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# Two Year Limitations Period Applicable to Texas General Fraud Statute Applies to 10b-5 Actions When Texas in Forum State and Cause of Action Accrued Prior to 1977.

Richard M. Mosher

## SECURITIES REGULATION—Rule 10b-5—Two Year Limitations Period Applicable to Texas General Fraud Statute Applies to 10b-5 Actions When Texas is Forum State and Cause of Action Accrued Prior to 1977.

*Wood v. Combustion Engineering Inc.*,
643 F.2d 339 (5th Cir. 1981)

Stockholders of American Pole Company, in 1973, accepted an offer to exchange their stock for the stock of Combustion Engineering, Inc. in connection with a merger of the two corporations. In May of 1977, the stockholders filed suit in Federal District Court for the Southern District of Texas seeking damages under sections 10 and 23 of the Securities Exchange Act of 1934,[1] and under rule 10b-5[2] for alleged fraudulent misrepresentations made in conjunction with the exchange. The action was filed less than three years, but more than two years after the discovery of the alleged fraud. The district court dismissed the complaint, holding the claim barred under the Texas two year statute of limititations for general fraud.[3] On appeal to the United States Court of Appeals for the Fifth Circuit, the Appellant-stockholders contended the three year statute of limitations in the Texas Securities Act should apply to 10b-5 actions brought in Texas federal courts.[4] Held-*Affirmed in part, reversed in part.* The two year limitations period applicable to the Texas General Fraud

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1. Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78(j) (1976). Section 10(b) prohibits the use of "manipulative or deceptive devices or contrivences in contravention of such rules and regulations as the Securities Exchange Commission may prescribe." *Id.* § 10(b). Section 23 authorizes the Securities Exchange Commission to make rules and regulations necessary for the protection of investors and the public interest. *Id.* § 78(i).

2. 17 C.F.R. § 240.10b-5 (1981). Rule 10b-5 provides in pertinent part:

> It shall be unlawful for any person to (a) employ any device scheme or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact, necessary in order to make the statements made in light of circumstances under which they made, not misleading; (c) to engage in any act practice or course of business which operates or would operate as fraud or deceit upon any person in connection with the purchase or sale of any security.

*Id.*

3. Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 341 (5th Cir. 1981); *see* TEX. REV. CIV. STAT. ANN. art. 5526 (Vernon 1976). The Texas two year statute of limitations for actions based on fraud applies to TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1976). *See* White v. Bond, 362 S.W.2d 295, 296 (Tex. 1962).

4. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 341 (5th Cir. 1981); *see also* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478.

Statute applies to 10b-5 actions when Texas is the forum state and when the cause of action accrued prior to 1977.[5]

Federal courts have long recognized an implied civil action under section 10(b) of the Securities Exchange Act of 1934 for damages resulting from violation of Securities Exchange Commission Rule 10b-5,[6] despite evidence of congressional intent to the contrary.[7] The implication of civil remedies under rule 10b-5 required federal courts to fashion substantive and procedural rules that were not provided for by Congress.[8] One of the first issues to arise in private 10b-5 actions was the selection of an appropriate limitations period.[9] Although the question arises under federal law, federal courts have adopted limitation periods from the law of the forum state in deference to a long standing judicial reluctance to create statutes of limitations as a matter of federal common law.[10] This policy has been

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5. Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 341 (5th Cir. 1981).

6. *See, e.g.*, J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964) (private remedies necessary to effectuate purpose of 1934 Act); Fratt v. Robinson, 203 F.2d 627, 633 (9th Cir. 1953) (federal courts may fashion remedy when federally created right invaded); Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946) (first case to imply civil action under rule 10b-5).

7. The legislative history of section 10(b) is silent as to private enforcement. *Cf.* S. Rep. No. 792, 73d Cong., 2d Sess. 5-6 (1934). The rule *expressio unius est exclusio alterius* (the expression of one thing is the exclusion of another), however, has been forcefully argued as evidence Congress did not intend for section 10(b) to create private rights. *See* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 NW.L.J. 627, 633 (1963).

8. *See* 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 2.2, at 461 (1970). The law of rule 10b-5 has in large part been judicially created. *Id.* § 2.3. Unlike the express liability provision throughout the Securities Act of 1933 and the Securities Exchange Act of 1934, section 10(b) does not provide a statute of limitations. *Compare* 15 U.S.C. § 78j (1976) (section 10(b) contains no limitations period) *with id.* § 77m (1977) (all actions authorized under 1933 Act must be brought within one year after discovery of violation and never more than three years) *and id.* § 78i(e) (within one year after discover or three years after violation for market manipulation) *and id.* § 79p(b) (two years for short swing profits) *and id.* § 79r(c) (misleading statements: within one year of discovery and within three years of violation) *and id.* § 78cc(b) (recission within one year of discovery and three years of violation) (1977).

9. *See* Fratt v. Robinson, 203 F.2d 627, 634 (9th Cir. 1953) (Washington limitations period applied by stipulation); Fischman v. Ratheon Mfg. Co., 188 F.2d 783, 787 (2d Cir. 1951) (decided question de novo).

10. *See* Campbell v. Haverhill, 155 U.S. 610, 613-20 (1895); McCluny v. Silliman, 28 U.S. (3 Pet.) 276-78 (1830). *Campbell* construed the Rules of Decision Act to require application of state law in actions to enforce federally created rights. *See* Campbell v. Haverhill, 155 U.S. 610, 614 (1895); Rules of Decisions Act, 28 U.S.C. § 1652 (1976). The Rules of Decisions Act, however, only applies to diversity claims. *See* Erie R.R. v. Tompkins, 304 U.S. 64, 66 (1938). Thus, the practice of applying state law to federal causes of action is done so as a matter of judicial discretion rather than constitutional mandate. *See, e.g.*, UAW v. Hoosier Cardinal Corp., 383 U.S. 696, 703 (1966) (state limitation period adopted as

consistently followed; however, the selection of alternative states of limitations within a given forum state has been far from uniform.[11]

Federal courts have followed two similar, yet distinguishable, lines of analysis in selecting limitation periods from among various state fraud provisions.[12] Following the United States Supreme Court decision in *UAW v. Hoosier Cardinal Corp.*,[13] many courts couched the problem in terms of selecting a limitations period from the forum state "which best effectuates the federal policy at issue."[14] Repeated application of this test, led some courts to conclude the broad remedial policies behind rule 10b-5 would be "best effectuated" by adopting limitation periods from state actions resembling rule 10b-5.[15] Thus, a number of courts began to elabo-

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a matter of policy in federal action to enforce collective bargaining contract); McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 891 n.4 (5th Cir. 1979) (state limitations statute adopted as a matter of federal common law); Moviecolor Ltd. v. Eastman Kodak Co., 288 F.2d 80, 83 (2d Cir. 1961) (creating statute of limitation is "not the kind of thing judges do"). *See generally* Hill, *State Procedural Law in Federal Nondiversity Litigation*, 69 HARV. L. REV. 66, 79-80 (1955).

11. *Compare* White v. Sanders, 650 F.2d 627, 632 (5th Cir. 1981) (limitations statute in Alabama Securities Act applied to 10b-5 action) *and* Robuck v. Dean Witter & Co., 649 F.2d 641, 644 (9th Cir. 1980) (state limitations period for breach of trust applied to 10b-5 action) *with* McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 894 (5th Cir. 1979) (Georgia statute of limitations for general fraud applied).

12. *Compare* Charney v. Thomas, 372 F.2d 97, 100 (6th Cir. 1967) (the correct statute is one which "best effectuates" the federal policy behind rule 10b-5) *with* Berry Petroleum Co. v. Adams & Peck, 518 F.2d 402, 407 (2d Cir. 1975) (should apply limitations period for cause of action most similar to 10b-5 and which best effectuates rule's purpose).

13. 386 U.S. 696 (1966). In *Hoosier*, the Court looked to state law for a statute of limitations in an action under section 301 of the Labor Management Relations Act, 29 U.S.C. § 185 (1977). *See* UAW v. Hoosier Cardinal Corp., 386 U.S. 696, 701 (1966). The Court characterized the action as one for breach of contract and applied an Indiana statute of limitations for actions on written contracts. *See id.* at 701.

14. *See, e.g.*, Schaefer v. First Nat'l Bank of Lincolnwood, 509 F.2d 1287, 1294 (7th Cir. 1975) (limitations period in Illinois securities act best effectuates federal policy behind rule 10b-5); Douglass v. Glen E. Hinton Inv., Inc., 440 F.2d 912, 915 (9th Cir. 1971) (in selecting state limitation statute issue is one of how to best effectuate federal objectives underlying rule 10b-5); Richardson v. Salinas, 336 F. Supp. 997, 999 (N.D. Tex. 1972) (should select limitation statute consistent with structure and purpose of federal action). The purpose of the 1934 Act is to remove impediments from national markets and ensure maintenance of fair and honest transactions. *See* Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (1977).

15. *See, e.g.*, Hudak v. Economic Research Analysts, Inc., 499 F.2d 996, 1000 (5th Cir. 1974) (limitations statute in Florida Securities Act best effectuates federal policy because of similarity to rule 10b-5); Parrent v. Midwestern Rug Mills, Inc., 455 F.2d 123, 126 (7th Cir. 1972) (statute which most resembles 10b-5 best effectuates its purpose); Vanderboom v. Sexton, 422 F.2d 1233, 1237 (8th Cir. 1970) (to select state statute which best effectuates federal policy should ask which statute resembles rule 10b-5). *But cf.* Nickels v. Koehler Management Corp., 541 F.2d 611, 618 (6th Cir. 1976) (broad remedial purposes of federal securities act "best served by longer, not shorter statutes of limitations"); Newman v. Prior,

rate on the test by making an independent inquiry of the extent to which the state cause of action "substantively resembles" the federal cause of action under rule 10b-5.[16] Regardless of the test used, courts have invariably adopted either the forum state's limitation statute for fraud[17] or a statute of limitations provided in the state's securities act.[18]

Under the "substantive resemblance" test, the choice depends on two variables: the substantive elements of a cause of action under the forum state's laws on securities fraud, and the particular circuit's requirements for a Rule 10b-5 cause of action.[19] Most circuit courts agree on the elements of a cause of action under rule 10b-5. The plaintiff must prove he purchased or sold a security[20] in reliance[21] on a material misrepresenta-

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518 F.2d 97, 100 n.4 (4th Cir. 1975) (limitations period not longer than those provided in other provisions of 1934 Act).

16. *See* Nickels v. Koehler Management Corp., 541 F.2d 611, 618 (6th Cir. 1976) (limitation period chosen on basis of state law's resemblance to 10b-5 and purpose of federal law); Berry Petroleum Co. v. Adams & Peck, 518 F.2d 402, 407 (2d Cir. 1975) (courts should apply limitations period for state action most similar to federal action and which best effectuates rule's purpose). *See generally* Jacobs, *Affirmative Defenses to Securities Exchange Act Rule 10b-5*, 61 CORNELL L.J. 857, 864-67 (1976). The Court of Appeals for the Fifth Circuit has apparently abandoned the "effectuation of federal policy criteria," framing the issue exclusively in terms of which state provision "bears the closest substantive resemblance" to rule 10b-5. *See* McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 891 (5th Cir. 1979).

17. *See, e.g.*, McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 894 (5th Cir. 1979) (Georgia statute of limitations for general fraud adopted); Clegg v. Conk, 507 F.2d 1351, 1355 (10th Cir. 1974) (Utah statute of limitations for general fraud adopted); Vanderboom v. Sexton, 422 F.2d 1233, 1237 (8th Cir. 1970) (Arkansas statute of limitations for fraud adopted).

18. *See, e.g.*, White v. Sanders, 650 F.2d 627, 633 (5th Cir. 1981) (limitations statute in Alabama securities act applied); Schaefer v. First Nat'l Bank of Lincolnwood, 509 F.2d 1287, 1294 (7th Cir. 1975) (statute of limitations in Illinois Blue Sky Act applied); Hudak v. Economic Research Analyists, Inc., 499 F.2d 996, 1000 (5th Cir. 1974) (limitation period in Florida securities act applied).

19. *See, e.g., In re* Alodex Corp. Sec. Litigation, 392 F. Supp. 672, 675-78 (S.D. Iowa 1975) (state law used to determine parameters of state cause of action and federal law for 10b-5); Klapmeiser v. Peat, Marwick, Mitchell & Co., 363 F. Supp. 1212, 1215-16 (D. Minn. 1973) (using state law to determine elements of state cause of action and federal law for 10b-5); Gilbert v. Meyer, 362 F. Supp. 168, 172-75 (S.D.N.Y. 1973) (federal law determines parameters of 10b-5). *See* Jacobs, *Affirmative Defenses To Securities Exchange Act Rule 10b-5*, 61 CORNELL L.J. 857, 866 (1976); SCHULMAN, *Statutes of Limitations in 10b-5 Actions: Complication Added to Confusion*, 13 WAYNE L. REV. 635, 640 (1967).

20. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731 (1975) (private action under 10b-5 confined to actual purchasers or sellers); Marbury Management, Inc. v. Kohn, 629 F.2d 705, 708 (2d Cir. 1980) (retention of stock in reliance on misrepresentation not actionable because no purchase or sale transpired); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 463 (2d Cir. 1952) ("in connection with" language in § 10(b) limits right of action to purchasers or sellers); *see* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78(j) (1976).

tion or omission,[22] and that the misrepresentation or omission was made with scienter.[23] The circuits conflict, however, over the degree of culpability required to establish scienter[24] and the extent to which the plaintiff must prove he relied on the misrepresentation.[25]

Two state remedies are available for securities fraud in Texas: section 27.01 of the Texas Business and Commerce Code[26] and section 33 of the Texas Securities Act.[27] Section 27.01 essentially represents a codification of common law fraud as applied to real estate and stock transactions.[28]

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21. *See, e.g.*, Huddleston v. Herman & MacLean, 640 F.2d 534, 547 (5th Cir. 1981) (district court erred in not submitting reliance and causation issue to jury); Marbury Management, Inc. v. Kohn, 629 F.2d 705, 718 (2d Cir. 1980) (must establish misrepresented fact proximately caused loss); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380 (2d Cir. 1974) (transaction causation shown when plaintiff demonstrates reliance on misrepresentation), *cert. denied*, 421 U.S. 976 (1975). The element of reliance includes inducement and loss causation. Rule 10b-5 requires proof of both. *See* 5 A. JACOBS, THE IMPACT OF RULE 10b-5, § 64.01(a), at 3-221 (Supp. 1980) (reliance includes transaction causation and loss causation).

22. Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972) (material facts are those which reasonable investor might have considered important in making investment decision); *accord* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 381 (2d Cir. 1974); Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 240 (2d Cir. 1974).

23. *See, e.g.*, Ernst & Ernst v. Hockfelder, 425 U.S. 185, 198-202 (1976) (civil action under 10b-5 requires proof of mental state embracing intent to deceive, manipulate, or defraud); Huddleston v. Herman & MacLean, 640 F.2d 534, 545 (5th Cir. 1981) (10b-5 action does not lie for simple or inexcusable negligence); Edwards & Hanley v. Wells Fargo Sec. Clearance Corp., 602 F.2d 478, 484 (2d Cir. 1979) (must show reckless or intentional conduct), *cert. denied*, 444 U.S. 1045 (1980).

24. *Compare* Rolf v. Blyth, Eastman, Dillon & Co., 570 F.2d 38, 44 (2d Cir. 1978) (recklessness may suffice as scienter for purposes of the antifraud provisions) *with* Huddleston v. Herman & MacLean, 640 F.2d 534, 545 (5th Cir. 1981) (to service as scienter reckless conduct requires "extreme departure from the standards of ordinary care . . . so obvious that the actor must have been aware of it"). *See generally* Bolger, *Recklessness and Rule 10b-5 Scienter Standard After Hochfelder*, 48 FORDHAM L. REV. 817, 819-22 (1980).

25. *See* Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54 (1972). In *Ute* the Supreme Court held that in certain non-disclosure cases, plaintiff does not have to prove reliance in order to recover under 10b-5. *Id.* at 154. The Fifth Circuit Court of Appeals has held that *Ute* merely creates a presumption of reliance in non-disclosure cases. *See* Simon v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 482 F.2d 880, 884 (5th Cir. 1973); *see also* Huddleston v. Herman & MacLean, 640 F.2d 534, 548-49 (5th Cir. 1981) (due diligence required as a separate element in 10b-5 cases, apart from questions of materiality and reliance).

26. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

27. TEX. REV. CIV. STAT. ANN. art. 581—33 (Vernon Supp. 1982).

28. *See* Huff, *Texas Business and Commerce Code Section 27.01: An Alternative To Federal Securities Fraud Remedies*, 33 SW. L.J. 703, 708-11 (1979). In Texas, the elements of actionable common law fraud consists of a "false material representation; the speaker made it knowing it to be false or made it recklessly without any knowledge of the truth and

Accordingly, the two year limitations period for general fraud applies to the statute.[29] A cause of action under 27.01 exists when (1) a false representation of a past or existing material fact is made for the purpose of inducing a person to enter into a contract, and relied on by that person in entering into that contract[30] or (2) when a person makes a false promise to do an act with the intention of not fulfilling it, and the promise is made for the purpose of inducing a person to enter into a contract and relied on by that person in entering into that contract.[31] Section 27.01 can be distinguished from common law fraud in two respects. First, the plaintiff is not required by the terms of the statute to prove the misrepresentation was made with intent to deceive if the misrepresentation concerns the existence or nonexistence of a material fact.[32] Second, the defrauded party is authorized to recover benefit of the bargain damages rather than the common law out of pocket measure of recovery.[33] Section 33 of the pre-1977 Texas Securities Act, on the other hand, only provided civil remedies in favor of purchasers of securities for material misrepresentations made in connection with a sale.[34] Although the act did not require the element of reliance, the buyer carried the burden of proving he did not know of the untruth or omission.[35] Unlike section 27.01, purchasers

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as a positive assertion; that he made it with the intention that it should be acted upon by the party; that the party acted in reliance upon it; that he thereby suffered injury." Stone v. Lawyers Title Ins. Corp., 554 S.W.2d 183, 185 (Tex. 1977); *see* Custom Leasing, Inc. v. Texas Bank & Trust Co., 516 S.W.2d 138, 143 (Tex. 1974); United States Steel Corp. v. Fryer, 493 S.W.2d 487, 491 (Tex. 1973).

29. *See* White v. Bond, 362 S.W.2d 295, 296 (Tex. 1962); TEX. REV. CIV. STAT. ANN. art. 5526 (Vernon 1968). The two year statute of limitations in article 5526 applies to actions brought under section 27.01. White v. Bond, 362 S.W.2d 295, 296 (Tex. 1962); *see* TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

30. TEX. BUS. & COM. CODE ANN. § 27.01(a)(1) (Vernon 1968).

31. *Id.* § 27.01(a)(2).

32. *Compare id.* § 27.01(a)(1) (actionable fraud consists of false representation of past or existing material fact made for purpose of inducing contract) *with* Stone v. Lawyers Title Ins. Corp., 554 S.W.2d 183, 185 (Tex. 1977) (common law fraud requires proof that speaker knew statement was false or that he made it recklessly without knowledge of it's truth) *and* TEX. BUS. & COM. CODE ANN. § 27.01(a)(2) (Vernon 1968) (if misrepresentation concerns promise to do act it must be alleged and proved that it was made with intent of not fulfilling it). The omission of scienter in the context of misrepresentations of fact is significant of legislative intent. *See* Keeton, *Rights of Disappointed Purchasers*, 32 TEXAS L. REV. 1, 13 n.37 (1953).

33. *Compare* TEX. BUS. & COM. CODE ANN. § 27.01(b) (Vernon 1968) (person defrauded may recover difference between value as represented and actual value) *with* George v. Hessee, 100 Tex. 44, 46-48, 93 S.W. 107, 108 (1906) (only out of pocket damages recoverable for common law fraud).

34. *See* Tex. Gen. Laws, ch. 170, § 12, at 478. Section 33 was substantially amended in 1977. *See* TEX. REV. CIV. STAT. ANN. art. 581—33 (Vernon Supp. 1982).

35. *See* TEX. REV. CIV. STAT. ANN. art. 581—33 (Vernon Supp. 1982). Under the old act,

did not have to show scienter in order to recover under the pre-1977 Texas Securities Act.[36] Violations of section 33 were, and still are, subject to a three year statute of limitations.[37]

In *Wood v. Combustion Engineering*,[38] the United States Court of Appeals for the Fifth Circuit examined these two fraud provisions in determining the timeliness of a 10b-5 action brought in Texas.[39] Applying the "substantive resemblance" test, the court concluded section 27.01 more closely approximated rule 10b-5 and, therefore, adopted its two year statute of limitations.[40] The court found section 33 inconsistent with rule 10b-5 on several grounds. First, the court noted section 33 does not predicate liability on a finding of scienter, thus allowing a considerably broader cause of action than that available under rule 10b-5 and section 27.01.[41] Moreover, section 33, at the time suit was filed, only applied to sales or offers of sale; whereas, purchasers and sellers may sue under rule 10b-5 and section 27.01.[42] The court further distinguished section 33 by noting

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the purchaser carried the additional burden of proving he could not have known of the untruth or omission in the exercise of reasonable care. *See* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478. The 1977 amendments to section 33 relieved the plaintiff of this burden. *See* TEX. REV. CIV. STAT. ANN. art. 581—33(A)(2) (Vernon Supp. 1982); Bromberg, *Civil Liabilities Under Texas Securities Act § 33 (1977) And Related Claims*, 32 SW. L.J. 867, 874 (1978).

36. *See* TEX. REV. CIV. STAT. ANN. art. 581—33(A) (Vernon Supp. 1982). The most significant change in the new act is that defendant sellers and buyers are given an affirmative defense to liability if they can prove they did not know of the untruth or omission and could not have known in the exercise of reasonable diligence. *Compare* 1973 Tex. Gen. Laws ch. 170, § 170, at 478 with TEX. REV. CIV. STAT. ANN. art. 581—33(B) (Vernon Supp. 1982).

37. *See* TEX. REV. CIV. STAT. ANN. art. 581—33(H) (Vernon Supp. 1982). The amended version of section 33 carries the same 3 year limitations period as the pre-1977 Act. *See* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478. Both versions permit the period to be shortened through recision offers. *See generally* Bromberg, *Civil Liabilities Under Texas Securities Act § 33 (1977) And Related Claims*, 33 SW. L.J. 867, 949 (1978).

38. 643 F.2d 339 (5th Cir. 1981).

39. *See id.* at 342. Since the claim in *Wood* arose prior to 1977, the court only considered the state law in effect at that time. Therefore, the court limited its discussion to the pre-1977 Act. *See id.* at 342 n.6; 1963 Tex. Gen. Laws, ch. 170, § 12, at 478.

40. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 346 (5th Cir. 1981). The court limited its review to comparing substantive elements of state and federal law rejecting any independent considerations. *Id.* at 344 n.11.

41. *See id.* at 346. The court relied on Susanoil v. Continental Oil Co., 519 S.W.2d 230, 234 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.), in concluding section 27.01 required proof of scienter to establish actionable fraud. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 n.18 (5th Cir. 1981).

42. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 346 (5th Cir. 1981). *Compare* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478 (only purchasers can sue) *with* Blue Chip Stamps v. Mannor Drug Stores, 421 U.S. 721, 722-23 (1975) (purchaser or sellers may sue under rule 10b-5) *and* TEX. BUS. & COM. CODE ANN. § 27.01(c) (Vernon 1976) (may bring action against any person who makes or benefits from false representation).

the act requires a tender of the security as a condition for bringing suit.[43] Finally, the court observed section 33 omitted any reference to reliance, while section 27.01 expressly requires proof of reliance and rule 10b-5 has been held to require reliance when material facts have been misrepresented.[44] The court reserved the question of whether the new Texas Securities Act would require a contrary result in 10b-5 actions arising after 1977.[45]

In light of the 1977 amendments to the Texas Securities Act,[46] it is doubtful that *Wood* will carry any precedental value in 10b-5 actions accruing after 1977.[47] Under the amended act, section 33 has been expanded to provide civil remedies for defrauded sellers, bringing the scope of persons liable in line with federal 10b-5 purchase and sale rules.[48] The amended act also provides a due diligence defense which allows a defendant to escape liability by proving he did not know of the untruth or omission and could not have known in the exercise of reasonable diligence.[49] Although a due diligence defense does not equate scienter in the common law meaning,[50] the new provision arguably brings the defendant's standard of culpability closer to federal notions of scienter as construed in 10b-5 actions.[51] For example, the United States Court of Appeals for the Fifth Circuit has recently intimated that scienter may be inferred under certain circumstances when statements are made with a

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43. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 (5th Cir. 1981). Neither section 27.01 or rule 10b-5 requires a tender of the security as a prerequisite for recovery. *See* TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1976); 17 C.F.R. § 240.10b-5 (1981).

44. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 (5th Cir. 1981).

45. *See id.* at 345 n.12.

46. *See* TEX. REV. CIV. STAT. ANN. art 581—33 (Vernon Supp. 1982).

47. *Compare* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 n.12 (5th Cir. 1981) (applicable statute of limitation is period which applies to state action bearing the closest substantive resemblance to rule 10b-5) *with* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478 (only purchasers can sue, defendants absolutely liable for misstatements or omissions) *and* TEX. REV. CIV. STAT. ANN. art. 581—33 (Vernon Supp. 1982) (purchasers and sellers liable for misstatements or omissions, defendant's given due diligence defense).

48. *Compare* Blue Chip Stamp v. Mannor Drug Stores, 421 U.S. 723, 730 (1975) (buyers and sellers may sue under rule 10b-5) *with* TEX. REV. CIV. STAT. ANN. art. 581—33(B), comment (Vernon Supp. 1982) (seller and buyers may bring suit).

49. *See* TEX. REV. CIV. STAT. ANN. art. 581—33(A)(2)(B) (Vernon Supp. 1982).

51. *See* L. PROSSER, LAW OF TORTS 700 (4th ed. 1971). Scienter means an intent to deceive, to mislead or to convey a false impression. *See id.* at 700.

51. *Compare* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194-204 (1976) (action under 10b-5 requires proof of mental state embracing intent to deceive, manipulate or defraud) *with* TEX. REV. CIV. STAT. ANN. art. 581—33(A)(2) & (B) (Vernon Supp. 1982) (person not liable if he proves he did not know of the untruth or omission and in exercise of reasonable care could not have known of the untruth or omission) *and* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478 (sellers absolutely liable for misrepresentation or omission).

reckless disregard for truth or falsity.[52] Thus, a 10b-5 plaintiff need not always prove the actor knew his statement was false.[53] Although drafted as an affirmative defense, the due diligence standard under the amended version of section 33, at minimum, creates an issue as to the defendant's state of mind.[54]

Moreover, a closer examination of section 27.01 reveals the court in *Wood* made a questionable assumption regarding the element of scienter under the statute.[55] Although section 27.01 requires that the misrepresentation be made for the purpose of inducing a person to enter into a contract, the statute does not speak to the issue of whether the speaker's misstatement must have been made with the intent to deceive.[56] Several Texas courts have held that scienter is not required under 27.01 when the misrepresentation concerns the existence or non-existence of a material fact.[57] Since the decision in *Wood* emphasized the element of scienter in comparing the two statutes, a contrary result could obtain under the

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52. *See* Huddleston v. Herman & Mclean, 640 F.2d 534, 545 (5th Cir. 1981). In order for reckless conduct to suffice as scienter "there must be an exteme departure from standards of ordinary care . . . so obvious the actor knew or must have been aware." *Id.* at 545.

53. *Cf. id.* at 545 (circumstantial evidence sufficient for jury to infer requisite scienter even though no direct testimony defendants acted knowingly).

54. *See* TEX. REV. CIV. STAT. ANN. art 581—33(A)(2) (Vernon Supp. 1982).

55. *Compare* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 n.18 (5th Cir. 1981) (§ 27.01 does not require scienter) *with* White v. Bond, 355 S.W.2d 225, 229 (Tex. Civ. App.—Amarillo) (unqualified statement of fact actionable regardless of scienter), *rev'd on other grounds*, 362 S.W.2d 285 (Tex. 1962). The court in *Wood* relied on Susanoil Inc. v. Continental Oil Co., 579 S.W.2d 230, 230 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.) in concluding scienter was a necessary element of a cause of action under 27.01. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 n.18 (5th Cir. 1981); Susanoil Inc. v. Continental Oil Co., 579 S.W.2d 230, 230 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.). In *Susanoil* the issue before the was whether summary judgment proof was sufficient to raise a disputed issue of fact in a suit under the statutory predecessor to section 27.01. *See* Susanoil Inc. v. Continental Oil Co., 579 S.W.2d 230-32 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.). The court held that a cause of action alledging false promises to perform an act requires proof that the promise was made with the intent not to perform. *Id.* at 236. Section 27.01 on the other hand, omits any requirement of scienter for misrepresentations of a fact as opposed to a promise. *See* TEX. BUS. & COM. CODE ANN. § 27.01(a)(1) (Vernon 1976).

56. *See* TEX. BUS. & COM. CODE ANN. § 27.01(a)(1)(A) (Vernon 1968). Since the statute under section 27.01(c) provides exemplary damages for willful misrepresentations, it would appear an innocent misrepresentation would suffice for general liability. *See* Keeton, *Rights of Disappointed Purchasers*, 32 TEXAS L. REV. 1, 12 n.37 (1953).

57. *See, e.g.*, White v. Bond, 355 S.W.2d 225, 229 (Tex. Civ. App.—Amarillo 1962) (false statement of fact made with intent to induce action implies fraudulent purpose), *rev'd on other grounds*, 362 S.W.2d 295 (Tex. 1962); Passero v. Loew, 259 S.W.2d 909, 914 (Tex. Civ. App.—El Paso 1953, writ ref'd n.r.e.) (knowledge of falsity not required); Roark v. Prideaux, 284 S.W. 624, 628 (Tex. Civ. App.—Forth Worth 1926) (good faith no excuse), *aff'd*, 291 S.W. 868, 870 (Tex. Comm'n App. 1927, judm't adopted).

amended act.[58]

The decision in *Wood* demonstrates the inconvenience of comparing state and federal law in order to determine the timeliness of a federal action.[59] The practice promotes non-conformity and uncertainty on an issue of vital importance to a comprehensive scheme of federal regulation.[60] Further complications arise when a state amends or enacts a new statutory action requiring federal courts to re-examine the issue under the applicable test.[61] Moreover, federal law on rule 10b-5 has not remained static.[62] Under a "substantive resemblance" analysis, decisions altering the substantive elements of the rule may also require reassessment of the applicable statute of limitations.[63]

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58. *See* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 345 n.19, 346 n.20 (5th Cir. 1981). The court in *Wood* noted the absence of due diligence under the old act; however, the court indicated that that factor alone did not bear as much weight as the scienter and reliance distinctions. *Id.* at 346.

59. *See* McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 892 (5th Cir. 1979) (Ainsworth, J.) (characterized substantive resemblance test as a "difficult and essentially esoteric exercise"). *See generally* Bateman, *Statutes of Limitations Applicable to Private Actions Under SEC Rule 10b-5: Complexity in Need of Reform*, 39 MARQ. L. REV. 165, 181 (1975); Schulman, *Statutes of Limitations in 10b-5 Actions: Complication Added to Confusion*, 13 WAYNE L. REV. 365, 366-67 (1967).

60. *Compare* Wood v. Combustion Eng'r, Inc., 643 F.2d 339, 346 (5th Cir. 1981) (two years in Texas) *with* I.D.S. Progressive Fund Inc. v. First of Michigan Corp., 533 F.2d 340, 344 (6th Cir. 1976) (six years in Michigan) *and* Weiser v. Schwartz, 286 F. Supp. 389, 391 (E.D. Pa. 1968) (one year in Louisiana). When a case is transferred to another state, the transferee court applies the statute of limitations from the original forum state. *See* Berry Petroleum v. Adams & Peck, 518 F.2d 402, 406 (2d Cir. 1975). In *Berry*, a 10b-5 action originally brought in Texas was consolidated and transferred by the Judicial Panel on Multidistrict Litigation to New York. *Id.* at 406. The second circuit applied the three year statute of limitations in the Texas Securities Act. *Id.* at 409; *see also* Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-54(1972) (in non disclosure cases positive proof of reliance not required).

61. *See* Fox v. Kane-Miller Corp., 542 F.2d 915, 917-18 (4th Cir. 1976) (amendments to Maryland securities act made statute more analagous to 10b-5, thus rendering prior precedent inapplicable). *But see* I.D.S. Progressive Fund, Inc. v. First Nat'l of Michigan, 533 F.2d 340, 355 (6th Cir. 1976) (limitations period applicable to actions should not be changed without good cause); Nichols v. Koehler Management Corp., 541 F.2d 611, 618 (6th Cir. 1975) (federal policy best effectuated by continued application of four year statute of limitations).

62. *See* 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 2.2, at 463 (1970.

63. *See* Wood v. Combustion Eng'r Inc., 643 F.2d 339, 344 (5th Cir. 1981). The court in *Wood* declined to follow any decisions prior to Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), which held that scienter is a necessary element of an action brought under 10b-5. *Compare* Wood v. Combustion Eng'r Inc., 643 F.2d 339, 344 (5th Cir. 1981) (post *Hochfelder* decision applying statute of limitations for general fraud to 10b-5 action) *with* Berry Petroleum Co. v. Adams & Peck, 518 F.2d 402, 409 (2d Cir. 1975) (pre *Hochfelder* decision holding section 33 more similar to 10b-5 actions).

One can only speculate as to whether the 1977 amendments to section 33 will produce a new three year statute of limitations under "substantive resemblance" analysis. The very fact that the question remains undecided illustrates the inexpediency of looking to state law for a statute of limitations in 10b-5 actions. In the interest of uniformity and judicial economy, Congress must enact a uniform statute of limitations for all 10b-5 claims.[64] In the meantime, courts could end the cumbersome process by adopting a limitations period from one of the express liability provisions in the 1934 Act.[65]

*Richard M. Mosher*

64. *See* MODEL FEDERAL SECURITIES CODE § 1421 (Tent. Draft No.2, 1973) (proposes uniform period of two years after discovery, but in no event more than four years after the action accrues).

65. *See* Securities Exchange Act of 1934 § 1, 15 U.S.C. § 78(j) (1977). The 1934 Act provides statutes of limitations for actions under sections 9(c) (three years), 16(b) (two years), 18 (three years), 29(b) (three years). 15 U.S.C. §§ 78i(c), 79p(b), 78(c), 78cc(b) (1977). In IDS Progressive Fund, Inc. v. First of Michigan Corp., 533 F.2d 340, 342 (6th Cir. 1976) the court considered but rejected a proposal to implement a uniform statute of limitations based upon the express limitations periods governing other sections of federal securities law.