Picking Your Battles

A Guide to Selecting Causes of Action Under Texas Law to Recover for Suitability Violations

By Nelson S. Ebaugh and Grace D. O'Malley*

One of the most common defenses to a suitability claim is that the investor ratified the unsuitable transactions. Fortunately for investors in Texas, a broker cannot raise ratification as a defense to a claim under the Texas Securities Act or the Texas Deceptive Trade Practices Act.[1] As a consequence, with artful drafting of the statement of claim, the investor's attorney can take the wind out of the broker's sails by only pleading causes of action that cannot be assailed by the ratification defense.

The above illustration is only one example of selecting particular causes of action to assert on an investor's behalf in Texas. This article examines over a half-dozen causes of action available to investors in Texas and highlights the pros and cons of each. By understanding the pros and cons of each cause of action, the investor's attorney can tailor the statement of claim to avoid the broker's anticipated defenses.

I. The SRO Suitability Doctrines

Before deciding which claims should be asserted against a broker for unsuitable recommendations, it is essential to understand the origin of a private plaintiff's right to relief for his broker's unsuitable recommendations. In the early twentieth century, self regulatory organizations ("SROs") such as the NASD and the NYSE, perceived a need to require brokers to make suitable recommendations to their customers. Consequently, the NYSE adopted the "know your customer" rule[2] in 1909 and the NASD adopted the "suitability" rule[3] in 1939. Although worded differently, the purpose of each of these rules is to ensure that brokers make suitable recommendations to their customers. The NASD "suitability" rule is the most cited of these two rules.

Pursuant to NASD Rule 2310, the "suitability" rule, brokers owe their customers a duty to make suitable investment recommendations. In order to fulfill this duty, brokers must first determine their customer's financial profile and investment objectives. In doing so, brokers must "examine (1) the customer's financial status, (2) the customer's tax status, (3) the customer's investment objectives, and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer."[4] Subsequently, the broker must "tailor his recommendations to the customer's financial profile and investment objectives,"[5] that is, make suitable investment recommendations to the customer.

If a broker breaches any of the suitability duties listed above, then the broker is subject to an NYSE or NASD enforcement action, which may result in license suspension and/or monetary sanctions.[6] As explained in more detail below, courts generally do not recognize a cause of action based solely upon the breach of an SRO rule.

Nonetheless, the SRO rules play a crucial role in private causes of action seeking redress for unsuitable recommendations. The Fifth Circuit has held that SRO rules provide useful guidelines for identifying the fiduciary duties that brokers owe their clients.[7] As stated by the Northern District of Texas in *Lange v. H. Hentz & Co.*,[8] "the NASD Rules may be used as evidence of the present standard of care which the NASD member should achieve. [In addition, the] NASD rules are admissible on the issue of what fiduciary duties are owed by a broker to an investor."

II. Is there a Private Cause of Action for the Violation of an SRO Suitability Rule?

The answer to this question depends upon the jurisdiction in which the investor filed suit. If the investor filed suit in Texas, the answer is probably "no."

In *Miley v. Oppenheimer & Co.*, the U.S. Court of Appeals for the Fifth Circuit declined to opine on whether a plaintiff may allege a private cause of action for violation of the suitability rule;[9] however, two federal district courts and one state court in Texas have taken a position on the issue.[10] The U.S. District Courts for the Northern and Southern Districts of Texas and at least one Texas state court have declined to recognize such an action.[11]

In *Porter v. Shearson Lehman Bros., Inc.*, the U.S. District Court for the Northern District of Texas observed that when Congress drafted the Securities Exchange Act of 1934 it specifically omitted any language allowing private causes of actions for violations of private dealer association rules.[12] The Court concluded that the private association rules of entities such as the NASD are merely guidelines—not rules "developed under the authority of the SEC, a statute or a law."[13] Therefore, there is no private right of action for the violation of an SRO rule.

There is, however, one federal district court in Texas that has taken the opposite position on whether a private cause of action may be asserted for the violation of any of the SRO suitability rules. In *Cook v. Goldman, Sachs & Co.*,[14] the Southern District of Texas held that a claimant does have a private cause of action for violation of the SRO rules. In so holding, the Court adopted the reasoning used by other circuits which have recognized a private cause of action for violation of an SRO rule.

There are few courts throughout the nation which have considered this issue because unsuitability claims typically must be asserted in arbitration, rather than in court. Those courts that have weighed in on the issue tend to hold, as do most Texas courts, that the SRO Rules do not give rise to an implied cause of action.[15]

In sum, although there is some authority in Texas for an implied cause of action under the SRO rules, counsel who assert such claims are certain to face a motion to dismiss based on the contrary decisions in Texas. It is understandable that an investor's counsel would seek recovery under such a cause of action because brokers are liable under the SRO suitability rules without proof of scienter or reliance. However, it might appear that the investor's counsel is overreaching by seeking recovery under a claim that most courts reject.

III. Common Law Fraud, Statutory Fraud, and Rule 10b-5

Due to the fact that an implied cause of action generally is not recognized under the SRO rules, counsel for the aggrieved investor often turns to claims for common law fraud, statutory fraud, and Rule 10b-5 violation. It is not surprising that they turn to such claims. Unsuitable recommendations may be actionable under these claims because the brokers have misrepresented the suitability of certain securities or a particular trading strategy. However, common law fraud, Rule 10b-5, and statutory fraud require proof of scienter and reliance, so these claims may be inappropriate for seeking recovery for damages caused by unsuitable recommendations.

Often brokers do not make unsuitable recommendations with the intent to defraud their customers. Instead, brokers may inadvertently make unsuitable recommendations. For instance, a rookie broker just learning the trade may not realize that a particular recommendation is unsuitable. Claims against the broker for common law fraud, statutory fraud, and Rule 10b-5 violations would fail because the broker did not act with the requisite scienter. And even if the broker did intend to defraud the investor, it may be difficult to prove that the broker acted with the requisite intent.

Regarding justifiable reliance, this element is almost always contested in an unsuitability case. Brokers usually deliver prospectuses to their customers, which, if read, could have revealed the brokers' misrepresentations. When any claim requiring proof of reliance is asserted against the broker, the broker will argue that the investor had a duty to read the prospectus and because the investor failed to read it, the investor could not have reasonably relied upon the broker's misrepresentations. To the dismay of most investors, the majority of courts agree with this reasoning.[16]

It is not surprising that most investors do not read the dense prospectuses and other documents that their brokers gave to them. In fact, most investors seek assistance from a broker because they do not have time to read these dense prospectuses or the ability to understand them. Consequently, most investors face an uphill battle if they are required to prove reliance in order to recover losses caused by unsuitable recommendations.

IV. Claims that do not Require Proof of Scienter or Reliance

Fortunately for investors, there are several claims that do not require proof of scienter or reliance and that may be used to recover damages resulting from unsuitable recommendations. Those claims are discussed below.

A. *Breach of Fiduciary Duty*

The breach of fiduciary duty claim is the workhorse claim in unsuitability cases. Generally this claim should be asserted in every suit to recover for unsuitable recommendations. The main advantage of this claim is that it simply requires proof of the following: (1) the existence of a fiduciary duty between the plaintiff and the broker; (2) the breach of that duty; and (3) the defendant's breach resulted in (a) injury to the plaintiff, or (b) benefit to the defendant.[17] Conspicuously absent is the requirement to prove scienter or reliance.[18] These elements are not needed to prevail on a breach of fiduciary duty claim.[19]

That is not to say that proving a breach of fiduciary duty claim is clear-cut or easy. Although the Fifth Circuit and Texas courts generally recognize that a broker owes his customer a fiduciary duty, the scope of that duty is typically the most contentious issue in an unsuitability case.

The scope of a broker's fiduciary duty to make suitable recommendations varies significantly depending upon the control that the broker exercises over his customers and their accounts. For instance, if the broker is simply an order-taker and never makes any recommendations to his customers, then he has no duty to make suitable investment recommendations.[20] On the other hand, if the broker has discretionary authority over his customers account, then the broker owes the customer a continuing fiduciary duty to monitor the customer's account and make suitable investment recommendations whenever appropriate.[21]

In the middle of these two extremes is the most common relationship between brokers and their customers—the nondiscretionary accounts. Most customers open nondiscretionary accounts with full service brokerage firms.

With these nondiscretionary accounts, a fiduciary duty only arises when the broker makes a recommendation, and that duty ceases immediately after the completion of the trade.[22] Consequently, the broker only has an intermittent duty to make suitable recommendations and such duty only arises sporadically during his relationship with the customer. This intermittent duty is in contrast to the continuing duty that a broker owes to customers with discretionary accounts.

Although the above described nondiscretionary/discretionary dichotomy serves as a useful guideline for identifying the duties that a broker owes his client, it is only a starting point for evaluating the broker's duties to his customer. For example, the Fifth Circuit, hesitant to allow form over substance, has stated that the nature of the fiduciary duty a broker owes to his customer is very fact-based.[23] The Fifth Circuit noted that whether or not the account was discretionary is but one factor to be considered in this fiduciary duty analysis and that other factors such as the degree of trust that the customer placed in the broker, and the intelligence and personality of the customer should also be considered in the analysis.[24]

Finally, it is important to note that the relationship between a broker and a customer holding a nondiscretionary account may often evolve, and the account may begin to resemble a discretionary account. In these instances, courts may deem that the broker owes the same fiduciary duty to a customers with a nondiscretionary account as he would to a customer with a discretionary account.

B. *Breach of ERISA Fiduciary Duty*

As with the state law cause of action for breach of fiduciary duty, a breach of ERISA fiduciary duty claim[25] does not require proof of scienter or reliance. However only an ERISA-governed plan may assert this claim. Additionally, the broker must be an ERISA-defined fiduciary.

Often the most contentious issue in a breach of ERISA fiduciary duty claim is whether the broker is a fiduciary under ERISA. Brokers are generally considered fiduciaries under ERISA if they render investment advice for a fee.[26] When a nondiscretionary account is involved, the analysis can become complicated.[27] If the broker is indeed an ERISA fiduciary, then he owes the following general duties: (1) to exercise the care of a prudent fiduciary and (2) to diversify plan investments.[28]

If an investor can establish a prima facie breach of ERISA fiduciary claim, the investor is generally in a good position. Typically, the defendant may not assert equitable defenses such as estoppel, waiver, or ratification to defend against a breach of ERISA fiduciary claim.[29] But if the plan's trustee is the sole beneficiary of the plan, then courts may be inclined to entertain such equitable defenses.[30]

C. *Texas Securities Act*

A claim for violation of the Texas Securities Act ("TSA") is an excellent claim to recover damages resulting from unsuitable recommendations. The anti-fraud provision of the TSA imposes liability on brokers who misrepresent the suitability of securities to their customers, as well as brokers who fail to disclose the unsuitability of securities that they recommend.[31]

Remarkably investors and their counsel often overlook the TSA, probably because the statute is somewhat convoluted and appears somewhat difficult to apply.[32] Nothing could be further from the truth. Although the TSA is not a model of clarity, it is perhaps one of the easiest of all claims to prove to recover for certain suitability violations.

For starters, neither scienter nor reliance are elements of a TSA claim.[33] In fact, the TSA imposes strict liability.[34] As if these qualities where not enough, a TSA claim is unassailable to common law defenses.[35] Brokers accused of making unsuitable recommendations often rely on the following affirmative defenses to avoid liability: ratification, waiver, estoppel, and failure to mitigate. Under the TSA, none of these common law defenses are valid.[36]

The only valid defenses are those two provided for in the TSA itself. Those two statutory defenses are: "(a) the buyer knew of the untruth or omission or (b) the offeror or seller did not know and, in the exercise of reasonable care, could not have known of the untruth or omission."[37]

Because the TSA is a strict liability statute and is unassailable to common law defenses, it is an excellent claim to bring on behalf of investors. In addition to these attributes, the TSA has another significant characteristic that distinguishes it from all other claims: an investor is not required to prove loss causation under the Texas Securities Act.

If the market performs poorly during the period in dispute, the broker's attorney will argue that the broker is not responsible for the losses incurred due to the market's general decline. Instead, the broker should only be responsible, if at all, for the damages directly caused by the unsuitable recommendation. Pursuant to *Duperier v. Texas State Bank*, this defense is not available under the Texas Securities Act.[38] Once liability under the Texas Securities Act is established, damages should equal the investor's out-of-pocket loss without any adjustment for market decline.

At first blush, this may seem counterintuitive. Under most claims, the broker is not penalized for general market decline. To protect the broker, the "customer's 'gross economic loss' is reduced by the percentage decline in the market during the period in question as measured by a reputable market index, such as the Dow Jones Industrial Average or Standard & Poor's 500 Index."[39] The purpose of the federal statute upon which the Texas Securities Act was modeled, however, was to serve as "a heightened deterrent against sellers who make misrepresentations by rendering tainted transactions voidable at the option of the defrauded purchasers regardless of whether the loss is due to the fraud or to a general market decline."[40] Considering the purpose of creating this heightened deterrent, the omission of loss causation in the Texas Securities Act is more understandable.

In sum, the ease of proving a TSA claim and the absence of loss causation as an element of proof makes this cause of action quite potent. However, there is a drawback to this claim: The misrepresentation or omission by the broker must be made in connection with the sale of a security.[41] Consequently, if an investor transfers an account to a broker that happened to be invested unsuitability and the broker simply recommends that the investor retain the unsuitable securities, the broker could not be held liable under the TSA. In the context of suitability claims, the TSA is not triggered unless there is a sale of a security.

D. *Negligence*

A negligence claim is similar to a breach of fiduciary duty claim because each claim requires proof that the broker owed a duty, the broker breached that duty, and the breach resulted in injury to the plaintiff. The only distinction is that an investor asserting a negligence claim must prove that the broker owed him a negligence duty instead of a fiduciary duty. "A duty, in the context of a negligence claim, is a legally enforceable obligation to comply with a certain standard of conduct."[42]

At least two federal courts in Texas have held that the NASD suitability rule may be used as evidence of negligence.[43] In *Lange v. H. Hentz & Co*, the District Court for the Northern District of Texas, for example, held that "the NASD Rules may be used as evidence of the present standard of care which the NASD member should achieve."[44]

Only a few Texas appellate courts have considered which negligence duties a broker owes an investor. In *Hand v. Dean Witter Reynolds, Inc.*,[45] the 14th Court of Appeals focused on the existence of the principal-agency relationship between the broker and the investor as determinative of which duties the broker owes an investor. In conclusion, the Court in *Hand* held that a broker does not always owe an investor a duty to accept requested trades.[46] In *Edward D. Jones & Co. v. Fletcher*,[47] the Texas Supreme Court held that the broker did not have a duty to ascertain the investor's mental capacity before assisting her with a securities transaction.

Although a negligence claim is preferable to claims that require proof of scienter, it still has its drawbacks. Because it is a common law claim, it is subject to the numerous common law defenses. For instance, quite often a negligence claim will raise the affirmative defense of comparative negligence. As most experienced practitioners know, even if the investor was not comparatively negligent, the broker's attorney may nonetheless gain some ground by arguing this affirmative defense.

E. *Breach of Contract*

The breach of contract claim is often pled because so many courts do not recognize a private cause of action under the SRO rules. The crux of this claim is that the agreement between the investor and the broker contained a clause essentially providing that the broker will comply with SRO rules. If the broker violates the SRO rules, such as the suitability rule, the investor may then claim that the broker breached the agreement by violating one of the SRO rules incorporated in the contract. Of course this claim hinges upon whether or not the agreement between the investor and the broker contains such a provision.

Although often pled, there is scant case law interpreting this cause of action in the context of a suitability violation. Neither federal nor state courts in Texas have construed this claim in the context of a suitability violation.

A few courts outside of Texas have opined on such breach of contract claims.[48] For example, in *Komanoff v. Mabon, Nugent & Co.* the United States District Court for the Southern District of New York held that, despite the fact that there is no implied private right of action for an SRO violation, a plaintiff could still sue the broker for breach of contract when the contract contained language stating that the brokerage firm was required to comply with the NYSE suitability rule.[49]

The largest drawback to the breach of contract claim is that it is vulnerable to common law defenses. As explained above and below, statutory claims are typically preferable because common law defenses generally may not be used to defend against statutory violations.

V. The Kitchen Sink

In addition to the claims addressed above, there are some additional claims that an investor may assert against a broker who made unsuitable recommendations. These claims do not fit neatly into either of the two broad categories discussed above. Negligent misrepresentation and violation of the Texas Deceptive Trade Practices Act ("DTPA") each require proof of reliance. However, scienter is only occasionally an element of a DTPA violation and is never an element of a negligent misrepresentation claim.

A. *Negligent Misrepresentation*

The claim for negligence misrepresentation is an excellent arrow in a claimant's quiver. There is no scienter element in a negligent misrepresentation claim, making it easier to prove. The elements of a negligent misrepresentation claim are: "(1) the representation is made by a defendant in the course of his business, or in a transaction in which he has a pecuniary interest; (2) the defendant supplies 'false information' for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers pecuniary loss by justifiably relying on the representation."[50]

Perhaps the greatest advantage of a negligent misrepresentation claim is its applicability in instances where the broker induced the investor to simply hold unsuitable securities. For instance, an investor's account may be transferred to a broker who does not recommend the purchase or sale of any securities in the account. Instead, the broker simply recommends that the investor continue to hold securities which are unsuitable. Unfortunately, the investor would not have a cause of action under the Texas Securities Act or the federal securities laws because they only apply to the sale or purchase of securities.[51] But the investor in this instance would likely have a cause of action against the broker for negligent misrepresentation.[52] This type of claim is often referred to as a "holder claim" or a "holding claim." Because it provides relief in instances where state and federal securities statutes do not offer a remedy, the holder's claim has recently grown in popularity.[53]

To date, there are no reported decisions in Texas where an investor successfully recovered damages for unsuitable recommendations under a negligent misrepresentation claim. Nonetheless, this claim is routinely pled in securities litigation and arbitration where the principle issue is suitability.[54]

Although a negligent misrepresentation claim is generally vulnerable to common law defenses, courts have expressly limited the application of certain common law defenses to the claim. For instance, while honesty and good faith are defenses to fraud they are not defenses to a negligent misrepresentation claim.[55] And, contributory negligence is arguably not a defense to a negligent misrepresentation claim in Texas.

Only one appellate court in Texas has held that contributory negligence is a defense to a negligent misrepresentation claim. In *Sloane*, the Tyler Court of Appeals did so in a footnote where it stated "presumptively and without any analysis that '[c]ontributory negligence is a defense to the cause of action for negligent misrepresentation.'"[56] Although this issue was argued on appeal in *D.S.A., Inc. v. Hillsboro Indep. Sch. Dis.*, the Waco Court of Appeals did not reach this issue because it was not preserved for review.[57] The Waco Court of Appeals did note, however, that several jurisdictions have held that contributory negligence is not a defense to negligent misrepresentation because "a party who misrepresents facts to another while reasonably expecting that party to rely upon those facts should not be permitted to benefit from a comparative negligence instruction."[58]

B. *Texas Deceptive Trade Practices Act*

Counsel for the investors should not forget the availability of the DTPA to recover damages for investors who are victims of unsuitable recommendations.[59] Although the DTPA requires proof of reliance (only if using a basis under section 17.46(b)), it often does not require proof of scienter.[60] Similar to a claim under the Texas Securities Act, a claim under the DTPA is generally unassailable to common law defenses.[61]

There is one significant downside to this claim. Texas Courts are split as to whether investors have standing under the DTPA to allege a cause of action under the DTPA against a broker.[62] In fact the majority of Texas courts have held that investors may not allege a DTPA claim against a broker.[63] Consequently, counsel for the investor may face a motion to dismiss based on the majority's holding. The consequence of such motions may be inconsequential but it might also appear that the investor is overreaching and lessen his credibility before the judge or arbitration panel. Arbitration panels have, however, granted awards based on the violation of the DTPA.[64]

VI. Sophistication

As noted earlier, each of the above claims has certain advantages and disadvantages that depend upon the proof that is required to establish a claim and the defenses that may be an obstacle to prevail on a claim. Despite the variations of all the above described claims, they all have one aspect in common: If the customer is a sophisticated investor, then the customer's sophistication may hinder his claims against the broker.

In claims requiring proof of reliance, the broker will argue that because the investor was sophisticated, then he could not have reasonably relied upon the misrepresentation.[65] If the claim is one for breach of fiduciary duty or negligence, then the broker will argue that scope of duty owed to the investor should be construed narrowly. Finally, investors seeking recovery under the Texas State Securities Act will be barred under the statutory defense that prohibits recovery if the investor knew of the misrepresentation.

VI. Conclusion

In sum, investors in Texas are fortunate to have so many claims at their disposal to recover damages for unsuitable recommendations. However, if the investor alleges all of the above described claims at once, the judge, jury, or arbitration panel may be easily confused and find it harder to conclude the existence of liability under any of the claims. Counsel who consider the numerous options to recover damages against brokers for unsuitable recommendations will serve their clients better if they choose their claims wisely.

At some point, the investor's attorney may wonder if focusing on the nuances of each of these claims is worthwhile given that arbitrators "are not strictly bound by case precedent or statutory law."[66] Although arbitrators do possess significant latitude when it comes to following the law, an arbitrator's decision is still subject to judicial review if it is shown that the arbitrator exhibited a manifest disregard for the law.[67] A gentle reminder of possible judicial review raised during closing argument may help the arbitrators focus on the law that supports the investor's case.

* Nelson S. Ebaugh is an attorney with Zimmerman, Axelrad, Meyer, Stern & Wise, P.C. in Houston, Texas. He practices securities litigation and arbitration. Grace D. O'Malley is an attorney with Johnson, DeLuca, Kennedy & Kurisky, P.C. in Houston, Texas. She practices commercial litigation and securities arbitration. Mr. Ebaugh and Mrs. O'Malley are married. They met at Georgetown University Law Center while each was pursuing an LL.M. degree in securities and financial regulation. Mr. Ebaugh can be reached at 713-552-1234 or nebaugh@zimmerlaw.com. Mrs. O'Malley can reached at 713-652-2525 or gomalley@jdkklaw.com.

1. Duperier v.Texas State Bank, 28 S.W.3d 740, 753 (Tex. App.–Corpus Christi 2000, pet. dism'd by agr.) ("The common law defense of ratification will not save a transaction which violates a statute."); LSR Joint Venture No. 2 v. Callewart, 837 S.W.2d 693, 699 (Tex. App.–Dallas 1992, writ denied).
2. NYSE Rule 405; Hoblin, "A Stock Broker's Implied Liability To Its Customer For Violation Of A Rule Of A Registered Stock Exchange," 39 Fordham. L. Rev. 253, 261 (1970)(stating that rule was adopted in 1909).
3. NASD Rule 2310 (formerly art. III ,§ 2 of the NASD Rules of Fair Practice (effective July 15, 1939)).
4. NASD 2310(b).
5. F.J. Kaufman, 50 S.E.C. 164, 168 (1989).
6. *E.g.*, NASD Department of Enforcement v. Howard, 2000 WL 1736882 (N.A.S.D.R.)
7. Miley v. Oppenheimer & Co., 637 F. 2d 318 (5th Cir. 1981)
8. 418 F. Supp. 1376, 1384 (N.D. Tex. 1976).
9. Miley v. Oppenheimer & Co., 637 F.2d 318 (5th Cir. 1981).
10. Porter v. Shearson Lehman Bros., Inc., 802 F. Supp. 41, 63 (S.D.Tex.1992); Cook v. Goldman, Sachs & Co. 726 F. Supp. 151, 156 (S.D. Tex.,1989); Lange v. H. Hentz & Co., 418 F.Supp. 1376, 1384 (N.D. Tex. 1976); Mercury Investment Company v. A.G. Edwards & Sons, 295 F. Supp. 1160, 1163 (S.D. Texas 1969); Millan v. Dean Witter Reynolds, Inc., 90 S.W.3d 760, 767 (Tex.App.–San Antonio 2002).
11. Porter v. Shearson Lehman Bros., Inc., 802 F. Supp. 41, 63 (S.D. Tex.1992); Lange v. H. Hentz & Co., 418 F. Supp. 1376, 1384 (N.D. Tex. 1976); Mercury Investment Company v. A.G. Edwards & Sons, 295 F. Supp. 1160, 1163 (S.D. Texas 1969); Millan v. Dean Witter Reynolds, Inc., 90 S.W.3d 760, 767 (Tex. App.–San Antonio 2002).
12. Porter, 802 F. Supp. at 63.
13. *Id.* at 63.

14. 726 F. Supp. 151, 156 (S.D. Tex.,1989).
15. See 54 ALR, Fed. 11, Private Federal Right of Action Against Brokerage Firm for Violation of Exchange or Dealer Association Rule.
16. E.g. Porter v. Shearson Lehman Bros. Inc., 802 F. Supp. 41, 57-58 (S.D. Tex. 1992)
17. Hawthorne v. Guenther, 917 S.W.2d 924, 934-35 (Tex. App.–Beaumont 1996, writ denied).
18. Hendricks v. Thornton, 973 S.W.2d 348, 360 (Tex. App.–Beaumont 1998, pet. denied) (superceded by statute on other grounds) ("reliance is not an element of . . . breach of fiduciary duty").
19. Upchurch v. Albear, 5 S.W.3d, 274, 283 (Tex. App.–Amarillo 1999, pet. denied).
20. Martinez Tapia v. Chase Manhattan Bank, 149 F.3d 404, 412 (5th Cir. 1998); Romano v. Merrill Lynch, Pierce, Fenner & Smith, 834 F.2d 523, 530 (5th Cir. 1987)
21. McCoun v. Rea (In re Rea), 245 B.R. 77, 89-90 (Bankr. N.D. Tex.2000).
22. Hand v. Dean Witter Reynolds Inc., 889 S.W.2d 483, 493-94 (Tex. App.–Hous. (14 Dist.) 1994)
23. Romano v. Merrill, Lynch, Pierce, Fenner & Smith, 834 F.2d 523, 530 (5th Cir. (La.)) 1987 (citing to Clayton Brokerage Company v. Commodities Futures Trading Commission, 794 F.2d 573, 582 (11th Cir. 1986).
24. *Id.*
25. 29 U.S.C. § 1109(a); 29 U.S.C. § 1132(a)(2).
26. 29 U.S.C. § 1002(21)(A)(ii).
27. See § 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (E.R.I.S.A.), 29 U.S.C.A. §1002(21) (specifically enumerating three criteria in order for an individual to be considered a fiduciary under ERISA). *See also* Labor Reg. § 2510.3-21(c)(1); Treas. Reg. § 54.4975-9(c)(1) (specifically enumerating two criteria to be satisfied in order for a broker or adviser to be considered a fiduciary over a non-discretionary account).
28. 29 U.S.C. §1104(1)(B)-(C). Note that the 7th Circuit went so far as to hold that a broker's fiduciary duties to ERISA plans are not just to render prudent advice to the trustees, but, also to refrain from misleading the ERISA trustees. *See* Wolin v. Smith Barney, Inc., 83 F.3d 847, 849-850 (7th Cir. 1996),
29. Dardaganis v. Grace Capital Inc., 889 F.2d 1237, 1241 (2nd Cir. 1989) ("[T]he trustees of an ERISA plan cannot waive the right of the beneficiaries to have fiduciaries comply with [ERISA]."); Lee v. Burkhart, 991 F.2d 1004, 1009 (2nd Cir. 1993) ("We have recognized that under 'extraordinary circumstances' principles of estoppel can apply in ERISA cases."); Openshaw v. Cohen, Klingenstein & Marks, Inc., 320 F. Supp.2d 357, 364 (D. Md. 2004)(disavowing the following affirmative defenses: estoppel, waiver, ratification, assumption of risk, contributory negligence and recklessness); Williams v. Provident Inv. Counsel, Inc., 279 F. Supp.2d 894, 906-7 (N. D. Ohio 2003); Gonyea v. John Hancock Mut. Life Ins. Co., 812 F. Supp. 445, 449 (D. Vt. 1993) ("[S]tate law defenses are invalid when they would frustrate important policies underlying a statutory scheme as broadly preemptive as ERISA."). But see Lisa S. Kahn and Laura M. Metcalfe, The Broker-Dealer as Fiduciary Under ERISA: Defending Claims by ERISA Plans for Recovery of Their Trading Losses 10 NO. 11 Insights 12, 14 (1996) ("Generally, brokers faced with ERISA claims may assert the same defenses available under common law for breach of fiduciary duty.")
30. Openshaw v. Cohen, Klingenstein & Marks, Inc., 320 F. Supp.2d 357, 364 n.10 (D. Md. 2004).
31. Westcap Enterprises v. City Colleges of Chicago (In re Westcap Enerprises.), 230 F.3d 717, 729 (5th Cr. 2000); Frank v. Bear, Stearns & Co., 11 S.W.3d 380, 384 (Tex.App.–Houston [14th Dist.] 2000, pet. denied).
32. Bromberg, Civil Liability Under Texas Securities Act § 33 (1977) and Related Claims, 32 Sw.L.J. 867, 870 n. 3 & 871 n. 6 (1978); Bordwine, Civil Remedies Under the Texas Securities Laws, 8 Houston L. Rev. 657, 675-676 (1971).
33. Busse v. Pacific Cattle Feeding Fund # 1, Ltd., 896 S.W.2d 807, 815 (Tex. App.–Texarkana 1995, writ denied) ("The Texas Securities Act does not require proof of scienter."); Geodyne Energy Income Production P'ship I-E v. Newton Corp., 97 S.W.3d 779, 783 (Tex.App.–Dallas 2003, pet. granted) ("the TSA does not require the buyer to prove reliance"); Granader v. McBee, 23 F.3d 120, 123 (5th Cir.1994) ("reliance is not required in a Section 33 action"). *But see* Gutierrez v. Cayman Islands Firm of Deloitte & Touche, 100 S.W.3d 261, 275 (Tex. App.–San Antonio 2002)("The law is not clear whether reliance is an element of a cause of action based on a violation of the Texas Securities Act.")
34. Sterling Trust Co. v. Adderley, 119 S.W.3d 312, 317 (Tex. App.–Fort Worth 2003) overruled on other grounds at __S.W.3d __, 2005 WL 1413154 (Tex. 2005); Bordwine, Civil Remedies Under the Texas Securities Laws, 8 Houston L. Rev. 657, 674 (1971).
35. See generally Duperier v. Texas State Bank, 28 S.W.3d 740 (Tex. App.–Corpus Christi 2000, pet. dismissed).
36. Duperier v. Texas State Bank, 28 S.W.3d 745, 753-754 (Tex. App.–Corpus Christi 2000, pet. dismissed) (holding neither ratification nor mitigation are defenses under the TSA); Tex. Rev. Civ. Stat. Ann. art. 581-33L (voiding waivers); Insurance Co. of N. Am. v. Morris, 928 S.W.2d 133, 154 (Tex. App–Houston [14th Dist.] 1996), aff'd in part and rev'd in part on other grounds, 981 S.W.2d 667 (Tex.1998) (holding neither ratification nor estoppel are defenses under the TSA).
37. Tex. Rev. Civ. Stat. Ann. art. 581-33(A)(2).
38. Duperier, 28 S.W.3d at 753.
39. Nancy E. Reich, *Proving Damages Caused by Securities Brokers' Excessive, Unsuitable, or Unauthorized Trading*, 35 Am. Jur. Proof of Facts 3d 161, § 12.
40. Casella v. Webb, 883 F.2d 805, 809 (9th Cir.1989).
41. Tex. Rev. Civ. Stat. Ann. art. 581-33A(2).
42. Hand v. Dean Witter Reynolds, Inc., 889 S.W.2d 483, 491 (Tex.App.–Houston [14th Dist.] 1994, writ denied).
43. Lange v. H. Mentz & Co., 418 F. Supp. 1376 (N.D.Tex. 1976); Mercury Investment Company v. A.G. Edwards & Sons, 295 F. Supp. 1160, 1163 (S.D. Texas 1969).
44. Lange v. H. Mentz & Co., 418 F. Supp. 1376 (N.D.Tex. 1976).
45. 889 S.W.2d 483 (Tex.App.–Houston [14th Dist.] 1994, writ denied).
46. Id. at 494.
47. Edward D. Jones & Co. v. Fletcher, 975 S.W.2d 539 (Tex.1998).
48. *See* Siedman v. Merrill, 465 F. Supp. 1233, 1236 (S.D.N.Y. 1979) (noting that the brother's violation of the New York Stock Exchange rules can be remedied by state law actions for breach of contract and negligence); Hofmayer v. Dean Witter & Co., 459 F. Supp. 733, 739 (N. D. Cal. 1978) (holding that the plaintiff should have separated its claim into two claims, one for breach of contract for failing to abide by the contractual language requiring compliance with the CBOT and Chicago Mercantile Exchange rules and then one for a violations of these SRO rules); Komanoff v. Mabon, Nugent & Co., 884 F. Supp. 848, 859-60 (S.D.N.Y. 1995).

49. Komanoff, 884 F. Supp at 860.
50. Federal Land Bank Ass'n of Tyler v. Sloane, 825 S.W.2d 439, 442 (Tex. 1991).
51. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) (holding that investor lacked standing to sue under 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder because, although the investor held the subject securities, the misrepresentations did not cause the investor to either purchase or sell the subject securities). Although no Texas court has considered whether a holder's claim may be asserted under the TSA, it is likely that a court would answer this question in the negative. "Article 581-33A(2) of the TSA is virtually identical in all relevant aspects to section 12(2) of the Federal Securities Act of 1933 . . . Accordingly, [courts] look to federal cases interpreting section 12(2) as a guide in interpreting article 581-33A(2)." Geodyne Energy Income Production P'ship I-E v. Newton Corp., 97 S.W.3d 779, 789-90 (Tex. App.–Dallas 2003) affirmed as modified in part and reversed in part on other grounds, 161 S.W.3d 482 (Tex. 2005). Pursuant to the Fifth Circuit, "standing to sue under [12(2) of the Securities Act] is based upon the requirement that the plaintiff be a 'purchaser' of the security at issue." 7547 Corporation v. Parker & Parsley Development Partners, L.P., 38 F.3d 211, 220 (5th Cir.1994). Consequently, a court would likely hold that a holder's claim could not be asserted under the TSA.
52. Although there are no reported decisions in Texas that have explicitly addressed the viability of the holder's claim under a negligent misrepresentation theory, it appears likely that a Texas court would approve of it if it was given the opportunity. The holder's claim under a negligent misrepresentation theory has been explicitly adopted in California and New Jersey. Small v. Fritz Cos., Inc., 30 Cal.4th 167, 132 Cal.Rptr.2d 490, 65 P.3d 1255, 1261 (2003); Gutman v. Howard Sav. Bank 748 F. Supp. 254 (D.N.J.1990). In an opinion that was withdrawn and replaced for other reasons, the Fourteenth Court of Appeals endorsed the holder's claim in the context of a common law fraud claim. Shirvanian v. Defrates, 2004 WL 35987 (Tex. App.–Houston [14 Dist.] 2004) withdrawn and replaced by 161 S.W.3d 102 (Tex. App.–Houston [14 Dist.] 2004) And, in Gutierrez v. Deloitte & Touche, LLP, the federal district court implicitly approved of the holder's claim. 147 F. Supp.2d 584, 594-95 (W.D. Tex. 2001). As noted by one commentator noted, "Some of the judicial concern [against recognizing the holding claim] is based on a fear that juries' sympathies would result in excessive verdicts against brokerage firms. This concern is not present in arbitration, where one of the three arbitrators is affiliated with the securities industry." Economic Suicide: The Collision of Ethics and Risk in Securities Law, 64 U. Pitt. L. Rev. 483, 525 n.264 (2003) (omitting citations).
53. *Recent Decisions Find State Holding Claims Viable: "Small" Represents the Most Significant Endorsement of Such Claims to Date*, 27 Nat'l L.J. No. 27 (March 14, 2005); Holding Claims: An Emerging Cause of Action for Securities Fraud, 10 Andrews Derivatives Litigation Reporter 11 (2004); Amanda M. Rose, *Life after SLUSA: What Is the Fate of Holding Claims?*, 69 Def. Couns. J. 455, 455 (2002); *Stockholders' Holding Claim Class Actions under State Law after the Uniform Standards Act of 1998*, 68 U. Chi. L.Rev. 1035, 1035-36 (2001).
54. E.g. Mallia v. PaineWebber, Inc., 889 F. Supp. 277, 282-283 (S.D. Tex. 1995).
55. D.S.A., Inc. v. Hillsboro Independent School Dist., 973 S.W.2d 662, 664 (Tex. 1998).
56. D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 975 S.W.2d 1, 18 (Tex.App.–Waco 1997), *rev'd on other grounds,* 973 S.W.2d 662 (Tex.1998) (citing to Federal Land Bank Assoc. of Tyler v. Sloane, 793 S.W.2d 692, 696 n. 4 (Tex.App.–Tyler 1990), *aff'd in part and rev'd in part on other grounds,* 825 S.W.2d 439 (Tex.1991)).
57. D.S.A., Inc., 975 S.W.2d at 19.
58. D.S.A., Inc., 975 S.W.2d at 18.
59. Note that a DTPA claim is actionable for investment advice/services in connection with securities. It is not actionable just for the sale of securities.
60. *See generally* Smith v. Baldwin, 611 S.W.2d 611, 616-617 (Tex. 1980) (identifying which provisions of the DTPA require proof of scienter.)
61. In re Norplant Contraceptive Products Litigation, 165 F.3d 374, 377 (5th Cir. 1999) (observing that Texas courts have generally disavowed the applicability of common law defenses to the DTPA, but that a few common law defenses to the DTPA have been recognized).
62. See generally Mark C. Watter, The Applicability of the Texas Deceptive Trade Practices Act to Securities Cases, 64 *Tex. B.J.* 542 (2001).
63. *See id.*; But see Prudential Securities Inc. v. Shoemaker, 981 S.W.2d 791 (Tex.App.–Houston [1 Dist.],1998).
64. See, e.g., In re Robert Fitts, et al v. Stratton Oakmont, Inc., 1997 WL 877060 (NASD).
65. "Plaintiff's sophistication and/or experience as a purchaser and/or seller of securities may rebut her reasonable reliance on the defendant's material misrepresentation or omission." Keith A. Rowley, Cause of Action for Securities Fraud Under Section 10(b) of the 1934 Securities Exchange Act and/or Rule 10b-5, 9 Causes of Action 2d 271 (2003).
66. *See* Securities Industry Conference on Arbitration, The Arbitrators Manual 31 (2005). ("Arbitrators are not strictly bound by case precedent or statutory law. Rather, they are guided in their analysis by the underlying policies of the law and are given wide latitude in their interpretation of legal concepts.").
67. See Shearson/American Exp., Inc. v. McMahon, 482 U.S. 220, 259 (1987) ("Judicial review is still substantially limited to the four grounds listed in § 10 of the Arbitration Act and to the concept of 'manifest disregard' of the law." *See also*, Kergosien v. Ocean Energy, Inc., 390 F.3d 346, 355 (5th Cir. 2004)("[M]anifest disregard for the law "means more than error or misunderstanding with respect to the law. The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing principle but decides to ignore or pay no attention to it."