UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 90-2882

IN RE: FIGGIE ACCEPTANCE CORPORATION,

DOUGLAS CHERRY,

Appellant,

versus

WOODSMALL FINANCIAL SERVICES, INC.,
f/k/a/ ENERGY ASSURANCE, INC.,

Appellee.

* * * * * *

No. 91-2069

IN THE MATTER OF: FIGGIE ACCEPTANCE CORPORATION,

Debtor.

FIGGIE ACCEPTANCE CORPORATION, ET AL.,

Appellees,

versus

DOUGLAS CHERRY, JONATHAN C. S. COX,
and MICHAEL WHITE,

Appellants.

Appeals from the United States District Court for the
Southern District of Texas
CA H 88 1155

March 31, 1993

Before REYNALDO G. GARZA, GARWOOD, and DUHÉ, Circuit Judges.*

GARWOOD, Circuit Judge:

A lender brought suit to collect on guaranty agreements signed by three individuals as part of their investment in an oil and gas venture. The guarantors brought cross-claims for fraud and securities violations against the organizers and promoters of the venture, raised suretyship and breach-of-contract defenses against the lender, and brought counterclaims of breach of fiduciary duty, breach of good faith, and negligence against the lender. The district court rendered summary judgment against the guarantors on their counterclaims and cross-claims, and granted summary judgment in favor of the lender for the full amount of the guaranties. On this appeal by the guarantors, we affirm.

Facts and Proceedings Below

Energy Assets International Corporation (EAIC) was a publicly held corporation that organized a joint venture in 1984 to purchase, develop, and resell oil and gas properties. It did so by creating a new corporation, West Basins Exploration, Inc. (Webex), and offering Webex stock for sale through a private placement. The price of the stock was $1 per share, and in purchasing the stock investors agreed to guarantee, severally, a part of Webex's line of credit proportionate to their ownership of Webex's common stock.

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* Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the Court has determined that this opinion should not be published.

The money borrowed by Webex and guaranteed by the investors was to constitute 90% of the joint venture's operating funds; EAIC was to contribute the remaining 10%, as well as transfer some of the oil and gas prospects it then held to the joint venture in exchange for reimbursement of their cost. EAIC, the managing partner of the venture, was to receive 55 percent of the profits over the venture's 3-year term, and Webex the remaining 45 percent.

Douglas Cherry (Cherry) was a personal injury attorney who invested in Webex, allegedly on the advice of his accountant Carol Cantrell (Cantrell) and on the representations of Fred Hofheinz (Hofheinz) and Donald Reiser (Reiser). Hofheinz was a director and major shareholder of EAIC; together with Reuben Askanase (Askanase), he held a controlling interest in EAIC through Fargo Partnership (Fargo). Reiser was an officer of Tangent, a company affiliated with EAIC.

Michael White (White) and Jonathan Cox (Cox) were two other Webex investors. White was vice-president of EAIC in 1984, and Cox was his attorney. After the formation of Webex, White became an officer and chairman of the board of Webex. Cherry also became a Webex director.

All three of these investors signed irrevocable subscription agreements in July or August of 1984--Cherry for 500 shares of Webex, White for 100, and Cox for 200. The subscription agreements, in addition to obligating the investors as guarantors, provided that the investor "further understands that the Webex Bank Line will be further secured by a surety bond issued by a national insurance underwriter." On October 31, 1984, Webex and Figgie

Acceptance Corporation (Figgie) entered into a three-year credit agreement under which Figgie gave Webex a revolving line of credit with a $4 million ceiling. Webex gave Figgie a promissory note evidencing the debt and, pursuant to their subscription agreements, Cherry, White, and Cox signed guaranty agreements for Figgie, also dated October 31st, guaranteeing their portion of the debt.[1] Webex paid $140,000 at closing as a premium for a surety bond. Figgie had its affiliate Waite Hill Services hire third-party defendant-appellee Energy Assurance Co. (now named Woodsmall Financial Services, Inc., and hereinafter referred to as "Woodsmall") to investigate whether Figgie should make the bond itself (through an affiliated company) or should seek out another surety. Woodsmall reviewed financial information on EAIC and the joint venture and concluded that Figgie should make the bond. Figgie decided to do so through its affiliate Colony Insurance Company (Colony). Woodsmall kept $20,000 of Webex's premium, and Figgie split the remainder with Colony.

Amid the sustained drop in oil and gas prices in the mid-1980s, the joint venture was a failure almost from the outset. Webex's draws on the line of credit consistently exceeded its payments of principal and interest, and its indebtedness to Figgie grew steadily from 1984 to 1987. In late 1986, White resigned from EAIC and the Webex board of directors, a decision he now claims was

[1] In their subscription agreements, investors agreed to guarantee $1000 of debt for each share they purchased. Four thousand six hundred shares of Webex stock were sold, so the shareholders ended up guaranteeing 1/4600 of a $4 million credit line for each share they owned.

prompted by his realization that the venture was being managed in EAIC's interest and in the personal interests of Hofheinz and Askanase, rather than in the Webex shareholders' interests.

On January 30, 1987, Cherry sued EAIC, Webex, the joint venture, Hofheinz, and Askanase in state district court in Harris County, Texas, alleging that he had been fraudulently induced to invest in Webex and guarantee Webex's indebtedness.

Upon maturity of the note on October 31, 1987, at which time Webex's indebtedness to Figgie equalled approximately $3.6 million, Webex was unable to pay, and Figgie promptly demanded payment on the guaranties from the Webex investors. Apparently no surety bond had been issued.[2] On November 5, 1987, Cherry amended his petition in the state case to name Figgie and others as defendants. On February 4, 1988, Figgie commenced 18 separate collection suits in the Eastern District of Virginia against the guarantors, including Cox, White, and Cherry. The cases were transferred on March 29, 1988 to the Southern District of Texas. On April 20, 1988, Cherry filed a plea in abatement in the federal suit, and also offered an affirmative defense and counterclaim alleging misrepresentations and omissions by Figgie in obtaining the guaranty. All of the collection suits in the Southern District of Texas were consolidated on June 13, 1988. Although Cherry's plea apparently was not formally ruled upon, no further action was taken on Figgie's suit against him for the next twenty-two months.

On August 24, 1988, a group of Webex investors including Cox

[2] The only bond in the record is one dated March 3, 1988, well after Webex's default.

and White filed an answer, counterclaim against Figgie, and third-party complaint against EAIC and Webex, alleging that those entities had conspired to induce them to enter into the guaranty agreement through misrepresentations about the structure of the investment and marketing of the transaction. Through several motions by EAIC and Webex for a more definite statement as required by Federal Rule of Civil Procedure 9(b), and several amendments by the Webex investors, it was clarified that the investors were bringing shareholders' derivative claims against EAIC for breach of fiduciary duty and negligence,[3] and were also suing EAIC directly for breach of the subscription agreement, securities fraud under 15 U.S.C. §§ 77*l* and 78j(b), securities fraud under section 33 of the Texas Securities Act, Tex. Rev. Civ. Stat. Ann. art. 581-33 (Vernon Supp. 1992), and statutory fraud under Tex. Bus. & Com. Code § 27.01 (Vernon 1987). In addition, they alleged that EAIC and Figgie together had committed common-law fraud, civil conspiracy, negligent misrepresentation, and RICO violations under 18 U.S.C. §§ 1962(c) and (d). The investors also brought separate claims for relief against Figgie. They argued that in continuing to lend money to Webex despite Webex's noncompliance with the terms of the credit agreement, including the obligation to periodically furnish financial statements, Figgie (1) materially breached the guaranty agreement, releasing the investors from all obligations, (2) was guilty of negligence, and (3) breached the duty of good faith and

[3] Webex was later substituted for the investors on the derivative claims. The claims were dismissed on August 29, 1990 for want of prosecution and are not a subject of this appeal.

fair dealing owed to the Webex investors.

By February 1990, all of the Webex investors who had brought those claims had agreed to settle with Figgie and EAIC, except for Cox and White. Following a hearing on February 21st, the district court issued an order directing that Cox and White take nothing from EAIC, and granting Figgie a judgment against Cox and White for the full amount of the guaranties.[4]

At the same hearing, the court announced that it would again proceed with Figgie's suit against Cherry, which had been informally abated pending the state court action. On May 4, 1990, Cherry filed a cross-claim against EAIC and third-party complaint against the joint venture, its promoters, and other entities involved, namely Fargo, Hofheinz, Askanase, EAIC executive vice-president Donald Lehto (Lehto), Colony, and Woodsmall. Cherry alleged violations of the registration and anti-fraud provisions of the Securities Act of 1933, 15 U.S.C. §§ 77e, 77*l*, and 77o, and of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78o; violations of the registration and anti-fraud provisions of the Texas Securities Act, Tex. Rev. Civ. Stat. Ann. arts. 581-7, 581-12, and 581-33 (Vernon 1964 & Supp. 1992); breach of the subscription agreement; statutory fraud under Tex. Bus. & Com. Code § 27.01 (Vernon 1987); common-law fraud; civil conspiracy; negligence; and violations of the Texas Deceptive Trade Practices Act (DTPA), Tex. Bus. & Com. Code Ann. § 17.46 (Vernon 1987). At hearings in September and October 1990, the district court granted

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[4] In the final judgment issued on October 19, 1990, the amounts were $224,496.99 from Cox and $119,748.28 from White.

summary judgment against Cherry on his counterclaim against Figgie, on his cross-claim against EAIC, and on all of his third-party complaints, and entered judgment against Cherry and in favor of Figgie in the amount of $559,733.

Cox, White, and Cherry (Guarantors) bring this appeal.

Discussion

We review a summary judgment *de novo* to determine whether, when viewed in the light most favorable to the party opposing the motion, the record discloses no genuine issue of material fact and demonstrates that the moving party is entitled to judgment as a matter of law. *Crenshaw v. General Dynamics Corp.*, 940 F.2d 125, 127 (5th Cir. 1991). Summary judgment is proper "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 106 S.Ct. 2548, 2552 (1986).

I. Guarantors' Third-Party Claims Against EAIC and the Other Promoters

A. Fraudulent inducement

The essence of the Guarantors' complaint against EAIC and the other promoters is that the joint venture was conceived and managed entirely for the benefit of the persons and entities who controlled EAIC and Tangent, namely Hofheinz, Askanase, Lehto, and Reiser. Specifically, the Guarantors suggest that by transferring worthless or high-risk properties to the venture, these persons could recoup their costs and spread the risk over all the Webex investors. The Guarantors contend that the true purpose of the venture was concealed from them through a number of material omissions from the Confidential Memorandum given to prospective Webex investors, and through oral misrepresentations by the Webex promoters.

Cherry alleges that some of the oil and gas prospects designated for assignment to the joint venture were ones that Hofheinz, Askanase, and Lehto had previously attempted to develop through other entities in which they held substantial interests, namely Allegro Exploration, Inc. (Allegro) and Northstar Resources, Inc. (Northstar), and that the Memorandum failed to disclose that these were high-risk "wildcat" areas. Cherry alleges that Sohio Petroleum Company (Sohio), engaged in a joint venture with Allegro, had begun to abandon leases in a region called the Salinas Valley play after considerable expenditures there had failed to yield any production, and that Northstar assumed some of those leases. He further contends that Northstar did not have enough money to pay the delay rentals on all of those prospects, that Webex was formed in part to assume these obligations, and that some leases from the Salinas play were transferred to the EAIC-Webex joint venture. Cox and White contend that the Gatchell Channel and Schutti Shot prospects were ones that EAIC had already decided to drop. Cox and White further claim that they were told that some of the prospects to be transferred to the venture had already been presold, *i.e.*, that buyers had already committed to buy them from the venture.[5] The Guarantors also point to the Memorandum's statement that the prospects would be transferred to the venture "at cost," claiming

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[5] This representation, like many of the ones alleged, was made to Cox only indirectly, through White.

that it misleadingly implied a bargain when in fact the market value for some of the prospects had fallen below their cost basis. Cherry notes that the Memorandum failed to divulge that some of the prospects that were to be transferred to the venture produced "heavy" oil, which is more expensive to refine and thus more vulnerable in a weak market.

The Guarantors claim that although the Memorandum noted the joint venture's plan to reassemble a team of geologists previously used by Allegro, and provided detailed information about the results obtained by that team for Allegro (mainly dry holes), it failed to explain that this history would adversely affect the marketability of the joint venture's prospects.

Cox and White contend that there were other conflicts of interest, in addition to the promoters' financial stake in deciding which prospects would be transferred to the venture, that the Confidential Memorandum failed to disclose: these included the significant investments in EAIC by Webex presidents Lehto and Thomas Martin (Martin), and a plan to place Webex funds in Texas American Bank as compensating balances for loans to other entities.

The Guarantors also all claim that they detrimentally relied upon the promoters' characterization of the investment as a special deal that was being offered only to EAIC insiders and that promised profits with little or no risk. They contend that Hofheinz and Askanase told them that the lender had agreed to look first to Webex, then to the assets acquired by the joint venture, and finally to EAIC for repayment, so that the investors' guaranties were virtually riskless. Cox and White claim that the promoters indicated that EAIC would see to it that the investors would never be called upon to pay on the guaranties. Cox and White also claim that the Memorandum inaccurately characterized the California gas market as "very strong and stable."

Finally, Cherry contends that Hofheinz and his affiliates were secretly paying Cherry's accountant Cantrell a commission to recommend their investments, and that Cherry's reliance on Cantrell's recommendation, which he believed represented her independent and disinterested assessment, was therefore fraudulently induced.

1. Federal securities law

Of their fraud claims based on federal securities law, the Guarantors press in this appeal only their argument under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

In order to establish a violation of Rule 10b-5, a plaintiff must show:

> "(1) a misrepresentation or omission or other fraudulent device; (2) a purchase or sale of securities in connection with the fraudulent device; (3) scienter by defendant in making the misrepresentation or omission; (4) materiality of the misrepresentation or omission; (5) justifiable reliance on the fraudulent device by plaintiff (or due diligence against it); and (6) damages resulting from the fraudulent device." *Fine v. American Solar King Corp.*, 919 F.2d 290, 294 (5th Cir. 1990) (quoting *Warren v. Reserve Fund, Inc.*, 728 F.2d 741, 744 (5th Cir. 1984)), *cert. dismissed sub nom. Hurdman v. Fine*, 112 S.Ct. 576 (1991).

Information is "material" for purposes of a 10b-5 action if a reasonable investor would view it as significantly altering the total mix of information available concerning the value of the security. *Securities & Exchange Commission v. Fox*, 855 F.2d 247, 252 (5th Cir. 1988). Materiality is a mixed question of law and fact, *TSC Industries, Inc. v. Northway, Inc.*, 96 S.Ct. 2126, 2132-33 (1976), and though ordinarily a determination for the jury, a misstatement may be immaterial as a matter of law if the facts are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality. *Huddleston v. Herman & MacLean*, 640 F.2d 534, 544 n.14 (5th Cir. Unit A 1981), *aff'd in part and reversed in part on other grounds*, 103 S.Ct. 683 (1983). For the most part, the statements or omissions relied upon by the Guarantors are not misrepresentations at all; to the extent that the Guarantors have identified statements or omissions with some potential to mislead, the alleged misrepresentations are not significant enough that a reasonable juror could regard them as significantly altering the total mix of information about the Webex investment.

Regarding the prospects that were to be transferred to the joint venture, the Confidential Memorandum listed each prospect and the costs attributable thereto through June 30, 1984. Once investors were told which prospects were to be transferred and the cost of each, the full and fair disclosure sought by the securities laws had been achieved. The investors' failure to ascertain whether or not the listed prices were favorable cannot be attributed to a misrepresentation by the borrowers, especially when, as here, the only alleged misrepresentation is the true statement that the prospects were to be transferred "at cost." Moreover, the Guarantors tendered no evidence of the prospects' market value in 1984 that would support the conclusion that the value was below the cost basis. The Memorandum also did not indicate that any prospects had been presold; it merely listed the companies that had purchased prospects from Allegro, and indicated that in addition EAIC had "been approached by several new prospective purchasers." If the promoters made a more definite representation about prospective purchasers, it was an oral one, and the Guarantors in their subscription agreements expressly disavowed any reliance on representations other than those in the Memorandum and attached exhibits. The Memorandum further stated that since EAIC itself had not conducted any prior operations, the results of the Allegro exploration staff were the best available track record for investors to examine. It then gave a table showing the prospects in California and Colorado that Allegro had sold, the sales price for each, the cost for each prospect, the drilling costs for carried wells, and the results for the wells (primarily dry holes). To further include in the Memorandum speculation about how this performance history would affect marketability of the joint venture's prospects is beyond the requirements of the securities laws.

The only concrete allegations of this nature made by the Guarantors are that the Confidential Memorandum failed to disclose that specific prospects had already been rejected by EAIC or one of the affiliated ventures. In support of his contention that the Salinas Valley acreage was such a prospect, Cherry furnished an affidavit from a manager with Sohio during the 1983-84 joint venture between Sohio and Allegro. The affiant stated that in his opinion, after the initial well in the Salinas Valley had been drilled, tested, and abandoned by Sohio in 1983, Sohio believed the area was not promising for further development and did not expect to recover its costs by selling the prospect to another company. However, Lehto testified in his deposition that only a very small portion of the Salinas Valley acreage held by Sohio wound up in the EAIC-Webex joint venture; he stated that the remainder was not regarded as viable and was let go. There was no contrary evidence. And, the Guarantors have offered no proof that the particular acreage transferred to the joint venture had been deemed worthless. Moreover, the transfers appear to have been decided upon and made in 1985, after the Webex venture was already a going concern and Cherry had already committed himself as a guarantor. There is no contrary evidence. And, Cherry has not produced any evidence that there were any plans for the Salinas Valley prospects at the time of his investment that were concealed from the investors.

Cox and White's contention about the Gatchell Channel and Schutti Shot prospects is based on an EAIC internal prospect review dated July 9, 1984. For both prospects, the report recommends that EAIC not spend further money trying to develop them; it suggests that EAIC either find a driller and retain a small carried position, or drop the prospect. According to the EAIC-Webex joint venture agreement, which was attached as an exhibit to the Confidential Memorandum, the total cost of all the prospects to be transferred from EAIC to the venture was approximately $170,000. Combined, the Gatchell Channel and Schutti Shot prospects represented only $946 of that total. Lehto testified that acquisition of those prospects for a very small investment, in the hopes of finding someone to drill the prospects without cost to the joint venture, was a reasonable business decision. Even if this business strategy were the type of information that would have been considered important by the average investor, the information regarding these two minor prospects does not significantly alter the total mix of information in the Confidential Memorandum, and does not support Cox and White's theory that the joint venture was a scheme by EAIC to get out from beneath its unprofitable investments.

The specific conflicts of interest alleged by Cox and White are similarly incapable of supporting a 10b-5 cause of action. The factual basis for the conflicts is that Martin, the president of Webex at its formation in October 1984, had borrowed $10,000 from Fargo and used the money to purchase EAIC stock, and Lehto, Martin's successor, held a warrant giving him the right to purchase $375,000 in shares of EAIC. The Confidential Memorandum had a separate section entitled "Conflicts of Interest," in which it stated that although as Managing Venturer EAIC had a duty to deal fairly with Webex, in some situations the interests of EAIC and Webex might diverge. It noted that several individuals who had expressed interest in becoming Webex shareholders were also shareholders in EAIC, including Hofheinz and Askanase, who held a controlling interest in EAIC. The Memorandum further noted that in the event any Webex board member or officer was also an EAIC shareholder, there existed a potential conflict of interest, and that prior to the formation of the Webex board, a full description of the candidates would be circulated, and any potential conflicts discussed. Cox and White allege that they were never informed of Martin's or Lehto's holdings. For a Rule 10b-5 cause of action, however, they need to demonstrate a material representation that was false when made and that induced their investment in August 1984. Instead, they have at best alleged (without any supporting evidence of the information that *was* distributed when Martin or Lehto was elected) that EAIC, at a time subsequent to their investment, failed to comply with a representation in its offering memorandum. Moreover, since EAIC fully apprised them in the Memorandum of the *possibility* of conflicts of interest, they have not shown that their investment was induced by a material misrepresentation.[6]

The Guarantors' claims that the investment was presented to them as one that was virtually riskless are contrary to the Confidential Memorandum, which stated in bold capital letters on the cover that "purchase of common stock in this enterprise and the proportionate guarantee of the credit line of this enterprise involve a high degree of investment risk and are suitable only for a person of substantial means who has no need for liquidity in his investment." A section of the Memorandum entitled "Certain Risk Factors" further warned of the speculative nature of oil and gas operations, and cautioned that participation in the venture was intended "only for persons who are sophisticated investors able to evaluate the risks involved and who can afford to lose all, or

[6] Cox and White have offered absolutely no evidence in support of their contention that Webex funds were deposited at Texas American Bank as compensating balances for loans to Hofheinz's and Askanase's other business interests.

substantially all, of their investment." Moreover, we do not believe that any investor could have reasonably relied upon a representation that this investment, in which investors put up only $1 for a 1/4600 share in 45 percent of a $4 million venture, was risk-free. The specific misrepresentation alleged by the Guarantors--that the lender had agreed to look to joint venture assets and to EAIC before attempting to collect on the guaranties--is contrary to the facially unqualified guaranty agreements signed by all three Guarantors.

In support of their claim that the Memorandum misrepresented the strength of the California gas market, Cox and White point out that the Memorandum neglected to mention oil prices' dramatic effect on natural gas consumption, the recent availability of large amounts of cheap hydroelectric power from the Pacific Northwest, the existence of only two primary pipeline companies in California, and a then-pending regulatory matter before the California Public Utilities Commission. The part of the Confidential Memorandum on which this theory is predicated is the single statement that prospective purchasers were "especially interested in natural gas prospects in California because the market for gas is very strong and stable in California." This statement, even if read to contain an implicit prediction that the stability of the California market would help to ensure its continued strength, does not rise to the level of a securities violation. Although we have recognized that predictions may be actionable if "false"--judged by whether the prediction suggested reliability, whether it was made in good faith, whether it bespoke caution, and whether it had a sound factual or historical basis, *Isquith v. Middle South Utilities, Inc.*, 847 F.2d 186, 203-04 (5th Cir.), *cert. denied*, 109 S.Ct. 310 (1988)--the prediction in this instance is not actionable under those criteria. It was a single, rather vague statement couched among numerous warnings about the riskiness of this investment. In addition to the warnings mentioned above, the section of the Memorandum on risk factors alerted prospective investors in general terms to the risks of regulatory action, availability of pipeline facilities, and the level of supply and demand for oil and gas.

Finally, Cherry has failed to make out a cause of action based on the alleged kickbacks paid to Cantrell by EAIC or the individual promoters. There was testimony that in 1984 Cantrell referred customers to Reiser, and that Reiser paid Cantrell a commission each time one of those customers invested in a Tangent program. Cantrell stated in her bankruptcy proceeding that Reiser would be listed as the selling representative on such sales, and that he would split with her the commission he received. She admitted that she did not inform her clients of this arrangement and that she and Reiser disguised the payments as accounting fees rather than commissions. Although there was testimony that Cantrell received a commission for Cherry's investment in a Tangent program in 1984, it was not the Webex venture; neither Reiser nor Cantrell testified to the payment of any commission in connection with the Webex investment. Indeed, since Tangent was not part of the Webex venture, it seems unlikely that Reiser would have received a commission to split with Cantrell under the arrangement as described in the testimony. Moreover, Cherry's effort to hold EAIC or the other promoters vicariously liable for a securities violation by Cantrell fails because he has not identified any particular misstatement about the Webex venture made to him by Cantrell.

2. Other theories

Guarantors alternatively argue that the previously discussed statements and omissions give rise to liability under a theory of common-law fraud, under the Texas Securities Act, under the Texas DTPA, under Texas statutory fraud, or under a theory of negligent misrepresentation. Our holding that the Guarantors have failed to demonstrate any material representation made to them that was false or misleading forecloses liability under all of these theories as well. *See DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990) (listing the elements of common-law fraud, including "a material misrepresentation, which was false"), *cert. denied*, 111 S.Ct. 755 (1991); Tex. Rev. Civ. Stat. Ann. art. 581-33(2) (Vernon Supp. 1992) (imposing liability for offering or selling a security "by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made . . . not misleading"); *McCrea v. Cubilla Condominium Corp.*, 685 S.W.2d 755, 759 (Tex. App.--Houston [1st Dist.] 1985, writ ref'd n.r.e.) ("[F]or a party to have a misrepresentation cause of action under the DTPA, the misrepresentation must have been material to the transaction."); *Haralson v. E.F. Hutton Group, Inc.*, 919 F.2d 1014, 1025 & n.4 (5th Cir. 1990) (Tex. Bus. & Com. Code Ann. § 27.01 imposes the same requirement of materiality as common-law fraud); *Federal Land Bank Association of Tyler v.*

Sloane, 825 S.W.2d 439, 442 (Tex. 1991) (Texas cause of action for negligent misrepresentation is based on Restatement (Second) of Torts § 552, which imposes liability on one who "supplies 'false information'").

B. Registration requirements under state law

Cherry argues that EAIC failed to establish its entitlement to an exemption from the Texas Security Act's registration requirements. However, the uncontroverted evidence, contained in an affidavit by Hofheinz, was that the Webex offering involved no public solicitation or advertising and that it was offered to fewer than 35 persons. Hofheinz also stated that all investors were either stock market professionals, were connected to EAIC, or had some personal connection to EAIC personnel and represented themselves as persons of economic means and investment experience. These facts would exempt the transaction from registration under Tex. Rev. Civ. Stat. Ann. art. 581-5(I)(a) (Vernon Supp. 1992).

C. Breach of contract

Cox and White claim that EAIC breached the subscription agreement by failing to obtain a surety bond. Although, as previously mentioned, the subscription agreement did contain a clause providing that the investor understood that the Webex bank line was to be secured by a surety bond, we do not read this clause to contain a promise by EAIC to the investor-guarantor. A surety bond would have been for the benefit of the lender; the amounts now owed Figgie by the Guarantors as a result of their investment would be owed to the surety if one had been obtained. The Shareholders' Agreement between Webex and the Guarantors stated:

> "If required, the borrowing of the Company will be further guaranteed by third parties, which guarantee may be in the form of a surety bond . . . . To secure any surety bond, each Shareholder agrees to furnish the Company, the Bank generating the Webex Bank Line and any such third party with such Shareholder's confidential financial statement."

Given this language in the Shareholders' Agreement, the most plausible function of the clause in the subscription agreement is to evidence the investors' awareness that a surety bond for the lender would be sought and their willingness to cooperate in its procurement.

In affidavits filed in opposition to Figgie's motion for summary judgment, Cox and White suggested that the significance of the representation was its assurance to investors that the Webex venture would be reviewed by an independent national insurance underwriter. They stated that had they been informed that no bond would be supplied, they would not have signed the guaranty agreements. In a separate affidavit, Cox indicated that the knowledge that the proposed surety was a Figgie affiliate would have been important to him in deciding whether to invest in Webex. These arguments are not persuasive because the subscription agreement does not purport to say that an independent entity *had* reviewed the investment; it is difficult to see what assurance an investor would derive from the possibility that at some point after he had signed an irrevocable subscription agreement, a national underwriter would examine the investment. At best, Cox and White might be stating another claim of misrepresentation, yet they do not even suggest that EAIC did not believe in August 1984 that the lender would seek a surety bond. All of the evidence, including

EAIC's subsequent payment of $140,000 of Webex funds as a premium for a surety bond, indicates the contrary.

D. Fraud claim against Woodsmall

Woodsmall is an insurance and surety bond broker whose role in the transaction was limited to acting as a broker in arranging financing for the Webex venture. Woodsmall was approached in 1984 by certain officers and directors of EAIC. Woodsmall sought financing for the venture from Figgie, and at Figgie's request collected financial data on the venture and on the individual investors. The ultimate decisions of whether to fund the venture and whether to obtain a surety bond rested solely with Figgie.

Cherry alleges that in its investigation Woodsmall reached the conclusions that poor prior performance by EAIC technical staff would create problems in trying to market Webex prospects, and that an independent program monitor for the venture would be very valuable to the underwriter. Cherry contends that in failing to see that this information was communicated to Webex investors, Woodsmall committed or aided common-law fraud or a deceptive trade practice. We held in part I(A) that the evidence would not sustain a finding that the sales of the Webex securities to these investors were effected through fraud or deception; this necessarily forecloses the argument that Woodsmall aided EAIC in one of these offenses. Furthermore, because Woodsmall acted only as a broker between EAIC and Figgie, and played no part in the solicitation of investors for Webex, we find no conceivable grounds to impose upon Woodsmall a duty of disclosure to investors. By Cherry's own admission, Woodsmall made no representations to him. We therefore likewise reject Cherry's claim that Woodsmall independently committed fraud or a deceptive trade practice.

II. Figgie's Suit Against the Guarantors

The Guarantors' arguments to resist Figgie's collection suit fall into three categories: alleged breaches of the guaranty agreements, alleged material modifications of the underlying credit agreement that excuse performance by the guarantor under common-law principles, and alleged breaches of a duty of good faith and fair dealing. In addition, the Guarantors argue that the district court erred in failing to reduce Figgie's judgment against them by $500,000, which Figgie recovered from EAIC under a reimbursement agreement.

A. Breach of the guaranty agreements

The Guarantors' breach-of-contract arguments focus on two provisions of the guaranty agreements they entered into with Figgie. Paragraph 4 states that Figgie "may renew, extend, modify, change or waive the time of payment and/or the manner, terms or place of payment, and may upon prior written notice to and written consent from Guarantor, renew, extend, modify or waive any part of any other obligations referenced in this Guaranty without effecting [sic] the Guarantor's liability under this Guaranty." Paragraph 6 states that Figgie "agrees that upon the occurrence of an Event of Default as defined in the Promissory Note or Credit Agreement, it shall immediately notify Guarantor in writing."

The Guarantors first argue that Webex continually failed to make timely interest payments, which constituted an Event of Default under the credit agreement, yet Figgie failed to notify the

Guarantors as required by Paragraph 6 of the guaranty agreements. Events of Default are defined in Article VII of the credit agreement between Figgie and Webex; section 7.01(a) lists events that constitute Events of Default if not cured within 30 days after written notice from Figgie to Webex, and section 7.01(b) lists events that "shall also be deemed to constitute an Event of Default within this Agreement." One of the events listed in section 7.01(b) is that Webex "shall default in the making of any payment of principal or interest when due on any debt owed to [Figgie]." The Guarantors argue that Figgie therefore breached Paragraph 6 of the credit agreement and, under the basic principle that a party cannot recover on a contract after materially breaching it,[7] should now be precluded from collecting on the guaranties.

The record reveals that although some of Webex's quarterly interest payments to Figgie were not paid on the first of the month, as specified in the credit agreement, they were all paid in the month they were due, and Figgie accepted them as timely. Reading Paragraph 6 in conjunction with Paragraph 4, we find it highly doubtful that Figgie's duty to notify the Guarantors was intended to be triggered by technical Events of Default such as this one. Paragraph 4 gives Figgie the right, without notice to the Guarantors, to waive or modify the time allowed Webex for interest payments. Here, insofar as the record reflects, Figgie did not even expressly make this type of a modification of the

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[7] *See, e.g.*, *Carr v. Norstok Building Systems, Inc.*, 767 S.W.2d 936, 939 (Tex. App.--Beaumont 1989, no writ); *Joseph v. PPG Industries, Inc.*, 674 S.W.2d 862, 867 (Tex. App.--Austin 1984, writ ref'd n.r.e.).

agreement[8]; it simply accepted individual late payments.

Even if we accepted the reading of the two clauses suggested by the Guarantors' argument, *i.e.*, that Figgie was entitled under Paragraph 4 to accept the late payments without resorting to its contractual remedies, but was still obligated under Paragraph 6 to notify the Guarantors of this fact, we would be unable to find that Figgie's noncompliance excused the Guarantors from their basic obligation to guarantee Webex's performance on the note. It is a prerequisite to the remedy of excuse of performance that the covenants in the contract be mutually dependent promises. *Hanks v. GAB Business Services, Inc.*, 644 S.W.2d 707, 708 (Tex. 1982). Although reciprocal promises in a contract are presumed to be mutually dependent absent intentions to the contrary, *Dallas Market Center v. The Swing, Inc.*, 775 S.W.2d 838, 842 (Tex. App.--Dallas 1989, no writ), the relation of the covenant to the overall contract may furnish evidence of a contrary intention. *See Hanks*, 644 S.W.2d at 708 (when a covenant goes only to part of the consideration on both sides and a breach may be compensated for in damages, it is to be construed as an independent covenant if the expressed intent of the parties permits that construction); *Hampton v. Minton*, 785 S.W.2d 854, 857 (Tex. App.--Austin 1990, writ denied) (performance is excused when the other party's breach is "of such materiality as to indicate an intention to repudiate the

[8] Section 8.10 of the credit agreement requires an amendment or waiver to be evidenced by a written instrument signed by the party against whom enforcement of the change is sought. Figgie delivered no such signed writing to Webex. Thus, Figgie's acceptance of late payments did not constitute a modification of the contract.

contract"); *Greenstein v. Simpson*, 660 S.W.2d 155, 160 (Tex. App.--Waco 1983, writ ref'd n.r.e.) (covenants are mutually dependent, making excuse-of-performance defense available, only when "each covenant is such an indispensable part of what both parties intended that the contract would not have been made with the covenant omitted").

The guaranty agreements in this case indicate that the promises at issue here, at least as regards reporting this character of late interest payment, were not mutually dependent covenants. The agreements state on the first page that the investor deems it in his interest that Figgie lend money to Webex, and that he understands that Figgie is willing to do so only upon certain terms and conditions, including the investors' *pro rata* guaranty of Webex's performance. The agreements then state that "Now, therefore, *the undersigned*, hereby agrees as follows:" and list the various promises, including that "*[f]or the valuable consideration, set forth above* . . . the undersigned hereby unconditionally and absolutely guarantees the faithful and prompt performance by Webex of the Guaranteed Portion of Webex's obligations . . ." (emphasis added). Paragraph 6 is the only one of the listed agreements imposing an affirmative obligation on Figgie. And it must be read in context with paragraph 4. The agreements are signed only by the Guarantors, not by Figgie. By their terms, then, the agreements list the obligations of the Guarantors given in exchange for Figgie's extension of credit to

Webex.[9]

Clauses like Paragraph 6 embody an important protection for guarantors. They ensure that, when a default has occurred, the guarantor has an opportunity to cure it by making the payment and thereby forestalling acceleration of the note, or if acceleration has occurred, that the guarantor can immediately pay the debt and exercise his right of subrogation before the debtor's financial position further deteriorates. In the present context, to view this clause, so far as it applies to the late interest payments that Figgie was empowered to waive under paragraph 4, as *not* being mutually dependent with the basic obligation to guarantee the debt, however, effectuates the general rule regarding necessity to provide notice: although failure by a creditor to provide notice of default may reduce or defeat his ability to recover, the guarantor is released only to the extent that he was prejudiced or damaged by the lack of notice. 38 Am. Jur. 2d *Guaranty* § 107 (1968).

In this case, no consequences to the debtor or the Guarantors arose from the tardiness of the interest payments. Any violation

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[9] The arguable breach of Paragraph 6 by Figgie is not comparable to the breach found to be of a "material provision," in *Premier Bank, National Association v. Mosbacher*, 959 F.2d 562 at 567 n.2 (5th Cir. 1992). In that case, the breached provision prohibited the creditor from agreeing to any modification of any obligation of a party to the agreement without the prior written consent of the guarantor. *See id*. at 566-67. Here, by contrast, the provision dealt only with notice following an event of default by the debtor (under a credit agreement in which "event of default" was defined very expansively). The protection that the clause provided to the creditor was not the basic right to consent to modifications to the agreement, but merely the chance to take steps to protect itself after default. *See infra*.

of paragraph 6 in regard thereto was immaterial here. To allow Paragraph 6 to release the Webex investors from their entire obligation, when no harm resulted from Figgie's alleged noncompliance on this matter, and when the clause's inclusion in the guaranty agreement was not such as to make the covenant in this respect a mutually dependent one with the basic obligation to guarantee the debt, would expand the clause dramatically beyond its ordinary and intended scope. Even under the principle of *strictissimi juris*, mandating a strict construction in favor of the Guarantors,[10] we cannot hold that this character of possible violation of Paragraph 6 under these circumstances would excuse the Guarantors' performance.

The Guarantors argue that they *were* harmed by the lack of notice of late interest payments because Figgie's notification responsibilities under Paragraph 6 also served the crucial purpose of alerting them to any deterioration in Webex's financial condition. They argue that they were damaged by Figgie's failure to give notice because, had they known of Webex's difficulty in making interest payments on time, they could have taken action as Webex shareholders to curtail Webex's draws on the line of credit and check the increase in their liability on the guaranties. In the present context, this argument is not persuasive. Both White and Cherry were involved in the Webex venture at the outset, serving on its board of directors, and White was a Webex officer until late 1986. It is not plausible that Paragraph 6 served the

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[10] *See McKnight v. Virginia Mirror Co.*, 463 S.W.2d 428, 430 (Tex. 1971).

role of keeping them abreast of Webex's financial condition. They are, in effect, complaining of the unchecked progress of Webex policies that they may have helped to implement and were certainly in a position to influence. *Cf. Federal Deposit Insurance Corp. v. Coleman*, 795 S.W.2d 706, 709 (Tex. 1990) (observing that guarantors who held controlling interests in the debtor "were fully able to protect themselves from any increased liability resulting from a decline in the market value" of the collateral).

The Guarantors also allege that Figgie failed to notify them of an Event of Default under section 7.01(b)(4) of the credit agreement, which states that an Event of Default occurs if Webex "shall be unable, or admit in writing its inability to pay its debts as they mature." The Guarantors point out that as early as 1985, it became clear to Figgie that Webex was struggling and was able to pay its debts only through further draws on the line of credit. They do not, however, refer to any actual failure by Webex to pay its debts to other entities, or to any collection efforts by such entities. The Guarantors are essentially arguing that an Event of Default under section 7.01(b)(4) could arise solely from Figgie's concern about Webex's condition, even if not acted upon. Such a construction would be at odds with other provisions of the credit agreement. For instance, although section 3.06 gave Figgie the right to refuse further advances under the line of credit if, in its "sole determination," a "material adverse change" in Webex's financial condition had occurred, the role of that clause was to give Figgie discretion to halt advances. The Guarantors are arguing that despite Figgie's decision *not* to halt advances, an

Event of Default occurred and, necessarily, all of the attendant consequences under the credit agreement followed. One of these was that Figgie's obligations were immediately and automatically terminated unless and until reinstated by Figgie in writing.[11] To give section 7.01(b)(4) this construction would be essentially inconsistent with the discretion afforded Figgie by section 3.06, and would also place a start-up venture such as Webex in a nearly impossible position.[12] We therefore reject this interpretation.

Finally, the Guarantors allege that Figgie breached Paragraph 4 of the credit agreement by waiving material provisions of the credit agreement without notice to or consent from the Guarantors. Section 7.01(a) provides that if Webex defaults in any material respect in the performance of any of its covenants under the guaranty agreement, then such failure shall be deemed an Event of Default if not cured within 30 days after written notice by Figgie to Webex. Sections 5.02 and 5.04 of the credit agreement required Webex to submit quarterly financial statements and "no default" certificates. Based on the absence of several of these documents in Figgie's files, the Guarantors argue that Figgie unilaterally waived or modified those requirements in violation of Paragraph 4.

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[11] Section 7.02(b) provided that upon the happening of any Event of Default, Figgie's obligations would "immediately and automatically cease and terminate unless and until [Figgie] shall reinstate the same in writing." The inclusion of the word "immediately" in this clause offers further evidence that the parties contemplated that Events of Default would be concrete events, not the type of general, incremental financial decline relied upon by the Guarantors.

[12] The Confidential Memorandum noted that it was expected that in the first years of the venture, Webex would operate at a loss.

Also, they allege that Webex suffered a "material adverse change in condition," as defined in section 5.05, but never submitted a statement describing such change to Figgie, as required by that section. They do not allege that Figgie ever gave the written notice to Webex required to make those occurrences Events of Default.

The record does not reflect, and the Guarantors do not allege, that Figgie ever indicated to Webex that the requirements of sections 5.02, 5.04, or 5.05 were waived or modified. The Guarantors appear to be relying on what was at most nonenforcement. Figgie had the right under the credit agreement to give written notice to Webex upon failing to receive any such statement, and then resort to acceleration or other remedies if the problem was not cured in 30 days. However, nothing in the contract as written suggests that Figgie was *obligated* to follow that course. If Figgie merely declined to avail itself of a particular remedy, as it had discretion to do under the contract, and never relinquished that remedy as to any future violations, we fail to see how Figgie modified the contract or waived Webex's obligations.[13] The Guarantors similarly note that under section 8.01 Webex granted Figgie a security interest and agreed to provide Figgie with documents required by Figgie to perfect the security interest, but that Figgie never acted to perfect the security interest. Again,

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[13] Section 8.06 of the credit agreement stated that "[n]o course of dealing on the part of [Figgie] . . ., nor any failure or delay by [Figgie] with respect to exercising any of its rights, powers or privileges under this Agreement, the Note or the Guaranty Agreements shall operate as a waiver thereof."

no waiver or modification has been shown.

B. Common-law suretyship defense

The Guarantors argue that even if this inactivity by Figgie did not constitute a breach of the guaranty agreements, it materially altered the terms of the underlying debt arrangement, excusing the Guarantors from their obligation. Under the common law, guarantors may invoke a suretyship defense of material alteration of contract: "if the creditor and principal debtor vary in any material degree from the terms of their contract, then a new contract has been formed and the guarantor is not bound to it." *Vastine v. Bank of Dallas*, 808 S.W.2d 463, 464 (Tex. 1991) (per curiam); *United States v. Vahlco Corp.*, 800 F.2d 462, 465 (5th Cir. 1986).

Initially, we note that, unlike the situation in *Vastine*, the agreement between the creditor and Guarantors in this case did authorize modifications of the underlying credit agreement on such matters as time of payment (Paragraph 4). We cannot regard the remaining complained of matters, such as failure to take action to strictly require the submission of financial statements and "no default" certificates, as altering the Guarantors' obligation to any material degree. Although in *McKnight v. Virginia Mirror Co.*, 463 S.W.2d 428 (Tex. 1971), the Texas Supreme Court did release a guarantor because of somewhat similar violations--failure to require weekly payments and inventories--in that case those conditions were affirmatively imposed on the guaranteed creditor by the express terms of the guaranty itself.

C. Affirmative claims against Figgie

The Guarantors further argue that the district court erred in granting summary judgment against them on their counterclaims against Figgie because the conduct described above, especially Figgie's failure to perfect its security interest in Webex's assets, assertedly violated a duty of good faith and fair dealing or constituted negligence. They argue that Figgie's willingness to continue to permit draws on the line of credit despite Webex's obviously dire financial condition showed a bad-faith or negligent disregard for their rights. In addition, they argue, Figgie assumed duties beyond the written guaranty agreement--for instance, by undertaking to obtain a surety bond from an independent bonding company--which it failed to pursue with ordinary diligence.

For the reasons explained above, we are not persuaded there is any evidence to sustain a finding that any of the conduct complained of caused any loss to the Guarantors. The surety bond would have enhanced only Figgie's security, and both the timing of the Guarantors' investments and their roles as Webex insiders belie the contention that they were depending upon independent, external review. Moreover, the Guarantors have not shown any special relationship with Figgie warranting the imposition of fiduciary duties. *See Coleman*, 795 S.W.2d at 709 ("[T]he relationship between a creditor and guarantor does not ordinarily import a duty of good faith.").

D. Entitlement to credit for $500,000 received from EAIC

The Reimbursement Agreement upon which the Guarantors rely is an agreement between Colony and EAIC in which EAIC, in exchange for

Colony's execution of surety bonds guaranteeing payment *of the loan guarantees of the Webex investors*, agrees to pay Colony up to $500,000 to reimburse it for any loss occasioned thereby, including the expenses of bringing suit to collect on the guaranties. As previously discussed, apparently no surety bond was executed in time to be effective. In any event, the substance of the agreement between EAIC and Colony was that EAIC would reimburse Colony for losses caused by failures of the Guarantors to pay. This is consistent with the descriptions in the record of the $500,000 payment from EAIC to Figgie; the money was stated to have been placed in escrow while Figgie was continuing its collection efforts against the Guarantors. Therefore, the Guarantors cannot rely on the Reimbursement Agreement or on the $500,000 payment to offset their liability.

Conclusion

Because the Guarantors have failed to raise a genuine issue of material fact on any of their cross-claims against the promoters of the Webex venture, their defenses against Figgie's collection suit, or their counterclaims against Figgie, the judgment of the district court is

AFFIRMED.