No. 02-0982

IN THE
SUPREME COURT OF TEXAS

MARIA MILLAN, Individually and
as Trustee for JAMES E. MILLAN,

Petitioner,

v.

DEAN WITTER REYNOLDS, INC.,

Respondent.

On Petition for Review from the
Fourth District Court of Appeals at San Antonio

BRIEF OF AMICUS CURIAE PUBLIC CITIZEN IN SUPPORT OF PETITION FOR REVIEW

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RULE 11 DISCLOSURE

Under Texas Rule of Appellate Procedure 11(c), amicus Public Citizen states that no fee has been paid or will be paid for the preparation of this brief.

ISSUE PRESENTED

In this brief, amicus Public Citizen addresses the first issue presented in the Petition for Review: Whether a brokerage house may be held liable for its employee's fraud, committed on one of the brokerage house's customers, under the common-law doctrine of respondeat superior.

INTEREST OF AMICUS

Public Citizen, a national non-profit consumer advocacy organization founded in 1971, submits this brief pursuant to this Court's Rule 11. Public Citizen is headquartered in Washington, D.C., and has a permanent office in Austin. On behalf of its 125,000 members, including approximately 4900 in Texas, Public Citizen engages in research, education, lobbying, and litigation on a broad range of issues that affect consumers. Over the last three decades, Public Citizen has worked in a variety of litigation and legislative contexts to provide consumers full and fair redress for their injuries under federal and state consumer protection statutes and traditional state tort and contract principles. As described more fully below, Public Citizen believes that corporate misconduct cannot be fully deterred, and its victims fully compensated, unless traditional doctrines of vicarious liability, such as the respondeat superior doctrine at issue here, are maintained. Public Citizen has therefore opposed efforts to narrow such doctrines, and, as relevant here, to restrict employer liability. Particularly in the wake of Enron and similar scandals, the need to protect consumers from financial harm at the hands of brokers, accounting firms, and others in the financial services industry has never been greater. And, yet, victimized consumers will have little recourse against the giants of that industry if the Court of Appeals' ruling is allowed to stand; instead, the industry will hide behind its employees who themselves have neither the resources nor proper incentive to make their victims whole.

STATEMENT OF FACTS

This case concerns the conversion of money invested by Maria Millan with the brokerage firm Dean Witter Reynolds, Inc., through the fraudulent acts of one of Dean Witter's brokers, Miguel Millan, Maria Millan's son. We adopt the facts set forth in the plaintiff's Petition for Review and in the Court of Appeal's decision. *Millan v. Dean Witter Reynolds, Inc.*, 90 S.W.3d 760, 763 (Tex. App.-San Antonio 2002). To the extent that the facts are relevant to our arguments, they are discussed in the argument section that follows.

SUMMARY OF ARGUMENT

This Court should grant review to resolve a conflict in the proper standard for imposing liability under the respondeat superior doctrine. In Public Citizen's view, the Court should reaffirm its holding in *American National Insurance Company v. Denke*, 95 S.W.2d 370, 373 (Tex. 1936), which allows a jury to hold an employer liable for its employee's torts if the employer has the "right and power to direct and control [the employee] in the performance of the causal act or omission" that caused the harm. That standard is appropriate because it is easy to apply and comports with the dual purposes of the respondeat superior doctrine: (1) providing incentives for employers to curtail the tortious conduct of their employees and (2) assigning the costs of such conduct to the entities best able to spread them to the community at large. This latter purpose also promotes make-whole compensation because the individual employee often cannot afford to pay the judgment.

The Court of Appeals' basic error was that, in determining that the employee here was not acting within the scope of his employment with Dean Witter, it relied on the employee's particular deceitful acts, not his general duties as an employee. That approach renders the respondeat superior a dead letter because an employer would rarely, if ever, authorize tortious or otherwise unlawful conduct. In this regard, the Court of Appeals' holding is directly at odds with fundamental common-law principles and relevant case law.

Finally, the Court should grant review on the respondeat superior issue because the Court of Appeals' decision conflicts with cases involving federal securities claims. Those cases are important because they involve financial fraud in circumstances similar to those presented here and they impose vicarious liability on brokerage houses such as Dean Witter under common-law agency principles. Unlike the Court of Appeals, those cases recognize that those common-law principles are essential tools for combatting financial fraud and compensating its victims.

ARGUMENT

I. Review Should Be Granted To Harmonize Texas Law And To Correct the Court Of Appeal's Fundamental Misunderstanding Of The Doctrine Of Respondeat Superior.

A. The Conflict In Texas Law Demands This Court's Attention. This case presents an ideal vehicle for resolving the tension in this Court's case law regarding the doctrine of respondeat superior. *Darensberg v. Tobey*, 887 S.W.2d 84, 89 (Tex. App.-Dallas 1994, writ denied) (acknowledging the conflict). The Court has developed two different tests for determining whether an employer should be held vicariously liable for its employee's torts. In *American National Insurance Company v. Denke*, 95 S.W.2d 370, 373 (Tex. 1936), this Court explained that, in deciding whether to impose respondeat superior liability, the court or jury should ask only a simple question: Did the employer have the "right and power to direct and control [the employee] in the performance of the causal act or omission" that caused the harm. That test continues to

be cited and, as noted in *Darensberg*, it has never been overruled. 887 S.W.2d at 89. Under the *Denke* formulation, this case would have gone to the jury on a respondeat superior theory, because, as even the majority below would acknowledge, Dean Witter had the power to direct and control Miguel in his dealings with Maria (and likely would have prevented the wrongful acts if it had exercised that control).[1]

On the other hand, *Leadon v. Kimbrough Bros. Lumber Co.*, 484 S.W.2d 567, 569 (Tex. 1972), sets forth a different test under which the employer is liable if the employee's conduct (1) falls within the scope of the employee's general authority; (2) is in furtherance of the employer's business; and (3) is for the accomplishment of the object for which the employee was hired. The Court of Appeals, purporting to rely on this test, held that "there was no evidence that Miguel acted within the scope of his authority as a broker at Dean Witter." *Millan*, 990 S.W.3d at 768. The court acknowledged that Miguel had "general authority" to open accounts for clients, receive deposits, and purchase and sell securities as directed by clients. Nevertheless, it ruled that because Miguel engaged in "a litany of deceitful acts [and] stole money from his mother," Miguel's conduct was "not within his general scope of authority as a broker for Dean Witter." *Id.* In this regard, the Court of Appeals confused *general* authority with *specific* authority and, thus, rejected respondeat superior recovery on the ground that Dean Witter

[1]For instance, Dean Witter acknowledges that it failed to review the forged change-of-address card, as company policy required, and it did not follow its special rules for the monitoring of familial accounts, such as the one established by Miguel for Maria. Petition for Review at 2.

had not authorized the specific unlawful acts engaged in by Miguel. If that were the law, respondeat superior would be rendered meaningless; where the plaintiff seeks to hold the employer vicariously liable for an employee's wrongful acts, those acts would rarely, if ever, be *specifically* authorized by the employer.

Indeed, many cases hold employers liable for intentional torts of employees that plainly were not authorized by the employer.[2] As Justice Stone said in dissent in this case: Under rudimentary agency law, "it is not a defense to liability to claim an agent was authorized only to do those acts that would be lawful." *Millan*, 90 S.W.3d at 769 (Stone, J., dissenting). Rather, "[i]f an agent acts within the scope of his general authority, his wrongful act, although not authorized, will subject his principal to liability." *Id.* To be sure, vicarious liability is subject to a narrow exception where the employee engages in "serious criminal activity" involving "intentional and malicious acts that are *unforeseeable considering the employee's duties*," *id.* (emphasis added), as might be true, for instance, if an employee, while driving the company car, stops along the side of the road and assaults a passing pedestrian. Here, by contrast, Miguel was purporting to

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[2]*See generally Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 12-15 (1991) (rejecting due process challenge to punitive damages award made on respondeat superior basis where insurance agent stole customers' insurance premiums without employer's knowledge); *see also American Soc. of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556 (1982); *Cantrell v. Forest City Publishing Co.*, 419 U.S. 245, 253 (1974) (although employer newspaper "had no knowledge" of employee's "knowing and reckless falsehoods," employer properly held "liable under traditional doctrines of respondeat superior"); *Gleason v. Seaboard Air Line Ry. Co.*, 278 U.S. 349 (1929); *Hendrickson v. Hendrickson*, 640 F.2d 880 (7th Cir. 1981); W.L. Prosser, *Law of Torts*, § 69, at 464-66 (4th ed. 1971) (discussing applicability of doctrine to intentional torts and citing cases).

invest Maria's money in a Dean Witter account — the quintessential task of a Dean Witter broker — and unless one is to believe that brokers never defraud their clients through forgery and the creation of fictitious accounts (two obvious means of perpetrating financial fraud), Miguel's conduct must be viewed as "foreseeable."

Thus, the decision below cannot be sustained under either the *Denke* or *Leadon* respondeat superior test, and this Court could simply grant review and explain that, under either test, the decision below should be reversed. We urge this Court, however, to reaffirm *Denke*'s "power to direct and control" standard because it is simpler than the *Leadon* standard and therefore less subject to the kind of misapplication that occurred below. Moreover, *Denke* is truer to the purpose of the respondeat superior doctrine, which is premised on two separate, complementary rationales. The first is deterrence: no matter how blameless an employer may appear, tortious conduct will be reduced if employers are required to bear the costs of that behavior. *See, e.g.*, *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 14 ("Imposing exemplary damages on the corporation when it commits intentional fraud creates a strong incentive for vigilance by those in a position 'to guard substantially against the evil to be prevented.'") (quoting *Louis Pizitz Dry Goods Co. v. Yeldell*, 274 U.S. 112, 116 (1927)); 2 Harper & James, *Law of Torts*, § 26.3, at 1368-69 (1956). This rationale is well-served by asking simply whether the employer had the right and ability to control the conduct in question, because, if it does, it can take steps to reduce the likelihood of wrongdoing (for instance, here, by having other

employees compare Maria's original signature card with the forged documents).

Second, respondeat superior is based on the principle that the cost of tortious behavior should be spread to the community "through prices, rates or liability insurance." *See* W.L. Prosser, *Law of Torts*, § 69, at 459 (4th ed. 1971). Under this insurance-based theory, the employer is held liable because, unlike the employee, it is able to internalize the costs of tortious conduct and spread them to all consumers of its goods or services. This principle, like the related principle of joint and several liability, also promotes make-whole compensation because it recognizes that the individual employee often does not have the resources to pay a judgment. This cost-spreading rationale is fully consistent with the *Denke* "control" test because, it effectively assigns the risks of employee misbehavior to the employer, which has the means for avoiding or mitigating those risks.

B. The Court Of Appeals' Further Misunderstandings Of Vicarious Liability Principles. As explained above, the Court of Appeals looked to the first prong of the three-part *Leadon* test and erroneously held that Miguel did not have the "general authority" to defraud Maria. Although the Court of Appeals did not expressly consider the second and third prongs — whether Miguel's actions were in furtherance of Dean Witter's business and for the accomplishment of the purpose for which he was hired — it did so implicitly and erred in that regard as well. The Court of Appeals seemed fixated on Miguel's unlawful acts — for instance, forgery and the creation of bogus Dean Witter's statements — acts that, viewed in isolation, were not in furtherance of Dean

Witter's business or the purpose for which Miguel was hired. Once again, however, the Court of Appeals focused too narrowly on the *specific* deceitful acts of the employee, which can never be said to be in furtherance of a *lawful* business. Rather, to give respondeat superior any meaning, with respect to an intentional tort, the Court of Appeals should have focused on Miguel's *general* acts — the opening of the Dean Witter account, the receipt of money for investment, and the like. That conduct was in furtherance of the employer's business and were exactly the kinds of acts that Miguel was hired to do. Without this general focus, respondeat superior would be a nullity in cases of financial fraud, because no legitimate brokerage house would ever be found to have hired its brokers to commit fraud.

The Court of Appeals' reliance on certain of Miguel's deceitful acts that were accomplished away from Dean Witter's premises was also erroneous. The Court of Appeals noted, for instance, that "opening a post office box so [Miguel] could receive his mother's [financial] statements" was "not related to Miguel's duties." *Millan*, 90 S.W.3d at 768. That conclusion is factually correct, but legally irrelevant for two separate, but related reasons. First, as petitioner notes (Petition for Review at 8), Miguel's off-premises behavior "would have been meaningless and ineffectual" had it not been accompanied by other acts that were conducted in the course of his employment while using Dean Witter facilities and property. As petitioner explains, obtaining the post office box (used as a drop box for stolen money) would have gained Miguel nothing

without his use of Dean Witter's database and other facilities, to which he had access in his job, that enabled him to change the address on Maria's account. Seen this way, *all* of Miguel's fraudulent activities sprang from the employer-employee relationship, and thus a jury should have been permitted to consider them in deciding whether to hold Dean Witter vicariously liable.

In any event, even if some of Miguel's acts could be said not to have arisen in the course and scope of his employment, the Court of Appeals' decision would still be deeply flawed. To keep the respondeat superior theory from the jury, the Court of Appeals was required to find that there was "*no* evidence that Miguel was acting within the scope" of his employment. *Millan*, 90 S.W.3d at 708 (emphasis added). And that holding required the Court of Appeals to ignore acts — such as the change-of-address card forgery, the generation of falsified Dean Witter statements, the use of checks written on a Dean Witter account — that were accomplished using Dean Witter forms or equipment on Dean Witter's premises, *i.e.*, types of conduct that were part and parcel of a broker's employment at Dean Witter. Thus, even if the Court of Appeals were correct that certain of Miguel's acts were outside the scope of his employment, it should have allowed the respondeat superior claim to go to the jury with an instruction limiting the kinds of evidence that could be considered.

C. The Court Of Appeals Ignored The "Mixed Purposes" Line Of Authority. The Court of Appeals also erred in failing to consider a body of case law holding that the

doctrine of respondeat superior applies even though the employee is acting for personal reasons or for his or her own benefit, as long as the employer is expected to derive some benefit from the employee's conduct. These "mixed" or "mingled" purposes cases impose liability under *Restatement (Second) of Agency*, § 246 (1958), which provides that employee conduct may trigger respondeat superior liability "although done in part to serve the purposes of the servant or of a third person." The Restatement explains that, even if the employee's "predominant" motive is self-interest, vicarious liability may be imposed if service to the employer "actuates the servant to any appreciable extent." *Id.* (comment B). Thus, an employer may be liable when its employee stops to drink beer on his way to the next day's business activities and runs over and kills a pedestrian with his car. *Dictaphone Corp. v. Torrealba*, 520 S.W.2d 869, 872 (Tex. Civ. App.-Houston [14th Dist.] 1975, writ ref'd n.r.e.); *accord Howard v. American Paper Stock Co.*, 523 S.W.2d 744, 747 (Tex. Civ. App.-Forth Worth 1975) (citing cases), *aff'd as reformed*, 528 S.W.2d 576 (Tex. 1975); *Cuyler v. Bennett*, 1992 WL 288989, *3 (Tex . App.-Houston [1st Dist.] Oct. 15, 1992, writ denied); *Josey-Miller Co. v. Sheppard*, 357 S.W.2d 488, 489 (Tex. Civ. App.-Beaumont 1962, no writ); *see also Palmer v. Flaggman*, 93 F.3d 196, 204 (5th Cir. 1996) (applying Texas law).

Here, no one knows whether Miguel's scheme was motivated in part for the benefit of Dean Witter. But we do know, unlike the cases cited immediately above, that Miguel's fraudulent conduct *did in fact benefit Dean Witter*. Maria's investments with

Dean Witter, and each transaction undertaken with her money, benefitted Dean Witter financially, for instance, by generating interest on the margin account opened in Maria's name. Petition for Review at 2, 8; *Millan*, 90 S.W.3d at 769 (Stone, J., dissenting); *Pacific Mut. Life Ins.*, 499 U.S. at 13 (affirming vicarious liability for punitive damages on employer and noting that, even though fraud was carried out for employee's benefit without employer's knowledge, employer "derived economic benefit" from employee's conduct). Where the employee's activities are part of the employer's business and actually produces income for the employer, it is error to conclude that the employee's conduct was not in the course of his or her employment. The Court of Appeals came to the contrary conclusion, in part, because of its failure to consider the mixed motive line of authority, and, for that reason as well, this Court should grant review.

D. The Court Of Appeals Also Failed To Consider The "Apparent Authority" Doctrine. Even if Miguel's fraud were said to have benefitted only himself, Dean Witter should still be subject to liability under common-law agency principles. "[U]nder general rules of agency law, principals are liable when their agents act with apparent authority and commit torts...." *American Soc. of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556, 565-66 (1982) (citing *Restatement (Second) of Agency* § 8 (1958)). This general rule applies specifically to an agent's fraud "though the agent acts *solely* to benefit himself." *Id.* at 566 (citing authorities) (emphasis added); *accord Restatement (Second) of Agency* § 235, comment e, § 219(d)(2) (1958); *Pacific Mut. Life*

Ins., 499 U.S. at 12-13. The parties do not dispute that Miguel had "apparent authority" to take Maria's money and invest it purportedly for her benefit, and thus it makes no difference whether Dean Witter was or was not an intended beneficiary of Miguel's scheme. The Court of Appeals' failure to analyze the case under the "apparent authority" doctrine also warrants this Court's attention.[3]

II. Review Should Be Granted Because Of The Court Of Appeals' Departure From Decisions Regarding Respondeat Superior Liability In Federal Securities Cases Involving Financial Fraud Of The Kind Presented Here.

Brokers like Dean Witter operate solely through agents like Miguel, who, if they are intent on stealing their customers' money, will invariably engage in the kinds of deceitful acts that the Court of Appeals believed took this case outside of the master-servant relationship. The Court of Appeals' ruling, if left undisturbed, would insulate brokerage houses and other financial institutions from most, if not all, of their agents' intentional fraud. Such a rule makes no sense because it would undermine the twin

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[3]To be sure, Miguel was not authorized to forge Maria's signature or engage in other deceitful acts, but the relevant question is whether, in general, Miguel had apparent authority to manage Maria's account on Dean Witter's behalf. In *American Society of Mechanical Engineers*, cited in the text, the United States Supreme Court affirmed vicarious antitrust liability against an organization for damages springing from its agent's creation of an unauthorized, fraudulent document under the common-law "apparent authority" doctrine. 456 U.S. at 559-70. The Court so held even though the agent's fraud did not benefit the defendant, a neutral non-profit standard-setting organization. *See also Gleason v. Seaboard Air Line Ry. Co.*, 278 U.S. 349, 356 (1929) (employer held liable under respondeat superior doctrine when, employee, acting with apparent authority, obtained payment by forging bill of lading; fact that employee sought only to enrich only himself deemed irrelevant because "few doctrines of the law are more firmly established or more in harmony with accepted notions of social policy than that of the liability of the principal without fault of his own.").

purposes of the respondeat superior doctrine: It would create diminished incentive for financial institutions to oversee their agents' conduct and make it far less likely that victims of fraud will be made whole. In that regard, the Court of Appeals should have — but did not — review authorities involving federal securities claims, which universally permit vicarious liability under circumstances similar to those presented here.

The most analogous case is *Hendrickson v. Hendrickson*, 640 F.2d 880 (7th Cir. 1981), where the husband, George, a Smith Barney stockbroker, looted his wife's (Wendee's) account by fraudulent means. Like Miguel here, George's fraud was perpetrated through forgery, specifically, by forging checks written on Wendee's Smith Barney account. And just like Miguel, George was all the while supplying Wendee with fraudulent financial statements indicating that the account was flush. The court imposed vicarious liability on Smith Barney under both federal securities law and state common law and did not even suggest that George's fraud came under an exception to the respondeat superior doctrine. Indeed, the court rejected Smith Barney's argument — similar to the argument accepted by the Court of Appeals here — that the firm should be absolved of liability because Wendee was in a better position than Smith Barney to prevent George's wrongdoing. Quite the contrary, as the court explained, "George was not acting nor was he authorized to act as Wendee's agent independent of his position as stockbroker employed by Smith Barney.... [T]he primary agency relationship created by the ... accounts was between Wendee and Smith Barney, with George acting on Smith

Barney's behalf." *Id.* at 887. Other federal securities precedents are to the same effect. *See, e.g., Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-19 (5th Cir. 1980); *Baker v. Wheat First Securities*, 643 F. Supp. 1420, 1425-26 (S.D. W. Va. 1986); *cf. Federal Savings & Loan Insurance Corp. v. Shearson-American Express, Inc.*, 658 F. Supp. 1331, 1338-37 (D.P.R. 1987) (upholding respondeat superior liability under common law and RICO; rejecting arguments similar to those accepted by Court of Appeals below).

Although these federal court precedents are not binding on the Texas courts, this Court should nonetheless be concerned that the decision below deviates dramatically from federal court decisions regarding the same kinds of financial fraud as involved here. Those courts concluded that imposing respondeat superior liability in such cases involves simple application, not extension, of time-honored common-law agency principles, and their application was necessary to curb financial fraud and compensate its victims. This Court should come to the same conclusion here.

CONCLUSION

For the reasons stated above, Public Citizen urges this Court to grant the petition for review.

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