to indicate otherwise, in accordance with the preamble to § 4. How that might happen is an open question, as is whether the exclusion of the specified trust extends to its trustees and agents.

36. *Agency; Vicarious Sales. See, e.g.*, Smith v. Fishback, 123 S.W.2d 771, 774-75, 777 (Tex. Civ. App.—Texarkana 1938, writ ref'd). David McCutcheon was a seller of the stock of a royalty pool corporation which he promoted and of which he was to receive 25%. The remaining shares were to be issued to royalty owners like plaintiffs who signed pool contracts transferring their royalties to Smith as trustee for the corporation, agreeing to take the stock in exchange. David McCutcheon assisted in securing the signature of one of the royalty owners and her husband to a pool contract. His agents (Cecil McCutcheon and Townsend) approached every royalty owner in the pool, some as many as three times, to persuade them to sign the pool contracts. The royalty owners took no initiative. "[T]he conclusion is inescapable that each of these pool contracts represents a sale by McCutcheon and his agents of stock to" the royalty owners. *Id.* at 777. However, the court apparently concluded that Smith (the trustee) was not a seller. The court refers to him as a "stake-holder" and does not indicate that he engaged in sales activity.

The Comments to Drafts 8-12 (of which the last went to the Legislature) note that § 33F (on liability of control persons and aiders) "does not supersede the common law liability of a principal for an agent's acts within the scope of authority."

If an agent of a corporation or other entity sells within the scope of his authority, the entity sells vicariously. But officers, directors, and shareholders of the entity do not sell vicariously, since they are not the principals of the agent (the entity is). They may be liable as aiders or control persons by § 33F, but they are sellers under § 33A(1) only if they have engaged individually in acts which constitute selling. For an example of controlling shareholders (who were probably also officers and directors) who were enjoined, along with their corporations, from selling without securities and dealer registration, see Enntex Oil & Gas Co. v. State, 560 S.W.2d 494 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.). *See generally* Annot., *What amounts to participation by corporate officer or agent in illegal issuance of security, in order to impose liability upon him under state securities regulations*, 44 A.L.R.3d 588 (1972).

indication of breadth.[37] The most general of the words are "every disposition or attempt to dispose of a security for value" and "any act by which a sale is made."

Decisions on the pre-1977 law gave "sale" and "seller" astoundingly broad meaning, best illustrated by examples. The Texas Supreme Court in *Brown v. Cole*[37A] held that Brown sold securities—promissory notes and stock in a Mexican mining venture owned by Fields—to Gould and Cole by (a) presenting the venture to Gould (who in turn made the proposal known to Cole), (b) furnishing Gould with a memo and prospectus from Fields, including a description of the properties, and a financial statement (which Gould mailed to Cole at the latter's request), (c) obtaining additional information for Gould and Cole, (d) taking Cole's auditor to Mexico for a firsthand investigation at Brown's expense, and (e) receiving checks from Gould and Cole payable to "Brown, Agent," depositing the checks in his account, and transmitting the funds to Fields. A group of about eight investors, including Gould and Cole at $5,000 each, put in $35,000; Brown himself invested on the same terms, and received no commission on anyone else's purchases. For the court, Justice Culver wrote: "[T]he seller may be any link in the chain of the selling process or in the words of the Act he is one who performs 'any act by which a sale is made,' "[38] adding that Brown's efforts "resulted in the participation by" Gould and Cole in the investment.[39]

In *Smith v. Smith*[39A] an even more startling decision, Howard Smith was held to have sold a security—a promissory note of Sandblom or an interest in Sandblom's group supposedly investing in contractors' retainage certificates—to his brother, Allen, by (a) writing Allen (and their three sisters) in "rather persuasive" terms about investments Howard was making in the group and inviting them to consider similar investments, (b) furnishing Allen all the information that Allen got about the investment, although Howard in turn got some of it from Sandblom, (c) receiving Allen's check payable to Howard, depositing it in his account and transmitting the funds to Sandblom, and (d) considering going into the business of selling these investments for a commission. These factors were sufficient to make Howard a seller as a matter of law, even though the jury found that Howard did not offer or sell securities and that Howard was acting solely as agent for

37. *Unitization Agreements.* An important exception to the definition of sale is found in an out of the way place, § 5Q: "No oil, gas or mineral unitization or pooling agreement shall be deemed a sale under this Act."

37A. 155 Tex. 624, 291 S.W.2d 704 (1956).

38. *Id.* at 708, discussed at length in Hill, *Pitfalls in the Texas Securities Act*, 10 Sw. L.J. 265 (1956). Brown's liability to Gould and Cole was based on: (1) sale of an unregistered security, *i.e.*, without a permit (discussed below in Part 5.1) and possibly (2) sale by an unregistered dealer (discussed below in Part 5.5, especially Part 5.5.3 at notes 260-67), and was imposed pursuant to the 1941-1963 civil liability provision (Appendix 3 below) voiding sales in violation of TSA. At the time there was no adequate small offering exemption like today's § 5I which would probably shield Brown from both violations.

39. See further discussion of this causation factor in the text accompanying note 48 *infra*.

39A. 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ).

Allen when he received Allen's $25,000 and transmitted it to Sandblom.[40]

In *Dean v. State*[40A] Gary Dean was deemed a seller to the Henrys of an override contract in the VibroSeat Company, although Ms. Lindsey (who was a cousin to the Henrys and often consulted with them on investments) initially suggested the investment to them, and although the Henrys decided to buy before ever meeting Dean. Dean had no connection with the company except that he owned an override contract himself and supplied mechanical parts for the company. At the request of the company president, Dean closed the deal with the Henrys at a meeting arranged by Ms. Lindsey. At the meeting Dean "disclosed the particulars of" the company to the Henrys, signed an override contract as representative of the company, received the Henrys' check (payable to the company) and handed it to Ms. Lindsey, who delivered the check to the company president. The Henrys testified that they had decided to buy before they met Dean, and that his representations at the meeting were not a procuring cause of their purchase. Nonetheless, Dean was held to be a seller.[41]

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40. *Id.* at 249-50. Howard's liability to Allen was based on two violations: (1) sale of an unregistered security (no exemption is discussed in the opinion; apparently Howard claimed none, perhaps because it was clear that Howard's activities were part of Sandblom's, which were far too public to satisfy the small offering exemption of § 5I, which may then have been in effect, and no other exemption seemed applicable), and (2) sale by an unregistered dealer, discussed in the next paragraph.

Dealer Question. Although the opinion mentions that Howard was not registered as a dealer, 424 S.W.2d at 248, and this was an alternative basis of the suit, *id.* at 245, there is absolutely no discussion of whether he was a dealer. Apparently this is because Howard did not make an issue of the point, but defended primarily or solely on the grounds that he did not sell at all, and that he was acting as agent for Allen (the buyer) and thus not required to be registered. [On the latter principle, see Part 3.1.4 below]. The jury agreed with him on both these assertions, but was overridden by the judgment n.o.v. for Allen, which was affirmed. The only facts noted by the court which could bear on the "dealer" issue are (1) "it has not been established that [Howard] ever discussed the [Sandblom] investment opportunity with prospective investors outside his family or that he ever received any sales commission," 424 S.W.2d at 247, (2) Howard considered "taking over" some of the Sandblom investment accounts (from a Dr. Meadows who acted as intermediary between the investors and Sandblom) receiving 1% higher interest from Sandblom than he (Howard) would pay the investors, opened a bank account for this use and consulted his lawyer about the problems involved, *id.*, (3) Howard (like Allen) "had inherited a sizeable sum and was devoting a great deal of time to investing and reinvesting it," *id.* at 249, and (4) as the older brother, Howard "frequently advised his brother and sisters as to his investment experiences and opportunities," *id.* In the absence of any analysis or even discussion of the "dealer" question, the decision cannot be regarded as a holding that these facts—family information-sharing, personal investing, and consideration of going into Sandblom's financing business—should suffice to make one a "dealer." Moreover, any authority the decision may have on the "dealer" point is further weakened by its failure to specify whether it is based on the 1941-1963 § 33 (Appendix 3 below) or the 1963-1977 § 33 (Appendix 2 below); the former, which declares all sales in violation of the TSA to be voidable may be a bit broader than the latter which (like the 1977 version) specified damages or rescission for sales in violation of § 12. The facts in the case span the Aug. 23, 1963, effective date of the 1963 amendment; the "solicitation" was before, the payment and acknowledgment after. The court never indicates when it thought the sale was made, or which statute applied.

40A. 433 S.W.2d 173 (Tex. Crim. App. 1968).

41. *Id.* at 175-77. The upper court rejected Dean's argument that the trial court erred in refusing to submit to the jury his affirmative defense (raised by the evidence) that he did not make a sale to the Henrys but that someone else did. Dean's conviction for sale without being registered as a dealer (§ 29A) was reversed on other grounds (jury issue as to exemption). Why he was ever prosecuted on the facts is something of a mystery.

In yet another example, a defendant, Mrs. Millar, was found to be a seller even though she did not solicit a sale. As an executive of a dealer, she confirmed sales to the plaintiff, and this was held to be a link in the selling process.[42]

More than one person may be a seller in the same transaction. *X* does not establish that he was not a seller by proving that *Y* was a seller.[43] Where multiple sellers have each violated, it appears that their liability is joint and several, and they have rights of contribution.[44]

Whether a person made a sale may be a jury question, in which case an instruction using the § 4E statutory definition of sale is proper.[45] Since a jury may well be confused, not to say bored, by the redundancies of § 4E, a better instruction could be fashioned by choosing only those elements of § 4E most closely related to the evidence in the case.

More commonly, even in situations which seem doubtful, the courts have used the broad interpretation to find that a defendant was a seller as a matter of law.[46]

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42. Christie v. Brewer, 374 S.W.2d 908, 917 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), sustaining the trial court's refusal to submit a jury issue on whether Mrs. Millar solicited plaintiff. "Mrs. Millar as executive officer of the Christie Company and agent for it confirmed the sales to appellee. This was certainly a link in the selling process. Accordingly, it was immaterial that Mrs. Millar did not solicit the sale. Mrs. Millar participated in a sale that was solicited." *Id.* Accordingly, she would be personally liable, under the 1941-1963 version of civil liability provision (Appendix 3 below) as a seller because the security was unregistered.

43. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 708 (1956); Dean v. State, 433 S.W.2d 173, 176 (Tex. Crim. App. 1968).

44. This is explicit in § 33F, added in 1977, for control persons and aiders. See the discussion of § 33F in a later installment. A fortiori, the same principles apply to multiple sellers.

Joint and several liability of multiple sellers was affirmed without discussion of this point in Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977), *rev'g* 559 S.W.2d 663, 664 (Tex. Civ. App.—Texarkana 1977).

45. Christie v. Brewer, 374 S.W.2d 908, 915-16 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.). The court overruled objections (1) to the special issue whether a defendant made sale, through employees, to plaintiff, as being a question of law, (2) to the definition of sale as being a general charge, duplicitous and multifarious (because of the numerous components of the statutory definition) and (3) to the 9-month time period to which the special issue related.

See Commercial Trading Corp. v. Searsy, 559 S.W.2d 663, 665 (Tex. Civ. App.—Texarkana 1977):

> The appellees (plaintiffs) did not submit a special issue inquiring whether or not the individual appellants [defendants] performed any act by which sales were made or whether they in any way participated in the selling process. The evidence does not establish as a matter of law that the individual appellants formed any such link in the chain of the selling process or performed any acts by which sales were made.

The court went on to assume the defendants were sellers, but held for them on the ground that the commodity options they sold were not securities. The supreme court reversed on the latter point, and affirmed the trial court judgment for plaintiffs without discussing whether defendants were sellers. 560 S.W.2d 637 (Tex. 1977), discussed further in note 46 *infra*.

46. *See* Christie v. Brewer, 374 S.W.2d 908 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), note 42 *supra*, refusing to submit a jury issue on whether Mrs. Millar solicited plaintiff, and Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*, holding Howard to be a seller as a matter of law, despite a jury finding to the con-

Conspicuously missing from the broad metaphorical link-in-the-chain test is a materiality-causation factor. Taken literally, the test would apply to the secretary who types an offer or confirmation and to the postman who delivers it. Obviously, the registration of such persons would do nothing to further the purposes of the securities laws, and it would be folly to treat them as sellers. When faced with such defendants, courts should insert a materiality or causation factor that focuses on whether they are significant elements in effecting the sale.[47] Indeed, this factor is suggested, if not required, by the supreme court's causation language in *Brown v. Cole*: "It is clear that but for Brown's activities and repeated efforts, the respondents [Gould and Cole] would not have participated in the transaction."[48]

Stone v. Enstam[49] is a good example of the needed materiality or causation factor. Another Dean (the president of Worldcom) was held not to be a seller of Enstam's Worldcom stock to Stone who had become interested in buying some of its stock after trying to sell computer services to the company. Dean made various statements to Stone about Worldcom's finances and prospects. Stone asked Dean how he could get some Worldcom stock; Dean said neither he nor Worldcom would sell shares, but Enstam might. Stone made up his mind to buy the stock before meeting Enstam, and discussed only payment terms with him.

A more precise proximate cause test is used under the comparable federal provision for registration and related liability, SA § 12(1). "We hold that the proper test is . . . did the injury to the plaintiff flow directly and

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trary. *See also* Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), refusing a jury issue in a criminal case.

Cf. Commercial Trading Corp. v. Searsy, 559 S.W.2d 663 (Tex. Civ. App.—Texarkana), *rev'd*, 560 S.W.2d 637 (Tex. 1977), note 45 *supra*. The quotation there leaves considerable question whether the individual defendants were sellers even under the broad test. (The intermediate court describes the individual defendants as directors of the corporate seller and assumes arguendo that they should be considered links in the selling chain "because they knew that unregistered commodity options were being sold and their names were being used in advertising literature to induce the sales." 559 S.W.2d at 665. But it held they were not liable because the options were not securities. In reversing the civil appeals court and affirming the trial court judgment (apparently against all defendants, including the individuals, now referred to as "stockholders," 560 S.W.2d at 639), the supreme court deals only with the "security" issue and does not consider whether the individuals were sellers, or by what standard they should be tested (or the effect of the 1963 amendment, see note 109 *infra*). It concludes, however, that "defendants have sold unregistered securities for which plaintiffs are entitled to rescission." 560 S.W.2d at 642.)

47. It seems doubtful that Mrs. Millar was a significant element in the *Christie* case, although we do not have enough facts to be sure. Since solicitation is such an important part of selling, the refusal of a jury submission on this point is dubious. A jury issue should have been submitted on whether she was a seller, as it was on whether the dealer who employed her was.

For the materiality element supplied by the 1977 amendment, see text accompanying note 83 *infra*.

48. 291 S.W.2d at 709. See also text accompanying note 39 *supra*.

49. 541 S.W.2d 473, 479-80, 475-76 (Tex. Civ. App.—Dallas 1976, no writ). The court distinguished Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), *supra* note 38, as involving an active negotiator whose efforts resulted in the sale, adding: "Dean was not acting as an agent of either Stone or Enstam. He only volunteered without benefit to himself to find someone who would sell Worldcom stock to Stone. It is apparent that . . . Dean was not a seller of securities under the Texas Securities Act." 541 S.W.2d at 480.

proximately from the actions of this particular defendant?"[50]

3.1.2 *An Analytical, Functional Approach.* A more systematic approach to the "seller" question is to examine the typical elements of a sale, and use as tests those which have significance to the purpose of the securities laws. Selling usually involves the following elements, whether the transaction takes place in the organized securities market or outside it:

(1) Solicitation
(2) Information transmission } These often overlap.
(3) Negotiation of terms
(4) Collection of purchase price
(5) Delivery of security

Of the five, only solicitation is specifically mentioned in § 4E, although negotiation is hinted at by the "contracts and agreements whereby securities are sold" language in § 4E. Any one of the five may be embraced by the judicial gloss—"any act by which a sale is made,"—which accompanies the metaphorical link-in-the-chain test.[51]

The Texas decisions have not attempted to identify these functional elements, much less to give relative weights to them in deciding a "sale" question, or to say which is or are indispensable. It may be impossible to do so with any precision. But it is possible to make some general weightings. Solicitation is normally the most important of the factors for several reasons: it usually comes first, it is (by hypothesis) directed at producing a purchase result, and it is (particularly as it overlaps information transmission) the phase in which investors are most likely to be injured. These reasons make solicitation—alone, or coupled with information transmission and negotiation—an appropriate trigger for legal responsibility. The Texas cases, as I read them, have implicitly stressed these first three elements: solicitation, information, and negotiation.[52] In addition, solicitation is the only one of the five elements specifically included in § 4E's

50. Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 693 (5th Cir. 1971). For further treatment of the federal law, see 2 BROMBERG §§ 8.5(310)-(319); 3 Loss 1712-20; 6 *id.* 3834-41.

51. *Supra* at note 38.

52. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*; Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*; Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ) (no sale where no solicitation and no negotiation), note 49 *supra*; Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735 (1943), note 66 *infra* (no sale where no negotiation).

Nonsolicitation may be the sounder but unspoken basis for a holding that Coastal did not sell to Chesnut a 3/4 interest in an oil and gas lease. Coastal assigned the 3/4 interest to Chesnut for $8,765 immediately after acquiring the 4/4 interest (from the landowner) in Coastal's name pursuant to a prior agreement with Chesnut that the lease was to be acquired for their joint account (*i.e.*, 3/4 for Chesnut and 1/4 for Coastal). The court's stated rationale is, however, that Chesnut, by the prior agreement, had equitable title to the 3/4 when Coastal procured the lease, so that the assignment from Coastal to Chesnut merely transferred the legal title to its equitable owner, and Chesnut's $8,765 payment was "only a repayment based on the agreement between the parties." Chesnut v. Coastal Oil & Land Corp., 543 S.W.2d 154, 158 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.). It was immaterial that the assignment to Chesnut recited $10 and other good and valuable consideration; this did not necessarily make the transaction a "sale" for TSA purposes. Chesnut

definition of sale, and solicitation is important elsewhere in TSA.[53]

Information transmission and negotiation, so far as they can be separated from solicitation, should be judged by the materiality-causation factor suggested above.[54] Thus, a stockbroker who, at a customer's request, gives the customer a third party writeup on *X* Corp. is not a seller if the customer later buys *X* securities from someone else. A seller's lawyer who negotiates the details—as distinct, perhaps, from the basic transaction or the agreement in principle—of a private placement or other sale agreement is not a seller.

The other two elements, collection and delivery, are considerably less important and perhaps wholly nonessential, although collection by the "seller" occurred in several of the decided cases and was noted by the courts in their review of the relevant facts.[55] Similarly, delivery by the "seller" took place and was mentioned in several cases.[56] Nonetheless, both of these are fairly mechanical or clerical functions. They commonly take place after the buyer has made his investment decision, and often occur after the buyer is contractually bound. For all these reasons, collection and delivery do not seem essential to make a person a seller.[57] If collection and delivery coexist with the other elements, they reinforce the "sale" or "seller" conclusion; but if they are all that a person has done, they are not enough to make him a "seller."

Another element, though not necessarily part of the transactional sequence with the buyer, is almost invariably present in a sale. This is some economic benefit to the "seller" by receipt of proceeds, commission, or something else. While it seems clear from the cases that this is not an indispensable element,[58] it is one that should not be ignored. Absence of

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sought to rescind the assignment from Coastal and to recover the $8,765 it paid for the 1/4 interest.

But see Christie v. Brewer, 374 S.W.2d 908 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), note 42 *supra*, holding Mrs. Millar a seller although she did not solicit, inform, negotiate, or do anything else very significant. I think this is wrong.

53. § 5P exempts from the registration requirements a dealer's execution of an unsolicited purchase order. § 5I conditions the limited, nonpublic offering exemption on the absence of public solicitation. *Semble* § 5Q for oil and gas interests. § 5E exempts offers by an issuer to its existing security holders if no commissions are paid for soliciting.

54. Notes 47-50 *supra* and accompanying text.

55. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*; Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App. — Houston 1968, no writ), note 40 *supra*; Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), note 41 *supra*.

56. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*; Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App. — Houston 1968, no writ), note 40 *supra*; Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), note 41 *supra*. In both *Brown* and *Smith* the "security" that was delivered was not the traditional stock or bond certificate but whatever paper the defendant happened to hand over.

57. "[T]he various activities which the legislature has defined as the making of a sale [are not] dependent upon receipt by the dealer, salesman, or broker of the purchase funds." Brown v. Cole, 276 S.W.2d 369, 379 (Tex. Civ. App.—Dallas 1955), *aff'd without discussion of this point*, 155 Tex. 624, 291 S.W.2d 704 (1956).

58. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*, held uncompensated persons liable. So did Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*. And an uncompensated person was held to be a seller in a criminal case. Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), note 41 *supra*.

economic benefit to a person is an indication, and sometimes an important one, that he is not a seller.[59]

3.1.3 *Additional Requirements.* A § 33A(1) defendant must be not only a "person who offers or sells," but also a violator of one of the provisions listed in § 33A(1). These provisions may have language limiting the class of defendant-violators. Thus, § 7A(1) does not say "No person shall sell" an unregistered security. It says "No dealer, agent or salesman shall sell" such a security.[60] Consequently, a § 33A(1) plaintiff suing on account of an unregistered security must prove that the defendant is a "dealer, agent or salesman" as well as a "person who offers or sells" the security.[61] Similarly, only a "dealer, agent or salesman" can violate a § 23B stop-advertising order or a § 23A stop-sale order, and thus be liable under § 33A(1) for these kinds of misconduct.

3.1.4 *Buyer's Agents or Brokers.* There is authority in earlier cases that an agent or broker for a buyer does not make a sale, is not a seller, and therefore need not be registered.[62] In more recent cases the result is contrary if the agent solicits his principal to buy. One decision

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A possible explanation of these decisions is that the seller in each instance may have been getting some indirect benefit through the receipt of funds by the organization in which he was also an investor. But there was no reported evidence or court discussion on the point.

59. *See* Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ), note 49 *supra* and accompanying text.

60. The language goes back to 1935 Tex. Gen. Laws, ch. 100, § 5, at 261.

61. Stone v. Enstam, 541 S.W.2d 473, 479 (Tex. Civ. App.—Dallas 1976, no writ).

62. The leading case is Fowler v. Hults, 138 Tex. 636, 161 S.W.2d 478 (1942), discussed in note 31 *supra* for the proposition that TSA is not intended to regulate buyers or protect sellers. The court squarely holds that an agent or representative of a buyer need not be registered as a dealer in order to obtain his agreed commission from the buyer. The jury was given the statutory definition of dealer and found that the agent was not a dealer. The high court reasoned that the only part of the definition that might cover buying was the phrase "or dealing in any other manner in . . . securities"; this general phrase following particular phrases that describe only selling must have the same character, by the doctrine ejusdem generis. 161 S.W.2d at 482. While the court was focusing on the dealer definition of what is now § 4C, it noted that essentially the same language appeared in the criminal fraud provision that has become § 29C. § 29C, since 1973, has contained explicit references to purchasing as well as to selling, 1973 Tex. Gen. Laws, ch. 97, § 2, at 217, thus suggesting that "dealing in any other manner" in § 29C includes buying as well as selling. But it seems highly unlikely that a change in the fraud provision changed the meaning of the dealer definition (§ 4C) or the dealer registration requirement (§ 12). Indeed, the very fact that the latter two sections were not altered along with § 29C in 1973 argues strongly that the Legislature intended them to retain their old meaning: sales only.

"The Act . . . does not apply to individuals acting as agents or employees for prospective purchasers." Dunnam v. Dillingham, 345 S.W.2d 314, 318 (Tex. Civ. App.—Austin 1961, no writ) (dictum?).

Whether a person is a buyer's agent (and thus protected) or a seller's agent or acting for himself as principal (and thus not protected) can be a difficult question, usually a question of fact. *See, e.g.*, Mecom v. Hamblen, 155 Tex. 494, 289 S.W.2d 553, 558 (1956) (Plaintiff Hamblen was not defendant's agent in acquiring an oil and gas lease; plaintiff "fixed the terms of the lease according to the requirements of the lessor, and . . . dictated the terms of the assignment [to defendant], showing that he was not acting as [defendant's] agent. He was a broker with this lease for sale.") (This was a "commission" case under what is now § 34, discussed in Part 5.5.5 below.) The burden of proof on agency in a § 33A(1) case seems to be on the buyer-plaintiff, who must show that the defendant is a "person who sells," *i.e.*, that the defendant is not his agent. However, agency for the buyer-plaintiff could be regarded as an affirmative defense, with the burden on the defendant.

holds that defendant's activities interesting his brother in an investment made him a seller as a matter of law, despite jury findings that he did not sell, and that he was acting solely as agent for his brother.[63] The State Bar Committee, in its comments accompanying § 33 to the Legislature, wrote that a "person who offers or sells" includes "a broker for the seller and, if he solicits, a broker for the buyer."[64] So there is some evidence of legislative intent to this effect. Absent solicitation, however, the old view remains valid. Thus, "one who is simply buying or procuring an oil and gas lease for another" is not a seller and "is not required to be registered."[65]

3.1.5 *Finders.* There is some high authority that one who brings parties together without having any power to negotiate terms for either party is not a seller.[66] Later intermediate court decisions have la-

63. Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra. See also* Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 709 (1956): "Petitioner [Brown] could not, by designating himself as an agent [for Gould and Cole], escape his responsibility for the negotiations with Gould and Cole leading up to their purchase. Brown himself admitted . . . that it was from his presentation of the proposal to [Gould and Cole] that they became interested." The facts are discussed in the text accompanying note 38 *supra.*

64. Draft 12, Comments.

65. Chesnut v. Coastal Oil & Land Corp., 543 S.W.2d 154, 157 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.), discussed in note 52 *supra.* The court correctly cites Fowler v. Hults, 138 Tex. 636, 161 S.W.2d 478 (1942), note 31 *supra*, in support. But its citation of Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735 (1943), note 66 *infra*, is dubious; that case rests on other grounds noted in note 66 *infra.*

66. Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735, 738-39 (1943), although the decision may rest as much on the view that there was no security (only an oil and gas drilling contract to develop the defendant landowner's property). The specific holding is that plaintiff was not barred as a matter of public policy (see notes 17-18 *supra*) from suit merely because he was unregistered as a dealer. But it is not clear whether he was regarded as a nondealer for the reasons just suggested (no security, or no sale in this transaction) or because he had no prior activity in selling securities (a ground on which Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940), note 17 *supra*, was distinguished). Indeed, it is not entirely clear that no security was involved. The terms of the drilling contract are not mentioned in the opinions of the supreme court, cited above, or of the lower courts before and after, 161 S.W.2d 511 (Tex. Civ. App.—Galveston 1942) and 188 S.W.2d 706 (Tex. Civ. App.—Galveston 1945). From the date of the transaction (1936) and the fact that a defendant landowner used a real estate broker (plaintiff) to obtain a drilling contract, and apparently agreed to pay the broker an interest in other acreage for procuring the contract, it seems likely that the driller was not to be paid cash. Rather, he was probably to receive an oil and gas lease or other interest in the minerals, which might have been a security.

A later Texas Supreme Court opinion does not rule on TSA, but sheds some light on *Herren* and confirms that non-sale was a critical part of its holding:

> [W]e held . . . that the Securities Act being directed against sellers rather than buyers, and the plaintiff being employed by the landowner to procure the driller as a mere 'prospect' for an ultimate development contract, which did not necessarily involve the 'prospect' acquiring an interest in the land, the plaintiff was not *selling* anything to the driller and certainly not selling anything to the defendant landowner, so was not required to have a license under the Act. The decision may also be authority for the proposition that, if the plaintiff could be considered as 'selling' something to the driller, all he could have sold would have been the mere possibility that the defendant would make a lease to the driller, such a possibility not being a 'security.'

Great W. Drilling Co. v. Simmons, 157 Tex. 268, 302 S.W.2d 400, 404 (1957) (emphasis in original).

The idea that a "go-between" who brings others together is not a seller also appears in Culver v. Cockburn, 127 S.W.2d 328, 330 (Tex. Civ. App.—Galveston 1939, writ dism'd

beled such a person a "finder," defined as "an intermediary who contracts to find and bring parties together, but [who] leaves the ultimate transaction to the principals; he is the procuring cause and his function ceases when negotiations between the principals begin."[67] One court has held squarely that a finder is not a seller, and therefore need not be registered under TSA § 12 in order to sue for commission or compensation under § 34.[68] But another court has rejected this view and applied § 34: "[W]e are not prepared to say . . . that a party may circumvent the requirements . . . [of TSA] merely by showing that his services were to be limited to the procurement of the agreement of the principals."[69] To add to the confusion, some earlier decisions applied § 34 to finders without considering whether they were sellers.[70] Finder is a convenient term, often used in business, but it has no magic for TSA. Whether one who claims to be a finder is really a seller will depend on the same kind of factual analysis used to determine whether anyone is a seller.[71]

3.1.6 *Joint Owners or Venturers.* When persons acquire securities together, for example, as co-owners or as joint venturers, they may be regarded as cobuyers rather than as sellers to each other,[72] and several decisions have so treated them.[73] More commonly, the courts have given

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judgmt cor.). However, the concept is so interwoven with the discussion of the exemption of the seller that it may not be an independent ground.

67. Rogers v. Ellsworth, 501 S.W.2d 756, 757 (Tex. Civ. App.—Houston [14th Dist.] 1973, writ ref'd n.r.e.), citing Annot., *Validity, Construction, and Enforcement of Business Opportunities or "Finder's Fee" Contract*, 24 A.L.R.3d 1160 (1969); Stahl v. Preston, 541 S.W.2d 278, 278-79 (Tex. Civ. App.—San Antonio 1976, no writ).

68. Rogers v. Ellsworth, 501 S.W.2d 756 (Tex. Civ. App.—Houston [14th Dist.] 1973, writ ref'd n.r.e.), note 67 *supra*. For a fuller discussion of § 34, see Part 5.5.5 below.

69. Thywissen v. FTI Corp., 518 S.W.2d 947, 951 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.). *Semble*, Fry v. Shaw, 508 S.W.2d 142, 146 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.) (unregistered plaintiff cannot sue buyer for compensation in arranging meeting between buyer and seller which resulted in the purchase).

70. Development Inv. Corp. v. Diversa, Inc., 393 S.W.2d 653, 658 (Tex. Civ. App.—Texarkana 1965, no writ); Shriver v. Stoddard, 188 S.W.2d 892 (Tex. Civ. App.—Dallas 1945, writ ref'd).

71. Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist] 1975, writ ref'd n.r.e.), note 69 *supra*; Stahl v. Preston, 541 S.W.2d 278 (Tex. Civ. App.—San Antonio 1976, no writ). Note that § 34 bans suits for compensation or commission "for services rendered in the sale or purchase of securities." It is slightly broader than "person who . . . sells" in § 33A(1); one may render services in a sale without being a seller. To this extent, there is more basis for a finder not being liable under § 33A(1) than for him to forfeit his right to compensation under § 34.

72. This may have been what the court had in mind when it wrote rather cryptically:

> It is well settled that the Act does not apply to a joint adventurer and to transactions between joint adventurers. Joint adventurers and partners are not to be denied the right to recover their interest merely because of a failure to comply with the Securities Act and we think it equally true that a dissatisfied joint adventurer may not recover from other joint adventurers merely because of the failure of the latter to comply with the Act.

Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 709 (1956), citing for this well settled proposition a single case, Polk v. Chandler, 276 Mich. 527, 268 N.W. 732 (1936). Or the court may have been thinking that a joint venture interest is not a security, as has been held in McConathy v. Dal Mac Commercial Real Estate, Inc., 545 S.W.2d 871 (Tex. Civ. App.—Texarkana 1977, no writ).

73. Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146, 149-50 (1947) (alleged partners; cause

lip service to this principle, but found that there was no joint venture because some requisite (*e.g.*, joint control, or loss sharing) was lacking.[74] There is no more magic in "joint venture" than in "finder."[75] A claimed joint venture should not be taken at face value, but should be examined for the elements of "security" and "sale."[76]

3.2 *Post-1977 Law.* The "person who offers or sells" phrase of § 33A(1) [and § 33A(2)]—which defines the class of defendants—is the same in the 1977 version as it was from 1963 to 1977, and the "sale" definition in § 4E is unaltered. Nonetheless, a narrower interpretation of this phrase is required by the 1977 addition of specific provisions to cover, with different standards, persons who might have been "any link in the chain of the selling process,"[77] and thus sellers under prior law.[78] Section 33C makes issuers liable for untruths and omissions when they register outstanding securities for secondary sale by the holders,[79] and § 33F makes control persons and aiders liable in certain instances noted below. These sections are more fully treated in a later installment of this Article.

The Bar Committee commented on the new context:

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of action stated though plaintiff not registered; TSA is not for the protection of sellers or the regulation of buyers, see text accompanying note 31 *supra*; Fitz-Gerald v. Hull, 150 Tex. 39, 237 S.W.2d 256, 258 (1951) (accord; joint venturers); Chesnut v. Coastal Oil & Land Corp., 543 S.W.2d 154 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.) (defendant who bought for joint account of defendant and plaintiff, was not seller to plaintiff; see further discussion at note 52 *supra*).

See MacKenzie v. Newton, 341 S.W.2d 498, 501 (Tex. Civ. App.—San Antonio 1960, writ ref'd n.r.e.) (defendant did not need dealer's license to enter joint venture with plaintiff to acquire oil interests for their joint ownership).

74. *E.g.*, Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 72 *supra*; Mummert v. Stekoll Drilling Co., 352 S.W.2d 526 (Tex. Civ. App.—Dallas 1961, writ ref'd n.r.e.); Fry v. Shaw, 508 S.W.2d 154 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.).

An agreement by defendant to give plaintiff an interest in property if plaintiff procures it for defendant does not necessarily make them co-buyers or joint venturers. Allen v. Sorenson, 388 S.W.2d 757, 759 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.) (decided under the real estate license act; plaintiff not licensed under that act cannot sue for agreed interest in property and cash commission).

The resistance of courts to the circumvention of TSA by joint venture allegation has probably led them to impose more stringent requirements for proving a joint venture than are justified. Normally, an agreement to share losses is inferred from a partnership or joint venture, rather than a prerequisite to its existence. *See* J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP 72, 191-92 (1968). Instead of restricting the concept of joint ventures, the courts would do better to abandon the implied exception of joint ventures from TSA and, as suggested in the text, focus on whether the facts point to a "security" and "sale" from one venturer to another.

75. See Part 3.1.5 above.

76. A good example with respect to "security" is McConathy v. Dal Mac Commercial Real Estate, Inc., 545 S.W.2d 871 (Tex. Civ. App.—Texarkana 1976, no writ), note 72 *supra*. On the distinctions between joint venture for TSA and for other purposes, and the need for analysis of "sale," see Hill, *Pitfalls in the Texas Securities Act*, 10 SW. L.J. 265, 273-78 (1956). On the elements of "sale," see Parts 3.1.1 above and 3.2 below.

77. *Supra* note 38.

78. The more important broad interpretations of seller were under pre-1963 law. The 1963 changes called for a somewhat narrower scope of liability. See note 109 *infra*.

79. § 33C, which is a fraud provision, has no application to § 33A(1) technical violations, although § 33C does cover violations that might otherwise be actionable under § 33A(2). Thus, § 33C is relevant to our argument on § 33A(1) only as part of the classification of defendants accomplished in 1977.

> The phrase 'person who offers or sells' . . . is taken from U.S. law and is intended to have the same meaning, e.g. including a broker for the seller and, if he solicits, a broker for the buyer. A broad interpretation of this sort implements the definitions of offer and sale in § 4E. Even so construed, § 33A(1) [like §§ 33A(2) and 33B] is a privity provision, allowing a buyer to recover from his offeror or seller [or a seller to recover from his offeror or buyer]. However, some nonprivity defendants may be reached under §§ 33C and 33F.[80]

The first two sentences of this comment were in the Bar Committee submission to the Legislature,[81] and thus may reflect official as well as unofficial legislative intent.[82] The last two sentences were added to stress that peripheral defendants are to be treated under §§ 33C and 33F, rather than by stretching "person who offers or sells" to cover them. The difference may be vital. By § 33F(1), a control person of a § 33A(1) defendant has a reasonable care defense that he would not have under § 33A(1) if he were a "person who offers or sells." By § 33F(2), an aider of a § 33A(1) defendant must be a material aider and is liable only if he acts with the specified intent (to deceive or defraud) or reckless disregard (for the truth or the law). Materiality should be a requirement for a § 33A(1) "person who offers or sells," but has not always been recognized as such.[83] And intent or recklessness is not required of § 33A(1) defendants. Thus, peripheral defendants should be tested by the carefully prescribed standards of §§ 33C and 33F rather than by a loose interpretation of the general phrase, "person who offers or sells."

4. *Other Preliminary Elements.* To prevail under § 33A(1) [or § 33A(2)], a plaintiff must plead and prove two preliminary elements: "offer or sale" and "security."

4.1 *Offer or Sale.* The first essential is an "offer" or "sale."[84] These terms ordinarily present little problem to the plaintiff since they are amply defined in § 4E, which prescribes, *inter alia*, that offer and sale each include "every disposition or attempt to dispose of a security for value" and that "sell" "means any act by which a sale is made."[85] There are few reported cases in which a plaintiff has failed to prove "sale."[86]

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80. TEX. REV. CIV. STAT. ANN. art. 581-33, comment (Vernon Supp. 1978).

81. Draft 12. The comment first appeared in Draft 8.

82. The more recent Texas cases are in accord, treating a soliciting agent of a buyer as a seller. Note 63 *supra* and accompanying text.

83. See text accompanying notes 47-50 *supra*.

84. There is no liability based on an offer which does not lead to a sale. See Part 5.1.2 below. But there are complex questions whether liability may be based on an improper offer which leads to a proper sale. See Parts 5.1.2(A)-(D) and 5.4.1 below.

85. The leading cases on sale in pre-1977 law are cited and discussed in Part 3.1.1 above. The narrower interpretation indicated by the 1977 revision is discussed in Part 3.2 above.

86. *See* Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ), note 49 *supra*; Chesnut v. Coastal Oil & Land Corp., 543 S.W.2d 154 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.), note 52 *supra*. Other cases finding no sale, in a different context (whether plaintiff, as a seller, was barred from suing for a commission or the like) are treated in Parts 3.1.4-3.1.6 above.

4.2 *Security*. The second essential is that the offer or sale was of a "security." This term is broadly defined by § 4A to include stock, bond, debenture, about a dozen other specific instruments, and several open-ended categories, such as "investment contract," "evidence of indebtedness," "interest in any or all of the capital, property, assets, profits or earnings of any company," and "any other instrument commonly known as a security." Whether investments outside the traditional categories (stock, bond, debenture, etc.) are "securities" because of the open-ended provisions is often a difficult and hard-fought question.[87] Moreover, this question may be affected by statutes other than TSA.[88] A full substantive interpretation

87. *Compare* Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977) (certain "naked" options to buy and or sell commodity futures contracts are both "investment contracts" and "evidences of indebtedness"), *with* State v. Monex Int'l, Ltd., [1971-1978 Transfer Binder] BLUE SKY L. REP. (CCH) ¶ 71,233 (No. 74-3243-A, 14th Dist. Ct., Dallas County, Texas, Judgment July 10, 1974, Findings of Fact and Conclusions of Law August 7, 1974) (commodities sold on margin are neither), *aff'd on other grounds* (federal preemption), 527 S.W.2d 804 (Tex. Civ. App.—Eastland 1975, writ ref'd). A fuller treatment of commodity interests as securities in federal and state law is Bromberg, *Commodities Law and Securities Law—Overlaps and Preemptions*, 1 J. CORP. L. 217, 221-67 (1976), substantially the same as 1 BROMBERG §§ 4.6(400)-(466).

Various franchise and distributorship arrangements have been held not to be securities. *See* Bruner v. State, 463 S.W.2d 205 (Tex. Crim. App. 1970); Koscot Interplanetary, Inc. v. King, 452 S.W.2d 531 (Tex. Civ. App.—Austin 1970, writ ref'd n.r.e.). The authority of these cases is undermined by the supreme court's reinterpretation of "investment contract" in *Searsy, supra*. Similar arrangements have been held to be securities under federal law, *e.g.*, SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974).

An interest in a joint venture to buy and hold land for appreciation has been held not to be a security. McConathy v. Dal Mac Commercial Real Estate, Inc., 545 S.W.2d 871 (Tex. Civ. App.—Texarkana 1976, no writ). See Part 3.1.6 above.

Most oil, gas, and mineral interests are embraced by one of the specific components of "security" in § 4A: "certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title." *See* Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940) (oil and gas lease); Cosner v. Hancock, 149 S.W.2d 239 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.) (oil payment). But original oil and gas leases procured from the landowner have been held not to be securities. Culver v. Cockburn, 127 S.W.2d 328 (Tex. Civ. App.—Galveston 1939, writ dism'd judgmt cor.); Allen v. Sorenson, 388 S.W.2d 757 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.), citing Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735 (1943), note 66 *supra*, which was decided on other grounds discussed there.

Pension plans and other employee benefit programs raise difficult questions that have not yet been considered in Texas. Controversy currently swirls around Daniel v. International Bhd. of Teamsters, 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 434 U.S. 1061 (1978) (No. 77-753), which affirmed a holding that an employee, who had been denied a pension, stated a federal securities fraud claim against his union, the union pension plan, and others. Particularly, the court held that the interest in the pension plan was an "investment contract," although the employee made no direct contribution to it and had no election whether or not to participate in the plan. For some of the criticism, see Alef & Short, *Problems created by CA-7 decision that pension plan participation is a security*, 47 J. TAX. 282 (1977); 433 SEC. REG. & L. REP. (BNA) A-11, I-1 (Dec. 21, 1977) (criticism of SEC's supporting position by Sen. Harrison Williams, Jr.); Siegel, *Pension Outlook*, N.Y.L.J., Jan. 9, 1978, at 1, col. 1. The most analytical treatment is *Daniel v. International Brotherhood of Teamsters, A Report to the Committee on Federal Regulation of Securities From the Study Group of 1933 Act—General Subcommittee on Daniel v. International Brotherhood of Teamsters*, 32 BUS. LAW. 1925 (1977), directed to the district court decision which was affirmed.

88. TEX. INS. CODE ANN. art. 3.72, § 1 (Vernon Supp. 1977) prescribes that a variable annuity is not a security. On certain savings and loan accounts, see note 105, para. (C) *infra*.

of the open-ended categories will not be attempted here.[89]

The existence of a security is determined by the economic features of the transaction, not by the pieces of paper delivered.[90]

The definition of a security in § 4A draws no distinction between different parts of the Act, and thus would seem to be the same for registration violations in § 33A(1) as for fraud violations in § 33A(2). Nonetheless, there is reason, in borderline situations, to construe the term more narrowly for § 33A(1) than for § 33A(2). The reason is that § 33A(1) is an absolute liability provision which can produce crushing damages against a seller who innocently guesses wrong on whether the interest being sold is a security or who in all innocence never realizes there is a "security" question.[91] Conversely, when the plaintiff must show the defendant's fault as in § 33A(2), there is less reason to give the defendant the benefit of the doubt on whether he is selling a "security."[92] The statutory basis for making such a distinction is the preamble to § 4, which prescribes definitions "unless the context otherwise indicates." The no-fault context of § 33A(1) may well indicate that a narrow interpretation of "security" is necessary for this section.

5. *Basis of Liability*. Section 33A(1) creates liability for violation of these provisions, which are analyzed in detail in the indicated Parts of this Article:

(A) Section 7, which requires registration of securities offers and sales

89. "Investment contract" seems the broadest and is the one most frequently invoked. It has generally been construed to require four elements: (1) an investment, (2) in a common enterprise, (3) with the expectation of profits, (4) from the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977), note 87 *supra*.

Cases on "investment contract" in state and federal securities law are collected in Annot., 47 A.L.R.3d 1375 (1973); Annot., 3 A.L.R. Fed. 592 (1970). For more analytical treatment, see 1 Loss 483-511; 4 *id.* 2487-88, 2500-56; Sowards & Hirsch ch. 2; Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. Res. L. Rev. 367 (1967); Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 Hastings L.J. 219 (1974).

90. *See* Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 710 (1956), discussed in the text accompanying note 38 *supra*. Brown contended unsuccessfully (although a dissenting justice agreed with him) that the memorandum he sent Gould and Cole regarding the proposed Mexican mining venture and the letters he wrote acknowledging receipt of their money for transmittal to Fields were not "securities." The court pragmatically noted that these were the only instruments issued to Gould and Cole, and these instruments recited the nature of the transaction.

91. The point is argued further in 1 Bromberg § 4.6(312). The SEC, in supporting a broad interpretation of "security" to include interests in pension plans, has stressed that it is speaking only of the antifraud provisions, not of the registration requirements (and the liabilities related to them). Brief of the SEC, Amicus Curiae, at 4-5, 58-59, Daniel v. International Bhd. of Teamsters, 561 F.2d 1223 (7th Cir. 1977), summarized in [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,846; Memorandum of SEC Office of General Counsel (Dec. 7, 1977), 433 Sec. Reg. & L. Rep. (BNA) I-1, at I-2 (Dec. 21, 1977). In response, the Seventh Circuit made it clear that it was deciding only the fraud question, not the registration question, *e.g.*, at 561 F.2d at 1242, 1250.

92. The same is true of an enforcement proceeding, which seeks only future compliance with the securities laws—if the holding does not foreclose the automatic liability issue.

unless the security or the transaction is exempt by §§ 5 or 6. Part 5.1 below.

(B) Section 9, which:

(a) Authorizes the Commissioner to require sale proceeds to be escrowed until sales reach a specified level. Part 5.2 below.

(b) Limits marketing expenses to 20% of the public offering price, or a lower level set by the Commissioner. Part 5.3 below.

(c) Requires that offers of registered securities be made by a full disclosure prospectus. Part 5.4 below.

(C) Section 12, which requires dealers and salesmen who sell securities to be registered except in exempt transactions. Parts 5.5 and 5.6 below.

(D) Section 23B, which bars a dealer or salesmen from using an advertisement that the Commissioner has notified him is misleading. Part 5.7 below.

(E) A stop-sale order under § 23A, which authorizes such orders if the Commissioner determines that a sale would violate TSA, tend to work a fraud, or not be fair. Part 5.8 below.

The common and potent characteristic of these liabilities is their absolute, strict, automatic, and no-fault character. They are absolute or automatic in the sense that liability is imposed for the regulatory violation without showing that the plaintiff was injured by the defendant's conduct.[93] They are strict or no-fault in the sense that the plaintiff need not show any misconduct of the defendant toward the plaintiff, or any intent or other state of mind of the defendant.[94]

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93. *Cf.* Commercial Trading Corp. v. Searsy, 559 S.W.2d 663, 668 (Tex. Civ. App.—Texarkana), *rev'd on other grounds*, 560 S.W.2d 637 (Tex. 1977), where the court spoke of "the strict liability theory of . . . failure to register . . . under the state and federal securities laws."

But cf. Matrix Computing, Inc. v. Davis, 554 S.W.2d 288, 292 (Tex. Civ. App.—Amarillo 1977, no writ): "[T]here being no evidence having probative force upon which the jury could have made a finding of damages in favor of [plaintiff] Matrix, the trial court correctly granted the motion for instructed verdict and rendered the take-nothing judgment." Plaintiff bought TCFC's commercial paper from a bank (and its trust officer), then sued the latter (after TCFC went bankrupt) for misrepresentation and nonregistration. Plaintiff's records of the purchase were in disarray and those it tendered as evidence were not qualified for admission under the business record statute, TEX. REV. CIV. STAT. ANN. art. 3737e (Vernon Supp. 1978). It had never received signed notes and the unsigned notes it had for part of the claimed investment were also excluded. So the case seems to hold that a plaintiff must be able to show some loss in order to recover under § 33A(1) [or § 33A(2)], but not that the loss was caused by defendant. On these unusual facts, the results would probably be the same if plaintiff sued for rescission since plaintiff would have no admissible evidence that it bought. But a rescission plaintiff should not have to prove damages under § 33A.

94. *Comparison of Criminal and No-Fault Civil Liability.* It is interesting to compare the no-fault civil liability provisions of § 33A(1) with the criminal provisions of § 29. Both create severe sanctions and cover approximately the same conduct. Their treatment is similar in some respects. Offering or selling a security without security registration results in both liabilities under §§ 33A(1) (via § 7) and 29B. Offering or selling a security without dealer or salesman registration results in both liabilities under §§ 33A(1) (via § 12) and 29A. Fraud results in both liabilities under §§ 33A(2) and 29C. Judging by the criminal penalties, these are the gravest offenses ($5,000 fine, 10 years prison, or both).

Other parts of § 29 carry criminal penalties only 1/5th as great: $1,000 fine, 2 years prison, or both. But the corresponding civil liability is the same as for the more serious violations.

5.1 *Unregistered Security—§ 7.*

5.1.1 *§ 33A(1) Civil Liability.* The purpose of securities registration is to give the Commissioner and his staff "an opportunity for close scrutiny [of the offering] for the buyers' protection."[95] The Commissioner can generally refuse registration on a finding that the offering would not be "fair, just and equitable" or would be fraudulent.[96]

The earlier securities laws indicated bluntly that their purpose—to be achieved largely through registration—was to prevent the sale of worthless securities.[97] An additional purpose, which has always permeated the federal law and has gradually come to be recognized under the Texas act, is to inform investors through a full-disclosure prospectus of the kind required by § 9C and discussed in Part 5.4 below.

Violation of a § 23A stop order brings full civil liability under § 33A(1) and the smaller criminal liability under § 29D. Violation of a § 23B stop-advertising order brings full civil liability under § 33A(1) and the smaller criminal liability under § 29G but the two provisions are not coextensive.

In an even more dramatic divergence, there are no criminal penalties for the violations of § 9, which create civil liability under § 33A(1). § 9C (the prospectus requirement) mutters ominously that "[f]ailure to comply with this requirement shall be treated as a violation of this Act, subjecting the parties responsible to the consequences thereof as provided herein." But this is not enough to invoke the criminal provisions of § 29, which prescribe particular violations and do not apply to "any violation of this Act," in contrast to most other state and federal securities statutes, *e.g.*, SA § 24, SEA § 32, UNIFORM ACT § 409. Thus, although the prospectus is traditionally regarded (at least in federal law) as the most important protection for investors, there is no Texas criminal penalty for failure to deliver it, unless that results in material and misleading nondisclosures or other fraud violations covered by § 29C.

Finally, §§ 29E and 29F create criminal penalties for false statements in filings with the Commissioner and false statements about registration, which have no correlate in § 33A(1), although at least the latter might be actionable under § 33A(2).

95. Spence & Green Chem. Co. v. Mouer, 510 S.W.2d 620, 622 (Tex. Civ. App.—Beaumont 1974, writ ref'd n.r.e.).

96. § 10A for § 7A qualification registrations; § 7C(2) for § 7C coordination registration. There is no explicit standard for denying a § 7B notification registration, but the Commissioner can stop the sale of any security, or revoke its registration, by a § 23A order invoking similar standards. See Part 5.8.1 below. The Commissioner's (or staff's) expression of disapproval is usually enough to cause withdrawal of a registration application. Formal denials of registration are comparatively rare. For an example, see Southern State Land & Cattle Co., Tex. State Sec. Board Order No. RD-553 (Sept. 3, 1976), denying registration of 5 breeding herds at $40,000 per herd (of 5 cows) plus $14,000 management contracts per herd over 3 years, because not fair, just, and equitable: exorbitant price, excessive management fees to sponsor, no tax opinion or IRS ruling, likelihood that IRS will successfully challenge the tax basis as unrealistic, unfair termination provisions, no reasonable expectation of profit for the investor, etc.

The pros and cons of this kind of merit regulation have been vigorously debated. Among the pros, see Jennings, *The Role of the State in Corporate Regulation and Investor Protection*, 23 LAW & CONTEMP. PROB. 193, 207-39 (1958); Hueni, *Application of Merit Requirements in State Securities Regulation*, 15 WAYNE L. REV. 1417 (1969); Goodkind, *Blue Sky Law: Is There Merit in Merit Regulation?*, 1976 WIS. L. REV. 79. Among the cons, see Manne & Mofsky, *What Price Blue-Sky—State Securities Laws Work Against Private and Public Interest Alike*, Barron's, Aug. 5, 1968, at 5; Bloomenthal, *Blue Sky Regulation and the Theory of Overkill*, 15 WAYNE L. REV. 1447 (1969); J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS (1971).

97. 1923 Tex. Gen. Laws, 38th Legis., 2d Called Sess., ch. 52, § 29, at 120; 1955 Tex. Gen. Laws, ch. 67, § 42, at 346-47; *see* Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197, 199 (1940).

A dealer, agent, or salesman[98] who sells an unregistered security or does not have a permit for the security[99] violates § 7 and is therefore liable by § 33A(1),[100] unless there is a § 6 security exemption (which generally requires the seller to be a registered dealer or a registered salesman)[101] or a § 5 transaction exemption.[102] Either type of exemption makes registration

98. For the meaning of these terms, see Parts 5.5.3 (dealer) and 5.6.3 (agent, salesman) below. See also note 112 *infra*.

99. *Registration v. Permit.* Registration and permit are used, with apparent equivalence, by the Legislature, the Commissioner, and the courts. §§ 7B and 7C use registration; §§ 9C and 10 use permit; §§ 7A, 22B and 29B (as well as the caption to § 7) use both. Finally, § 5.O(9) uses registration to refer to all three types. Although TSA specifies the granting of a permit only for a § 7A (qualification) registration, it has long been the Commissioner's practice to issue permits for §§ 7B (notification) and 7C (coordination) registrations as well. For the judicial recognition of the equivalence, see McQueen v. Belcher, note 111 *infra*. For instances in which the difference might be important, see notes 204-05 *infra* and accompanying text.

This Article generally uses registration, registered and unregistered, rather than permit, permitted and unpermitted, because of the ambiguity and awkwardness in the latter set of words, because registration is more widely used in TSA, and because registration is the phrase in federal and most other state securities laws.

100. Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977), *rev'g* 559 S.W.2d 663 (Tex. Civ. App.—Texarkana 1977); Bierschwale v. Oakes, 497 S.W.2d 506, 521-22 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974); Bateman v. Petro Atlas, Inc., Civ. No. 75-H-445 (S.D. Tex. Sept. 26, 1977), Findings ¶¶ 4-5, Conclusions ¶¶ 9-10; *see* Flowers v. Dempsey-Tegeler & Co., 472 S.W.2d 112 (Tex. 1971) (offense proved for venue purposes).

For the same proposition under the 1941-1963 voidability provision, Appendix 3 below, see Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*; Christie v. Brewer, 374 S.W.2d 908 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), note 42 *supra*; Prokop v. Krenek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.); McQueen v. Belcher, 366 S.W.2d 670 (Tex. Civ. App.—Amarillo 1963, no writ) (offense proved for venue purposes); and possibly Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*.

For the same proposition under pre-1941 common law voidability for violation of TSA, see Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App.—Texarkana 1938, writ ref'd), note 18 *supra*.

101. The exception is § 5R which allows a § 6 security to be sold by its issuer or a subsidiary. § 5R creates a transaction exemption for this purpose. See note 102, para. (A)(7) *infra*.

Exempt Securities. The most important § 6 exemptions are for government and municipal securities, §§ 6A, 6B; certain bank and savings association securities, §§ 6C, 6G (and see note 105 *infra*); certain railroad and public utility securities, § 6D; commercial paper and negotiable notes of less than 24-month maturity, § 6H; securities of certain nonprofit organizations, §§ 6E, 6J; and securities listed on the major stock exchanges, § 6F. The stock exchange exemption is liberally construed, in an important respect, to include as "fully listed" on an exchange (and thus exempt by § 6F) securities that have been "approved for listing upon notice of issuance." Tex. State Sec. Board Rule VI.F, Tex. Reg. No. 065.06.00.006, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,606 para. F (1978). Such approval is given by the exchange in advance of issuance, so the exemption covers not only outstanding securities that are listed, but also new securities that will be listed on issuance. The same rule contains the exchanges the Commissioner has approved for the § 6F exemption in addition to those named in the statute.

102. *Exempt Transactions.* The more important transaction exemptions—classified functionally by who can use them, although they are not so grouped in TSA—are summarized below. They are preceded by this highly significant and emphatic preamble:

> Except as hereinafter in this Act specifically provided, the provisions of this Act shall not apply to the sale of any security when made in any of the following transactions and under any of the following conditions, and the company or person engaged therein shall not be deemed a dealer within the meaning of this Act; that is to say, the provisions of this Act shall not apply to any sale,

[note 102 cont'd]:

> offer . . . dealing in or delivery of any security under any of the following transactions or conditions.

(A) *Issuer Exemptions.* The main exemptions for an issuer selling its own securities (and for anyone acting for an issuer) are:

(1) *Private, Limited Offerings*: sales, without public solicitation or advertisement so long as the total number of holders does not exceed 35 or (with prior notice to the Commissioner) to no more than 15 buyers in 12 months, §§ 5I(a) and (c), construed in Tex. State Sec. Board Rule V.I, Tex. Reg. No. 065.05.00.009, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,605 para. I (1978). For general treatment of the § 5I exemption, see Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities,* 18 SW. L.J. 537 (1964); Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities—The Prohibition on Advertisements.* 20 SW. L.J. 239 (1966). Cases interpreting § 5I include Sibley v. Horn Advertising, Inc., 505 S.W.2d 417 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert. denied*, 420 U.S. 929 (1975), discussed note 132 *infra* (no public solicitation or advertisement); Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), discussed note 41 *supra* (jury issue on public solicitation); Birchfield v. State, 401 S.W.2d 825 (Tex. Crim. App. 1966) (public solicitation). A case misconstruing § 5I (on advertisement) is Tumblewood Bowling Corp. v. Matise, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.), criticized in the second of my articles cited above.

(2) *Sales to Existing Securityholders.* Existing security holders include holders of the issuer's stock and debentures as well as convertibles and nontransferable warrants. No commission (other than a standby commission, *e.g.*, to an underwriter who will purchase the securities not bought by the offerees) may be paid for soliciting holders in Texas. § 5E. The securities need not be offered to all holders, or all holders of a particular class. Tex. State Sec. Board Rule V.E. 1, Tex. Reg. No. 065.05.00.005 para. 1, *reprinted in* 3 BLUE SKY L. REP. (CCH) § 46,605 para. 1 (1978). A court has, somewhat questionably, construed the exemption to be inapplicable where the offering was to a large number of security holders who became such in apparent violation of the registration requirements. Spence & Green Chem. Co. v. Mouer, 510 S.W.2d 620 (Tex. Civ. App.—Beaumont 1974, writ ref'd n.r.e.), upholding a Commissioner's stop-sale order (apparently under § 23A). While the facts indicated egregious past violations, it is improbable that the Legislature intended the § 5E exemption to call in question the validity of all claimed prior exemptions. Certainly there is nothing in § 5E that says an existing shareholder must have become such in an exempt or registered transaction.

(3) *Sales in the Course of Certain Reorganizations and Acquisitions.* §§ 5F, 5G, construed in Tex. State Sec. Board Rule V.G, Tex. Reg. No. 065.05.00.007, *reprinted in* 3 BLUE SKY L. REP. (CCH) § 46,605 para. G (1978), and in Maddox v. Flato, 423 S.W.2d 371 (Tex. Civ. App.—Corpus Christi 1967, writ ref'd n.r.e.).

(4) *Sales to Certain Financial Institutions.* § 5H, construed in Tex. State Sec. Board Rule V.H, Tex. Reg. No. 065.05.00.008, *reprinted in* 3 BLUE SKY L. REP. (CCH) § 46,605 para. H (1978).

(5) *Sales Pursuant to Certain Employee Stock Option and Employee Pension and Similar Benefit Plans.* §§ 5I(a), 5H (last clause), construed in Tex. State Sec. Board Rule V.I.6-7, Tex. Reg. No. 065.05.00.009 paras. 6-7, *reprinted in* 3 BLUE SKY L. REP. (CCH) § 46.605 paras. I.6-7 (1978).

(6) *Sales to Security Dealers.* The dealer must be registered and "actually engaged in buying and selling securities." § 5H, construed in Dunnam v. Dillingham, 345 S.W.2d 314 (Tex. Civ. App.—Austin 1961, no writ); Gerchsheimer v. American Heritage Bank & Trust Co., 437 F.2d 1332 (10th Cir. 1971); misconstrued (as to "main course of business") in Development Inv. Corp. v. Diversa, Inc., 393 S.W.2d 653, 657 (Tex. Civ. App.—Texarkana 1965, no writ). This exemption raises a number of tough and unanswered questions as to the extent it covers sales to dealers for resale or as agents for other persons.

(7) *Sales of Exempt Securities.* § 6 exempts a variety of securities (*e.g.*, those of banks, savings associations, railroads and utilities and securities listed on the major stock exchanges; see note 101 *supra*) if sold by a registered dealer (or salesman). § 5R was added to exempt the same securities (except those of nonprofit organizations named in § 6E, which are partly covered already by § 5K) if sold directly by the issuer. 1963 Tex. Gen. Laws, ch. 170, § 6, at 476. By virtue of § 5R, a § 6 issuer selling its own securities is not a dealer; § 4C is contrary but must yield to the later and more specific § 5R so far as they are in conflict (*i.e.*, as to issuers of § 6 securities).

(8) *Sales of Securities of Nonprofit Issuers.* § 5K considerably overlaps §§ 6E and 6J, especially when the latter are combined with § 5R, discussed in the previous paragraph. §

[note 102 para. (A) cont'd]:
5K, among other conditions, prohibits the payment of commissions on the sales.
(B) *Nonissuer Exemptions.* The main exemptions for a seller of securities who is not their issuer are:

(1) *Sales of Outstanding Securities By Owners.* This provision, § 5C(1), so bristles with restrictions that it defies paraphrase and needs to be quoted in full:

> Sales of securities made by or in behalf of a vendor, whether by dealer or other agent, in the ordinary course of bona fide personal investment of the personal holdings of such vendor, or change in such investment, if such vendor is not engaged in the business of selling securities and the sale or sales are isolated transactions not made in the course of repeated and successive transactions of a like character; provided, that in no event shall such sales or offerings be exempt from the provisions of this Act when made or intended by the vendor or his agent, for the benefit, either directly or indirectly, of any company or corporation except the individual vendor (other than a usual commission to said agent), and provided further that any person acting as agent for said vendor shall be registered pursuant to this Act.

The most troubling, and unresolved, questions are what is the "ordinary course of bona fide personal investment . . . or change in such investment" and what are "isolated transactions not made in the course of repeated and successive transactions of a like character."

See generally Comment, *Exemptions to the Securities Act of 1957 and Their Importance to Persons Dealing in Oil and Gas Interests*, 12 Sw. L.J. 359, 361-64 (1958); Gilchrist & Hanna, *Secondary Distribution of Corporate Securities*, 13 Sw. L.J. 1, 41-42 (1959); Meer, *A New Look at the Texas Securities Act*, 43 TEXAS L. REV. 680, 685, 697 (1965); Annot., *Sales as "Isolated" or "Successive," or the Like, Under State Securities Acts*, 1 A.L.R.3d 614 (1965). *Cf.* Annot., *Who is "Dealer" under state securities acts exempting sales by owners other than issuers not made in course of successive transactions and the like*, 6 A.L.R.3d 1425 (1966). Decisions construing § 5C(1) are Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 519 S.W.2d 125 (Tex. 1974) (no finding sales were isolated) and Prokop v. Krenek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.) (benefit of another), note 100 *supra*. Earlier decisions construing § 5C(1) or its predecessors must be read very closely because the statute has been amended in important respects in its evolution from 1935 Tex. Gen. Laws, ch. 100, § 3(c), at 259. 1955 Tex. Gen. Laws, ch. 67, § 3(c) added the references to dealer or agent. 1957 Tex. Gen. Laws, ch. 269, § 5C(1), at 579 added the isolated transaction requirement and the repeated transaction prohibition, as well as the requirement that an agent be registered, and struck out some other language, to reach the present provision. See notes 295-97 *infra* and accompanying text on whether an unregistered agent destroys the exemption for the owner.

(2) *Sales of Outstanding Securities by Dealers.* § 5.O is the critical exemption which permits registered dealers (and, presumably, their registered salesmen) to make markets and otherwise trade in outstanding securities. It has nine sets of requirements. Several of them are not easily interpretable, *e.g.*, when are "securities . . . outstanding in the hands of the public," § 5.O(2), and what are "prices reasonably related to the current market price," § 5.O(3)? The latter is partly construed in Tex. State Sec. Board Rule V.O.2, Tex. Reg. No. 065.05.00.015 para. 2, *reprinted in* 3 BLUE SKY L. REP. (CCH) § 46,605 para. 0.2 (1978). For other factors considered by the Commissioner in granting the exemption when it is not automatically available, see Secondary Trading Exemption Notice, in State Securities Board, Rules, Appendix V.B. (looseleaf, orig. pub. 1976). An important interpretation of § 5.O by the Commissioner appears to be moving toward publication as a rule: § 5.O permits the sale by a registered dealer acting either as principal or as agent.

(3) *Sales of Outstanding Securities by Dealers Pursuant to Unsolicited Purchase Orders.* Several requirements are imposed by § 5P. But there is no specific requirement that the dealer be registered, although it would be consistent with the statutory scheme of registering professionals that he should be registered. Presumably the exemption extends to the dealer's salesmen on the same basis.

(4) *Private, Limited Offerings of Oil and Gas Interests.* § 5Q is patterned after the § 5I issuer private, limited offering discussed in para. (A)(1) above. An agent acting for the owner must be registered (as a dealer or salesman).

(5) *Sales to Certain Financial Institutions.* This exemption, in § 5H, discussed in para. (A)(4) above, is equally available to issuers and nonissuers.

unnecessary[103] and therefore eliminates liability for nonregistration.[104] In addition, some other statutes create exemptions from all or part of TSA.[105] By § 37, the burden of proof of an exemption is on the person claiming

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[note 102 para. (B) cont'd]:

(6) *Sales to Security Dealers.* This exemption, in § 5H, discussed in para. (A)(6) above, is equally available to issuers and nonissuers.

(7) *Sales by Executors, Administrators, Receivers, etc.* § 5A is discussed and partly quoted in note 294 *infra*.

(8) *Sales by Pledgees.* § 5B.

(9) *Sales of Securities of Nonprofit Issuers.* This exemption, in § 5K, discussed in para. (A)(8) above, is equally available to issuers and nonissuers.

(10) *Sales by Banks and Savings Associations of Their Own Securities.* This exemption, in § 5L, partly overlaps §§ 6C and 6G as well as external exemptions. See paras. (A) and (C) of note 105 *infra*.

(11) *Sales of Certain Options.* § 5S is primarily for publicly traded options and has a number of requirements including sale by or through a registered dealer, option performance guarantee by a dealer, underlying security listed on a stock exchange or quoted on NASDAQ, and no benefit to the issuer of the underlying security.

103. § 7A(1) repeats that registration is not required when § 5 or § 6 exemptions are in effect.

104. Sibley v. Horn Advertising, Inc., 505 S.W.2d 417, 419-20 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert. denied*, 420 U.S. 929 (1975) (exempt by § 5I for certain nonpublic offerings); Anderson v. Eliot, 333 S.W.2d 654 (Tex. Civ. App.—Eastland 1960, writ ref'd) (exempt by predecessor of § 5C(1) for certain resales by individual investors).

See Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974), note 100 *supra*, recognizing that an exemption would preclude § 33A(1) liability, but finding that the claimed § 5C(1) exemption was not proved. *Semble*, under the 1941-1963 voidability provision, Appendix 3 below, Prokop v. Krenek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.); Riggs v. Riggs, 322 S.W.2d 571, 573-74 (Tex. Civ. App.—Dallas 1959, no writ) (dictum since plaintiff failed to make the requisite tender).

There is no criminal liability under § 29B for sale of an unregistered security if one of the exemptions applies. *See* Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), note 41 *supra*. The principle has been recognized in other cases where, however, the exemption was not proved. *E.g.*, Cox v. State, 523 S.W.2d 695 (Tex. Crim. App. 1975); *cf.* Bridges v. State, 360 S.W.2d 531 (Tex. Crim. App.), *cert. denied*, 371 U.S. 821 (1962) (conviction affirmed; indictment need not negate exemptions; it is not clear from the opinion whether this is a § 29B or § 29A violation).

105. (A) *Banks.* Texas Banking Code, TEX. REV. CIV. STAT. ANN. art. 342-411a (Vernon Supp. 1978) (added 1977): an officer, director or employee of a bank with fewer than 500 shareholders is exempt "from the registration and licensing provisions" of TSA as to participation in a sale of securities issued by the bank but "may not be compensated for services provided under this article." §§ 6C and 6G exempt national and most state bank securities, when sold by registered dealers or salesmen. § 5L exempts national and all state bank securities when sold by the issuer and (like most other § 5 exemptions) makes it unnecessary for the issuer to register as a dealer. The implication of § 5L is that the bank's officers and employees (and perhaps its directors), through whom it sells securities when it does not use registered dealers, need not register. The relationship between § 5L and art. 342-411a is obscure. Superficially, they overlap to a considerable degree. But presumably the Legislature intended something by adding art. 342-411a which is much later and is specific about officers, directors, and employees while § 5L is not. A reasonable reconciliation is that art. 342-411a supersedes the exemption of bank officers, directors and employees implied by § 5L. Thus, such persons are exempt only when not compensated for selling and when in banks with fewer than 500 shareholders. Such persons would not be exempt when compensated, or when in banks with more than 500 or more shareholders. The prohibition on compensation for services would literally prevent the payment of salary to an officer, etc., whose duties included selling securities. Since all officers and employees, and many directors, are compensated, it seems likely that the Legislature intended only to prevent extra or special compensation, such as commissions per share, for selling securities. At the least, there may be a fact question about what a person is being compensated for. Assuming the correctness of my interpretation of art. 342-411a vis-à-vis § 5L, the combined civil liability

[note 105 cont'd]:
of the four sections are these. There are no § 33A(1) claims based on nonregistration of the security (§ 7) of any bank covered by §§ 6C or 6G if the security is sold by a registered dealer. There are no such § 33A(1) claims if the security is sold by an uncompensated officer, director, or employee of the bank and the bank has fewer than 500 shareholders. There are no § 33A(1) claims based on § 9 violation in any of these instances since § 9 is tied to securities registration, which is not required in these instances. There are no § 33A(1) claims based on § 12 violation in any of these instances since the dealer is registered (by hypothesis) or the officer, director or employee is exempt by art. 342-411a. But there is § 12 violation, and hence § 33A(1) liability, if a compensated but unregistered officer, director, or employee sells a security for any bank, or if a compensated or uncompensated officer, director, or employee sells a security for a bank with 500 or more shareholders (unless some other § 5 exemption, such as §§ 5E, 5H or 5I, is applicable). A § 23A or § 23B order might be made against a bank security in any instance and, if violated, would be actionable under § 33A(1). The registered dealer would not be barred from suing for commission or compensation by § 34. The officer-director-employee exemption in art. 342-411a would seem to neutralize the § 34 bar against commission suits by unlicensed persons, but the art. 342-411a ban on compensation creates the same bar, or leaves § 34 in effect. There is no exemption from the fraud provisions. Nor do any of the bank exemptions extend beyond securities issued by the bank or, at least in the case of § 6G, securities guaranteed by the bank. *Cf.* Matrix Computing, Inc. v. Davis, 554 S.W.2d 288 (Tex. Civ. App.—Amarillo 1977, writ dism'd), in which a bank not registered as a dealer was sued for selling third party commercial paper to plaintiff; the bank won for other reasons (plaintiff failed to prove damages).

(B) *Professional Corporations.* TEX. REV. CIV. STAT. ANN. art. 1528e, § 19 (Vernon Supp. 1978): the "sale, issuance or offering" of professional corporation stock to permitted buyers is exempted "from all provisions of the laws of this state . . . which provide for supervision, registration or regulation in connection with the sale, issuance or offering of securities." (Professional corporations are those formed to render accounting, dental, legal, and other professional services.) The quoted language appears to make inapplicable all the parts of TSA on which §§ 33A(1) or 34 operate. Less clear is whether the fraud provisions are part of "regulation"; arguably, they are not, and thus § 33A(2) liability remains in effect for professional corporation securities. It seems somewhat clearer that TEX. BUS. & COM. CODE § 27.01 (Vernon 1968) is not the kind of law from which exemption is provided. And it seems quite clear that there is no exemption provided from common law fraud.

(C) *Savings Associations.* TEX. REV. CIV. STAT. ANN. art. 852a, § 11.01 (Vernon Supp. 1978) (as amended 1975): "[s]avings accounts, certificates, and other evidences of interests in the savings liability" of associations subject to the Savings and Loan Act, and of federal savings associations, "are not 'securities' for any purpose" of TSA. Since all of TSA depends on "securities," no part of TSA is applicable to the described interests. Art. 852a, § 11.01 continues that other securities of such associations (*i.e.*, their common or capital stock) are not subject to the TSA registration requirements, hence securities registration is not required for these securities, and there is no civil liability under the parts of § 33A(1) referring to §§ 7 or 9. §§ 34, 33A(2) and the other parts of § 33A(1) apparently remain applicable except as indicated in the following sentences. Art. 852a, § 11.01 adds that association "officers" are exempt "from the registration and licensing provisions" of TSA for transactions in securities of their associations. This eliminates civil liability for the part of § 33A(1) that refers to § 12, and probably eliminates (by implication) § 34 sanctions. § 33A(2) probably remains applicable to securities other than the specified accounts, certificates, and interests, while common law fraud remains applicable to all savings and loan securities and § 27.01 remains applicable to all savings and loan "stock." As with the bank provisions discussed in (A) above, the outside exemption overlaps the inside ones, §§ 6G (certain state savings associations) and 5L (federal and certain state savings associations). But the conflicts are fewer here, since there is no ban on compensation of selling officers, and no distinction based on the number of shareholders of the association. Thus, the outside exemption can be read as an implementation of the implied exemption of officers in § 5L, rather than as a supersession or limitation of it. But one limitation can be clearly inferred by comparing art. 852a, § 11.01 with the banking provision and with its own predecessor (1963 Tex. Gen. Laws, ch. 113, § 1101, at 269). The current savings and loan exemption is only for officers. It does not cover directors or employees, although the bank provision covers both, and the predecessor covered employees (as well as agents). Thus, it appears that there is § 33A(1) liability for violation of § 12 when an unregistered director or employee (who is

it, *i.e.*, the § 33A(1) defendant.[106] The elements of the plaintiff's case are that he bought[107] and the defendant sold[108] to the plaintiff[109] a security,[110] the security was not registered under § 7 at the time of the sale,[111] and the

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not also an officer) sells stock of a saving association, unless some other § 5 exemption applies.

(D) *Other.* No other exemptions can be located through the index to the annotated statutes. However, the cross references at the beginning of title 19, Blue Sky Law, Securities, TEX. REV. CIV. STAT. ANN. arts. 581-1 to -39 (Vernon Supp. 1978), list other, less important, statutes, some of which provide exemptions from TSA.

106. *Accord*, Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 711 (1956). All elements of the exemption must, of course, be proved. *See* Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974), note 100 *supra*, where defendant proved some but not all of the § 5C(1) exemption, and therefore was liable. *Semble*, Prokop v. Krenek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), note 104 *supra*.

107. See Part 2.1 above.

108. See Parts 3 and 4.1 above. On offers as distinct from sales, see Part 5.1.2 below.

Territorial Aspects. Nothing in § 7 specifically limits the securities registration requirement to sales in Texas, although that was almost certainly the legislative intent, as well as a general territorial principle of state law and a federal constitutional necessity. (By contrast, the dealer registration mandate of § 12 applies "in this state."). In any event, most cross-border transactions in either direction are covered. The authorities noted below are not § 33 or § 34 cases, but should be applicable to them.

Outside Sellers. Sales by out-of-state persons to Texas buyers are Texas sales, covered by TSA. Thus an Arizona dealer sold, or at least offered, in Texas when he called a Texas prospect from Arizona, offered municipal bonds over the telephone, and confirmed them by mail from Arizona. Shappley v. State, 520 S.W.2d 766, 768-69 (Tex. Crim. App. 1974). The court affirmed the § 29A conviction for not being registered in Texas as a dealer or salesman. And it rejected defendant's argument that the sale took place in Arizona pursuant to TEX. BUS. & COM. CODE §§ 8.301(a), 8.313(a)(3) (Vernon 1978) (which state that a sale takes place at delivery and that delivery of a security takes place on confirmation). However, the Code, in § 10.104(3), specifically yields to TSA. The court never quite indicates whether defendant sold in Texas or only offered. The distinction would be unimportant in a criminal case since § 29A applies equally to both offenses. The distinction could be important in a § 33A(1) case; see Part 5.1.2 below.

Outside Buyers. Similarly, sales by Texas persons to outside buyers are Texas sales covered by TSA. 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.) (affirming § 32 injunction against defendants in Texas selling oil and gas leases by telephone and mail to persons outside Texas; sales were subject to acceptance in Texas and Texas bank accounts were used; defendants were not registered in Texas, nor were the securities); Enntex Oil & Gas Co. v. State, 560 S.W.2d 494, 496-97 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.) (*semble*).

Dealers and Salesmen. Whether a person is acting as a dealer or salesman in Texas is governed by the general principles stated above and by a specific rule defining a dealer activity as occurring "within this state" if either the dealer "or his agent is present in this state or the offeree/purchaser or his agent is present in this state at the time of the particular activity." Tex. State Sec. Board Rule IV.B.28, Tex. Reg. No. 065.04.00.002 para. 28, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,604 para. B.28 (1977). There is an identical definition for a salesman. *Id.*

109. § 33A(1) [like § 33A(2)] creates liability to "the person buying the security from him" (the defendant). *Semble* § 33B creating fraud liability of a buyer "to the person selling the security to him." This language, which has been in § 33A since 1963, is somewhat tighter than the 1941-1963 language (Appendix 3 below): "the purchaser . . . shall be entitled to recover from the seller," not specifying the seller to the purchaser. The narrowing of the language in 1963 is another reason for distinguishing the broad "seller" liability cases (Part 3.1.1 above) under prior law. See Part 3.2 above. This aspect was not considered in the *Searsy* cases, 559 S.W.2d 663 (Tex. Civ. App.—Texarkana), *rev'd*, 560 S.W.2d 637 (Tex. 1977), notes 46 and 45 *supra*.

110. See Part 4.2 above.

111. (A) *Proof of Nonregistration and Related Matters.* The plaintiff (or his attorney) may ascertain the fact of the registration or nonregistration by examining the Commis-

defendant was a "dealer, salesman or agent" at the time of the sale.[112] The plaintiff loses if he is unable to prove, or the defendant is able to disprove, any of the elements just listed. Registration of the security under federal law, or the law of another state, is irrelevant if the security was not registered in Texas. However, registration of the security by any of the three

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sioner's records, which are open to the public by virtue of § 11. (*See also* TEX. REV. CIV. STAT. ANN. art. 6252-17a (Vernon Supp. 1978) dealing generally with public access to information in custody of state agencies). But there are quicker and more effective ways. A call to the staff of the State Securities Board in Austin will usually produce an immediate answer as to whether a security, dealer, or salesman was registered at a given time. A few days more, and a few dollars for a fee, will bring from the Commissioner a certificate of noncompliance (or compliance) which is prima facie evidence in court by authority of § 30. For an application, see Dempsey-Tegeler & Co. v. Flowers, 465 S.W.2d 208, 216-17 (Tex. Civ. App.—Beaumont), *rev'd on other grounds*, 472 S.W.2d 112 (Tex. 1971). *Cf.* McQueen v. Belcher, 366 S.W.2d 670 (Tex. Civ. App.—Amarillo 1963, no writ) (Commissioner's certificate that no permit had been issued was evidence that no securities registration had been accomplished; venue case). A stipulation or admission will usually be made, so that the certificate becomes unnecessary at trial.

The Commissioner will certify other matters ascertainable from his records that may be relevant to a § 33A(1) case, *e.g.*, whether a notice was filed for a § 5I(c) exemption, whether a filing was made to clear an issue for exempt secondary trading under § 5.O, whether he revoked a § 5.O or § 5I(c) exemption, whether he issued a § 23A stop-sale order or a § 23B stop-advertising order, and what notice he gave relevant persons of such orders. He will also furnish a certified copy of a § 9A escrow order or a permit which may contain limitations on marketing expense under § 9B. In general the registration material filed by persons seeking to sell securities is open to inspection and copying.

Cf. Aiken v. State, 137 Tex. Crim. 211, 216, 128 S.W.2d 1190, 1193 (1939), in which, without considering the predecessor of § 30, the court accepted the uncontroverted testimony of a Securities Division employee that defendant was not registered for certain years.

For an unsuccessful effort to prove nonregistration by the buyer's testimony as a shareholder of the issuer and as to statements made to him by the selling salesman, see LeNoble v. Weber, Hall, Cobb & Caudle, Inc., 503 S.W.2d 321 (Tex. Civ. App.—Tyler 1973, no writ). The upper court did not rule on the admissibility of this evidence but sustained the directed verdict for the seller on the ground that the testimony—which was excluded by the trial court—was not properly tendered or included in a bill of exception.

(B) *Duration.* The time when securities registration becomes effective is discussed in note 121 *infra*. A registration lasts one year, whether under § 7A (see § 10B), § 7B (see § 7B(2)b), or § 7C (see § 7C(3)). Renewals are permitted by each provision if the requisite standards are met at the time of renewal. The Commissioner may revoke a registration, after it has become effective, by § 23A. See Part 5.8.1 below.

112. § 7A(1) prohibits a "dealer, agent or salesman" from selling unregistered securities. Other persons are not subject to the registration requirement or to consequent liability under § 33A(1) for nonregistration. The definition of dealer is broad enough to include many persons who are active in securities transactions although not dealers in the business sense. See Part 5.5.3 below. (The definition of salesman and agent is treated in Part 5.6.3 below.) Nonetheless, plaintiff still has the burden of proving that defendant is in one of the specified categories, and loses if he fails. Stone v. Enstam, 541 S.W.2d 473, 479 (Tex. Civ. App.—Dallas 1976, no writ), discussed note 273 *infra*.

The criminal provision, § 29B (see note 155 *infra* and accompanying text), sets penalties for "any person" who sells or offers unregistered securities. At first glance, this appears broader than the "dealer, salesman or agent" in § 7A(1). But § 29B seems to incorporate § 7A(1), and thereby its limiting language, by cross reference to it ("unless said security . . . have been registered . . . as provided in Section 7"). In any event, § 33A(1) creates liability not for violation of § 29B, but for violation of § 7. *But cf.* Ladd v. Knowles, 505 S.W.2d 662, 666, 668 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.), in which the trial court permitted a rescission claim, based on § 29B—apparently because limitations had run on § 33A(1)—to go to the jury. The jury found against plaintiffs and the intermediate court affirmed (on pari delicto grounds, see notes 116, 364 *infra*) without discussing the validity of an implied claim under § 29B.

Texas procedures (qualification, notification, and coordination, §§ 7A, 7B, and 7C respectively) will defeat the plaintiff's claim. But it is irrelevant whether the seller was registered (as a dealer or salesman) under Texas or any other law, except that Texas registration might permit him to claim a § 6 exemption that would otherwise be beyond his reach. Exemptions are the main defenses to a § 33A(1) complaint.[113]

5.1.2 *Improper Offers.* Section 33A(1) [like § 33A(2)] makes liable "[a]ny person who offers or sells" in proscribed ways. The question raised by this apparently disjunctive language is what liability arises from an improper (proscribed) offer. No reported Texas case considers the question, and plaintiffs have apparently overlooked its potential.

If an improper offer does not lead to a sale, it is clear from the statute that there is no liability to the offeree since (1) he is not "the person buying the security," (2) there is no transaction to rescind, and (3) except perhaps in very unusual situations, there are no damages to the offeree. In broader terms, the offeree has suffered no injury for which he should be compensated.[114]

By contrast, it is equally clear that an improper offer may result in sanctions other than civil liability—such as a § 32 injunction, a § 29B prosecution, a § 23A stop order, or a § 14E registration revocation (dealer or salesman)—whether or not the offer leads to a sale.

What is not so clear is whether an improper offer, followed by a proper sale to the offeree, creates liability. The following paragraphs analyze several variants of this problem. In view of the uncertainties in this area, one who discovers in time that he has made improper offers would be wise from a legal viewpoint (with which business considerations may, of course, conflict) not to sell to those offerees but only to other persons.

(A) *Offers Before Registration Filed (Gun Jumping).* Unless a particular exemption is applicable, an offer—written or oral—made before the filing of a registration statement violates § 7A(1). The consequence seems to be liability to the buyer under § 33A(1), even though registration is completed before the sale is made. This draconian result has been reached in federal law, which is similarly structured.[115] This result, while indicated by the phrasing of TSA, is not inevitable. It might be avoided by doctrines such as ratification, cure (looking at the transaction

113. See the partial discussion of exemptions in notes 101, 102, 105 *supra*.

114. While § 33A(1) [like § 33A(2)] may not say explicitly that the violating offer must be to the person who buys, that is the grammatical and logical implication, as well as the intent so far as I am familiar with it. Thus, *Z*'s illegal offer to *X* does not create any § 33 rights in *Y*, even though *Y* buys from *Z*. (If an illegal offer is made to *Y* too, that is a different story.) The same is true for § 33B offers to buy. However, it is possible that the offer to *X* destroys an exemption that would otherwise cover the sale to *Y*. See Part 5.1.2(E) below.

115. Diskin v. Lomasney & Co., 452 F.2d 871 (2d Cir. 1971) (liability although security later registered and full prospectus delivered; the "result here reached may appear to be harsh," Judge Friendly concedes. *Id.* at 876). See 3 Loss 1695-98; 6 *id.* 3830-31 for a discussion of federal and state law.

as a whole), and pari delicto,[116] or on policy reasons suggested below. Any of these might be implemented or complemented by a *conjunctive* reading of "offers or sells" in the context of automatic liability created by § 33A(1).[117]

In policy terms, liability for an improper offer followed by a proper sale can be justified—if at all—only by a rather punitive view that exalts deterrence of violations above other policy considerations. On the facts hypothesized, whatever violation occurred has been cured; the registration system has been vindicated by complying with it; the investor has received the protection afforded by the Commissioner's clearing the registration; and any loss the investor suffered can hardly have been from the failure to register. The strongest case for liability can be made in the situation where the investor was hard-sold before registration and before he received a prospectus, so that he did not have—when he effectively made his investment decision—the benefits the registration system is supposed to give him. If, in fact, he bought before registration, liability on that basis is perfectly appropriate.[118] If there were material misrepresentations or omissions in the offer, fraud liability under § 33A(2) is appropriate if they were not corrected before purchase.

Liability for improper offers, followed by proper sales was not, so far as I can recall, discussed by the State Bar Committee, which carried forward prior and familiar statutory language on this point for the reasons described in Part 9.2 below. Unless the courts find a way to eliminate this liability, the statute should be amended by deleting "offers or" from § 33A(1),[119] or by adding an exception.[120]

(B) *Offers During Waiting Period.* The waiting period is the time after a registration is filed and before it becomes effective.[121] One

116. *See* Ladd v. Knowles, 505 S.W.2d 662, 668 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.): "Thus if the transactions were in fact illegal solely because the stock was not registered, plaintiffs, by knowingly joining with defendants in the illegal scheme, were equally culpable with defendants and, therefore, in pari delicto." In this case the shares were never registered. The argument is much stronger in the situation considered in the text where the shares are registered before sale. See further discussion in Part 6 below.

117. *See* TEX. REV. CIV. STAT. ANN. art. 10 para. 6 (Vernon 1969): "In all interpretations [of civil statutes] the court shall look diligently for the intention of the Legislature, keeping in view at all times the old law, the evil and the remedy." The essence of my argument is that the remedy of automatic civil liability for most of the improper offers described in the text, if cured before sale, is wholly disproportionate to these slight evils, for which other sanctions remain available.

118. "Sale" is very broadly defined in § 4E to include *inter alia*, "contracts and agreements whereby securities are sold." "Buy" or "purchase" should have correspondingly broad meaning. Thus, an investor who has agreed—in writing, orally, or by conduct—to buy a security offered to him has been "sold" the security and should win under § 33A(1) on this basis.

119. This is the technique of the proposal that would supersede the federal law. ALI FEDERAL SECURITIES CODE § 1702 (Proposed Official Draft 1978). *See* Comment (3) to *id.* § 1401, at 72 (Tent. Draft No. 2, 1973).

120. CAL. CORP. CODE § 25503 (West 1977), last sentence, expressly denies liability if the security is qualified (registered) before any payment for the security even though there was an improper offer.

121. *Effective Time.* A qualification registration under § 7A becomes effective on the

looks in vain for any part of TSA that permits "offers" to be made during the waiting period.[122] This is slightly incredible, since waiting period oral offers are fully approved by federal[123] and most other state[124] laws, and are almost universally used in Texas, as elsewhere, to inform investors of coming issues that will be sold when registration is complete and to give investors time to consider relevant information about the issue.

A literal application of § 33A(1) would make rescindable virtually all registered issues sold through traditional marketing practices. Such a disastrous result might be avoided in the courts by applying concepts of ratification or cure,[125] by treating sales efforts during the waiting period as not being "offers,"[125A] by treating such sales efforts as permitted "advertising,"[126] or by treating "offers or sells" as conjunctive. Reinforcing all these theories is the reality that Texas investors will be deprived of good buying opportunities, and Texas dealers will be deprived of good selling opportunities, if the nationwide practice is not permitted in Texas.[127] An amendment specifically authorizing offers during the waiting period, perhaps along the lines of Uniform Act § 402(b)(12), would be a much better solution.

(C) *Preliminary Prospectuses During Waiting Period.* As just

Commissioner's issuance of a permit under § 10. A notification registration under § 7B generally becomes effective five days after it is received by the Commissioner. § 7B(2)b. A coordination registration under § 7C generally becomes effective simultaneously with the SEC registration to which it is coordinated. § 7C(2). Despite the statutory prescription of effective dates for § 7B and § 7C registrations, and the limitation of § 10 (governing permits) to § 7A registrations—confirmed by the § 22B references to permits (for § 7A) and completion of registration for §§ 7B, 7C—the Commissioner traditionally issues the same kinds of permits in all three types of registration. See note 99 *supra*. If the exact time of effectiveness of a registration statement becomes critical, it seems clear that the statutory language should take precedence over the administrative practice. For the duration of a registration, see note 111 para. (B) *supra*.

122. But see Part 5.1.2(C) below. A proposal is being developed which would, if enacted, amend § 22 to permit oral offers during the waiting period.

123. 1 Loss 225-26; 4 *id.* 2321.

124. Uniform Act § 402(b)(12) (if registration statement filed under U.S. law and in the state).

125. See text accompanying notes 116-17 *supra*.

125A. All § 4 definitions are applicable "unless the context otherwise indicates." The widespread industry practice—of which there is common knowledge, and which apparently has been undisturbed by enforcement action—may well provide a context that indicates otherwise. Common knowledge that most securities dealers are corporations was a factor in the supreme court's holding that "person" included "corporation," even when § 4B did not say so. Flowers v. Dempsey-Tegeler & Co., 472 S.W.2d 112, 115 (Tex. 1971), discussed in note 35 *supra*.

126. See Part 5.1.2(C) below. This theory depends on characterizing the offer as "[t]he whole, or any part, of" a "document" (*e.g.*, a preliminary prospectus) filed with the SEC and with the Commissioner before use. § 22D. It would probably be necessary that the offer be limited to what is contained in the document and not include, for example, earnings projections that are rarely placed in such documents. There are obvious problems of proof of the content of an oral communication. And it seems clear—from the § 22D requirement that all advertising permitted by that section carry a printed legend—that only written advertising is contemplated by that section. Still, the oral communication might be regarded as incidental to the written.

127. It is the best securities that are most likely to be sold fastest, and thus no longer be available for offers first made after registration becomes effective.

noted, there is no express authorization for "offers" during the waiting period. But there is an express authorization in § 22D for the use of "the whole, or any part, of any written . . . documents theretofore filed" with the SEC under the 1933 Act. These documents are primarily preliminary prospectuses.[128] Their express permission by § 22D is, though not so phrased, an exemption from § 7A(1)'s prohibition on offers before registration, and therefore an exemption from § 33A(1) liability for such offers. (Why comparable treatment is not given to preliminary prospectuses filed with the Commissioner under § 9C, but not with the SEC, is not evident.)

But § 22D contains three conditions or requirements which, if not met, raise § 33A(1) questions: (1) The preliminary prospectus must be sent to the Commission before it is used.[129] (The advance filing allows the Commissioner to review the document and decide whether it is misleading so that it should be informally withdrawn or formally banned by a § 23B stop-advertising order.) (2) The material may not be broadcast on radio or TV, or printed in newspapers. (3) The material must be overprinted or stickered with a prescribed legend stating, *inter alia*, that it is for "informational advertising only" and that the securities have not been qualified in Texas. Except for the local reference, the legend is similar to that required on preliminary prospectuses by the SEC.[130] Multistate offerings, whose prospectuses are printed elsewhere, do not normally contain the Texas language, and Texas dealers often forget to append it.

The first two of the three provisions are written as conditions of the § 22D exemption, prefaced by "if." The third is written as a requirement. This permits a distinction that would create § 33A(1) liability for violation of the first two provisions, but not the third.[131] Certainly, the third requirement, which is silly if the SEC legend is present, serves no significant investor protection purpose; this is a policy reason not to impose civil liability for failure to comply with it, especially if the investor later receives a final prospectus. Even a violation of the first requirement, if it is cured by filing before the sale is made, provides little justification for imposing liability.

(D) *Unfiled Advertising After Registration.* Once a registra-

128. Tex. State Sec. Board Rule XIV.B.2, Tex. Reg. No. 065.14.00.002 para. 2, *reprinted in* 3 BLUE SKY L. REP.(CCH) ¶ 46,614 para. B.2 (1978), confirms that preliminary prospectuses may be used under § 22D.

129. § 22D so states. There is a rule requiring § 22B(3) advertising to be filed with the Commissioner five days before use. Tex. State Sec. Board Rule XIV.B.1, Tex. Reg. No. 065.14.00.002 para. 1, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,614 para. B.1 (1978). See Part 5.1.2(D) below. But it applies only to post-registration advertising, not to a preliminary prospectus used during the waiting period. However, § 22D does not specify that the preliminary prospectus be filed with the Commissioner before the registration application is filed. The rules allow the prospectus to be filed after (which in practice means with) the application or if an application "is in the process of being filed" and will be filed before the effective date at the SEC. Tex. State Sec. Board Rule XIV.B.2, Tex. Reg. No. 065.14.00.002 para. 2, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,614 para. B.2 (1978).

130. SEC Sec. Act Rule 134(b)(1), 17 C.F.R. § 230.134(b)(1) (1977).

131. However, the last sentence of § 22D treats violations of all three as equally unlawful and subject to the same criminal penalties.

tion statement has become effective, no restraints on offers are imposed by § 7. But—in one of those abrupt shifts of vocabulary that make TSA so maddening—offers in the form of "advertising" are restricted by § 22B,[132] which imposes three requirements in the absence of an exemption:[133] (1) dealer or salesman registration of the person using the advertising, (2) registration of the security, and (3) filing of the advertising with the Commissioner.[134] Violation of either of the first two requirements is likely to result in direct liability under § 33A(1), which incorporates similar requirements by reference to §§ 12 and 7. What about violation of the third requirement, which has no parallel in § 33A(1)? Such a violation does not automatically create civil liability to a buyer who received the noncomplying advertisement, because § 33A(1) contains no reference to § 22.[135] The connection is not supplied by the last clause of § 22A which says of illegal advertising: "[I]n addition, the state and purchasers shall have all other remedies provided for where the unlawful [*sic*] sales are made under this Act." Purchasers no longer have remedies for "unlawful sales." They presumably did have "voidability" rights for such sales under a provision similar to Appendix 3 below, when the predecessor of § 22A came into the law.[136] The more precise civil liability amendments of 1963 and 1977 should be read to nullify any automatic civil liability for advertising that contravenes § 22, unless it also contravenes § 7, § 12, or one of the other sections specifically referenced in § 33A(1).

(E) *Offers to Nonbuyers.* We have already noted at the beginning of Part 5.1.2 above that an improper offer to *X* does not create any civil liability to *X* if *X* does not buy. But it is possible that an improper offer to *X* may destroy an exemption for a sale to *Y*, allowing *Y* to sue. An example is an attempted nonpublic, limited offering under § 5I [or § 5Q]. If the offer to *X* amounts to "public solicitation or advertisements," it may destroy the exemption for sales to all buyers about the same time, so that

132. Advertising is implicitly defined by § 22A as "any circular, advertisement, pamphlet, prospectus, program or other matter." For a critical discussion of what is advertising, with emphasis on distribution and use, see Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities—The Prohibition on Advertisements*, 20 SW. L.J. 239, 250-54 (1966). Generally following those ideas are Sibley v. Horn Advertising, Inc., 505 S.W.2d 417, 419-20 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert. denied*, 420 U.S. 929 (1975); Tex. State Sec. Board Rule V.I.1-2, Tex. Reg. No. 065.05.00.009 paras. 1-2, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,605 paras. I.1-2 (1978).

133. By § 22E, § 22 does not apply to § 5 exempt transactions or to § 6 exempt securities, unless the advertising violates a § 23B stop-advertising order or, presumably, a § 23A stop-sale order. The "unless" clause looks redundant; what is the point of making a violation of § 23 also a violation of § 22? The purpose is apparently to invoke the criminal penalties of § 29G, which refers to § 22. § 29G overlaps § 29D so far as an ad violates § 23A. But only § 29G covers a violation of § 23B (via § 22E). In any event, the "unless" clause seems to have no bearing on civil liability.

134. Advance filing is required. See note 129 *supra*.

135. An ad which violates § 22 is a criminal offense by §§ 22A and 29G, and is subject to other sanctions, such as a § 32 injunction, a § 23A stop-sale order, a § 23B stop-advertising order, and a § 14E revocation order.

136. 1955 Tex. Gen. Laws, ch. 67, § 23(a), at 338. The voidability provision was *id.* § 34. For an effort to impose liability under it for an advertising violation, see Christie v. Brewer, 374 S.W.2d 908, 914-15 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.).

buyer *Y* may sue under § 33A(1) even though *he* received no public solicitation or advertisement. This result depends on whether "such sale" in § 5I—which must be without public solicitation or advertisement—means the specific sale to *Y* or all concurrent sales activity including the offer to *X*. The latter interpretation has some support from the run-together language of § 4E, which, as noted in Part 3.1 above, defines "sale" and "offer for sale" identically to include "every attempt . . . to dispose of a security for value." This language suggests that the Legislature may have been looking at the whole offer-and-sale process as a single activity.[137] Precedent under the very differently worded federal private offering exemption[138] points the same way.[139] On the other hand, there is a windfall inequity in letting the legally solicited investor win because someone else—particularly someone who did not buy—was illegally solicited. There is some precedent in SEC Rule 146 (which interprets the federal private offering exemption) for disregarding the improper solicitation that results in no sale.[140] And the reference in § 5I to "such sale" rather than to, say, "the offering," is a strong indication that, for § 33A(1) purposes, *Y* cannot recover because of public solicitation of *X*. But the question is far from decided,[141] and plaintiffs and defendants should argue for the inter-

137. It also suggests, more convincingly, that the definition was addressed to requiring registration before offers were made, rather than to civil liability. In fact, the irrational sale-equals-offer definition was in the Act before civil liability was added in 1941. *See, e.g.*, 1935 Tex. Gen. Laws, ch. 100, § 2(e), at 257. For the advent of civil liability, see notes 19-21 *supra* and accompanying text.

138. 1933 Act § 4(2) exempts "transactions by an issuer not involving any public offering." In contrast, TSA § 5I exempts certain sales, provided "such sale" is made without public solicitation or advertisement.

139. *E.g.*, Henderson v. Hayden, Stone, Inc., 461 F.2d 1069, 1071-72 (5th Cir. 1972) (sophisticated, experienced buyer of $180,000 of $300,000 unregistered offering allowed to recover under 1933 Act § 12(1) because other offerees not shown to be within private offering exemption of 1933 Act § 4(2), although he alone would have been). *See* Donra v. Petroleum Management Corp., 545 F.2d 893 (5th Cir. 1977) (sophisticated, experienced buyer of $125,000; judgment for seller reversed and remanded to determine whether other seven offerees (all of whom were sophisticated and four of whom bought) received sufficient information for private offering exemption).

140. SEC Sec. Act Rules 146(d)(1), (2), 17 C.F.R. §§ 230.146(d)(1), (2) (1977), distinguish between the qualification of offerees and those of buyers. As to offerees, the seller must have reasonable grounds to believe that the offeree is sophisticated (able to evaluate the investment offered) or able to bear the risk of the investment. As to buyers, the seller must have reasonable grounds, after reasonable investigation, to believe that the buyer is sophisticated or both that the buyer and his representative together are sophisticated and that the buyer is able to bear the risk. The implication is clear that an offeree who turns out to be unqualified does not destroy the exemption so long as the seller had reasonable grounds to think he was qualified before offering to him. Moreover, the Note following rule 146(e)(3) specifies information, which must ordinarily be given to all offerees, need not be given to offerees who are not going to buy. Thus, the rule 146 exemption survives despite a nonbuying offeree who is unqualified and uninformed.

141. The only relevant decision seems to be Sibley v. Horn Advertising, Inc., 505 S.W.2d 417, 419-20 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert. denied*, 420 U.S. 929 (1975). Justice Guittard's opinion dealt with the question only by implication. In holding that there was no public solicitation, it considered only the solicitation of the buyer in the suit (who happened to be a defendant, urging unregistered security as a defense to a suit against him on his contract to buy securities). In holding that an offering memorandum was not an advertisement, because there was no public distribution of the memo, it considered that the memo was shown to no more than 20 selected acquaintances of the promoters. The intima-

pretations that aid them.

5.1.3 *Meaning of Unregistered.* At first glance, it appears that a security is registered or it is not. Certainly any one of the three modes of registration—§ 7A qualification, § 7B notification, or § 7C coordination—produces the same result: a registered security. But there are instances in which "registration" is murky.

Oversales are an example. Consider a multistate offering of which 100,000 shares are registered in Texas. Through miscalculation, or shifts by the managing underwriter to places of strong demand, 102,000 shares are sold in Texas. If the registration application is not amended in time—and what is timely is not clear—are the last 2,000 shares (if they can be identified, which they probably cannot since the typical closing is simultaneous for all shares) unregistered? Or 2/102 of each sale? Or all 102,000 shares? There are no firm answers.[142]

Other obscure questions relate to suitability or minimum purchase standards imposed by rule[143] or, occasionally, by permit.[144] Is a sale that fails to meet these standards a violation of the § 7 registration requirement precipitating civil liability under § 33A(1)? The answer should clearly be no for the suitability standards which are usually too vaguely stated to be the basis of automatic liability under § 33A(1). Even when more precisely stated, in terms of the buyer's income or net worth, these involve definitional and valuational problems, and the underlying information is exclusively within the buyer's knowledge. The seller typically (and wisely) asks for the buyer's written representation that the buyer meets the suitability standards. If the buyer miscalculates or misstates, the seller should not be liable. More technically, it seems to me that the securities have been registered, and thus there can be no liability under § 33A(1) for lack of registration, even if suitability standards are not met in all sales.[145] The minimum purchase standards are sufficiently precise and compliance is largely

tions are that public solicitation is to be measured only by the buyer in court, but that advertisement is to be measured by all recipients of the document.

142. *See Blue Sky Oversales*, 7 REV. SEC. REG. 831 (1974).

143. *See, e.g.*, Tex. State Sec. Board Rule IX.C, Tex. Reg. No. 065.09.00.003, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,609 para. C (1978) (real estate programs: $2,500 minimum purchase ($10,000 for certain kinds of programs), prospectus to state suitability requirements); Tex. State Sec. Board Rule X.C.1 & .4, Tex. Reg. No. 065.10.00.003 paras. 1 and 4, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,610 paras. C.1 and 4 (1976) (cattle feeding programs: $5,000 minimum purchase, general remarks on suitability); Tex. State Sec. Board Rule XI.C.1 & .4, Tex. Reg. No. 065.11.00.003 paras. 1 and 4, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,611 paras. C.1 and .4 (1978) (oil and gas drilling programs: $5,000 minimum purchase ($2,500 if income or production purchase program), dealer or sponsor shall take all action reasonably required to assure sales only to purchasers for whom suitable).

144. *See, e.g.*, TEX. STATE SEC. BOARD, TEX. MONTHLY SEC. BULL. 6 (Jan. 1971): permit issued to Jade Oil & Gas Co. for sales of units (of convertible preferred and warrants) no smaller than $10,000 to buyers with net worth no less than $500,000.

145. The contrary view would be that a registration, or at least a permit (see note 99 *supra* for the difference), is conditional on meeting the prescribed standards in sale, so that failure to do so would make the permit or registration ineffective. Apart from questions whether the Commissioner has authority to impose conditions of this kind—on which TSA is silent—it seems that any such condition would have to be stated with great particularity in the permit or registration document in order to form the basis for § 33A(1) liability. A

within the seller's control, so it would not be inherently unreasonable to hold the seller responsible for violating them. Nonetheless, there is still a question whether violation renders the securities so sold "unregistered" for § 33A(1) liability.

Price variations raise similar questions. With rare exceptions (such as, for open-end investment companies which sell shares at net asset value, often plus a percentage sales load), securities are registered for sale at a fixed price, *e.g.*, 100,000 shares at $10 each. The price is more than a matter of tidiness or fee computation under § 35E. Price affects the maximum marketing expense under § 9B, considered in Part 5.3 below. Even more substantively, it affects the Commissioner's determination of fairness under § 10A, which directs him to consider the difference between the price paid for earlier securities (by "promoters") and the price being paid by the public in the proposed offering.[146] Thus, it may well be that a sale below or, even worse, above the specified price is not a "registered" sale and is therefore in violation of § 7 and actionable under § 33A(1).

Yet another question is for whom are securities registered. Section 7A(1) plainly contemplates that an application for a qualification registration will be filed by and a permit granted to the issuer of the securities or to a registered dealer who is selling them. Sections 7B(2) and 7C(1) are in accord, except there is no reference to a permit. Section 10A calls for the Commissioner to "issue to the applicant a permit authorizing it to issue and dispose of such securities." The form of permit used by the Commissioner is addressed to the particular issuer or dealer. The implication of all this is that registration is only for the applicant issuer or dealer, and that the securities are "registered" for them but no one else. This is so far from the reality of securities distribution that it cannot be accepted as correct. In the usual offering there are multiple underwriters who (through the managing underwriter) sell to other dealers at a discount from the public offering price and possibly still other dealers who buy from the prior dealers at a smaller discount. All these persons sell the securities to public investors. This process (including the name and number of securities for each underwriter) is carefully described in the prospectus which is a part of the registration application. In this context, there can be no serious doubt that the underwriters and the other selling dealers are all selling "registered" securities even though they are not named in the application or permit.[147] But there is a substantial question whether an investor who buys in the registered offering and then resells at a later date is selling a "regis-

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suitability standard in the prospectus, whether voluntary on the part of the issuer or "suggested" by the Commissioner, does not meet this criterion.

146. *Semble*, § 7C(2). See also Tex. State Sec. Board Rule VII.D.3, Tex. Reg. No. 065.07.00.004 para. 3, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. D.3 (1976) on how the prior price is computed in going concerns.

147. The usual dealer's exemption, § 5.O (note 102, para. (B)(2) *supra*) is inapplicable for a number of possible reasons: the securities are part of an unsold allotment in a distribution, there may be no comparable securities in public hands, there may be no current market price, the proceeds go to the issuer, etc. *See* §§ 5.O(1)-(4). A dealer who is not part of the underwriting or selling group may use § 5.O as soon as its conditions are satisfied, *e.g.*,

tered" security. However, if he is not a "dealer, salesman or agent," he is not a violator of § 7, and consequently not liable under § 33A(1).[148] In any event, he may have exemptions like § 5C(1) available to him. While the practical problems may be small, there is an important theoretical distinction here. Texas registration is much more like federal registration of a particular offering by particular persons than like Uniform Act registration of all outstanding securities for nonissuer sales.[149]

5.1.4 *§ 34 Commission Ban.* An unregistered security invokes another sanction besides rescission or damages under § 33A(1). A person who renders services in a sale[150] of an unregistered security is barred by § 34 from suing for a commission or compensation in the sale, unless he shows that his transaction was exempt by § 5,[151] or that the security was exempt by § 6.[152] Additional exemptions outside TSA may negate § 34.[153]

The commission ban applies also to unregistered dealers, and has usually been litigated in that context, so detailed discussion is postponed to Part 5.5.5 below.

5.1.5 *Related and Implied Claims.* An additional sanction imposed upon the seller of an unregistered security (assuming no exemption) is that his violation precludes him from suing for any unpaid purchase price, by the express language of § 33K (which will be discussed in a later installment) and by the common law which preceded it.[154]

Sale or offer of an unregistered security is a felony, punishable by a $5,000 fine, 10 years in prison, or both, under § 29B.[155] Only natural persons can be convicted under § 29, *i.e.*, not corporations, partnerships, and

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securities in public hands. The registration will satisfy the § 5.O information requirement.

148. See note 112 *supra* and accompanying text.

149. *See* UNIFORM ACT § 305(i) and Official Comment to §§ 305(i), (j); L. LOSS & E. COWETT, BLUE SKY LAW 314-23 (1958).

150. Although § 34 starts off as though it applies to purchases as well as sales, the purchase part pertains only to unregistered dealers. See Part 5.5.5 below. This is logical, since securities have to be registered only when sold, not when purchased. *See* § 7A(1). The interpretation is confirmed by the middle portion of § 34, which refers to registration of "the securities so sold."

151. The preamble to § 5 reinforces this result. The transaction exemptions are sketched in note 102 *supra*.

152. The § 6 exemptions are summarized in note 101 *supra*. The preamble imposes as a condition of each exemption that the security be sold by a registered dealer (or salesman). Thus an unregistered person cannot use a § 6 exemption to avoid the commission bar of § 34 on a sale transaction. But he apparently can use a § 6 exemption to sue for a commission on a purchase. See note 289 *infra*.

153. See note 105 *supra*.

154. *See, e.g.*, Anderson v. Eliot, 333 S.W.2d 654 (Tex. Civ. App.—Eastland 1960, writ ref'd), and Sibley v. Horn Advertising, Inc., 505 S.W.2d 417, 419-20 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert. denied*, 420 U.S. 929 (1975), in which the courts recognized this principle but found it inapplicable because there was an exemption.

155. *See, e.g.*, Cox v. State, 523 S.W.2d 695 (Tex. Crim. App. 1975); Sharp v. State, 392 S.W.2d 127 (Tex. Crim. App. 1965); and, apparently, Bridges v. State, 172 Tex. Crim. 508, 360 S.W.2d 531, *cert. denied*, 371 U.S. 821 (1962). See also note 112 *supra*.

other entities.[156] The usual exemptions apply.[157]

The criminal penalties create the possibility of using leverage to obtain satisfaction of a civil claim.[158] They also raise the possibility of an implied civil action based on the criminal provisions. Such actions were entertained by the courts before express civil liability was included in TSA,[159] and were expressly authorized by the 1941-1963 provision for voidability of any transaction in violation of TSA, reproduced in Appendix 3 below.[160] Do such implied actions survive the particularization of civil liability for specific violations in the 1963 and 1977 versions of § 33A(1)? Probably not, since the legislative intent to limit civil liability is conspicuous. However 1977 § 33M (and its 1963 predecessor, § 33F) makes it clear that the express liabilities of § 33 are in addition to any other remedies that may exist. But these sections do not answer the question whether the courts *should* imply a remedy under § 29B when an explicit remedy is given by § 33A(1). The Texas courts have not addressed this question.[161] In any event, it seems likely that plaintiffs will get no more from an implied action based on § 29B than from an express action based on § 33A(1).[162] So the implied action is probably not worth pleading where § 33A(1) clearly applies. If pleaded, the defendant should attack its sufficiency to state a claim, *e.g.*, by special exception and motion for summary judgment in state court, or by motion to dismiss in federal court.

The discussion above, also applies to a possible implied action based on § 29A (the criminal provision for sale without dealer or salesman registration) or § 29D (the criminal provision for sale in violation of a § 23A stop-sale order). These situations are amply covered by the explicit liabilities of § 33A(1).

On the other hand, an implied action based on § 29C (the general antifraud criminal provision, based on SEC Rule 10b-5, 17 C.F.R. § 240.10b-5) may well be broader than the explicit antifraud liability of § 33A(2) and should be seriously considered by plaintiffs with fraud claims. A further

156. § 4B, last sentence.

157. See notes 101, 102, 105 *supra*.

158. See Part 5.5.6 below.

159. See notes 17-18 *supra* and accompanying text.

160. See note 19 *supra* and accompanying text.

161. An implied claim based on § 29B was asserted in Ladd v. Knowles, 505 S.W.2d 662, 666 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.), but was disposed of on other grounds.

For some of the considerations in implying an action under the federal antifraud securities provisions, see 1 BROMBERG § 2.4 and Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 24-42 (1977), and under other federal statutes, Cort v. Ash, 422 U.S. 66 (1975). The United States Supreme Court's reluctance to imply remedies for acts that are covered by express remedies troubles me in fraud cases that no legislature can completely foresee. But it seems appropriate for technical violations that a legislature can obviously foresee since it is creating them.

If implied claims are accepted by the courts, they should include elements like causation of loss that are required by basic tort principles but not by automatic § 33A(1).

162. On the probably insignificant difference between "any person" in § 29B and "dealer, agent or salesman" in § 7A(1) referenced by § 33A(1), see note 112 *supra*.

§ 29B is probably narrower than § 33A(1) in applying only to natural persons. See note 156 *supra* and accompanying text. Whether this limitation would carry over to civil actions based on § 29B is unclear.

discussion in connection with § 33A(2) and § 33M will appear in a later installment of this Article.

In the typical unregistered security case, the disclosure to the buyer will have been sparse, without the benefit of a § 9C prospectus. So claims of omission and fraud, under § 33A(2) or related provisions, are common in § 33A(1) suits.[163] Fraud claims will be discussed under §§ 33A(2) and 33M in a later installment of this Article.

Parallel liabilities for securities unregistered under those statutes are created by 1933 Act § 12(1) and Uniform Act § 410(a)(1).

5.2 *Escrow Violation—§ 9A.*

5.2.1 *§ 33A(1) Civil Liability.* The Commissioner has discretionary authority by § 9A to require the proceeds of an issuing company's securities sales to be escrowed until they reach a specified monetary amount which "in his opinion will reasonably assure protection of the public." The main purpose is to safeguard investors from the total loss that is likely to occur if a company needs some minimum amount to carry out its plans and does not sell enough securities to obtain that amount.[164] An escrow agreement is signed by the selling company, the escrow agent (a bank or trust company), and perhaps the chief dealer or underwriter selling the securities. If the Commissioner finds, on a showing by the company and the escrow agent that the prescribed minimum has been achieved, the funds are released to the company. If the minimum is not achieved in two years (or a shorter period, which may be set in the agreement), the funds are returned to the buyers. The statute does not require that every penny of sale proceeds go into escrow; the Commissioner may allow "expenses and commissions" to be excluded and presumably kept by the company (in the case of expenses) or dealer (in the case of either). However, the usual practice seems to be to require escrow of 100% of proceeds.[165] The securities may also be required to be escrowed, to assure their delivery to buyers if the funds are released to the selling company. This requirement is not customarily imposed.[166]

Escrow of proceeds is not commonly required of established companies, of companies with alternate sources of financing, or for firm commitment

163. *See, e.g.*, Bateman v. Petro-Atlas, Inc., Civ. No. 75-H-445 (S.D. Tex. Sept. 26, 1977); Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ); Ladd v. Knowles, note 161 *supra*; Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd and remanded sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974).

164. Another purpose is to assure that expense limits are not exceeded. See Part 5.3.1 *infra*. Yet another is to assure reasonable diversification in certain risky operations, such as those of oil and gas drilling. *See* Tex. State Sec. Board Rule No. 065.11.00.004 para. 4, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,611 para. D.4 (1978): minimum amount of funds to activate program shall be sufficient to accomplish its objectives, including spreading the risk; minimum below $500,000 will be presumed inadequate to spread the risk; provision must be made for return of payments to buyers if minimum not reached.

165. *See* Tex. State Sec. Board, Rules, Form VII.D. (Escrow Agreement) ¶ 1 (looseleaf, orig. pub. 1976). This is the form commonly used.

166. The standard form of escrow agreement, note 165 *supra*, says nothing about escrowing the securities.

underwritings (in which the dealer-underwriter assures that the issuer will have the proceeds of the full offering). Thus, escrow of proceeds is used primarily for best efforts or all-or-none underwritings of small or new companies. Escrow cannot be imposed if the securities or transactions are exempt.[167]

Section 33A(1) imposes civil liability on one who "offers or sells a security in violation of Section . . . 9 (or a requirement of the Commissioner thereunder)," although I have found no reported cases concerning the liability. Failure to deposit proceeds in escrow is the main violation at which the liability is aimed.[168] But premature or improper release of proceeds is also covered.[169]

What § 9A violations, beside the two just mentioned, will generate § 33A(1) liability is obscure partly because the 300-word § 9A is redundant, inconsistent, and, in some respects, pointless, like so much of TSA. It is not clear, for example, whether buyer *X* (whose payment was properly escrowed) has a claim under § 33A(1) because buyer *Y*'s payment was not escrowed. This might logically depend on whether *X* has been injured, *i.e.*, on whether *Y* has a claim on the escrow fund. One clear requirement of § 9A is that the issuing company, or its dealer, furnish buyers' names and amounts to the escrow agent and the Commissioner. Violation of this requirement indicates liability by § 33A(1), but the result would be absurd if the required amount had been sold and the escrow properly closed by delivery of proceeds to the issuer.[170] Not clear is whether errors in submitting buyers' names and amounts, or submitting them to the bank and not the Commissioner (or vice versa), are actionable by § 33A(1). Here, as elsewhere,[171] the courts could call for a materiality or causation factor in

167. Preamble to §§ 5 and 6. See also notes 101, 102, 105 *supra* and accompanying text.

168. Arguably, the "offer or sale" is not in violation of § 9, only the disposition of proceeds after sale. But this must be rejected, for it would gut § 33A(1) so far as § 9A is concerned.

SEC 1934 Act Rule 15c2-4, 17 C.F.R. § 240.15c2-4 (1977) requires a broker or dealer participating in an "all or none" underwriting to segregate or escrow proceeds in certain instances. For examples of enforcement actions by the SEC for violation in such underwritings, see SEC v. Commonwealth Chem. Sec. Inc., ['75-'76 Decisions] FED. SEC. L. REP. (CCH) ¶ 95,495 (S.D.N.Y. 1976), ['76-'77 Decisions] ¶ 95,741 (S.D.N.Y. 1976), *modified and aff'd*, [Current] ¶ 96,351 (2d Cir. Mar. 3, 1978); Lloyd D. Sahley, [1973 Decisions] FED. SEC. L. REP. (CCH) ¶ 79,562 (SEC Admin. Law Judge Nov. 1, 1973), *aff'd summarily sub nom. In re* Midwestern Sec. Corp., 5 SEC Docket 67 (1974); *In re* R. Basile & Co., 7 SEC Docket 71 (1975); United States v. Grant, 462 F.2d 28 (2d Cir. 1972); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972); A.J. White & Co. v. SEC, 556 F.2d 619 (1st Cir. 1977); Exchange Bank & Trust Co., SEC Sec. Exch. Act. Rel. No. 9708, ['72-'73 Decisions] FED. SEC. L. REP. (CCH) ¶ 78,974 (1972); SEC v. Rega, ['75-'76 Decisions] FED. SEC. L. REP. (CCH) ¶ 95,222 (S.D.N.Y. 1975).

169. For a federal case against a bank escrow agent, see Exchange Bank & Trust Co., SEC Sec. Exch. Act Rel. No. 9708, ['72-'73 Decisions] FED. SEC. L. REP. (CCH) ¶ 78,974 (1972), note 168 *supra*.

170. Although most of § 9A is written in terms of "company," it suddenly shifts to "corporation" when it deals with release of escrow funds to the issuer. "Company" includes "corporation" by § 4B, but not conversely. A rationalist might argue that § 9A is thus impliedly limited to corporate issuers. But it does not pay to be too rational about TSA. Plainly, the intent is to cover all "companies."

171. See notes 47-50 *supra* and accompanying text.

liability.

If the escrow funds are returned to the buyers because the minimum has not been sold, buyers are generally better off than they would be in a § 33A(1) suit; they are spared the trouble and expense of litigation, and they do not have to worry about collecting a judgment. But they are worse off in at least one respect: they do not get interest on their money, unless the escrow agreement happens to provide otherwise.[172]

The escrow agreement is ordinarily not signed by the Commissioner, but he effectively dictates its terms. This may, or may not, make the terms of the agreement[173] "requirements" pursuant to § 9A, which become actionable under § 33A(1).[174]

A dealer selling for the issuer is a seller to the persons who buy from him and probably violates § 9A (and is therefore liable by § 33A(1)) if he does not turn the proceeds over to the escrow agent. It seems likely that this is true whether or not the dealer is a signer of the escrow agreement, since he will almost certainly be aware of the agreement. On the other hand, it seems unlikely that a dealer would be liable because of an improper release of the funds from escrow if he had nothing to do with the release.

An issuer that sells through a dealer is a seller to the persons who buy from the dealer and probably violates § 9A (and is therefore liable by § 33A(1)) if the dealer does not turn the proceeds over to the escrow agent. Thus, it is to the issuer's advantage to have the dealer sign and be bound by the escrow agreement.

The escrow bank would normally fall outside the broad definition of sale,[175] and would not be a seller to the plaintiff, and thus would not be liable under § 33A(1) for the company's failure (or a dealer's failure) to put the funds in escrow. Conceivably, there might be situations in which the bank could be reached as an aider under § 33F(2). A bank's improper release of funds from escrow to the company is further removed in time from the initial selling effort, but has so critical an economic connection with the sale that the bank might be a seller in violation of § 9A. In any

172. The usual form of escrow agreement, note 165 *supra*, does not require investment of the funds and therefore provides no interest.

173. The usual form of agreement, note 165 *supra*, prescribes such details as listing buyers' addresses and numbers of securities (as well as names and dollar amounts, which are specified in § 9A) on the deposit slips, furnishing the deposit slips biweekly to the Commissioner; furnishing the Commissioner quarterly reports of the amount in escrow; and furnishing disbursement reports from the bank to the Commissioner after he has authorized release or return of the funds.

174. Violation of the Commissioner's requirements under § 9 creates the same civil liability as violation of § 9 itself, by virtue of the parenthetical clause in § 33A(1): "(or a requirement of the Commissioner thereunder)." The Commissioner's determinations are often made by the Deputy Commissioner pursuant to § 2C, which authorizes the Deputy to perform the Commissioner's duties when the Commissioner "is absent or unable to act for any reason." In practice, determinations are often made informally by staff members in negotiation with registrants. Whether these are "requirements" for § 33A(1) liability is unclear and may raise fact questions. See also note 185 *infra* and accompanying text; note 199 *infra*.

175. See Part 3 above.

event, there would be a strong case against a bank as an aider under § 33F(2), as well as possible claims for breach of the escrow agreement (viewed as a third party beneficiary contract) or breach of trust.

Another form of escrow is sometimes required by the Commissioner: escrow of outstanding shares held by promoters or other early investors. The purpose of this escrow is to prevent resale of the outstanding shares to the public until certain conditions are met. There is no authority for this escrow in § 9 (or elsewhere in TSA), so violations of it do not lead to civil liability under § 33A(1).[176]

The elements of plaintiff's § 33A(1)-§ 9A case are that he bought[177] and the defendant sold[178] to the plaintiff[179] a security[180] for which a § 9A escrow requirement was in effect,[181] and the defendant violated the escrow requirement.[182]

5.2.2 *Related and Implied Claims.* There seem to be no related or implied claims under TSA or federal law, unless the escrow violation can be classed as fraud.[183] Uniform Act § 410(a)(1) is an express civil liability for violation of § 305(g) escrow violations, closely corresponding to the Texas provision.

5.3 *Excessive Marketing Expense—§ 9B.*

5.3.1 *§ 33A(1) Civil Liability.* Selling expense limitations are the oldest substantive feature of Texas securities[184] law. The present provision refers to the "total expenses for marketing securities, including all commissions . . . and all other incidental selling expenses." The limit is 20% of "the price at which the . . . securities . . . are to be sold, or offered for sale, to the public of this State." Moreover, the limit may be reduced by the Commissioner "to a less percentage which is in his opinion fair, just and equitable under the facts of the particular case." The Commissioner often uses his power to reduce the limit, typically to 15%.[185] Au-

176. For examples of authority to require escrow of outstanding shares, and of civil liability for violation, see Uniform Act §§ 305(g), 410(a)(1); CAL. CORP. CODE §§ 25141, 25133, 25503 (West 1977). The Texas securities escrow requirement is imposed by Tex. State Sec. Board Rule VII.D.5, Tex. Reg. No. 065.07.00.004 para. 5, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. E.5 (1976).

177. See Part 2.1 above.

178. See note 108 *supra* and cross references there.

179. See note 109 *supra*.

180. See Part 4.2 above.

181. See notes 111, 174 *supra* on proving the requirement.

182. Plaintiff should plead the way the requirement was violated, *e.g.*, failure to escrow proceeds or premature release.

183. For examples, see note 168 *supra*.

184. See note 14 *supra*.

185. *See* Tex. State Sec. Board Rule VII.E.7.2, Tex. Reg. No. 065.07.00.005 para. 7.2, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. E.7.2 (1977): "The expenses for marketing the securities paid by the Program shall not ordinarily exceed 15% of the gross proceeds of the offering." "Program" is used elsewhere in the rules to designate a tax shelter offering, usually of limited partnership interests. Nonetheless, the Commissioner commonly applies the 15% limit to all equity offerings. However, his application rarely takes the form of a condition of the permit or other formal determination by the Commissioner. Typically, the limit is in the form of an undertaking by the registrant (issuer) that marketing expenses

tomatic civil liability for violation of the § 9B expense limit (including the Commissioner's requirement of a limit below 20%) is generated by § 33A(1).

Apart from policy questions about expense limits,[186] there are difficult questions of measurement to determine whether there has been a violation, and hence civil liability.

First, what expenses are included? The statute refers to "marketing" and "selling" expenses.[187] Plainly, these include commissions, discounts, expense allowances, and other payments or benefits to underwriters and dealers who sell the securities.[188] The value of options to underwriters is

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will not exceed 15%, or that sales in Texas will not be finally accepted unless they exceed a specified dollar amount (of which the estimated expenses will be less than 15%). This latter version is sometimes, but not often, inserted in the permit. All this makes it hazy whether the 15% limit in a given case is a "requirement" under § 9B whose violation leads to absolute liability under § 33A(1). See note 174 *supra*; cf. note 199 *infra*. Defendants should be prepared to challenge the "requirement" of less than 20%, and plaintiffs to prove it if challenged.

Lower limits are imposed for certain types of offerings. For publicly offered cattle feeding programs, "[a]ll expenses of organizing the venture and selling interests therein to the public, including underwriting discounts and commissions" must be paid by the sponsor if the sponsor is to receive the maximum first year 12.5% management fee allowed him; but if the publicly owned venture "is to pay such expenses, the total of such expenses it shall pay, together with the first year management fee, shall not exceed 12-1/2% of the gross receipts of the public offering." Tex. State Sec. Board Rule X.B.3.a, Tex. Reg. No. 065.10.00.002 para. 3.a., *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46, 610 para. B.3.a (1976).

186. They obviously protect investors against dissipation of their investment. But they bear disproportionately heavily on small offerings (hence on small companies and those who have invested in them). *See* SEC, COST OF FLOTATION OF REGISTERED ISSUES 1971-1972, at 9 (1974): average compensation (*e.g.*, commissions) and other expense of common stock offerings to the public ranged from 13.24% and 10.35%, respectively (total 23.59%), for offerings under $500,000 down to 3.03% and 0.15%, respectively (total 3.18%), for offerings over $100,000,000. The figures reflect that some costs of an offering (legal, accounting, printing) do not vary greatly with size, while others (commissions) are more nearly proportional to size. This in itself tends to bar small offerings from the market, and the legal limits reinforce that tendency by making some small offerings illegal as well as uneconomical. By the SEC's figures, the average total compensation and other expense does not drop below 20% until the offering exceeds $1,000,000, below 15% until the offering exceeds $2,000,000, below 10% until the offering exceeds $5,000,000 and below 5% until the offering exceeds $50,000,000. *See generally* Mofsky, *Adverse Consequences of Blue Sky Regulation of Public Offering Expenses*, 1972 WIS. L. REV. 1010.

187. Tex. State Sec. Board Rule VII.E.7.1., Tex. Reg. No. 065.07.00.005 para. 7.1, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. E.7.1. (1977) makes it clear that all "marketing" expenses are to be counted toward the 20% limit, "regardless by whom or what entity they are paid." Juxtaposed with rule VII.E.7.2, note 185 *supra*, this means that the issuer can pay up to 15% and other persons (controlling shareholders, general partners, selling shareholders, etc.) can pay an additional 5%.

188. For a transparent effort to circumvent the expense limit by selling to underwriters at $100 for resale at $130 (the $30 difference to be retained by the underwriters), see Coleman v. Miller, 19 S.W.2d 829, 835-37 (Tex. Civ. App.—Dallas 1929), *aff'd*, 29 S.W.2d 991 (Tex. Comm'n App. 1930, judgmt adopted). The main issue before both courts was the validity of a claimed exemption from the TSA (1923 version, see note 15 *supra*) which had a 20% expense limit. Neither court considered whether the limitation was exceeded if the exemption did not apply. *Cf.* Green v. Jackson, 113 S.W.2d 252 (Tex. Civ. App.—Dallas 1938, writ dism'd), in which excess marketing expenses figured tangentially. Plaintiff had received 200 shares of Faith Oil, allegedly as a 25% commission from Faith on the sale of other shares for it. The court held that, even if this were true, it was no defense to plaintiff's suit against a third person who had agreed to buy the shares from him. The court also held that Faith's

included.[189] And, although you would never guess it from anything in the Rules, the Commissioner considers legal, accounting, and printing expenses to be included.[190] Clarification by rule is badly needed for a provision that can lead to strict liability.[191] Meanwhile, defendants should argue that legal, accounting, and printing expenses are not included.

Second, what kind of allocation is permitted for a multistate offering? The statute could be read to require that nationwide (or for that matter, worldwide) marketing expenses not exceed the specified percent (20% or less if required) of the Texas portion of the offering. This would be patently unreasonable and probably unconstitutional as a burden on interstate commerce. A much more reasonable reading is that total Texas expenses (allocated geographically or pro rata, *e.g.*, per share) not exceed

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lack of a permit did not help defendant, since no permit was required for plaintiff's resale of privately owned stock.

189. Tex. State Sec. Board Rule VII.D.11.c(7), Tex. Reg. No. 065.07.00.004 para. 11.c(7), *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. D.11.c(7) (1977), adding that "[a]n arbitrary value of twenty percent (20%) of the original exercise price of such options shall be used in the computation of commissions unless evidence indicates that a contrary valuation exists."

190. The staff's position is that marketing expenses are commissions or discounts plus everything listed in SEC Form S-1, Item 23, 2 FED. SEC. L. REP. (CCH) ¶ 7124 (1978), which is filed by the registrant. Item 23 calls for "expenses in connection with the issuance and distribution of the securities," which may be broader than "marketing [expenses] . . . including . . . all other incidental selling expenses" in § 9B. Item 23 refers specifically to printing, legal, accounting, and engineering fees, among others.

Nonmarketing Legal and Accounting Fees. Customarily excluded from Item 23 are legal expenses for the corporate cleanup (charter and bylaw amendments, restructuring of affiliates and of transactions between the company and its management, etc.), which often precede a first public offering. Accounting fees for a regular audit that is used in the registration statement as well as for internal purposes may also be excluded from Item 23. Even if included as "expenses in connection with the issuance and distribution of the securities," they seem rather clearly not to be "marketing" expenses subject to the § 9B limit.

Management Fees. Maximum fees for managing the issuer's business or properties are specified for certain kinds of offerings, *e.g.*, Tex. State Sec. Board Rule IX.D, Tex. Reg. No. 065.09.00.004, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,609 para. D (1976) (real estate programs: property acquisition fees, property sale commissions, program management fee, etc.); Rule XI.B.4, Tex. Reg. No. 065.11.00.002 para. 4, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,610 para. B.4 (1977) (oil and gas drilling programs: maximum 15% of the program's cash receipts from public offering may be paid to sponsor for organizational and offering expenses including any first year management fees; other limits specified); Rule XII.B.3, Tex. Reg. No. 065.12.00.002 para. 3, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,612 para. B.3 (1977) (open end investment companies: maximum management fee 1.5% of average net assets). See also note 185 *supra* concerning cattle feeding programs. While it is usually a fact question what fees are being paid for, management fees of the kind described here are rather clearly not for marketing the securities. Thus, management fees would not be counted against the § 9B maximum and would not create § 33A(1) civil liability for § 9B violation if they exceed the maximum. However, when specifically subjected to a combined limit with marketing expenses (as for oil and gas, above, and cattle feeding, note 185 *supra*), management fees probably have the effect of reducing the § 9B limit on marketing expenses to the combined limit minus the management fee.

191. For a comprehensive list of selling expenses used by one state in applying its limit (normally 15%), see CAL. ADMIN. CODE, tit. 10, ch. 3, rule 260.140.20 (1972), *reprinted in* 1 BLUE SKY L. REP. (CCH) ¶ 8591 (1978). For a comprehensive but different list of the components used by the NASD in imposing its rather similar limits on underwriter compensation, see NATIONAL ASSOCIATION OF SECURITIES DEALERS MANUAL ¶ 2151, at 2031-32 (1972); Merrifield, *Underwriting Compensation*, 26 BUS. LAW. 1235, 1244-47 (1971).

the specified percent of the Texas portion of the offering.[192]

Third, over what time interval is the limit measured? Front end expenses in a slow offering may mean the limit is exceeded for the first three or six months of the offering, but is not exceeded at the end of a year. It seems reasonable to look at the entire span of the offering, but there is no conclusive authority to this effect.[193]

All these uncertainties offer untried opportunities to plaintiffs and unknown perils to defendants.

The expense limits do not apply to exempt securities or transactions.[194] But they do apply to registered securities, whether registered by §§ 7A, 7B, or 7C.

The elements of the plaintiff's § 33A(1)-§ 9B case are that he bought[195] and the defendant sold[196] to the plaintiff[197] a security,[198] and the total expenses for marketing the securities (including all commissions for the sale of securities and all other incidental expenses) in the aggregate exceeded 20% of the price at which the securities were sold or offered to the public in Texas, or a less percentage required by the Commissioner in accordance with § 9B.[199]

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192. A related problem might arise if substantially more securities are offered in Texas than are sold in the state. § 9B sets the limit at 20% of the price at which the securities "are to be sold, or offered . . . to the public of this State." The danger is the possibility that expenses of unsuccessful marketing efforts (travel, advertising, etc.) would be measured against the smaller base of actual sales. Again, the reasonable solution is to prorate over the entire offering.

193. To assure compliance with the limits, "an escrow of the proceeds of the offering may be required." Tex. State Sec. Board Rule VII.E.7.3, Tex. Reg. No. 065.07.00.005 para. 7.3, 3 BLUE SKY L. REP. (CCH) ¶ 46,607 para. E.7.3 (1977). (The escrow procedure is described in Part 5.2.1 above.) This suggests strongly that the limit is to be measured at the end of the escrow period, *i.e.*, at the end of the offering. In accord is the Commissioner's much more common practice of accepting an undertaking that sales will not become final until they reach a level which brings the estimated expenses below the designated percent. See note 185 *supra*.

194. Preamble to §§ 5 and 6. See also notes 101, 102, 105 *supra* and accompanying text. Note, however, that § 5E (sales to existing security holders) bars the payment of any commission other than a standby commission. And § 5.O, which is not really comparable since it is only for dealer sales of outstanding securities (hence not for issuer sales) prohibits excessive markups by requiring that the sales be at prices reasonably related to the current market price. § 5.O(3).

195. See Part 2.1 above.

196. See note 108 *supra* and cross reference therein.

197. See note 109 *supra*.

198. See Part 4.2 above.

199. An expense limit below 20%, if imposed in the permit, can be proved from the Commissioner's records in the manner described in note 111 *supra*. If imposed by rule (see note 185 *supra*), it can be proved by authenticated copy of the rule. If not imposed by permit (see note 185 *supra*) or by rule, the method of proof is not clear; possibly the Commissioner or a member of his staff can be called to testify that a lower limit was otherwise "required" by the Commissioner.

Information on a company's actual selling expenses is not necessarily available from filings with the Commissioner. It is normally reported by the company in its final SEC Form S-1, Item 23, note 190 *supra*, which may be filed with the Commissioner by statutory requirement for a § 7C coordination registration, or voluntarily in other cases. It is available from the SEC if not from the Commissioner. However, in slow offerings, the Item 23 information will be only estimated. Another possible source of itemized information on actual selling expense is SEC Form SR, 2 FED. SEC. L. REP. (CCH) ¶ 7401 (1972), which

5.3.2 *Related and Implied Claims.* There seem to be no related or implied claims under TSA, federal law, or the Uniform Act,[200] unless there are nondisclosures or misrepresentations of the marketing expenses that are material and thus fraudulent, or the expenses are so great that they amount to fraud. Excessive expenses or markups may also violate the rules of the National Association of Securities Dealers and permit private suits based on those rules.[201]

5.4 *Prospectus Violation—§ 9C.*

5.4.1 *§ 33A(1) Civil Liability.* A curiously drafted § 9C[202] mandates that the Commissioner require offers of securities "to be made through and by a prospectus which fairly discloses the material facts about the plan of finance and business" of the issuer. The prospectus must be "filed with and approved by the Commissioner" or be an SEC prospectus or offering circular. Noncompliance leads to civil liability under § 33A(1).

Section 9C does not apply if the securities or transactions are exempt.[203]

Civil liability for § 9C violations does not appear to have been litigated in the reported cases. There are some difficult interpretive questions:

First, does § 9C apply to all types of registration? The statute is prefaced by "In connection with any permit to sell . . . ." We have seen that permits are authorized by the statute only for § 7A (qualification) registrations,[204] but that they are commonly issued by the Commissioner for § 7B (notification) and § 7C (coordination) registrations as well. A gratuitous permit from the Commissioner may well be insufficient to invoke the prospectus requirement of § 9C, and the corresponding civil liability for violation.[205] If so, only § 7A qualification registrations are subject to § 33A(1)

companies registering first-time offerings with the SEC are required to file with the SEC (in Washington) three months after an offering and every six months thereafter while the offering continues. This too is available from the SEC. The Commissioner is considering a requirement to report selling expenses. If the reported filings do not have the desired information, or the plaintiff thinks the reports understate the expenses, he can use discovery to obtain the information.

200. Some other states have civil liability for violation of maximum expense limits. *See, e.g.*, CAL. CORP. CODE §§ 25141, 25503 (West 1977).

201. *See, e.g.*, NASD Guide ¶¶ 2151.02 (Review of Corporate Financing) and 2154 (Fair Prices and Commissions; Mark-up Policy); S. JAFFE, BROKER-DEALERS AND SECURITIES MARKETS §§ 11.04, .10, .11 (1977); N. WOLFSON, R. PHILLIPS & T. RUSSO, REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS ¶ 2.09 (1977); Lowenfels, *Private Enforcement in the Over-the-Counter Securities Markets: Implied Liabilities Based on NASD Rules*, 51 CORNELL L.Q. 633 (1966), *reprinted in* L. LOWENFELS, SELECTED ARTICLES UNDER THE FEDERAL SECURITIES LAW (1978); Merrifield, *Underwriting Compensation*, 26 BUS. LAW. 1235 (1971).

202. The curious feature is that § 9C directs the Commissioner to require a prospectus instead of § 9C requiring a prospectus. It makes no difference for liability purposes; see note 174 *supra*. A similar locution appears in § 13D.

203. Preamble to §§ 5 and 6. See also notes 101, 102, 105 *supra* and accompanying text.

204. Note 99 *supra*.

205. The point is largely academic as to a § 7C coordination registration which is, by hypothesis, registered with the SEC and subject to federal law so that 1933 Act § 12(1) gives a cause of action for failure to comply with the prospectus delivery requirements of 1933 Act § 5(b). But there is no prospectus requirement for a § 7B notification requirement unless it happens to be subject to federal law too. In fact there is a plain inference that prospectuses

liability for a prospectus violation.

Second, is § 9C violated by oral or written offers in addition to a prospectus? Literally, "all offers" must be "made through and by prospectus." The language could be read to prohibit any offers except prospectuses. The resulting world of mute salesmen handing out prospectuses to customers and refusing to furnish research reports or advice is too far from reality, and too uninformative to investors, to be required by the statute. The more reasonable meaning of the statute is that all sales *include* a prospectus along with any other communication that is not otherwise barred. This is confirmed by another part of TSA.[206]

Third, is a late prospectus a violation? Plainly, failure to furnish a prospectus is, and this is the main target of § 9C. I have already argued that providing a prospectus after an oral offer is not a violation. But how late may it be? The statement in § 9C that it is "in all respects . . . satisfied" by an SEC prospectus or offering circular filed with the Commissioner must mean that the use of such a document according to federal law does not violate § 9C. Federal law, although encouraging the circulation of preliminary prospectuses to offerees during the waiting period,[207] does not require that prospectuses reach offerees before their first written communication from the offeror (dealer), which is typically the written confirmation of a sale pursuant to an oral buy order.[208] Whether the adoption of the federal practice carries over to offerings not registered with the SEC is an open question, and the makers of such offers are well advised to get their prospectuses out in time for the offerees to see them before deciding whether to buy, because this is the purpose of a prospectus. A buyer of a non-SEC offering who first sees a prospectus with his confirmation should not hesitate to allege a § 9C violation, and a defendant should not hesitate to deny that this is a violation.

Fourth, does a defective prospectus—one which does not "fairly disclose the material facts about the plan of finance and business"—violate § 9C? A couple of decisions have said yes under the comparable federal prospec-

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are optional in § 7B; § 7B(2)a.7 requires the filing with the Commissioner of "[a] copy of the prospectus, if any, describing such securities." Even under § 7B, however, most sellers will use a prospectus, if only to avoid the fraud liabilities for nondisclosure that are likely to be incurred without a prospectus.

206. § 22 expressly permits certain kinds of advertising. See discussion in Parts 5.1.2(C) and (D) above.

It is hard to wriggle around the specification of § 9C that "all offers"—not merely all sales—be made by prospectus. This is wholly at odds with industry practice, which is to solicit customers by telephone—thereby making offers—but to send prospectuses (which are expensive in printing and mailing) later and only if they are interested. Each such offer is a literal violation of § 9C, although fully consonant with federal law. Enforcement action has never been taken, so far as I know, and probably never will be, against oral offers of this sort so long as they are free of fraud. They produce no civil liability to nonbuyers who receive no prospectuses. See the 2d para. of Part 5.1.2 above. For these reasons, little sleep is lost over the technical violations. But the statute should be amended to change "offers for sale" to "sales."

207. *See* SEC Sec. Exch. Act Rule 15c2-8, 17 C.F.R. § 240.15c2-8 (1977).

208. 1 Loss 246-47. This is the typical state rule too. UNIFORM ACT § 304(d).

tus delivery requirement.[209] These decisions have been sharply criticized as short-circuiting the fraud provisions, *i.e.*, allowing recovery based on allegation of fraud without really having to prove it, and without the defenses that are available in a fraud case.[210] They should not be followed in Texas, and not only for the reason just stated. An additional reason is that § 9C does not authorize private parties to look behind the administrative approval or clearance of the prospectus or to question the adequacy of its disclosure.[211] This is stated slightly more emphatically for an SEC-filed prospectus, by which, as already noted, "this subsection shall in all respects be satisfied." The Legislature could hardly have intended to accord any less deference to the Texas Commissioner when it required the prospectus to be "filed with and approved by the Commissioner."[212] Thus, I think administrative action allowing use of a prospectus is conclusive that it complies with § 9C so far as § 33A(1) liability is concerned.

Fifth, is an issuer or other seller (in the common law sense of owner) liable when an underwriter or dealer engaged to sell the stock fails to deliver a prospectus to a buyer? Since both the issuer or seller and the dealer are sellers under TSA,[213] both have violated § 9C and are liable under § 33A(1).[214]

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209. SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1098-1100 (2d Cir. 1972) (injunction); Jefferies & Co. v. Arkus-Duntov, 357 F. Supp 1206, 1214-15 (S.D.N.Y. 1973) (civil liability).

210. ALI FEDERAL SECURITIES CODE 560 Note (Proposed Official Draft 1978) (by Prof. Loss, Reporter for the Code; § 1703(f) of the Code would reverse these decisions). *See also* 2 BROMBERG § 6.11(321), at 138.405(1977).

211. This argument relates, of course, only to a § 33A(1) automatic liability suit for violation of § 9C. Administrative approval does not preclude a fraud suit, based on the prospectus, under § 33A(2) or other fraud provisions. Nor does it preclude a § 23A stop-sale order or other administrative or criminal sanction.

212. Normally, of course, the Commissioner does not "approve" anything. *Cf.* § 10B: the issuance of a permit "is permissive only, and does not constitute a recommendation or endorsement of the securities." This language is repeated in bold face on the cover of the Commissioner's Suggested Outline to Assist in Preparing Prospectus for Local Texas Offerings Only (rev. ed. Sept. 10, 1975). But § 9C mandates that he approve a prospectus (if it is not filed with the SEC) before its use. His grant of a permit, after reviewing the registration application and accompanying prospectus, is thus approval of the prospectus for the limited purpose of satisfying § 9C. The Commissioner's Suggested Outline, *supra*, is some further evidence of his "approval" of prospectuses for this purpose. Page 2 of the Suggested Outline confirms that it is "mandatory that an applicant . . . file such prospectus with the Securities Commissioner and receive his approval thereof before its use." Earlier forms of permit similarly echoed § 9C by specifying that "all offerings hereunder must be made by and through a prospectus, filed with the registration statement, which has been approved by the Securities Commissioner." Beginning about 1970, however, the language was changed to "through a prospectus which has been filed with this Agency," omitting all reference to approval.

213. See Part 3 above. In view of the broad definition of sale in TSA, it probably makes no difference whether the underwriting is firm (with the dealer buying from the issuer or seller and reselling for his own account) or best efforts (with the dealer acting as agent for the issuer or seller).

214. The usual underwriting agreement between issuer or seller and dealer or underwriter requires the latter to deliver prospectuses in accordance with law. Such a provision is a valuable encouragement to compliance, but probably does not shield the issuer or seller from liability to the buyer if the underwriter or dealer fails to furnish the prospectus.

The elements of a plaintiff's § 33A(1)-§ 9C case are that he bought[215] and the defendant sold[216] to the plaintiff[217] a security[218] for which a prospectus was required by § 9C,[219] and the defendant violated § 9C by not making the offer to the plaintiff through and by a prospectus.[220]

5.4.2 *Related and Implied Claims.* Failure to deliver a prospectus violates and produces liability under 1933 Act §§ 5(b) and 12(1). The same is true under Uniform Act § 410(a)(1) if the Commissioner exercises his discretionary power in § 304(d) of that Act to require a prospectus. Failure to provide a prospectus may well constitute fraudulent omissions under any of the statutes, and a false or misleading prospectus will also be fraudulent. These seem to be the only related or implied claims under TSA, Uniform Act, or federal law.

5.5 *Unregistered Dealer—§ 12.*

5.5.1 *§ 33A(1) Civil Liability.* The purposes of dealer (and salesman) registration, as gleaned from the regulation imposed, are several: to limit entry to honest[221] and knowledgeable[222] persons, to encourage compliance with TSA by making them liable to administrative discipline[223] and judicial receivership[224] for violations, and to require the keeping of records which will facilitate enforcement and investor protection.[225] A security seller who should be registered or licensed[226] as a

215. See Part 2.1 above.

216. See note 108 *supra* and cross references there.

217. See note 109 *supra.*

218. See Part 4.2 above.

219. It seems illogical to require plaintiff to prove that the Commission required a prospectus when § 9C says that the Commissioner is to require it. See note 202 *supra.* It is probably necessary for plaintiff to prove that a permit was issued; see notes 204-05 *supra* and accompanying text. The typical permit has a prospectus requirement; see note 212 *supra.*

220. If plaintiff is alleging some other violations discussed above, such as a late or defective prospectus, he should so specify.

221. §§ 13B, 13C (application to include information enabling Commissioner to determine whether sales would be fraudulent, and establishing applicant's good reputation). For the information actually required in dealer and salesman registration applications, see Tex. State Sec. Board Rules, Appendix, Items VIII.A-D (looseleaf, orig. pub. 1976).

222. § 13D requires applicants to pass a written examination on their "qualifications and competency to engage in the business . . . of securities." On examinations, and full and partial waivers, see Tex. State Sec. Board Rule VIII.C, Tex. Reg. No. 065.08.00.003, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,608 para. C (1977).

223. § 14.

224. § 25-1.

225. There appears to be no statutory provision dealing with record keeping. The Board has published minimum requirements; applicants for dealer registration agree to comply with them. Tex. State Sec. Board Rule VIII.E, Tex. Reg. No. 065.08.00.005, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46.608 para. E (1977); Tex. State Sec. Board Rules, Appendix, Items VIII.B.2-4 (looseleaf, orig. pub. 1976).

226. *Registration v. License.* §§ 12-21, 29A, 32, 5C(1), 5.0 and 5S consistently use "registered" (or its derivatives) to refer to the process by which dealers and salesmen are authorized by the Commissioner to engage in business. But §§ 34 and 5Q, most of the securities industry, and many courts use "licensed" to refer to the same thing. The two terms are identical in meaning. "Licensed" is the more logical term, since it immediately distinguishes person registration from securities registration. Nonetheless, we will almost consistently follow the almost consistent statute and use registration, with modifiers where necessary to distinguish the two kinds.

dealer (or salesman), but is not, violates § 12 and is therefore liable under § 33A(1)[227]—whether or not the security is registered—unless a § 5 transaction exemption[228] or some external exemption[229] makes § 12 registration inapplicable and thereby eliminates § 33A(1) liability for nonregistration.[230] By § 37, the burden of proof of an exemption is on the person claiming it, *i.e.*, the defendant in the § 33A(1) case.[231]

The elements of a plaintiff's § 33A(1)-§ 12 case are that he bought[232] and the defendant sold,[233] directly or through agents or salesmen,[234] to the

227. Bierschwale v. Oakes, 497 S.W.2d 506, 521-22 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974); Bateman v. Petro Atlas, Inc., Civ. No. 75-H-445 (S.D. Tex. Sept. 26, 1977), Findings ¶¶ 4-5, Conclusions ¶¶ 9-10; and possibly Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*.

For the same proposition under the 1941-1963 voidability provision, Appendix 3 below, see Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), note 38 *supra*; Riggs v. Riggs, 322 S.W.2d 571, 573-74 (Tex. Civ. App.—Dallas 1959, no writ) (dictum since plaintiff failed to make the then requisite tender); and possibly Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), note 40 *supra*.

For the same proposition under pre-1941 common law voidability for violation of TSA, see Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App.—Texarkana 1938, writ ref'd), note 18 *supra*.

228. The preamble to § 5 not only makes the TSA inapplicable (unless otherwise specifically provided), it also states that a person engaged in a § 5 transaction "shall not be deemed a dealer." The more important exemptions are summarized in note 102 *supra*, and the full preamble is quoted there.

However, § 5.O (certain sales of outstanding securities) can be used only by registered dealers, and § 5S (certain options) is limited to sales "by or through" a registered dealer. § 5C(1) (certain sales of outstanding securities by owners) and § 5Q (private, limited offerings of oil and gas interests) require that any person acting for a seller be registered. For the background of this requirement, and the consequence for the owner if the person acting for him is unregistered, see Part 5.5.6 below.

229. See note 105 *supra*.

230. The principle was recognized in Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974), note 227 *supra*, but the claimed § 5C(1) exemption was not proved.

For the same proposition under the 1941-1963 voidability provision, Appendix 3 below, see Anderson v. Eliot, 333 S.W.2d 654 (Tex. Civ. App.—Eastland 1960, writ ref'd) (exempt by predecessor of § 5C(1) for certain resales by investors); Riggs v. Riggs, 322 S.W.2d 571 (Tex. Civ. App.—Dallas 1959, no writ), note 227 *supra*.

231. All elements of the exemption must, of course, be proved. *See* Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974), note 227 *supra*, in which defendant proved some but not all of the § 5C(1) exemption, and therefore was liable.

232. See Part 2.1 above.

233. See Parts 3 and 4.1 and note 108 above.

Improper Offers. While § 12 prohibits both offers and sales by unregistered persons, only buyers can sue by § 33A(1). In effect, then, offers that do not lead to sales are not actionable. See Part 5.1.2 for a fuller discussion. But there are at least two kinds of improper offers that need to be considered. One is relatively rare: a person makes an offer before he is registered and completes the sale after he is registered. The other is more common: an unregistered person participates in an offer (and perhaps in the sale), but a registered person closes and confirms the sale. I do not try to analyze these situations fully. For the kinds of arguments which can be made, see the discussion of improper offers in the context of the securities registration requirements in Part 5.1.2 above.

Offers by unregistered persons—absent exemption—may result in sanctions other than civil liability—such as a § 32 injunction, a § 29A prosecution, or a § 23A stop order—whether or not the offer leads to a sale.

234. § 12 so specifies.

plaintiff[235] a security[236] in the state,[237] and the defendant was a person, firm, corporation, or dealer[238] not registered under § 12 at the time of the sale.[239] A plaintiff loses if he is unable to prove, or the defendant is able to disprove, any of these elements. Registration of the defendant under federal law, or the law of another state, is irrelevant if he was not registered in Texas.[240] Nor does membership in a self-regulatory organization, like the New York Stock Exchange or National Association of Securities Dealers, equate with Texas registration. The varieties of registration in Texas, and their effect, are discussed in Part 5.5.4 below. Exemptions are the principal defenses to a § 33A(1) nonregistration suit.[241] But there may also be a substantial question whether defendant is a dealer, and, if he is not, whether this relieves him from having to register. This is discussed in Parts 5.5.2 and 5.5.3 below.

5.5.2 *Significance of Dealer.* Much ink has been spilled on who is a dealer, and I will spill some more. But before doing so, it is apropos to inquire why it matters. The significance was clear in the pre-1961 law: civil liability derived—by common law or by the 1941-1963 voidability provision (Appendix 3 below)—from a violation of TSA. This usually meant a criminal provision, and the pertinent criminal provision in those days was for a "dealer, agent [or] salesman" who was unregistered and sold securities.[242] Whether the defendant was a dealer thus became a pivotal question in determining liability. In 1961, the present § 29A came into effect with broader wording: "Any person who shall: A. Sell, offer . . . or who shall deal in any other manner in any security . . . without being a registered dealer or salesman as in this Act provided shall be deemed guilty of a felony . . . ."[243] Under that phrasing, the inquiry should have shifted to whether the person was selling a security or (only if he was not) whether he was dealing in a security (probably the same as whether he was a dealer). Then the 1963 express civil liability (Appendix 2 below) moved the basis of liability from the criminal provision to the § 12 registration requirement which reads: "Except as provided in Section 5 . . . no person,

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235. See note 109 *supra*.

236. See Part 4.2 above.

237. § 12 so specifies. See note 108 *supra* on territorial aspects of sales subject to TSA.

238. The effect of this alternative language in § 12 is considered in Part 5.5.2 below.

239. See note 111 *supra* on proof of nonregistration.

Duration. All dealer and salesman registrations are annual and expire on December 31; renewal requires application. § 19. Registrations may be revoked by the Commissioner for insolvency, violations of TSA and other misconduct. § 14.

240. *Cf.* Shappley v. State, 520 S.W.2d 766 (Tex. Crim. App. 1974), discussed note 108 *supra*. "[I]t would likewise be immaterial whether or not Arizona required dealers in securities to be licensed since the security laws of Texas govern this transaction." 520 S.W.2d at 768.

241. See, *e.g.*, notes 101, 102, 105 *supra*.

242. 1935 Tex. Gen. Laws, ch. 100, § 30, at 276; 1955 Tex. Gen. Laws, ch. 67, § 30, at 342; 1957 Tex. Gen. Laws, ch. 269, § 29, at 598.

243. 1961 Tex. Gen. Laws, ch. 466, § 1, at 1047. This was the provision that raised the penalties for the major offenses—fraud and sales without securities or dealer-salesman registration—from $1,000 and/or 2 years imprisonment to $5,000 and/or 10 years imprisonment.

firm, corporation or dealer shall, directly or through agents or salesmen, offer for sale, sell . . . any securities in this state without first being registered as in this Act provided . . . ."[244] Except perhaps for a trained chimpanzee or a vending machine, every seller of a security will be a "person, firm, corporation or dealer" and therefore apparently in violation of § 12, hence liable by § 33A(1), unless there is an exemption. Thus, it would seem that the only exceptions to a universal registration requirement are those in the § 5 transaction exemptions,[245] which do not require a registered dealer, and that there is no need to decide whether someone is a dealer.

There is another reason why the quest for the true nature of "dealer" may be a waste of time. In most cases where a defendant is sued for being an unregistered dealer, he is also sued for selling an unregistered security. The same transaction exemptions[246] that will save him on the latter count will usually save him on the former as well.[247] If so, it seems irrelevent whether—apart from the exemption—he is a dealer.

Nonetheless, there is some continuing tendency in civil liability cases to focus first on whether the defendant is a dealer (or salesman). There are several possible reasons for this, none of which have been articulated. One is the habit of publishers, counsel, and courts to digest, annotate, compile, and cite cases without regard for the statutes under which they were decided, or for changes in those statutes.[248] Another reason, more understandable in policy terms, is because the § 5 exemptions are so excruciatingly narrow in some areas.[249] A third reason, more substantive, is that the sweeping language of § 12 ("person, firm, corporation or dealer") may well be limited to "dealer" by the phrase which follows it ("registered as in this Act provided"). The Act provides only for registration of dealers (and salesmen). This is explicit in each of §§ 13-18. To argue that "person, firm, corporation or dealer" means "dealer" is not very good statutory construction, but TSA is not a very good statute. Perhaps the more persuasive and analytical way to state the argument is that a person is not required to register as a dealer unless he is one.[250]

244. The language goes back to 1935 Tex. Gen. Laws, ch. 100, § 12, at 265.

245. Or the external exemptions, note 105 *supra*.

246. See notes 102 and 105 *supra* and accompanying text. Security exemptions, note 101 *supra*, do not help since they are contingent on the seller being a registered dealer.

247. Note, however, that some transaction exemptions are limited to registered dealers, or require that persons acting for owners be registered as dealers (or salesmen). *See* note 228 *supra*.

248. This is part of the common law tradition that somehow values cases higher than statutes. *Cf.* Pioneer Specialties, Inc. v. Nelson, 161 Tex. 244, 339 S.W.2d 199, 200 (1960): "We have been cited to no Texas cases, and we have found none, which are determinative. Our decision must rest, therefore, on the bylaws of the corporation and the Texas statutes regulating corporations."

249. *E.g.*, resales of outstanding securities, ostensibly covered by § 5C(1). See note 102, para. (B)(1) *supra*.

250. A supporting argument is that TSA is full of surplusage and § 12 is a good example. "Dealer" includes "person or company" by § 4C; "person" and "company" each include "corporation" and "firm" by § 4B. So nothing is added to "dealer" in § 12 by ranging "person, firm, corporation" beside it. All that the Legislature probably intended to do by the

5.5.3 *Meaning of Dealer.* Assuming, for any of the reasons just examined in Part 5.5.2, that dealer (or salesman) status is essential to § 33A(1) liability for violation of § 12,[251] we turn then to the meaning of the term. Section 4C defines dealer to 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 dealing in any other manner in security . . . ." "Dealer" means much more in TSA than it does in ordinary parlance. The statutory word includes (1) a securities professional selling for his own account,[252] often called a principal and embracing a market-maker, (2) a securities professional buying or selling as agent for a customer, often called a broker,[253] (3) a securities professional who advises clients on buying and selling securities, but who does not necessarily buy or sell them himself, often called an investment adviser or counselor,[254] (4) a company or other issuer selling its own securities, unless it does so to or through a registered dealer or in a transaction exempt by § 5,[255] and (5) a nonprofessional who has sufficient activity in the transaction in question, or otherwise, to fall into the statutory net. Thus, it is erroneous to approach TSA with the idea that a dealer is someone who holds himself out the public as being in the securities business. A buyer plaintiff is missing a good bet if he fails to sue as unregistered dealers every unregistered person who had anything significant to do with his transaction.

The interpretive problems come mainly in the fifth category, *i.e.*, when does a nonprofessional become a dealer? The breadth of the statutory definition has been taken to mean that very slight selling activity will make a person a dealer, especially if undertaken on behalf of another person and for compensation. Attempts by a plaintiff to sell a defendant's oil payment to two different persons made the plaintiff a dealer and barred him from

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redundancy was to require registration of dealers whether they were individuals, partnerships, corporations, or otherwise organized.

251. "Dealer" is unmistakably critical to other liabilities, *e.g.*, § 33A(1) for violation of § 7 (see note 112 *supra*).

252. This is the common meaning, and coincides with SEA § 3(a)(5). Whether buying activity makes one a dealer is considered in note 30 *supra*.

253. A broker is so defined in SEA § 3(a)(4).

254. *Investment Advisers.* § 4C explicitly includes "investment adviser" in the definition of a "dealer." An investment adviser is thus a dealer whether or not he buys or sells securities. By my reading of § 12 (see note 30 *supra*), he is required to register only if he sells. Since advice to buy could be construed as selling, an adviser is wise to register as a dealer. Indeed he is instructed to register by the Board, which reads TSA more broadly. Tex. State Sec. Board Rule VIII.A.1.c., Tex. Reg. No. 065.08.00.001 para. 1.c, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,608 para. A.1.c (1977): "The Securities Act requires the registration of Investment Advisers and their agents actually involved in the rendering of investment advice."

Investment adviser is not defined in TSA, but is defined in Tex. State Sec. Board Rule IV.B.12, Tex. Reg. No. 065.04.00.002 para. 12, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,604 para. B.12 (1975). The definition resembles, but differs in some important particulars from, the standard definition in UNIFORM ACT § 401(f) and Investment Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (1976).

255. § 4C explicitly so states. If the issuer is not a dealer, its executives or employees who do the selling are not salesmen, and need not be licensed as such. § 4D.

recovering a commission since he was unregistered.[256] Then came the logical (or illogical) extension: one sale is enough, and it may be the sale on which the lawsuit is based.[257] None of these cases involved an express civil liability for failure to have a dealer registration; no such provision existed at the time. Rather, these cases involved what is now a § 34 defense to a suit for commission by any unregistered "person or company," or its common law predecessor—the illegality defense based on violation of the then criminal provisions for an unregistered dealer, agent, or salesman.[258] The cases may be distinguishable on the difference in statutory context and the difference in economic sanction involved. It is far less radical to deny an unregistered person a commission, which is a small percentage of the sale price, than to hold him automatically liable for the full sale price under § 33A(1). More sales activity, *e.g.*, in other transactions, seems necessary to justify the latter sanction.[259]

The leading case awarding damages or rescission—under the 1941-1963 voidability provision, as applied to the 1935-1961 penal provision for an unregistered "dealer, agent or salesman"[260]—gives scant attention to the "dealer" question. In *Brown v. Cole*[261] the supreme court lists "unlicensed 'dealer' " as the first element of the plaintiffs' cause of action and affirms the judgment for the plaintiffs against Brown without ever discussing the issue whether Brown was a dealer, despite Justice Smith's vigorous dissent that this was an essential and unproved element of the suit.[262] The court

256. Cosner v. Hancock, 149 S.W.2d 239, 243 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.). A similar fate befell the plaintiff in Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197, 199 (1940); all the court said on the "dealer" issue was that plaintiff was "active in undertaking to sell various oil and gas leases."

257. Breeding v. Anderson, 152 Tex. 92, 254 S.W.2d 377 (1953), affirming the denial of a commission recovery on a sale of oil properties. Citing Cosner v. Hancock, 149 S.W.2d 239 (Tex. Civ. App.—El Paso 1941 writ dism'd judgmt cor.), with approval, the court added: "It is settled law that one engaging in a single or isolated transaction is not exempt from securing a license." 254 S.W.2d at 380.

258. Note 242 *supra*.

259. One would expect the same argument to apply to an even more serious criminal sanction. But evidence of "four other attempts at solicitation of investments" plus very limited activity in the transaction before the court (described in the text accompanying note 41 *supra*) was sufficient for conviction for selling without a dealer registration. "The gist of appellant's actions in these four instances was to make the initial contact with potential investors to determine if they would be interested in participating in newly proposed ventures." The conviction was, however, reversed on other grounds and remanded to determine if the small offering exemption was applicable. Dean v. State, 433 S.W.2d 173, 176-77, 179 (Tex. Crim. App. 1968). There was no indication that Dean expected or received compensation in the other four efforts or in the one for which he was prosecuted. There was no discussion of whether the prosecution had to prove Dean was a dealer; since the indictment charged that he was, there was no reason for the court to question whether that was an essential element of the case.

260. Note 242 *supra*.

261. 155 Tex. 624, 291 S.W.2d 704 (1956).

262. 291 S.W.2d at 711, 717:

> The majority assumes that Brown was a dealer because it was admitted that Brown had not registered as a dealer . . . . In order for the Act to have been violated, it would have been necessary for the [plaintiffs] to plead and prove that Brown was a dealer as that term is defined. . . . The [plaintiffs] plead that Brown was a dealer in securities, and it is my contention that the establishment of the fact that Brown was a dealer was a condition precedent to

may have glossed over this point since it was plain that Brown was in the securities business,[263] he probably had sufficient activity in this transaction to make him a dealer,[264] and the court's attention was directed to the "sale" issue by the defense.[265] Consequently, the decision cannot be regarded as a holding on "dealer" at all, only on "sale," "security," and related exemption questions.[266] In particular, the decision rests primarily, if not wholly, on Brown's sale of an unregistered security without exemption, rather than on his sale as an unregistered dealer.[267]

The most recent holding on "dealer" is the most dubious, at least in civil liability terms. In *Enntex Oil & Gas Co. v. State*[268] Spindletop, on the liquidation of its wholly owned subsidiary (Enntex), became the manager and co-owner of oil and gas leases in which buyers from Enntex were also co-owners. "By managing the wells drilled by Enntex . . . which were owned jointly . . . Spindletop . . . became a 'dealer' under [TSA] . . . irrespective of the fact that it did not attempt to sell any securities. It was dealing with securities which should have been licensed and regulated under the Act."[268A] Accordingly, the court affirmed a § 32 injunction against Spindletop acting as a dealer without being registered. As a non-seller, Spindletop would have no § 33A(1) liability, except perhaps vicariously as a control person, aider, or transferee of Enntex. I have grave doubts whether "dealing" was intended to cover co-ownership, even with a degree of management. Fortunately, § 5Q (exempting sales of interests in a single oil or gas lease to 35 or fewer persons in 12 months if there is no public solicitation) will prevent most of the automatic liability that would attach to an occasional sale of a lease interest by a manager under a joint operating agreement, unitization agreement, or similar arrangement, if the

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recovery under the pleadings as well as the law. The question . . . was a question of fact to be determined by the jury.

263. He was a registered salesman of a dealer. 276 S.W.2d at 371.

264. He brought at least four investors and perhaps nine into the Mexican mining venture. Besides Gould and Cole, there was Bloch (Cole's auditor, whom Brown took to Mexico for the investigation) and Ivey-Brown Co. (Brown's partnership with Frank Ivey) who were "sold" by Brown. Five other investors, who may or may not have been "sold" by Brown, are listed at *id.* at 369, 373.

Whether a registered salesman who moonlights like this must also be registered as a dealer to avoid liability under § 33A(1) is considered in Part 5.6.4 below.

265. True, one of Brown's points of error in the court of civil appeals was that the trial court was wrong, "(6) in holding that defendant Brown was a 'dealer,' within the terms of the Securities Act, the undisputed proof showing he was not, in the transactions with plaintiffs, dealing in securities under said Act." 276 S.W.2d at 375. But this seems aimed at the question whether the interests involved were "securities" (which all courts held they were) rather than whether Brown was a "dealer." The intermediate court paid as little attention to the "dealer" question as the high court did, merely saying, after noting that "sell" includes a solicitation, "the word 'dealer' having a like comprehensive meaning." *Id.* at 378.

266. See, *e.g.*, the court's designation of the issues and defenses at 291 S.W.2d at 707, which begins: "the question here presented for determination is [whether] or not petitioner Brown made a sale of 'securities' to the respondents."

267. See also the discussion of Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), on the dealer question, note 40 *supra*.

268. 560 S.W.2d 494 (Tex. Civ.App.—Texarkana 1977, writ ref'd n.r.e.).

268A. *Id.* at 498.

holding is extended to civil liabilities.[269] The holding is questionable in its own legal context and special facts;[270] it should not be expanded to others.

It is hard to believe that the Legislature intended everyone who sells a security to register as a dealer unless the transaction is exempt by § 5.[271] The patent purpose of dealer-salesman registration is to regulate an industry or business. Indeed, the § 4C definition rather clearly contemplates some continuity of activity to become a dealer. A line of decisions, both early[272] and late,[273] construe "dealer" to be someone who is in the business of selling securities. I think this is sound, especially in the civil liability area, and connotes not only continuity of activity[274] but activity with the

269. Note, however, that an "oil, gas or mineral unitization or pooling agreement" is not deemed a sale. § 5Q.

270. The court indicated that it was motivated by the unusual circumstance of the dissolution: "The securities were at the time of disposition [by Enntex], and are now, subject to regulation. Regulation cannot be avoided simply by a wrongdoer . . . transferring its assets." 560 S.W.2d at 498.

271. The counterargument is the obvious one that the Legislature created the exemptions it wanted in § 5, and that they apply to dealer registration as well as to securities registration in most instances.

272. Culver v. Cockburn, 127 S.W.2d 328 (Tex. Civ. App.—Galveston 1939, writ dism'd judgmt cor.), affirming a $1,500 judgment for plaintiff, as an agreed commission for finding a buyer for defendant's oil and gas lease. The main defense was that plaintiff was not registered under TSA. (The court said he had no permit, a term usually associated with securities registration, but referred to statutes dealing with person registration.) The court held that plaintiff was not a dealer, noting that he had made only two other sales, and that decisions in other states held isolated transactions to be outside the securities act. (These decisions probably interpreted specific exemptions for isolated transactions.) The supreme court rejected the isolated transaction concept in Breeding v. Anderson, 152 Tex. 92, 254 S.W.2d 377 (1953), note 257 *supra* and accompanying text.

See also Cosner v. Hancock, 149 S.W.2d 239, 243 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.), and Anderson v. Eliot, 333 S.W.2d 654, 658 (Tex. Civ. App.—Eastland 1960, writ ref'd), both construing the predecessor of the § 5C(1) exemption to apply to the "owner of the security; [so] that he is not a dealer if he sells for the purposes named . . . provided, of course, he is not in that . . . business." 333 S.W.2d at 658. The earlier court restated the point more emphatically: "If one attempts to sell, as a business, securities for himself or others, he comes within the definition of a dealer within the meaning of the Act." 149 S.W.2d at 243. The same statement is made in Flournoy v. Gallagher, 189 S.W.2d 108, 111 (Tex. Civ. App.—Eastland 1945, no writ).

Cf. Aiken v. State, 128 S.W.2d 1190, 1192 (Tex. Crim. App. 1938): Indictment sufficiently charged appellant was a dealer when it "affirmatively stated that appellant was engaged in the business of a dealer 'by soliciting, offering for sale and selling' securities. The acts charged against appellant clearly define him as a dealer in securities."

273. Stone v. Enstam, 541 S.W.2d 473, 479 (Tex. Civ. App.—Dallas 1976, no writ): "A dealer is one who attempts to sell securities for himself or others as a business, and a salesman is one employed by a dealer to sell, offer to sell, solicit subscriptions, or deal in any other manner in securities." Using this interpretation, the court held it was not against the weight of the evidence for the trial court to find that Dean (the president of Worldcom) was not a dealer or salesman in Stone's purchase of Worldcom stock from Enstam (vice president of Worldcom). Dean made various statements to Stone about Worldcom's finances and prospects. Stone asked Dean how he could get some Worldcom stock; Dean said neither he nor Worldcom would sell shares but Enstam might. Stone made up his mind to buy the stock before meeting Enstam, and discussed only payment terms with him. Apparently there was no evidence of any prior sales activity by Dean.

The finding that the president was not an agent was also upheld, although the court did not supply a definition of agent. *Id.* at 479. The agency point was touched on again, *id.* at 480.

274. *Evidence.* There should be no difficulty about the admissibility of evidence of sales or offers to other persons for purposes of showing the defendant was a dealer. Such evidence was admitted in Cosner v. Hancock, 149 S.W.2d 239 (Tex. Civ. App.—El Paso 1941,

investing public for the purpose of making profit from the services (as distinguished from profit from the ownership of the securities).[275] Thus, to take the easy cases, an investor who trades his own account, even though quite actively, solely by transactions through or with a registered dealer is not in the securities business, does not deal with the public, profits only from the ownership of his securities, and should not be regarded as a dealer. On the other hand, a person who actively sells securities to other investors and, for compensation, aids investors in selling to third persons—all without the intervention of a registered dealer—is in the securities business, deals with the investing public, profits from his activities, and should be regarded as a dealer.

Finally, the Legislature, with the emphasis of repetition,[276] has decreed that a person engaged in a § 5 exempt transaction is not a dealer, even though he may be a dealer in other transactions.[277]

5.5.4 *Meaning of Unregistered.* Just as there are different ways to register securities (discussed in Part 5.1.3 above), there are different ways to register persons. Moreover, the latter lead to different results in terms of the kinds of securities which can be sold by the registered person.[278] Registration may be general (for all kinds of securities) or restricted to one or more of the present categories: (1) oil and gas interests, (2) municipal and government bonds, (3) real estate syndication interests or condominium securities, (4) sales to the dealer's own employees, (5) open end investment company securities, and (6) securities issued by the

writ dism'd judgmt cor.); Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940), note 256 *supra*; Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968), note 259 *supra*; Culver v. Cockburn, 127 S.W.2d 328 (Tex. Civ. App.—Galveston 1939, writ dism'd judgmt cor.), note 272 *supra*. Other criminal cases in which sales to other persons were admissible, over objections that they related to extraneous offenses, include Morgan v. State, 557 S.W.2d 512, 513-14 (Tex. Crim. App. 1977) (a fraud prosecution under § 29C); Shappley v. State, 520 S.W.2d 766, 771 (Tex. Crim. App. 1974) (prosecution for lack of dealer registration, § 29A). *But see* Christie v. Brewer, 374 S.W.2d 908, 916-17 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), in which such evidence was inadmissible to impeach a defendant's testimony that he never offered the stock to anyone other than plaintiff, because this was a collateral issue. "We would . . . exclude this testimony unless it is admissible for some other reason." *Id.* at 917. The court gives as an example of a good reason, the determination of the scope of the defendant's authority as an agent for his employer. Establishing that defendant was a dealer—if that were relevant to liability—would be a similar reason for admitting the evidence.

275. As a matter of policy, it should be a rare situation in which one who assists gratuitously in a transaction is regarded as a dealer. Indirect or nonmonetary compensation is, of course, compensation and keeps the transaction from being gratuitous. Compensation, it will be recalled, is not absolutely essential for a person to be a *seller*; see notes 58-59 *supra* and accompanying text.

276. § 5 preamble, quoted in note 102 *supra*. See also the last clause of § 4C.

277. The § 5 exemptions are summarized in note 102 *supra*. Especially important for the investor trading his own account is § 5C(1). *Cf.* Annot., *Who is "dealer" under state securities acts exempting sales by owners other than issuers not made in course of successive transactions, and the like*, 6 A.L.R.3d 1425 (1966).

278. There is no explicit statutory authority for different kinds of dealer registration. But the necessary authority is probably implicit in § 13D (Board may waive examination of "any applicant or class of applicants"), § 17 (Commissioner to determine the form of registration certificate given to dealers), and § 28-1B (Board may classify persons and prescribe different requirements).

dealer.[279]

While not spelled out anywhere in TSA, it seems clear that a dealer (or salesman) with a restricted registration is registered only when dealing in his specified area. Thus, an oil-and-gas-only dealer is unregistered if he sells a corporate share or a municipal bond, and is correspondingly in violation of § 12 and liable by § 33A(1). An applicant for registration is apparently not registered until his certificate is issued by the Commissioner.[280]

Dealer registration also registers one or more officers or partners of the dealer.[281] I have already remarked[282] that registration with the SEC or in another state, or membership in a self-regulatory organization, does not amount to Texas registration.

5.5.5 *§ 34 Commission Ban.* An unregistered dealer (or salesman[283]) is subject to another private sanction beside rescission or damages under § 33A(1). He is barred by § 34 (Appendix 4 below) from suing for a commission or compensation from either the seller or the buyer in either the sale or the purchase of securities.[284] Thus, a buyer from or

279. Tex. State Sec. Board Rule VIII.A.2.a, Tex. Reg. No. 065.08.00.001 para. 2.a, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,608 para. A.2.a (1975). Temporary registrations are also authorized by § 15.

280. This is the implication of § 15 for dealers and § 18 for salesmen.

For the duration of registrations, see note 239 *supra* and § 19. The latter provision contemplates automatic renewal if timely application is made.

281. Note 304 *infra*.

282. Note 240 *supra* and accompanying text.

283. § 34 bars suits by any "person or company . . . without alleging and proving that such person or company was duly licensed under the provisions hereof." It is not explicitly limited to dealers (and salesmen). But only dealers (and salesmen) are, in our view, required to register. See Part 5.5.2 above. Hence only dealers (and salesmen) are subject to § 34.

284. Breeding v. Anderson, 152 Tex. 92, 254 S.W.2d 377 (1953), discussed in note 257 *supra*; Sibley v. Coffield, 193 S.W.2d 239 (Tex. Civ. App.—Austin 1946, writ ref'd n.r.e.) (suit against seller); Tumblewood Bowling Corp. v. Matise, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.) (suit against seller); Development Inv. Corp. v. Diversa, Inc., 393 S.W.2d 653 (Tex. Civ. App.—Texarkana 1965, no writ) (suit against buyer); Maddox v. Flato, 423 S.W.2d 371 (Tex. Civ. App.—Corpus Christi 1967, writ ref'd n.r.e.) (suit against buyer; history repeats itself; securities of same company as in Sibley v. Coffield, 193 S.W.2d 239 (Tex. Civ. App.—Austin 1946, writ ref'd n.r.e.), two decades earlier); Fry v. Shaw, 508 S.W.2d 142, 146 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.) (suit against buyer); Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.) (suit against buyer); Remley v. Street, 523 S.W.2d 430 (Tex. Civ. App.—Beaumont 1975, writ ref'd n.r.e.) (suit against seller); Stahl v. Preston, 541 S.W.2d 278 (Tex. Civ. App.—San Antonio 1976, no writ) (suit against buyer and seller).

See Flournoy v. Gallagher, 189 S.W.2d 108 (Tex. Civ. App.—Eastland 1945, no writ) (unlicensed plaintiff barred by predecessor of § 34 from suing defendant for share of proceeds of oil and gas leases plaintiff aided defendant in acquiring for resale).

See also Hall v. Hard, 160 Tex. 565, 335 S.W.2d 584, 590-91 (1960) (fact issue whether sale of properties sued on included securities; if it did, plaintiff is barred).

§ 34 codifies early decisions that an unlicensed dealer is barred from suing for commissions on transactions because he is acting illegally and his contracts with customers are unenforceable by him. *See, e.g.*, Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940); Cosner v. Hancock, 149 S.W.2d 239 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.). For the history and interpretation of § 34 and the criticism which led to its present form in 1975, see Bromberg, *Collectibility of Commissions on Exempt Transactions in Securities*, 11 BULL. SEC. ON CORP., BANK. & BUS. LAW, STATE BAR OF TEXAS, No. 1, Oct. 1973, at 3.

through an unregistered dealer or salesman, if the buyer wants to keep the security [instead of rescinding or suing for damages under § 33A(1)], can refuse, with impunity, to pay the commission.[285] Similarly, a seller to or through an unregistered dealer or salesman can refuse to pay a commission.[286] Section 34, in effect, gives a person using an unregistered dealer or salesman a right to withhold commissions, but it says nothing about recovering commissions if they have already been paid. Whether a right of recovery would be inferred, in the face of the explicit limits of § 34 and the specific right of a buyer to rescission or defined damages under § 33A(1), is an open question, but seems doubtful.

The commission barred by § 34 may include the markup charged by an unregistered broker or dealer who acquires a security in his own name and then resells to a buyer.[287]

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§ 34 has an analogue in TEX. REV. CIV. STAT. ANN. art. 6573a, § 20(a) (Vernon Supp. 1978) that bars suits for real estate commissions by persons who are not licensed real estate brokers or salesman under that act. When the transactions involve oil and gas or other interests that are real estate as well as securities, both provisions come into play. *See, e.g.*, Breeding v. Anderson, 152 Tex. 92, 254 S.W.2d 377 (1953); Hall v. Hard, 160 Tex. 565, 335 S.W.2d 584 (1960); Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.).

285. *See* Development Inv. Corp. v. Diversa, Inc., 393 S.W.2d 653 (Tex. Civ. App.—Texarkana 1965, no writ); Maddox v. Flato, 423 S.W.2d 371 (Tex. Civ. App.— Corpus Christi 1967, writ ref'd n.r.e.); Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.); Stahl v. Preston, 541 S.W.2d 278 (Tex. Civ. App.— San Antonio 1976, no writ); Fry v. Shaw, 508 S.W.2d 142 (Tex. Civ. App.— Dallas 1974, writ ref'd n.r.e.); Remley v. Street, 523 S.W.2d 430 (Tex. Civ. App.— Beaumont 1975, writ ref'd n.r.e.).

Note the paradox that a person aiding a buyer is not considered a seller unless he solicits the buyer (Part. 3.1.4 above) and only a seller is required to register by § 12. But such a person—if otherwise a dealer or salesman (see note 283 *supra*)—is deprived of his right to compensation by § 34 unless he is registered. However, a mere finder may be considered outside § 34; see Part 3.1.5 above.

286. *See* Sibley v. Coffield, 193 S.W.2d 239 (Tex. Civ. App.—Austin 1946, writ ref'd n.r.e.); Tumblewood Bowling Corp. v. Matise, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.); Stahl v. Preston, 541 S.W.2d 278 (Tex. Civ. App.—San Antonio 1976, no writ).

287. Mecom v. Hamblen, 155 Tex. 494, 289 S.W.2d 553, 556-58 (1956) (alternative holding). Plaintiff took an oil and gas lease in his own name from the landowner for 25¢ an acre, and instantly assigned it to defendant for 50¢ an acre and an alleged agreement to pay an additional $1 an acre for acreage retained and selected. The court held that the additional $1 an acre never became due but, even if it had, it was barred by § 34 as "commission on the sale of a lease." 289 S.W.2d at 556. This conclusion rested on the prior negotiation of the resale, simultaneous taking and resale of the lease, and the use of the same practice by plaintiff in five to seven prior leases of the same property. Justice Culver, for a unanimous court, wrote:

> This was patently just a method of selling a lease and earning a commission. [Plaintiff] admits that the lessor had told him that he could have for himself all over and above a certain price. We think the law is not to be circumvented in such manner. If so, then all that one must do to avoid the penalties of the Act is to take the security in his own name when he has found a purchaser and then convey the same, adding to the price the amount of his commission.

Id. at 557.

The court emphasizes that this was a riskless transaction for plaintiff, who therefore was never a true owner. The holding would therefore be inapplicable to someone who assumed real risk by acquiring ownership with his own funds and retaining it for some reasonable time.

Cf. Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist.] 1975,

The § 34 sanction, by its own terms, does not operate—and commissions may be recovered—on sale transactions exempted by § 5[288] or on the purchase or sale of securities exempted by § 6.[289] Exemptions outside TSA may also provide relief from § 34.[289A]

5.5.6 *Related and Implied Claims.* An additional sanction imposed upon the unregistered dealer who sells a security is that (assuming no exemption) his violation precludes him from suing for any unpaid purchase price, both by the express language of § 33K (which will be discussed in a later installment) and by the common law which preceded it.[290]

An unregistered person who sells or deals in securities commits a felony and may receive a $5,000 fine, 10 years in prison, or both, under § 29A.[291]

While prosecutors are not collection agents for private citizens, a plaintiff may find that a complaint to the prosecutors,[292] or even the threat of a

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writ ref'd n.r.e.), in which plaintiff sued—unsuccessfully, in part because of § 34—a buyer for the difference between the initial price plaintiff quoted defendant and the lower price that seller had originally quoted plaintiff, *i.e.*, the markup. Plaintiff never bought; rather, defendant negotiated directly with, and bought from, seller.

288. Hedley v. duPont, 558 S.W.2d 72 (Tex. Civ. App.—Houston [14th Dist.] 1977, no writ) (§ 5Q, 35 or fewer sales of oil-gas interests in 12 months); Dunnam v. Dillingham, 345 S.W.2d 314, 318-19 (Tex. Civ. App.—Austin 1961, no writ) (present § 5H, sale to registered dealer); Gerscheimer v. American Heritage Bank & Trust Co., 437 F.2d 1332 (10th Cir. 1971) (*semble*).

One court held that the plaintiff had to be registered even if the transaction was exempt. Rowland Corp. v. Integrated Sys. Technology, Inc., 488 S.W.2d 133 (Tex. Civ. App.—Waco 1972, writ ref'd n.r.e.). This was a misreading of the statute. Bromberg, *Collectibility of Commissions on Exempt Transactions in Securities*, 11 BULL. SEC. ON CORP., BANK. & BUS. LAW, STATE BAR OF TEXAS, No. 1, Oct. 1973, at 3; Lebowitz, *Recent Developments in Texas Corporation Law*, 28 SW. L.J. 823, 864-67 (1974). The section was amended to overrule the case and restore the original meaning. 1975 Tex. Gen. Laws, ch. 78, § 3, at 206. Bateman & Dawson, *The 1975 Amendments to the Texas Business Corporation Act and the Texas Securities Act*, 6 TEX. TECH L. REV. 951, 1010-13 (1975).

Note that some of the § 5 exemptions can be used only by registered dealers, or require that any person acting for a seller be registered. See note 228 *supra*.

289. However, § 6 exempts the specified securities when sold or dealt in by registered dealers or salesmen. Thus an unregistered dealer (or salesman) cannot use the courts to collect a commission on the sale of a § 6 security. Apparently he can sue for a commission on the purchase of a § 6 security; otherwise the reference to "purchase" in the last clause of § 34 would be meaningless.

289A. Note 105 *supra*.

290. *See, e.g.*, Anderson v. Eliot, 333 S.W.2d 654 (Tex. Civ. App.—Eastland 1960, writ ref'd), in which the court recognized this principle but found it inapplicable because there was an exemption.

291. *See, e.g.*, Muse v. State, 137 Tex. Crim. 622, 132 S.W.2d 596 (1939); Atwood v. State, 135 Tex. Crim. 543, 121 S.W.2d 353 (1938); Aiken v. State, 137 Tex. Crim. 211, 128 S.W.2d 1190 (1939); Springfield v. State, 172 Tex. Crim. 341, 356 S.W.2d 940 (1962); Sharp v. State, 392 S.W.2d 127 (Tex. Crim. App. 1965); Wilson v. State, 386 S.W.2d 282 (Tex. Crim. App. 1965); Dean v. State, 433 S.W.2d 173 (Tex. Crim. App. 1968); Shappley v. State, 520 S.W.2d 766 (Tex. Crim. App. 1975).

Only natural persons may be convicted. See note 156 *supra* and accompanying text.

If the transaction is exempt by § 5, registration is not required by § 12, and there is no violation of § 29A. *See* Dean v. State, 433 S.W.2d at 177-79.

292. TSA § 3 envisions prosecution by district and county attorneys on advice from the Securities Commissioner, and by the Attorney General if the local officials do not respond. Nothing here prevents a citizen from complaining directly to the local district or county attorney. However, a complaint to the Securities Commissioner may add force, or invoke other sanctions, such as an injunction suit under § 32.

complaint, hastens a favorable settlement of his claim for damages or rescission. However, an attorney may not participate in such a threat if it is solely to gain a civil advantage.[293]

The possibility of an implied civil action based on the criminal provision has already been discussed for sellers in Part 2.2 above and, more generally—under the parallel criminal provision for selling unregistered securities—in Part 5.1.5 above.

Despite a lack of decisional authority, it should be clear that the participation of an unregistered dealer or salesman in a transaction does not destroy a § 5 exemption for a transaction if the exemption would otherwise be available.[294]

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293. State Bar of Texas Rule DR 7-105, 1A TEX. REV. CIV. STAT. ANN. 353 (Vernon 1973). "A lawyer shall not present, participate in presenting, or threaten to present criminal charges solely to obtain an advantage in a civil matter." *See In re* Thompson, 416 F. Supp. 991 (S.D. Tex. 1976).

294. *Dealer and Salesman Coverage by § 5.* The supreme court has interpreted § 5A ("judicial, executor's, administrator's, guardian's or conservator's sale, or any sale by a receiver or trustee in insolvency or bankruptcy") as applicable only to the executor, administrator, etc. and not to an unregistered person acting for him in the sale. The unregistered person was barred by § 34 from suing for compensation in the transaction. Breeding v. Anderson, 154 Tex. 92, 254 S.W.2d 377, 379 (1953): "Subsection (a) . . . excludes sales made by executors, administrators, etc., but it does not exempt dealers or salesmen who make sales or offer securities for any of those named exempt persons." No rationale beyond this literal reading of the statute is given. How far it extends to other parts of § 5 has not been decided.

Dealers are rarely mentioned in § 5 except when they are required to be registered, explicitly (as in §§ 5.O, 5S) or implicitly (as in §§ 5C(1) ("any person acting as agent for said vendor shall be registered"), 5Q ("if such sale or sales are made by an agent for such owner . . . such agent shall be licensed")). Only § 5P (unsolicited purchase order handled as agent for the buyer) speaks of a dealer without a registration requirement. The reference to an unsolicited order obviously contemplates someone in the securities business and therefore required to be registered. This legislative intent may be clear enough to interpolate the word "registered" and limit § 5P to registered dealers. See note 102, para. (B)(3) *supra*.

Salesmen are not mentioned at all in § 5 except in § 5N, which makes the exemption inapplicable to salesmen (or agents) of farmers' cooperatives if they sell to nonmembers or receive commissions. The effect is to require them to be registered in these two instances. The structure of § 5N makes it clearer than in §§ 5C(1) or 5Q that an unregistered agent does not destroy the exemption for his principal (the owner or issuer of the security). See notes 295-97 *infra* and accompanying text. Nor are agents—which are the same as salesmen in the context of the person registration requirements, see Part 5.6.3 below—mentioned except in the sections just cited.

There are at least three good arguments against reading unregistered dealers (or salesmen) out of the exemptions that do not mention them, as *Breeding* read them out of § 5A. First, *Breeding*'s narrow interpretation is not very consistent with the emphatic and sweeping preamble to § 5, quoted in note 102 *supra*. This broad language was not even considered in *Breeding*, and may not have been called to the court's attention. Second, the 1957 Legislature codified the parallel holding of *Breeding* that a person acting as an agent for the seller in a personal investment resale under § 5C(1) must be registered. 1957 Tex. Gen. Laws, ch. 269, § 5C(1), at 579. It imposed the same requirement in the similar exemption for sales of oil and gas interests. *Id.* § 5Q. But it did not make similar changes elsewhere in § 5, *e.g.*, in §§ 5A, 5B, 5F, 5G, 5H, 5I, thus encouraging an inference that it rejected *Breeding* except for §§ 5C(1) and 5Q transactions (and for § 5N, the farmer's cooperative exemption discussed above, which had required licensing of salesmen and agents in certain transactions since its origin in 1935 Tex. Gen. Laws, ch. 99, § 3(q), at 261). Third, the 1975 Legislature clarified that a person need not be registered to collect a commission on a § 5 transaction (unless otherwise specifically required by § 5). 1975 Tex. Gen. Laws, ch. 78, § 3, at 206. (The occasion for this amendment is described in note 288 *infra* and the sources cited there). The Legislature would hardly have emphasized in § 34 that unregistered persons could collect

Closely related, and equally lacking in authority, is whether the presence of an unregistered person aiding a seller in a § 5C(1) or § 5Q transaction (both of which require agents for sellers to be registered) destroys the exemption for the seller. The answer should be no, for several reasons. First, the history of the requirement shows that it was intended to keep unregistered persons from claiming commissions under the shelter of the seller's exemption,[295] not to constrict the exemption for the seller. Second, the requirement is, by its syntax, a proviso at the end of each exemption, rather than a condition written into the exemption.[296] Third, it would be unreasonable to impose on an individual investor (the seller) the burden of another person's compliance with an industry registration requirement applicable only to the other person. So perverse a result should be rejected unless required by unmistakable legislative language. On the other hand, it seems clear that the unregistered person aiding the seller in a § 5C(1) or § 5Q transaction does not have the benefit of the exemption, and is therefore in violation of § 12 and liable under § 33A(1),[297] even though the seller is not.

A person's lack of a dealer's (or salesman's) registration generally does not excuse him from performing his contracts.[298]

Federal law requires dealers to register,[299] but does not specify any civil liability for failure to do so. However, such liability has been implied.[300] Uniform Act § 201 requires broker-dealer and agent (salesman) registration, and § 410(a)(1) creates civil liability for violation.

5.6 *Unregistered Salesman or Agent—§ 12.*

5.6.1 *§ 33A(1) Civil Liability.* The purposes of salesman and agent registration are essentially the same as those of dealer registration, discussed in Part 5.5.1 above. Registration of salesmen and agents is required by the same § 12 that compels dealers to register. So the civil liability of an unregistered salesman or agent is virtually the same as that of an unregistered dealer. Thus the analysis of the latter in Part 5.5.1 is applicable and need not be repeated. But there are some refinements and special problems which are considered below.

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commissions on § 5 transactions while intending that they be liable for the full amount of the purchase price in a § 33A(1) suit.

295. See note 294 *supra*.

296. § 5C(1) is quoted in full in note 102, para. (B)(1) *supra*. § 5Q has an even more extraneous provision tagged on the end (unitization or pooling agreement not deemed a sale). However, the legislative intent is less clear in the syntax of §§ 5C(1) and 5Q than it is in § 5N, note 294 *supra*.

297. This assumes that he is a dealer or person required to register by § 12. See Part 5.5.2 above.

298. MacKenzie v. Newton, 341 S.W.2d 498, 501 (Tex. Civ. App.—San Antonio 1960, writ ref'd n.r.e.) (defendant, sued for interest in royalty he acquired for partnership of himself and plaintiff, is "estopped to take advantage of his own failure to secure a dealer's license if such was necessary"; he had represented to plaintiff that he did not need one).

299. 1934 Act § 15(a)(1). There is no federal requirement that salesmen register.

300. Eastside Church of Christ v. National Plan, Inc., 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968).

Since a dealer sells through his salesman or agent,[301] and they are virtually his slaves in the contemplation of TSA,[302] the dealer—even though he is registered—is liable by § 33A(1) for a sale made by his unregistered salesman or agent.[303]

5.6.2 *Significance of Salesman or Agent.* Although § 12 covers dealers, salesmen, and agents, it phrases the registration requirement much more clearly for the latter: "No salesman or agent shall . . . sell, offer . . . unless registered as a salesman or agent." This contrasts with the "person, firm, corporation or dealer" language employed for the dealer registration requirement and discussed in Part 5.5.2 above. Thus, there can be no doubt that a person must be a "salesman or agent" before being subject to § 12 registration as such, and a plaintiff must prove him to be such.

5.6.3 *Meaning of Salesman or Agent.* "Salesman" is carefully defined by § 4D to include: "every person or company employed or appointed or authorized by a dealer to sell, offer . . . or deal in any other manner, in securities within this state, whether by direct act or through subagents."[304] "Agent," on the other hand, is utterly undefined.[305] We might cast about for definitions from other areas. But it seems tolerably clear from the language just quoted and from the side-by-side use of "salesman" and "agent" through most of TSA,[306] that the words mean the same thing and are just one more example of the legislative predilection

301. §§ 4C, 4D, and 12 all recognize this reality.

302. See Part 5.6.4 below.

303. *Semble* § 14D: a dealer's registration may be revoked for using an unregistered salesman.

The dealer's civil liability for an unregistered salesman can usually be reached by an alternate route, § 33F(1).

304. *Officers or Partners of Dealer.* § 4D adds "provided, that the officers of a corporation or partners of a partnership shall not be deemed salesmen, where such corporation or partnership is registered as a dealer hereunder." Officers and partners would seem to be covered by the dealer's registration so there is no need for them to be registered again as salesmen. See §§ 15, 17 (dealer registration certificate states the names of "principals, officers, directors or managing agents," and is to be changed when they change). In practice, a distinction is drawn between (A) those officers and partners who are to be actively engaged in business in Texas—who must supply additional information, take one or more examinations and who are covered by the dealer registration, and (B) other officers and partners who are not to be actively engaged in business in Texas—who supply less information, do not take examinations and are not covered by the dealer registration. See Tex. State Sec. Board Rules, Appendix Items VIII.B (questions 6-8), VIII.B.1 (Forms LD3-A and LD-E-1). At least one officer must be registered by a corporate dealer registration. Tex. State Sec. Board Rule VII.A.4, Tex. Reg. No. 065.08.00.001 para. 4, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,608 para. A.4 (1977). Presumably the same applies to partners of a partnership dealer. And presumably an officer or partner who is not registered by the dealer registration is—if he sells in Texas—a salesman or agent who must be registered in that capacity to avoid § 33A (1) liability for himself and the firm.

305. *Cf.* Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ), discussed in note 273 *supra*, where Dean was held not to be an agent, without an attempt to define the term.

306. *E.g.*, §§ 7A(1), 12, 13 (caption), 14, 18, 22B(1), 23B, 25, 29A. See § 4C, which defines dealer to include one who sells "directly or through an agent," without mentioning "salesmen" but using "agent" in precisely the same way that § 12 (requiring dealer registration) uses "directly or through agents or salesmen." "Agent" is used without "salesman" in

for redundancy.[307] It follows that a salesman or agent must be connected to a dealer in one of the ways described in § 4D.[308] Moreover, he must be selling or offering[309] securities himself or through subagents.

As a matter of policy, clerical personnel—who typically are not registered—should not be treated as salesmen or agents even though they have incidental connection with sales: *e.g.*, a salesman's secretary who mails a prospectus to a customer at the salesman's direction, or receives and records a customer's order after the salesman has made an offer; an order clerk; a delivery clerk; etc. Despite statutory definitions of "salesman" and "sell" that might be stretched to cover clerical personnel, such persons perform no significant selling tasks, and their registration would add nothing to investor protection. Their supervision by registered salesmen and dealers provides all that the regulatory system contemplates.

5.6.4 *Meaning of Unregistered—The Moonlighting Salesman.* Salesman registration, like dealer registration, may be limited to certain kinds of securities listed in Part 5.5.4 above. The consequence is that a salesman selling outside his restricted area is unregistered.

A salesman registered in another state, or with a self-regulatory organization like the New York Stock Exchange or the National Association of Securities Dealers, is not registered in Texas for purposes of §§ 12 and 33A(1).[310]

A murkier question arises from the differences between salesman and dealer registration. One effect of these differences is to make the salesman something of an indentured servant to the dealer for whom he works.[311] Moreover, the definition quoted in Part 5.6.3 above suggests that he is a salesman when—and only when—acting with authority from his dealer.[312]

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§§ 5C(1) and 5Q but in a different context (the principal is not a dealer). § 14D uses "salesman" without "agent."

307. See, *e.g.*, note 250 *supra*. The Board has apparently reached the same conclusion. Its rule refers only to dealers and salesman, and says nothing about agents. Tex. State Sec. Board Rule VIII, Tex. Reg. No. 065.08.00.001-.005, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶ 46,608 (1977).

308. A person not so connected may be a dealer in his own right, and liable as such if unregistered. See Part 5.1 above.

309. Or dealing, which we think is limited to selling. See note 30 *supra* and accompanying text.

310. See note 240 *supra*.

311. By § 12 he must be "registered as a salesman or agent of a registered dealer." The dealer applies for the salesman's registration; the certificate is issued to (and retained by) the dealer, and states that the salesman is registered as agent for the dealer, § 18. The salesman's registration is cancelled on the dealer's application. *Id.* A salesman moving from one dealer to another may transfer his registration to the second dealer with the latter's approval; otherwise, a salesman who leaves a dealer will have his registration surrendered by the latter for cancellation. Tex. State Sec. Board Rules VIII.D.3 & .4, Tex. Reg. No. 065.08.00.004 paras. 3 and 4, *reprinted in* 3 BLUE SKY L. REP.(CCH) ¶ 46,608 paras. D.3 and 4 (1977). The Application for License as a Securities Salesman contains an Agreement by Employer (*i.e.*, the dealer) that he will notify the Commissioner of violations by the salesman and will be responsible for all his securities transactions. Tex. State Sec. Board Rules, Appendix Item VIII.C, at 4.

312. One of the questions on the Application for License as a Securities Salesman is: "Do you understand that you are to sell only those securities authorized by your employing dealer?" Tex. State Sec. Board Rules, Appendix Item VIII.C, para. 13.

His registration may be coextensive with such authority. If so, he is unregistered—and therefore potentially liable under § 33A(1)—when he moonlights, *i.e.*, sells securities his employing dealer has not authorized him to handle, typically of a private company in which he is interested. Usually the transaction is not executed through the dealer's facilities and does not appear on its records or customer statements; if compensation is paid, it is to the salesman individually.[313] Thus, he may not be sheltered by his salesman registration if the transaction in question or other transactions (*e.g.*, prior moonlighting) make him a dealer.[314] In this event he is liable under § 33A(1) unless he can show an appropriate § 5 exemption, *e.g.*, § 5I (for small offerings). This may have happened to Brown in *Brown v. Cole*,[314A] since he was held liable—under the 1941-1963 voidability provision (Appendix 3 below)—although he was a registered salesman. While the decision seems to avoid the "dealer" issue and to be based on "seller" and unregistered security questions,[315] it shows that the danger for the moonlighter is more than theoretical, and indicates that the courts may be thinking that a registered salesman is as much an unregistered dealer as any other person.

There are policy arguments against unregistered dealer liability for the moonlighting salesman. The primary purposes of regulation and investor protection have been fulfilled when a person is registered as a salesman. He has filed considerable information about himself with the Commissioner, has passed tests on securities and on securities law, has made himself known to the regulatory authorities, and is aware that his registration is good only for the current year, after which it must be renewed[316] and during which it may be revoked (under § 14) for violation of TSA. But there are policy factors pointing in the opposite direction, suggesting that a salesman's license should not bar liability for dealer activity. These in-

313. For some examples of moonlighting in other contexts, see Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973) (moonlighting saleswoman and employer liable by SA § 12(1) (similar to TSA § 33A(1)) for sale of unregistered securities; saleswoman was "seller" by touting the securities, by arranging a meeting between the buyers and officers of the issuer at which the first purchase took place, and notifying the buyers before each of their later purchases that additional stock was available; the test is whether the party is the "proximate cause" of the sale; employer liable because saleswoman was within the scope of employment although she was not authorized to sell these securities, the sales were not executed through the employer's facilities or recorded on its books, and the employer received no commission on them); Jackson v. Bache & Co., 381 F. Supp. 71 (N.D. Cal. 1974) (moonlighting salesman breached no duty to plaintiffs (some of whom were his customers) in supplying them some information about a company in which they invested; he received 10% finder's fees; the transactions did not appear on the employer's books; employer not liable).

As held in Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973), a salesman may have apparent authority even when lacking actual authority. See also note 321 *infra*.

314. The definition of dealer is discussed in Part 5.5.3 above. Since "dealer" and "salesman" are mutually exclusive categories in §§ 4C, 4D, 12, and 29A, it is arguable that "salesman" activity does not make one a "dealer."

314A. 155 Tex. 624, 291 S.W.2d 704 (1956).

315. See discussion in text accompanying notes 38-39 *supra*.

316. See §§ 13D, 18, 19. The form of Application for License as a Securities Salesman is reproduced in Texas State Securities Board, Rules Adopted by the State Securities Board, Appendix Item VIII.C (looseleaf, orig. pub. 1976).

clude somewhat more extensive disclosure required of a dealer,[317] detailed record keeping requirements for dealers,[318] and the indentured servant quality of the salesman-dealer relation which presupposes that the dealer will supervise and be financially responsible for the salesman's acts. The latter appear to be the weightier arguments, so—insofar as policy is relevant—a registered salesman, when moonlighting as a dealer, has the same liability as anyone else for not possessing a dealer's registration.

However, there may not be any such thing as a moonlighting salesman under Texas law. In the Agreement by Employer[319] signed by a dealer as part of a salesman's registration application, the dealer agrees to be "responsible for all securities transactions performed by the applicant salesman," and agrees to "properly administer the duties and functions of the applicant." If valid,[320] this language implies that a salesman is always "employed or appointed or authorized" by the dealer within § 4D and is therefore always a salesman—hence not a dealer—and is sufficiently registered as a salesman under § 12, even though the transaction in question was a personal one not reflected on the dealer's records.[321]

5.6.5 *§ 34 Commission Ban.* The commission or compensation ban of § 34 seems to operate in the same way for salesmen as for dealers, so the discussion in Part 5.5.5 above is valid for salesmen too.

5.6.6 *Related and Implied Claims.* See Part 5.5.6 above, which applies to salesmen as well as dealers.

5.7 *Stop-Advertising Order Violations— § 23B.*

5.7.1 *§ 33A(1) Civil Liability.* The Commissioner has authority to order a stop of misleading advertising under § 23B:

> No dealer, agent or salesman shall publish within this state or use in connection with any sale or offer of sale any circular, advertisement,

317. The form of Application for License as an Individual General Securities Dealer or Investment Adviser is reproduced in Texas State Securities Board, Rules Adopted by the State Securities Board, 317, Appendix Item VIII.A (looseleaf, orig. pub. 1976), and includes a detailed financial statement, a "statement of plan of business" and other information which is not required in the salesman's form.

318. See note 225 *supra.*

319. Note 311 *supra.*

320. One can certainly question whether the Commissioner's authority in § 18 to prescribe the "form" of the application extends to substantive agreements about responsibility and supervision.

321. Another aspect of the Agreement by Employer is that it may be a third party beneficiary contract that bars a dealer from claiming—*e.g.*, in a suit by a salesman's moonlight customer—that the salesman was acting outside the scope of his authority.

Apparent Authority. In any event, a securities salesman has extensive apparent authority to sell securities. Christie v. Brewer, 374 S.W.2d 908, 913 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.): "The evidence is conclusive, in our opinion, that Allen possessed apparent . . . authority to solicit [plaintiff] for the purchase of stock. He was an employed salesman of [the dealer firm]. A salesman without authority to solicit is of a very peculiar breed." Accordingly the trial court properly (1) rejected evidence that the dealer had instructed Allen not to solicit sales of the stock plaintiff bought and (2) refused a jury issue on whether Allen's sale to plaintiff was within the scope of employment. Evidence of offers and sales of the same securities to other persons is admissible on the question of authority. *Id.* at 917. *See also* Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973), note 313 *supra.*

> prospectus, program or other matter in the nature thereof, after notice in writing has been given him by the commissioner that, in the commissioner's opinion, the same contains any statement that is false or misleading or otherwise likely to deceive a reader thereof.

A § 23B stop-advertising order, commonly titled a "Cease Publication Notice,"[322] need not be preceded by notice or an opportunity for hearing. But the order is not binding on a person until the Commissioner gives him notice, typically by sending him a copy of the order.[323] Appeals may be made to the Commissioner under § 24 for a hearing, and then to the Travis County district court (for trial de novo) under § 27.[324] The stop-advertising order is rarely issued,[325] is (in my opinion) available only against sale advertising,[326] and is typically directed against out-of-state persons advertising in Texas by mail or in local periodicals. The purpose

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322. For an example, see Gary R. Paro, Tex. State Sec. Board Order No. CP-556 (July 6, 1977) (advertisement seeking investments in an advertising campaign, with "guaranteed" returns ranging from $150 in 36 days on a $100 investment to $20,000 in 90 days on a $10,000 investment). The order contains typical findings: the advertiser is not a registered dealer in Texas, the securities are not registered in Texas, the advertisement is an offer of securities, the advertisement has not been filed with the Commissioner in compliance with § 22, and the advertisement is misleading and likely to deceive. Only the last finding is necessary for a § 23B order. The others relate to matters that might become the basis for a § 23A order, or lead to prosecution under §§ 29A (unregistered dealer), 29B (unregistered security) or 29G (§ 22 advertising violation).

§ 23B does not explicitly empower the Commissioner to issue an order, only a notice. The paper issued by the Commissioner, like the example just cited, is in form both an order and a notice. Whatever distinction there may be in administrative law between an order and a notice, there seems to be no practical difference so far as § 33A(1) liability for violation of § 23B is concerned.

A § 23B order is permanent unless later modified or revoked by the Commissioner. See note 347 *infra* and accompanying text on the corresponding procedure for a § 23A order.

323. It may be that summary publication of the order in the State Securities Board Monthly Bulletin will be notice to those who receive the Bulletin (typically all dealers registered in Texas). But the point is largely academic since, as noted in the text, stop-advertising orders are used mostly against non-Texans not registered in the state.

324. See also the appeal procedure in the Administrative Procedure and Texas Register Act, TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 19 (Vernon Supp. 1978), which may be applicable.

325.

	Fiscal Year Ending Aug. 31			
Statistics on certain enforcement orders:	1977	1976	1975	1974
Cease publication (§ 23B stop-advertising)	1	2	3	6
Cease and desist (§ 23A stop-sale)	—	—	6	2
Revocation of § 5.0 exemption	1	2	7	4

Source: Tex. State Sec. Board, Annual Report to the Governor 19 (1977); *id.* at 19 (1975). *Id.* at 17 (1977) explains the post-1975 disappearance of the § 23A stop-sale order. The reason is that the Administrative Procedure and Texas Register Act, TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 19(b)(3) (Vernon Supp. 1978), which took effect Jan. 1, 1976, makes such an order considerably less durable by automatically vacating the order when judicial review is requested under TSA § 27. Consequently, the Board's enforcement thrust shifted from § 23A orders to § 32 injunctions.

326. See note 28 *supra*.

of the stop-advertising order is obviously to halt the circulation of misleading offers before investors respond to them.

A stop-advertising order may not be issued if the security or transaction is exempt.[327]

If a dealer is advertising securities issued by someone else, the order may be directed to both the dealer and the issuer. If the advertising is subsequently used, liability falls on either or both of them who can be considered sellers.[328] While § 33A(1) has apparently not been invoked for § 23B violations, its thrust is relatively plain. It imposes liability on a person who sells[329] in violation of § 23B, *i.e.*, by using an ad that the Commissioner has notified him is misleading.

The elements of a plaintiff's case are that he bought[330] and the defendant sold[331] to the plaintiff[332] a security[333] by publishing in Texas[334] or using in connection with the sale[335] a circular, advertisement, prospectus, program, or other matter after notice in writing was given to the defendant by the Commissioner stating that, in the Commissioner's opinion, the same contained a statement that was false, misleading, or otherwise likely to deceive a reader thereof.[336]

It seems clear that a plaintiff must prove he received or saw the advertisement. But it is probably not essential that the defendant directed the advertisement to the plaintiff if the defendant in some other way "used" it "in connection with" the sale, *e.g.*, by selling to the plaintiff after the plaintiff replied to the ad. Apart from this, it appears that the plaintiff need not prove reliance on the ad, or that his purchase was caused by the ad. Clearly the plaintiff does not have to prove that the ad was misleading, only that the Commissioner notified the defendant that the Commissioner thought it was. Nor does the plaintiff have to prove any scienter or other state of mind of the defendant.

Anyone circulating an ad after a § 23B notice from the Commissioner would probably revise the ad, if only to have a basis for claiming it was not

327. This is another of the horrible examples of the lack of coordination among the parts of TSA. §§ 5 and 6 exempt "[e]xcept as hereinafter in this Act expressly provided." Other provisions expressly override the exemptions, *e.g.*, § 23A stop-sale orders, § 29C criminal prosecutions for fraud, § 32 injunctions for fraud, and §§ 33A(2) and 33B civil liability for fraud. But not § 23B stop-advertising orders. § 22E does not fill the gap; it only confirms that the exemptions override § 22 unless the advertising violates § 23. But, as we have just seen, exempt advertising is beyond the reach of § 23B, although within § 23A. Exempt securities or transactions are dealt with administratively by the § 23A stop-sale order or the § 5.O suspension (see Parts 5.8.1 and 5.8.2 below).

328. See Part 3 above.

329. An offer, *e.g.*, by prohibited advertising, that does not lead to a sale is not actionable. See Part 5.1.2 above.

330. See Part 2.1 above.

331. See note 108 *supra* and cross reference there.

332. See note 109 *supra*.

333. See Part 4.2 above.

334. § 23B so specifies as to publication violation but not as to use violation. Presumably the general territorial principles of note 108 *supra* apply to both.

335. See note 334 *supra*.

336. On proof of notice, see note 111 *supra*.

the same one to which the notice pertained. Whether the ad is the same one should be tested by something like "substantial similarity."[337] The plaintiff apparently has the burden of proof on this point.

5.7.2 *Related and Implied Claims.* Federal law contains no corresponding stop-advertising procedure and no corresponding civil liability. The closest thing in the Uniform Act is § 403, which authorizes the Administrator to require the filing of advertising, and § 410(a)(1), which creates civil liability for violation of § 403.

If the offending ad is in fact misleading, a buyer has fraud claims under § 33A(2) and related provisions.

Texas has a criminal provision, § 29G, for the publishing of any advertising that does not comply with § 22. Most advertising subjected to a § 23B order will not comply with § 22, *e.g.*, because the security or dealer has not been registered. So § 29G will partially overlap § 23B. But it seems unlikely that any implied civil liabilities will arise from § 29G.[338]

5.8 *Stop-Sale Order Violations—§ 23A.*

5.8.1 *§ 33A(1) Civil Liability.* The Commissioner has authority in § 23A to stop the sale of any security for unfairness, fraud, or noncompliance with TSA:

> If it appears to the Commissioner at any time that the sale or proposed sale or method of sale of any securities, whether exempt or not, would not be in compliance with this Act or would tend to work a fraud on any purchaser thereof or would not be fair, just or equitable to any purchaser thereof, the Commissioner may, after notice to the issuer, the registrant and the person on whose behalf such securities are being or are to be offered, by personal service or the sending of a confirmed telegraphic notice, and after opportunity for a hearing (at a time fixed by the Commissioner) within 15 days after such notice by personal service or the sending of such telegraphic notice, if the Commissioner shall determine at such hearing that such sale would not be in compliance with the Act or would tend to work a fraud on any purchaser thereof or would not be fair, just or equitable to any purchaser thereof, issue a written cease and desist order, prohibiting or suspending the sale of such securities or denying or revoking the registration of such securities. No dealer, agent or salesman shall thereafter knowingly sell or offer for sale any security named in such cease and desist order.

A § 23A stop-order, commonly designated a "Cease and Desist Order,"[339]

337. This is the test the Commissioner suggests when his order, note 322 *supra*, gives notice to cease publication of the specified advertisement "and any other advertising materials substantially similar thereto." The test should logically focus on those parts of the advertisement cited or quoted in the notice as misleading.

338. See notes 135-36 *supra* and accompanying text.

339. For an example, see Sale of Securities of Bethel Baptist Church of Midland, Texas, Tex. State Sec. Board Order No. CD-604 (Jan. 11, 1978), finding that the church's bonds are publicly held and in default as to interest and principal, the indenture is not being followed as to sinking fund payments, the books do not show the precise amount of bonds, bond sale proceeds have been used to retire maturing bonds, the bank paying agent for interest has

requires notice and opportunity for hearing. There is some doubt about just who is covered by a § 23A order. The first sentence suggests that it is persons who receive notice of the hearing on the proposed order, although it could also be read to include the whole world.[340] The second sentence seems to narrow the scope to dealers, agents, or salesmen[341] who knowingly sell. Section 33A(1) creates liability for violation of a § 23A "order," not for violation of § 23A itself. Thus, the first sentence of § 23A (which authorizes the order) is the basis for § 33A(1) liability, not the second sentence (which adds a prohibition). It follows that the persons potentially liable by § 33A(1) for violation of a § 23A order are all those validly covered by the order, whether they are the ones who receive the advance notice or those referred to in the order. Even if this reading is correct, § 33A(1) liability should be limited to persons who "knowingly" violate, both because the Legislature probably so intended, although it may have put the word in the wrong sentence, and because of due process considerations.[342] "Knowingly" presumably refers to knowledge of the order.[343]

By § 24, a § 23A order may be appealed to the Commissioner— essentially a rehearing in this context—by any person who "take[s] exception" to the order. Then an appeal lies to the Travis County district court under § 27 for a trial de novo.[344]

The stop-sale order is not very frequently used,[345] and a high proportion of its use seems to be against securities sales of nonprofit organizations.

The obvious purpose of the stop-sale order is to halt sales the Commissioner believes to be inequitable, fraudulent, or otherwise not in compliance with TSA. It complements and expands his power in §§ 7C(2) and

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resigned, the church revenues are insufficient to service the bonds and keep the church operational, and the church is not making significant payments toward bond retirement, and concluding that "it would be inequitable for the issuer, any dealer or salesman or any other person, including existing bond holders, to sell bonds issued by" the church. The formal order is that "all sales of bonds of [the church] by the issuer and its officers, directors, pastors, employees and agents and by dealers, salesmen and other persons, including existing bond holders, CEASE AND DESIST" until default is cured, sinking funds are receiving regular payments that will reasonably insure payment of bond interest and principal, and the order has been lifted or modified. On lifting or modifying, see note 347 *infra* and accompanying text.

340. See note 339 *supra* for an order purporting to bind the issuer, its agents, dealers, and other persons including existing holders.

341. Two of these are defined terms. See Parts 5.5.3 and 5.6.3 above.

342. The other provisions for administrative stop orders all specify that they are inapplicable to a person until he has received actual notice: § 5I (last sentence), § 5.O (penultimate para., last sentence), § 23A (quoted in Part 5.7.1 above). To eliminate possible doubts, § 33A(1) should be conformed by making it refer to a violation of § 23A rather than to a violation of a § 23A order. Or § 23A could be clarified.

343. The order is communicated in summary form in the State Securities Board Monthly Bulletin to all registered dealers, which probably gives them sufficient knowledge. And the order is normally sent directly to the persons who were given notice of the hearing. Moreover, it may be publicized through press release, mailing to lists of security holders of the security, or otherwise.

344. See also the appeal procedure in the Administrative Procedure and Texas Register Act, TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 19 (Vernon Supp. 1978), which may be applicable.

345. See note 325 *supra*.

10A to deny registration when he finds unfairness or fraud. A stop-sale order may be issued whether or not the security or transaction is exempt,[346] whether or not the security has been registered, and whether or not the seller is registered as a dealer or salesman. If the security is registered, the order may revoke the registration. In any case, the order may temporarily suspend or entirely prohibit sales. Most orders are permanent in form, although they may be modified or vacated by the Commission on application of an interested party under § 24, if the circumstances leading to the order have been corrected.[347]

While § 33A(1) has apparently not been invoked for § 23A violations, its thrust is reasonably plain. Section 33A(1) imposes liability on a person who sells[348] in violation of § 23A, *i.e.*, by selling a security named in a § 23A order.

The elements of a plaintiff's case are that he bought[349] and the defendant knowingly[350] sold[351] to the plaintiff[352] a security[353] named in a § 23A stop-sale (or cease-desist) order. The principal defenses would appear to be that the defendant did not know of the order, or that the order was not valid, at least to him.

5.8.2 *Related and Implied Claims.* The SEC has power summarily to suspend trading in a security for 10 days if "in its opinion the public interest and the protection of investors so require."[354] There is no express civil liability for violation, but one could easily be implied. The SEC also has power, after notice and opportunity for hearing, to issue a

346. This was not always so. In 1935 Tex. Gen. Laws, ch. 99, §§ 23 and 3 (preamble), at 272 and 259, the stop-sale procedure was inapplicable to exempt transactions and its applicability to exempt securities was obscure. In 1955 Tex. Gen. Laws, ch. 67, §§ 24, 3 (preamble), and 4 (preamble), at 339, 324, and 327, the stop-sale procedure was inapplicable to exempt transactions and to exempt securities. In 1957 Tex. Gen. Laws, ch. 269, § 23A, at 595, the stop-sale procedure became applicable to exempt transactions and to exempt securities except to government and municipal securities exempt by § 6A. The present all-inclusive form was reached only in 1973 Tex. Gen. Laws, ch. 97, § 1, at 216 (amending § 23A).

347. For an example, see Sale of Securities of Power Oil Co., Tex. State Sec. Board Order No. V-557 (Aug. 3, 1977), *vacating id.* No. CD-319 (Nov. 7, 1967) and No. 5.0-309 (July 31, 1967), after change in management, shareholders, auditors, and assets, and after becoming a reporting company under the 1934 Act. For a more restricted example, see Securities of Am. Guar. Life Ins. Co., Tex. State Sec. Board Order No. M-CD-558 (Sept. 15, 1977), *modifying id.* No. CD-428 (Mar. 27, 1970), to permit two named holders to sell 9.5 shares at $5 each to the chief operating officer of the company so he can qualify as a director. The 1970 order was later vacated, *id.* No. V-612 (May 12, 1978), noting that the vacation does not relieve the company from complying with the registration requirement in future sales, or finding an applicable exemption.

348. An offer that does not lead to a sale is not actionable. See Part 5.1.2 above.

349. See Part 2.1 above.

350. See the discussion of knowingly, and whether it is an element of plaintiff's case, earlier in this Part 5.8.1. On the evidence of notice of the order—which relates to "knowingly"—available from the Commissioner's records, see note 111 *supra*.

351. See note 108 *supra* and cross references there.

352. See note 109 *supra*.

353. See Part 4.2 above.

354. 1934 Act § 12(k) which in 1975 combined former §§ 15(c)(5) and 19(a)(4). The SEC's longstanding practice of renewing suspensions for additional 10-day periods was held invalid in SEC v. Sloan, 98 S. Ct. 1702, 56 L. Ed. 2d 148 (1978).

stop order suspending the registration statement for a security, after which a sale would be a violation leading to automatic civil liability.[355] The latter provisions have approximate analogues in the Uniform Act: §§ 306, 301, and 410(a)(1).

Other provisions within TSA are comparable in some ways to § 23A. Section 23B stop-advertising orders have already been considered in Part 5.7.1 above. The § 5I(c) exemption (15 sales a year by issuers)[356] may be summarily suspended by the Commissioner if he has reasonable grounds to believe the sale would be fraudulent. A sale by the issuer after notice of the Commissioner's action would—unless some other exemption was available—violate § 7 and be actionable under § 33A(1). More potently, the § 5.O exemption (which permits secondary trading by dealers in a security)[357] may be summarily revoked or suspended by the Commissioner if he has reasonable cause to believe the sale of the security would be fraudulent. If the § 5.O exemption is revoked or suspended, dealers may not trade the security unless some other exemption (like § 5P, for unsolicited purchase orders, or § 6F, for securities listed on certain stock exchanges) is applicable.[358]

The § 5.O revocation or suspension is favored by the Commissioner over a § 23A stop-sale order, and is more frequently used[359] because the former is a summary proceeding and does not require any hearing or advance notice.[360] This enables the Commissioner to act quickly when a company files for bankruptcy or undergoes some other significant change that may not be known to the investing public.[361] However, the revocation or suspension is not applicable to a particular dealer "until he has received actual notice from the Commissioner" of the revocation or suspension.[362] A revocation or suspension is permanent unless it states otherwise. But it

355. 1933 Act §§ 8(d), 5(c), 12(1).

356. See note 102, para. A(1) *supra*.

357. See *id.* para. (B)(2).

358. Salesmen are undoubtedly affected in the same way as the dealers for whom they work. Nondealers (who may not use § 5.O anyway) are not legally affected, and may continue to use whatever exemptions, such as § 5C(1), are available to them. But nondealers are practically affected in that their ability to sell to dealers is virtually destroyed since no dealer is likely to buy a security he cannot resell.

359. See note 325 *supra*.

360. § 5.O, penultimate para. This provision has been held constitutional against claims that it does not provide for a stay. Holladay v. Intercontinental Indus., Inc., 476 S.W.2d 779 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.). The same decision read in a right of judicial review, although one is not given expressly in the statute; the review is by trial de novo in the district court.

361. *See, e.g.*, Commonwealth Oil Refining Co., Tex. State Sec. Board Order No. 5.0-608 (Mar. 7, 1978), revoking any secondary trading exemption for that company which filed for reorganization under the bankruptcy laws on March 2, 1978.

362. The statute specifies that notice by certified or registered mail (with return receipt) be given to dealers believed to be selling the security. But this may not be mandatory since the last clause, making the action inapplicable before receipt of "actual notice," does not indicate that the actual notice must be by registered or certified mail. The difference is important since all registered dealers are sent the State Securities Board Monthly Bulletin which summarizes § 5.O suspensions (and other orders). Thus, by the time the Bulletin is circulated, all dealers probably have "actual notice" sufficient to bind them by the § 5.O order. Indeed, the Commissioner's typical press release on a § 5.O suspension, and the en-

may be vacated by the Commissioner on application of an interested party under § 24 if the conditions leading to the order have changed.[363]

A person who offers or sells a security after notice of a § 23A stop-sale order on the security is a felon and may be fined $1,000, imprisoned two years, or both, under § 29D. It seems doubtful that there is an implied civil liability based on the criminal provision, for the Legislature has indicated otherwise by creating the express liability; see Part 5.1.4 above.

6. *Defenses.* The main statutory defenses to § 33A(1) actions are exemptions from the securities or person registration requirements on which most § 33A(1) liability is based. These have already been discussed in the relevant portions of Part 5 above dealing with the different bases of liability. There may be defenses of invalidity of administrative actions whose violation is alleged as the basis of liability. These too have been discussed in place.

The scope of nonstatutory defenses is not well defined, and we will not attempt an exhaustive treatment here. The courts have accepted equitable defenses, such as pari delicto, in appropriate instances.[364] Ratification

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suing coverage in the financial and business press, may amount to "actual notice" although it is not directly from the Commissioner to the dealer.

363. *See, e.g.*, Fidelity Mortgage Investors, Tex. State Sec. Board Order No. V 5.0-609 (Mar. 20, 1978), *vacating id.* No. 5.0-534 (Feb. 4, 1975). The earlier order was issued when the company filed for bankruptcy reorganization, the later one when a bankruptcy reorganization plan was confirmed by the court and the company reported positive earnings and net worth.

364. *See* Ladd v. Knowles, 505 S.W.2d 662, 668 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.). Plaintiffs actively sought to buy stock that was already outstanding from a private offering and that they thought would be enhanced by a future public offering. Defendants had made no effort to sell the stock. Plaintiffs knew the stock was speculative. They knew it was unregistered and subject to transfer restrictions that might never be removed. They knew the stock was not even in the seller's name. *Id.* at 670-71. In affirming judgment for defendants based on a jury verdict, the court wrote:

> [I]f the transactions were in fact illegal solely because the stock was not registered, plaintiffs, by knowingly joining with defendants in the illegal scheme, were equally culpable with defendants and, therefore, in pari delicto. As such, plaintiffs were precluded from an instructed verdict on the ground alleged by the provisions of [old § 33D].

Id. at 668. Old § 33D (the same as new § 33K) makes contracts in violation of TSA unenforceable. Prof. Hamilton has pointed out that § 33D is not relevant since plaintiffs were trying to rescind the contract, not to enforce it. Hamilton, *Corporations, Annual Survey of Texas Law*, 29 Sw. L.J. 146, 169-70 (1975). He also criticizes any application of pari delicto to registration violations because of the broad public policy in favor of registration. *Id.* I have little trouble with this policy when applied to an issuer, which has the primary responsibility for complying with the securities laws. Even then, there may be situations in which the equities between the parties outweigh the registration policy and justify pari delicto. But for private resales, on which the § 5C(1) exemption is notoriously fuzzy (see note 102, para. (B)(1) *supra*), there is less to say for the registration policy and more to say for balancing the equities between the parties. I find the *Ladd* facts quite appropriate for pari delicto.

A version of pari delicto appears as dictum in an earlier case. "Only by charging [plaintiff] with knowledge that the Ambrosia stock was unregistered and that this fact made it illegal for Allen [a defendant salesman] to solicit its sale could the question of Allen's authority [to bind his employer] arise under this record." Christie v. Brewer, 374 S.W.2d 906, 913 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.).

In Malamphy v. Real-Tex Enterprises, 527 F.2d 978 (4th Cir. 1975), a pari delicto defense was properly submitted to the jury and applied against buyers who were also brokers selling for defendants to other buyers. The suit appears to have been mainly a fraud case, although

may also be a defense.[365] Laches has been held not to be a defense to a statutory right like § 33A when suit is filed within the period of limitations.[366]

Because § 33A(1), read literally, is a no-fault provision leading to potentially huge liabilities for defendants and windfalls for plaintiffs, there is room for the courts to deny rescission, or to deny any relief at all, when a good faith effort to comply with an exemption has failed in some minor respect.[367]

7. *Relief.* For § 33A(1) [like §§ 33A(2) and 33C] the prescribed relief is rescission or (if the buyer no longer owns the security) damages. If the buyer still has the security, he must sue for rescission. This is the pattern of most express liability statutes covering privity transactions.[368] The details of rescission and damages, including interest, costs, and (if the court finds equitable) attorneys' fees are specified by § 33D and will be discussed under that section in a later installment.

Despite the narrow range of remedies in § 33D, there may be room for courts to fashion other remedies in suitable circumstances.[369]

Section 33A(1) claims, based as they are on automatic liability for relatively discrete and objective violations that are the same as to all concurrent buyers, tend to be well suited for class actions under Texas Rule of Civil Procedure 42 and Federal Rule of Civil Procedure 23. "Security," nonregistration (of security or person), escrow violation, excess marketing expense, stop-advertising order, stop-sale order, and exemption raise typical claims and defenses and common questions of law or fact that

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the court refers to a § 33A allegation without saying whether it was § 33A(1) or (2). In any event, the state claims were not submitted to the jury so there is no holding on pari delicto as to the state claims.

For more general discussion of pari delicto and estoppel, see SOWARDS & HIRSCH § 9.02[4]; Annot., *Purchaser's right to set up invalidity of contract because of violation of state securities regulation as affected by doctrines of estoppel or pari delicto*, 84 A.L.R.2d 479 (1962).

365. Ratification was found by the trial court in Stone v. Enstam, 541 S.W.2d 473, 481 (Tex. Civ. App.—Dallas 1976, no writ), discussed in notes 49 and 273 *supra* and accompanying text. But the relevant facts are not given since the decision was affirmed on other grounds.

366. Riggs v. Riggs, 322 S.W.2d 571, 574 (Tex. Civ. App.—Dallas, 1959, no writ).

367. For a full discussion in connection with the corresponding federal provision, see Schneider & Zall, *Section 12(1) and the Imperfect Exempt Transaction: The Proposed I & I [Innocent and Immaterial] Defense*, 28 BUS. LAW. 1011 (1973).

368. *E.g.*, 1933 Act § 12; UNIFORM ACT § 410(a). Express liability provisions for nonprivity transactions typically authorize damages, *e.g.*, 1933 Act §§ 11(a), (e); 1934 Act §§ 9(e), 18(a). But implied liability by SEC Rule 10b-5 may take the form of damages even though the buyer still holds the security. *E.g.*, Pfeffer v. Cressaty, 223 F. Supp. 756 (S.D.N.Y. 1963); 1 BROMBERG §§ 2.5(5) and 9.1, at 226.

369. *Cf.* Meadows v. Bierschwale, 516 S.W.2d 125, 129-30 (Tex. 1974), *rev'g and remanding sub nom.* Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973). The supreme court approved the imposition of a constructive trust on the proceeds the seller of securities received from resale of the property transferred to him in payment for the securities. Although the seller's liability was based in part on § 33A(1) in the intermediate court, the § 33A(1) element was expressly not ruled on by the supreme court, which decided only on common law or equitable grounds.

predominate over individual questions.[370] Thus, the principal issues in a class determination will be whether the class is so numerous that joinder is impractical, whether the plaintiff will fairly and adequately protect the interests of the class, and whether a class action is superior to other methods of adjudication.

8. *Limitations Period.* Section 33A(1) suits may be brought within three years after the sale, but the limitation period may be shortened by a rescission offer. The details of limitations are prescribed by § 33H(1) and discussed in the later installment of this Article covering § 33H. The three-year period is long compared to the one year for comparable violations of federal law[371] and the two years for comparable violations of the typical state law.[372] This is a great advantage for Texas plaintiffs.

9. *Conclusion.* We consider here the use, actual and potential, of § 33A(1), and offer criticisms of the statute as it is written.

9.1 *Use of § 33A(1).* Section 33A(1) is an automatic liability or strict liability provision, not based on any fault of the defendant toward the plaintiff. Liability is based solely on the defendant's failure to comply with registration or other specified regulatory requirements. (See Part 5 above.) It is an extremely potent provision, perhaps too potent, as we shall see in Part 9.2 below. Nonetheless, to judge from the reported cases, plaintiffs have not taken advantage of its power. I find only a handful of cases—five reported and one unreported[373]—in which a buyer plaintiff has obtained a final judgment in a nonregistration suit under § 33A(1) or its predecessors. In six other cases § 33A(1) plaintiffs have failed to prove a necessary element,[374] and in three more, defendants have established ex-

370. A good example, although not discussing the class criteria, is Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977), *rev'g* 559 S.W.2d 663 (Tex. Civ. App.—Texarkana 1977), and affirming a trial court judgment of $187,759 for an 84-plaintiff class suit based on nonregistration of commodity options as securities.

The most likely nontypical claim under § 33A(1) will be under § 9C if prospectuses are given to some buyers but not all. If the issue is a defective prospectus, it will be typical and common for all buyers who received the same prosepctus about the same time.

Improper offers (Part 5.1.2 above) may also present nontypical and noncommon issues.

There may be different sellers of the same security in different situations. See Part 3 above.

371. 1933 Act §§ 13, 12(1).

372. UNIFORM ACT §§ 410(e), (a)(1). All the state limitations statutes for technical or registration violations are summarized in Bromberg, *Curing Securities Violations: Rescission Offers and Other Techniques*, 1 J. CORP. L. 1, 7 n.27 (1975), and, more recently, in SOWARDS & HIRSCH § 9.02[5.].

373. Searsy v. Commercial Trading Corp., 560 S.W.2d 637 (Tex. 1977), *rev'g* 559 S.W.2d 663 (Tex. Civ. App.—Texarkana 1977); Bateman v. Petro Atlas, Inc., Civ. No. 75-H-445 (S.D. Tex. Sept. 26, 1977); Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956); Prokop v. Krenek, 374 S.W.2d 265 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.); Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ); Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App.—Texarkana 1958, writ ref'd), note 18 *supra*.

374. LeNoble v. Weber, Hall, Cobb & Caudle, Inc., 503 S.W.2d 321 (Tex. Civ. App.—Tyler 1973, no writ), note 111, para. (A) *supra* (nonregistration); Riggs v. Riggs, 322 S.W.2d 571 (Tex. Civ. App.—Dallas 1959, no writ), note 227 *supra* (tender required by 1941-1963 voidability provision, Appendix 3 below); Stone v. Enstam, 541 S.W.2d 473 (Tex. Civ. App.—Dallas 1976, no writ), note 273 *supra* (seller, dealer or salesman); Chesnut v. Coastal

emptions[375] or equitable defenses.[376] The remaining reported nonregistration cases were not final dispositions. And there have been no reported § 33A(1) recoveries—indeed no reported litigation—for violations of § 9 (escrow, expense limits, and prospectus) or § 23 (stop-sale and stop-advertising orders).

By contrast, nonregistration was a successful defense (under § 34 and its predecessors) in more than a dozen suits for commissions.[377]

There are various possible explanations of the paucity of litigation under § 33A(1). One is that most securities litigation is brought under federal law, using federal claims. But that does not prevent pendent state claims, and there are instances in which § 33A(1) gives considerably broader rights than the corresponding 1933 Act § 12(1).[378] A second possible explanation is that Texans are too sporting to take advantage of regulatory or technical provisions like § 33A(1) to recover investments that have gone bad. But that does not square very well with the happy embracement of the same regulatory violations as a § 34 defense.[379] A third possible explanation is that potential plaintiffs and their counsel often overlook § 33A(1). I suspect this is true in many instances. Yet another possible explanation is that, in many situations, § 33A(1) liability is so clear that a defendant pays on threat of suit, or does not appeal from a trial court decision.

Whatever the reason for the sparseness of § 33A(1) cases, a review of them (and § 34 cases) reveals other interesting information about the use

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Oil & Land Corp., 543 S.W.2d 154 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.), note 31 *supra* (sale); McConathy v. Dal Mac Commercial Rest Real Estate, Inc., 545 S.W.2d 871 (Tex. Civ. App.—Texarkana 1977, no writ), notes 72, 87 *supra* (security); Matrix Computing, Inc. v. Davis, 554 S.W.2d 288 (Tex. Civ. App.—Amarillo 1977, no writ), note 93 *supra* (damage).

375. Anderson v. Eliot, 333 S.W.2d 654 (Tex. Civ. App.—Eastland 1960, writ ref'd), notes 104, 230 *supra* (§ 5C(1)); *see* Sibley v. Horn Advertising, Inc., 505 S.W.2d 417 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), note 104 *supra* (buyer, sued on purchase contract, defended by alleging nonregistration; seller-plaintiff established § 5I(a) exemption).

376. Ladd v. Knowles, 505 S.W.2d 662 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.), notes 166, 364 *supra* (pari delicto).

377. *See* cases in note 284 *supra*.

378. *Comparison of § 33A(1) and 1933 Act § 12(1).* § 33A(1) allows or may allow recovery for various things not actionable under federal law; *e.g.*, oral offers during waiting period, Part 5.1.2(B) above; preliminary prospectuses without the Texas legend, Part 5.1.2(C) above; escrow violation, Part 5.2 above; excessive marketing expense, Part 5.3 above; unregistered dealer (although there is an implied federal claim), Part 5.5 above; unregistered salesman, Part 5.6 above; violation of stop-advertising order, Part 5.7 above. The state claim based on unregistered security appears to be broader than the federal in at least one important respect because the state exemption for resale of outstanding securities, § 5C(1), may be significantly narrower than the federal analogue, 1933 Act § 4(1). See note 102, para. (B)(1) *supra*. The Texas three-year limitation period is substantially longer than the federal, Part 8 above. In addition, a § 33A(1) plaintiff may receive attorney's fees if the court finds it equitable to award them. § 33D(7). A 1933 Act § 12(1) plaintiff generally cannot win attorney's fees except in a class action, although an award is theoretically possible in any case in which the court "believes the . . . defense to have been without merit." 1933 Act § 11(e).

379. There are readily apparent differences—both psychological and financial—between not suing and not defending when sued, *i.e.*, between not fighting and not fighting back. So it is natural that regulatory violation issues would emerge with greater proportional frequency in the latter situation.

of the two statutes. With very few exceptions,[380] they have been used only for off-market transactions (privately or individually negotiated) in non-market securities (closely held company stock or, in almost all the early cases, oil and gas interests). This is no great surprise, since regulatory compliance is a norm for securities and persons in the organized markets.

9.2 *Critique.* The State Bar Committee gave no real consideration to making fundamental changes in § 33A(1).[381] The general feeling—and my own at the time—was that § 33A(1) had not caused serious problems in the past, that other sections had caused serious problems which needed attention, and any effort to make significant change in § 33A(1) would meet with strong resistance from the Commissioner and his staff, which might imperil the whole bill.

The research and analysis for this Article have persuaded me that there are serious problems with § 33A(1). To start with a minor one, its content and balance are curious by comparison to the criminal provisions which cover roughly the same range of conduct.[382] Much more importantly, § 33A(1) and similar absolute liability provisions are a welsher's paradise. They allow the buyer of a security to speculate—at the defendant's expense—on the market performance of the security and the economic performance of the issuer for the three-year limitation period (unless a rescission offer is made earlier). This distorts the risk distribution functions of the capital market and has strong elements of unfairness. There can be little doubt that absolute liability for regulatory violations contributes to important enforcement and deterrent purposes. (It may well be the single most effective deterrent for honest businesses.) But it does not satisfy the other purpose of civil liability: to compensate victims. Rather, it compensates those who have incurred investment losses, for whatever reason.[383]

Nothing in § 33A(1) requires plaintiffs to show that their losses were in any way caused by the violation. The section does not compensate victims so much as it fines violators for the benefit of supposed victims. Moreover, in many instances, the economic burden of these windfall fines is borne at least indirectly by other innocent investors (shareholders of corporate violators). Often the violators acted in good faith, thinking they were not

380. The only organized-market cases we have found are LeNoble v. Weber, Hall, Cobb & Caudle, Inc., 503 S.W.2d 321 (Tex. Civ. App.—Tyler 1973, no writ), note 111 *supra*; Flowers v. Dempsey-Tegeler & Co., 472 S.W.2d 112 (Tex. 1971), *rev'g* 465 S.W.2d 208 (Tex. Civ. App.—Beaumont 1971), note 35 *supra*; and perhaps Christie v. Brewer, 374 S.W.2d 908 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), note 42 *supra*.

381. Changes were made or considered in the measure of damages, liability of peripheral defendants, statute of limitations, and rescission offers for § 33A(1) situations. See discussions of §§ 33D, 33F, 33H, and 33I in a later installment of this Article.

382. See note 94 *supra*.

383. Losses typically stem from factors which have nothing to do with securities violations, *i.e.*, macroeconomic developments (recession, inflation, interest rate changes, etc.), market conditions, industry conditions, or the business misfortunes of the issuer of the security. These are investment risks of the kind securities investors undertake voluntarily. To transfer them to innocent perpetrators of technical violations requires very strong justification.

selling "securities" or that an exemption—which later turned out to be inapplicable—made registration unnecessary.

All these problems are more acute in the Texas statute than in most other securities laws because of the long limitation period in TSA. They are compounded by the inadequacy or uncertainty of some of the exemptions on which liability for nonregistration depends—such as § 5C(1) for sales of outstanding securities by owners.

The other no-fault provision, § 34 (banning commission suits by unregistered persons), is subject to two of the same criticisms: it encourages welshing (to the extent of the commission or compensation) and does not compensate for losses caused by the violation. Indeed, § 34 may be used by an investor who has profited on his transaction.

The reported cases on § 33A(1) and related no-fault provisions get very low marks for equity. The decisions have often relieved business persons of obligations incurred in arm's length transactions,[384] and allowed them to shift high risks they accepted with open eyes.[385] In other instances, plaintiffs have complained of fraud and won without having to prove it;[386] indeed they sometimes won from persons who clearly had no part in the fraud.[387]

Some courts have frankly recognized the inequities of their holdings:

> True enough to hold Brown liable to respondents is a harsh penalty and a rather inequitable result. The respondents were not misled by Brown who made no profit or commission and likewise sustained a total loss of his investment. The respondents knew that it was a spec-

384. *See, e.g.*, Kadane v. Clark, 135 Tex. 496, 143 S.W.2d 197 (1940), discussed in note 17 *supra*. *Semble*, under § 34 barring commission or compensation suits by unregistered persons in nonexempt transactions, Maddox v. Flato, 423 S.W.2d 371 (Tex. Civ. App.—Corpus Christi 1967, writ ref'd n.r.e.), Remley v. Street, 523 S.W.2d 430 (Tex. Civ. App.—Beaumont 1975, writ ref'd n.r.e.), Sibley v. Coffield, 193 S.W.2d 239 (Tex. Civ. App.—Austin 1946, writ ref'd n.r.e.), Thywissen v. FTI Corp., 518 S.W.2d 947 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.), and Tumblewood Bowling Corp. v. Matise, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965, writ ref'd n.r.e.), note 284 *supra*; Mecom v. Hamblen, 155 Tex. 494, 289 S.W.2d 553 (1956), note 287 *supra*.

385. *See, e.g.*, Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), discussed in text accompanying notes 38-39 *supra*; Smith v. Smith, 424 S.W.2d 244 (Tex. Civ. App.—Houston 1968, no writ), discussed in text accompanying note 40 *supra*.

386. *See, e.g.*, Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App.—Texarkana 1938, writ ref'd), discussed in note 18 *supra*; Brown v. Cole, 155 Tex. 624, 391 S.W.2d 704 (1956), discussed in text accompanying notes 38-39 *supra*. That this was at bottom a case of fraud by nondefendants is acknowledged by the court: "Some months later, the parties hereto [plaintiffs Gould and Cole and defendant Brown] ascertained that the affairs of these two Mexican corporations had been misrepresented to them by Fields and Kane . . . ." 291 S.W.2d at 707.

In Bierschwale v. Oakes, 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974), notes 100, 227 *supra*, plaintiffs proved untruths and omissions but failed to bring themselves within old (1963) § 33A(2). Nonetheless, they won under § 33A(1).

Cf. Christie v. Brewer, 374 S.W.2d 908 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.), discussed in text accompanying note 42 *supra*. This may well have been a fraud case at bottom (one of the defendants was under felony indictment for the same transactions). Plaintiff won the trial, but the case was reversed and remanded.

387. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704 (1956), notes 38-39 *supra*.

> ulation and presumably at the time considered that they stood to lose. Naturally if the venture had turned out to be in their favor no doubt they would gladly have accepted the profit. On the other hand, the case is not one dealing with equitable principles, but with the application of the Securities Act that was enacted to prevent the very thing that happened here, namely, the sale of worthless stock. Despite our natural sympathy for the petitioner under these circumstances we must sustain respondent's cause of action . . . .[388]

The courts could improve their marks by shading their interpretations—of "security,"[389] of §§ 33A(1) and 34,[390] and of exemptions from them—to fit the equities of the facts at bar.

A more equitable § 33A(1) could be drafted. It might be one, like Ohio's, which creates civil liability for registration and related violation "unless the court determines that the violation did not materially affect the protection contemplated by the violated provision."[391] It might, like existing and proposed federal provisions, allow a defense that plaintiff's loss was not caused by the violation.[392] Better yet would be a more general mitigation standard.[393]

A no-fault provision like § 33A(1) should have a short statute of limitations since the windfall character becomes more pronounced the longer the buyer of a security can speculate on the market or the success of the issuer

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388. Brown v. Cole, 155 Tex. 624, 291 S.W.2d 704, 711 (1956), note 38 *supra*.

389. See further argument on this in Part 4.2 above.

390. *E.g.*, of critical terms like "dealer" and "person who sells." See Parts 5.5.3 and 3 above.

391. OHIO REV. CODE ANN. § 1707.43, amendment reprinted in 2 BLUE SKY L. REP. (CCH) ¶ 38,143 (1978). Defendant has the burden of proving that the violation did not affect the protection intended by the statute. Biernbaum v. Midwest Oil & Gas Co., 108 Ohio App. 560, 160 N.E.2d 410 (1959). Apparently he does not do so merely by showing that plaintiff's loss was caused by factors such as the failure of the company. Miller v. Griffith, 92 Ohio L. Ab. 488, 196 N.E.2d 154 (C.P. 1961). On the other hand, he should be able to do so by showing that plaintiff received the same disclosure he would have had if the sale had been registered instead of exempt.

392. 1933 Act § 11(e): damages for untrue or omissive registration statement not recoverable to extent defendant proves "that any portion . . . of such damages represents other than the depreciation in value of such security resulting from such [untrue or omissive] part of the registration statement." For application, see Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 586 (E.D.N.Y. 1971) (loss of value proportional to general stock market decline, measured by Standard & Poor's Daily Stock Price Index, not recoverable). ALI FEDERAL SECURITIES CODE § 1708(B)(2) (Proposed Official Draft 1978): for certain frauds, the specified measure of damages "is reduced to the extent (which may be complete) that the defendant proves that the violation did not cause the loss."

393. The maximum flexibility is given by ALI FEDERAL SECURITIES CODE § 2007 (Proposed Official Draft 1978):

> If a defendant in an action under section 1702 [sales without registration, etc.] proves (a) that he acted honestly and reasonably, and (b) that any illegality on his part was inadvertent and did not substantially threaten the purposes of this Code, the court may deny or modify rescission or limit damages to the extent justice requires.

For other methods of mitigating the strictures of absolute civil liability, see Schneider & Zall, *Section 12(1) and the Imperfect Exempt Transaction: The Proposed I & I Defense*, 28 BUS. LAW. 1011 (1973); Bromberg, *Curing Securities Violations: Rescission Offers and Other Techniques*, 1 J. CORP. L. 1, 50 (1975).

before he demands his money back with interest from the seller. Texas' three-year period is far too long on the equities, and considerably longer than the one year under federal law and the two years of most other states.[394]

Another essential of a fair system of absolute liability—and of a system in which self-policing can work optimally—is a reasonable and clear set of definitions and exemptions which determine whether registration is necessary. TSA has major shortcomings in this respect, *e.g.*, the overbroad § 4C definition of dealer (Part 5.5.3 above), the overnarrow § 5C(1) exemption for resales of outstanding securities by owners,[395] and the uncertainty whether use of an unregistered dealer or agent destroys a seller's § 5C(1) or § 5Q exemption.[396]

Clarification is also badly needed for what is included in the 20% maximum on marketing expenses for § 9B, and when is a lower limit a "requirement" of the Commissioner (Part 5.3.1 above). Given the dubious effects of such limits, I have grave doubts whether they should be imposed at all, and even graver doubts whether automatic liability—for the entire consideration paid, not just the excess expense—should result from exceeding them. Other parts of § 33A(1) liability based on § 9 are fuzzy too. Liability for § 9A violations should be limited to failure to escrow funds and improper release of funds, and there is need for more specificity about the measure of liability (Part 5.2.1 above). Liability for § 9C violations should be limited to failure to deliver a prospectus (Part 5.4.1 above).

Liability based on § 23 violations needs better definition too, especially as to who is covered by a § 23A stop-sale order (Part 5.8.1 above).

There are other acts which appear to, but should not, lead to absolute liability under § 33A(1). I have already noted the bizarre results that § 33A(1) may produce when sales comply with TSA but are preceded by offers which do not.[397] I have considered there the means by which the courts might avoid these results, and the ways in which TSA should be amended to avoid them, *e.g.*, by deleting "offers" from § 33A(1) so that it is confined to "sales" in violation.

Section 33A(1) does not extend civil liability to all regulatory violations that might injure investors. Thus, § 22 advertising rules are not covered by § 33A(1). There is no good reason why they should be covered. Other sanctions are available to enforce them. Moreover, as noted in Parts 5.1.2(C) and (D) above, there is considerable overlap between § 22 and other provisions, and what § 22 adds is not significant in terms of the kind of investor protection for which automatic civil liability ought to be imposed.

Absolute liability serves important enforcement and deterrent functions. So does capital punishment, but no one has suggested that it be decreed for

394. See Part 8 above.
395. Note 102, para. (B)(1) *supra* and accompanying text.
396. Notes 295-97 *supra* and accompanying text.
397. Parts 5.1.2, 5.1.2(A)-(D), 5.4.1 above.

failure to register under the securities laws. Powerful sanctions require very selective application in very clear-cut circumstances. Section 33A(1) and the provisions it incorporates should not be scrapped, but should be limited in some respects and clarified in many.

APPENDIX 1

1977 Civil Liability Provision—TSA § 33[398]

Sec. 33. Civil Liabilities

A. *Liability of Sellers.*

(1) *Registration and Related Violations.* 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.

(2) *Untruth or Omission.* A person who offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) 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, in the light of the circumstances under which they are made, not misleading, 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. However, a person is not liable if he sustains the burden of proof that either (a) the buyer knew of the untruth or omission or (b) he (the offeror or seller) did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. The issuer of the security (other than a government issuer identified in Section 6A) is not entitled to the defense in clause (b) with respect to an untruth or omission (i) in a prospectus required in connection with a registration statement under Section 7A, 7B, or 7C, or (ii) in a writing prepared and delivered by the issuer in the sale of a security.

B. *Liability of Buyers.* A person who offers to buy or buys a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) 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, in the light of the circumstances under which they are made, not misleading, is liable to the person selling the security to him, who may sue either at law or in equity for rescission or for damages if the buyer no longer owns the security. However, a person is not liable if he sustains the burden of proof that either (a) the seller knew of the untruth or omission, or (b) he (the offeror or buyer) did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

C. *Liability of Nonselling Issuers Which Register.*

(1) This Section 33C applies only to an issuer which registers under Section 7A, 7B, or 7C of this Act, or under Section 6 of the U.S. Securities Act of 1933, its outstanding securities for offer and sale by or for the owner of the securities.

(2) If the prospectus required in connection with the registration contains, as of its effective date, an untrue statement of a material fact or an

398. 1977 Tex. Gen. Laws, ch. 170, § 1, at 344.

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. However, an issuer is not liable if it sustains the burden of proof that the buyer knew of the untruth or omission.

D. *Rescission and Damages.* For this Section 33:

(1) On rescission, a buyer shall recover (a) the consideration he paid for the security plus interest thereon at the legal rate from the date of the payment by him, less (b) the amount of any income he received on the security, upon tender of the security (or a security of the same class and series).

(2) On rescission, a seller shall recover the security (or a security of the same class and series) upon tender of (a) the consideration he received for the security plus interest thereon at the legal rate from the date of receipt by him, less (b) the amount of any income the buyer received on the security.

(3) In damages, a buyer shall recover (a) the consideration he paid for the security plus interest thereon at the legal rate from the date of the 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.

(4) In damages, a seller 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.

(5) For 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.

(6) On rescission or as a part of damages, a buyer or a seller shall also recover costs.

(7) On rescission or as a part of damages, a buyer or a seller may also recover reasonable attorney's fees if the court finds that the recovery would be equitable in the circumstances.

E. *Time of Tender.* Any tender specified in Section 33D may be made at any time before entry of judgment.

F. *Liability of Control Persons and Aiders.*

(1) A person who directly or indirectly controls a seller, buyer, or issuer of a security is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer, unless the controlling person sustains the burden of proof 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.

(2) A person 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 is liable under Section 33A, 33B, or 33C jointly and severally with the seller, buyer, or issuer, and to the same extent as if he were the seller, buyer, or issuer.

(3) There is contribution as in cases of contract among the several persons so liable.

G. *Survivability of Actions.* Every cause of action this Act survives the death of any person who might have been a plaintiff or defendant.

H. *Statute of Limitations.*

(1) No person may sue under Section 33A(1) or 33F so far as it relates to Section 33A(1):

(a) more than three years after the sale; or

(b) if he received a rescission offer (meeting the requirements of Section 33I) before suit unless he (i) rejected the offer in writing within 30 days of its receipt and (ii) expressly reserved in the rejection his right to sue; or

(c) more than one year after he so rejected a rescission offer meeting the requirements of Section 33I.

(2) No person may sue under Section 33A(2), 33C, or 33F so far as it relates to 33A(2) or 33C:

(a) more than three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence; or

(b) more than five years after the sale; or

(c) if he received a rescission offer (meeting the requirements of Section 33I) before suit, unless he (i) rejected the offer in writing within 30 days of its receipt, and (ii) expressly reserved in the rejection his right to sue; or

(d) more than one year after he so rejected a rescission offer meeting the requirements of Section 33I.

(3) No person may sue under Section 33B or 33F so far as it relates to Section 33B:

(a) more than three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence; or

(b) more than five years after the purchase; or

(c) if he received a rescission offer (meeting the requirements of Section 33J) before suit unless he (i) rejected the offer in writing within 30 days of its receipt, and (ii) expressly reserved in the rejection his right to sue; or

(d) more than one year after he so rejected a rescission offer meeting the requirements of Section 33J.

I. *Requirements of a Rescission Offer to Buyers.* A rescission offer under Section 33H(1) or (2) shall meet the following requirements:

(1) The offer shall include financial and other information material to the offeree's decision whether to accept the offer, and shall not contain 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.

(2) The offeror shall deposit funds in escrow in a state or national bank doing business in Texas (or in another bank approved by the commissioner) or receive an unqualified commitment from such a bank to furnish funds sufficient to pay the amount offered.

(3) The amount of the offer to a buyer who still owns the security shall be the amount (excluding costs and attorney's fees) he would recover on rescission under Section 33D(1).

(4) The amount of the offer to a buyer who no longer owns the security shall be the amount (excluding costs and attorney's fees) he would recover in damages under Section 33D(3).

(5) The offer shall state:

(a) the amount of the offer, as determined pursuant to Paragraph (3) or (4) above, which shall be given (i) so far as practicable in terms of a specified number of dollars and a specified rate of interest for a period starting at a specified date, and (ii) so far as necessary, in terms of specified elements (such as the value of the security when it was disposed of by the offeree) known to the offeree but not to the offeror, which are subject to the furnishing of reasonable evidence by the offeree.

(b) the name and address of the bank where the amount of the offer will be paid.

(c) that the offeree will receive the amount of the offer within a specified number of days (not more than 30) after receipt by the bank, in form reasonably acceptable to the offeror, and in compliance with the instructions in the offer, of:

(i) the security, if the offeree still owns it, or evidence of the fact and date of disposition if he no longer owns it; and

(ii) evidence, if necessary, of elements referred to in Paragraph (a)(ii) above.

(d) conspicuously that the offeree may not sue on his purchase under Section 33 unless:

(i) he accepts the offer but does not receive the amount of the offer, in which case he may sue within the time allowed by Section 33H(1)(a) or 33H(2)(a) or (b), as applicable; or

(ii) he rejects the offer in writing within 30 days of its receipt and expressly reserves in the rejection his right to sue, in which case he may sue within one year after he so rejects.

(e) in reasonable detail, the nature of the violation of this Act that occurred or may have occurred.

(f) any other information the offeror wants to include.

J. *Requirements of a Rescission Offer to Sellers.* A rescission offer under Section 33H(3) shall meet the following requirements:

(1) The offer shall include financial and other information material to the offeree's decision whether to accept the offer, and shall not contain 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.

(2) The offeror shall deposit the securities in escrow in a state or national bank doing business in Texas (or in another bank approved by the commissioner).

(3) The terms of the offer shall be the same (excluding costs and attorney's fees) as the seller would recover on rescission under Section 33D(2).

(4) The offer shall state:

(a) the terms of the offer, as determined pursuant to Paragraph (3)

above, which shall be given (i) so far as practicable in terms of a specified number and kind of securities and a specified rate of interest for a period starting at a specified date, and (ii) so far as necessary, in terms of specified elements known to the offeree but not the offeror, which are subject to the furnishing of reasonable evidence by the offeree.

(b) the name and address of the bank where the terms of the offer will be carried out.

(c) that the offeree will receive the securities within a specified number of days (not more than 30) after receipt by the bank, in form reasonably acceptable to the offeror, and in compliance with the instructions in the offer, of:

(i) the amount required by the terms of the offer; and

(ii) evidence, if necessary, of elements referred to in Paragraph (a)(ii) above.

(d) conspicuously that the offeree may not sue on his sale under Section 33 unless:

(i) he accepts the offer but does not receive the securities, in which case he may sue within the time allowed by Section 33H(3)(a) or (b), as applicable; or

(ii) he rejects the offer in writing within 30 days of its receipt and expressly reserves in the rejection his right to sue, in which case he may sue within one year after he so rejects.

(e) in reasonable detail, the nature of the violation of this Act that occurred or may have occurred.

(f) any other information the offeror wants to include.

K. *Unenforceability of Illegal Contracts.* No person who has made or engaged in the performance of any contract in violation of any provision of this Act or any rule or order or requirement hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

L. *Waivers Void.* A 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 hereunder is void.

M. *Saving of Existing Remedies.* The 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.

APPENDIX 2

1963-1977 Civil Liability Provision[399]

Sec. 33. Civil Liabilities

A. Any person who

(1) Offers or sells a security in violation of Sections 7, 9 (or any requirement of the Commissioner thereunder), 12, 23B or any order under 23A of this Act, or

(2) Offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading (when the person buying the security does not know of the untruth or omission, and who in the exercise of reasonable care could not have known of the untruth or omission) is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent (6%) per year from the date of payment, less the amount of any income received on the security upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less (a) the value of the security when the buyer disposed of it and (b) interest at six per cent (6%) per year on such value from the date of disposition. Nothing herein shall prevent the award of punitive or exemplary damages in an amount not to exceed twice the actual damages, as found by the jury, when such false representation or omission is proven to be willfully made.

B. Every cause of action under this Act survives the death of any person who might have been a plaintiff or defendant.

C. No person may sue under Subsection A(1) of this Section 33 more than three (3) years after the contract of sale. No person may sue under said Subsection A(1) if the buyer received a written offer accompanied by reasonable financial information before suit and at a time when he owned the security, to refund the consideration paid together with interest at six per cent (6%) per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within thirty (30) days of its receipt; or if the buyer received such an offer in the amount specified above less the value of the security when the buyer disposed of it, and less interest at six per cent (6%) per year on such value from date of disposition, before suit and at a time when he did not own the security, unless he rejected the offer in writing within thirty (30) days of its receipt. In connection with any such offer, the seller shall deposit funds in escrow in a state or national bank doing business in the State of Texas, or receive an unqualified commitment from such bank to furnish funds, sufficient to provide for the refund on all securities covered by the offer. The notice accompanying such offer shall state (1) the name of such bank

399. 1963 Tex. Gen. Laws, ch. 170, § 12, at 478.

where the refund may be obtained upon the surrender of the security, or if the buyer has disposed of such security upon satisfactory proof of such disposition and of the value received therefor, and (2) that buyer, upon receipt of the refund, may not sue to recover the consideration paid plus interest or for damages under Subsection A(1) of this Section 33, and (3) that the buyer, in the event of failure to accept the offer within thirty (30) days of its receipt, may not sue to recover the consideration paid plus interest or for damages under Subsection A(1) of this Section 33. No person may sue under Subsection A(2) more than three (3) years after the contract of sale or more than three (3) years after the buyer in the exercise of ordinary care should have discovered that such sale was made in violation of said Subsection A(2). Nothing in this Subsection C shall affect or restrict the periods of limitation or other rights applicable to causes of action based on fraud brought pursuant to Article 4004 of the Revised Civil Statutes.

D. No person who has made or engaged in the performance of any contract in violation of any provision of this Act or any rule or order or requirement hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

E. Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this Act or any rule or order or requirement hereunder is void.

F. The rights and remedies provided by this Act are in addition to any other rights or remedies that may exist at law or in equity.

APPENDIX 3

1941-1963 Civil Liability Provision[400]

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 security, the full amount paid by such purchaser for such security, with interest from the date of purchase; provided that any action by a purchaser to enforce any right or liability based upon any sale made in violation of any provision of this Act or any Acts predecessor thereto or amendatory thereof or upon any misrepresentation made in connection with such sale, shall be commenced within two (2) years after the purchaser thereof has knowledge that such sale was made in violation of any provision of this Act, or Acts predecessor thereto or amendatory thereof, or upon a misrepresentation, or within two (2) years after such purchaser, by the exercise of ordinary care, should have discovered that such sale was made in violation of this Act or Acts predecessor thereto or amendatory thereof, or upon a misrepresentation, and not thereafter; and provided further, that no purchaser shall bring any action under this Act against the seller unless: (1) at least fifteen (15) days before filing suit, he shall have made a written demand on the seller for a refund of the full amount paid by the purchaser for the security, with interest from the date of purchase, less the amount of any income from such security that may have been received by the purchaser, and he shall have tendered to the seller the securities sold in proper form for transfer; and (2) the seller shall not have made such refund and accepted such tender within the said fifteen (15) days.

400. 1941 Tex. Gen. Laws, ch. 363, § 1, at 593, adding § 33a; 1955 Tex. Gen. Laws, ch. 67, § 34, at 344; 1957 Tex. Gen. Laws, ch. 269, § 33, at 600-01. The advance demand requirement (the clause beginning "and provided further") was not added until 1955.

APPENDIX 4

1975 Commission Ban—TSA § 34[401]

34. Actions for Commission; Allegations and Proof of Compliance

No person or company shall bring or maintain any action in the courts of this state for collection of a commission or compensation for services rendered in the sale or purchase of securities, as that term is herein defined, without alleging and proving that such person or company was duly licensed under the provisions hereof and the securities so sold were duly registered under the provisions hereof at the time the alleged cause of action arose; provided, however, that this section or provision of this Act shall not apply (1) to any transaction exempted by Section 5 of this Act, nor (2) to the sale or purchase of any security exempted by Section 6 of this Act.

401. 1941 Tex. Gen. Laws, ch. 363, § 2, at 593-94 (except that the proviso read: "this Section or provision of this act shall not apply to the exempt transactions set forth in Section 3 of this Act or to the sale and purchase of securities listed in Section 23 of this Act, when sold by a registered dealer"); 1957 Tex. Gen. Laws, ch. 269, § 34, at 601 (except that the proviso read: "this section or provision of this Act shall not apply to the exempt transactions set forth in Section 5 of this Act nor to the sale and purchase of exempt securities listed in Section 6 of this Act, when sold by a registered dealer"); 1975 Tex. Gen. Laws, ch. 78, § 3, at 206, codified as TEX. REV. CIV. STAT. ANN. art. 581-34 (Vernon Supp. 1978). The reason for the 1975 change is discussed in note 288 *supra*.