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Erosion of the Privity Requirement in Section 12(2) of the Securities Act of 1933: The Expanded Meaning

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ARTICLES

EROSION OF THE PRIVITY REQUIREMENT IN SECTION 12(2) OF THE SECURITIES ACT OF 1933: THE EXPANDED MEANING OF SELLER

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INTRODUCTION

Section 12(2)[1] of the Securities Act of 1933[2] provides a securities purchaser with an express cause of action against his seller if the purchaser can establish that the seller used interstate commerce or the mails to offer or sell a security by means of a written or oral communication which misstated or omitted to state a material fact of which the purchaser was unaware.[3] Upon proof of the foregoing, the purchaser is entitled to rescind his purchase or, in the event he no longer owns the security, to recover equivalent damages unless the seller sustains the burden of proving that the seller did not know, and in the exercise of reasonable care could not have known, of the misstatement or omission.[4]

Historically, section 12(2) has been little more than a weak stepsister to the private cause of action for securities fraud implied by federal courts under section 10(b)[5] of the Securities Exchange

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1. Section 12(2) reads:

> Any person who—
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> . . . .
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> (2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Securities Act of 1933 § 12(2), 15 U.S.C. § 77*l*(2) (1976) [hereinafter referred to as section 12(2)].

2. Securities Act of 1933, 15 U.S.C. §§ 77(a)–(mm) (1976) [hereinafter referred to as the 1933 Act].

3. *See supra* note 1.

4. *See supra* note 1.

5. Section 10(b) of the Securities Exchange Act of 1934 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1976) [hereinafter referred to as section 10(b)].

Act of 1934[6] and rule 10b-5[7] promulgated thereunder.[8] To the extent that a purchaser alleges misrepresentations or omissions in connection with acquisition of a security, section 12(2) and rule 10b-5 may both provide potential avenues of relief.[9] For many

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6. Securities Exchange Act of 1934, 15 U.S.C. §§ 78(a)-(kk) (1976) [hereinafter referred to as the 1934 Act].

7. Rule 10b-5, promulgated under § 10(b), *supra* note 5, provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To 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 the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1983) [hereinafter referred to as rule 10b-5].

Unlike § 12(2), § 10(b) and rule 10b-5 do not expressly provide for a private right of action. The district court for the Eastern District of Pennsylvania first implied a private right of action under § 10(b) in Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). A majority of lower federal courts followed suit, and by 1969 ten of the eleven courts of appeals recognized the existence of an implied remedy under § 10(b) and rule 10b-5. *See* 6 L. LOSS, SECURITIES REGULATION 3871-73 (Supp. to 2d ed. 1969) (collecting cases). The United States Supreme Court confirmed the existence of an implied cause of action under § 10(b) and rule 10b-5 in Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971). The Supreme Court recently reaffirmed recognition of such a cause of action in Herman & MacLean v. Huddleston, 103 S. Ct. 683, 687 (1983) ("The existence of this implied remedy is simply beyond peradventure.").

8. Professor Donald E. Schwartz aptly described the underdeveloped state of the interpretative history of § 12(2) as follows:

> In talking about Section 12(2), I can analogize to the Israeli's revival of the long-dead Hebrew language. Like Hebrew, Section 12(2) was long neglected and, consequently, it is now in a retarded state of development. When David Ratner's casebook came out a couple of years ago it did not even mention Section 12(2), which seems to me to have been an appropriate allocation of resources because the vast expansion of litigation under Rule 10b-5 meant that section was not very important. This is a situation that is unlikely to continue.

PLI, NINTH ANNUAL INSTITUTE ON SECURITIES REGULATION 341, 348 (A. Fleischer, Jr., M. Lipton, B. Vandegrift eds. 1978). *See also* Kaminsky, *An Analysis of Securities Litigation under Section 12(2) and How It Compares with Rule 10b-5*, 13 HOUS. L. REV. 231, 231 (1976).

9. In Herman & MacLean v. Huddleston, 103 S. Ct. 683 (1983), the Supreme Court held that the availability of an express remedy under § 11 of the 1933 Act, 15 U.S.C. § 77k (1976), does not preclude a defrauded purchaser from maintaining an implied action under rule 10b-5. *Id.* at 690. The Court's rationale in *Huddleston* supports a cumulative construction of the remedies in § 12(2) and rule 10b-5 as well. The majority of courts which considered this question prior to *Huddleston* so held. *See generally* 1 A. BROMBERG & L. LOWENFELS, *infra* note 11, at §§ 2.4 (220), 2.4 (420). For a recent decision prior to *Huddleston* supporting a cumulative construction of § 12(2) and rule 10b-5, see Berger v. Bishop Inv. Corp., 695 F.2d 302 (8th Cir. 1982). For two recent decisions subsequent to *Huddleston* which support a cumulative construction of § 12(2) and rule 10b-5, see Amunrud v. Taurus Drilling Ltd.,

years, however, the interpretative history of section 12(2) remained largely in a state of arrest, eclipsed by the ever-burgeoning volume of litigation brought under rule 10b-5.[10] Lower federal courts became embroiled in the task of delineating the parameters of the private cause of action which they had judicially created under the rule. These courts expansively interpreted rule 10b-5, which became the premier weapon in a plaintiff's arsenal.[11]

In the mid-1970s, however, the Supreme Court began to take a more restrictive approach towards interpretation of the scope of coverage and the protection afforded by the federal securities laws.[12] In recent securities law opinions the Court has relied on

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1983 FED. SEC. L. REP. CCH ¶ 99,649, at 97,596 (D. Mont. Dec. 23, 1983); *In re* Longhorn Sec. Litig., 1983 FED. SEC. L. REP. CCH ¶ 99,630, at 97,481 (W.D. Okla. Sept. 28, 1983). The decision in *Huddleston* is further discussed *infra* note 14 and in text accompanying notes 402–410.

10. *See supra* note 8.

11. *See generally* 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD § 2.2 (462) (1983) (tracing chronologically from the 1940s to the mid-1970s the most significant lower federal court opinions, administrative decisions of the Securities and Exchange Commission (SEC), and United States Supreme Court opinions expansively interpreting rule 10b-5).

As noted therein, the bulk of expansionist activity during this period occurred at the lower federal court level. However, the only two Supreme Court decisions which addressed the parameters of the implied remedy under rule 10b-5 during this period took a similarly expansive approach. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (relaxing the reliance requirement in cases of nondisclosure under § 10(b)); Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) (recognizing the existence of an implied remedy under § 10(b) and finding under somewhat tenuous circumstances that a complaint sufficiently alleged an adequate connection between the alleged fraudulent activity and the sales transaction for purposes of withstanding a motion to dismiss).

The Supreme Court's securities law opinions outside the area of the implied remedy under rule 10b-5 also exhibited expansionist tendencies during this period. *See, e.g.*, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) (causation requirement in an implied private cause of action under rule 14a-9, 17 C.F.R. § 240.14a-9 (1983), is satisfied if the proxy solicitation itself, rather than the particular defect, is an essential link in the accomplishment of the transaction); SEC v. National Sec., Inc., 393 U.S. 453 (1969) (confirming SEC's power to regulate the activities of insurance companies); J.I. Case Co. v. Borak, 377 U.S. 426 (1964) (recognizing implied private cause of action for damages under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a) (1976)); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) (upholding requirement that registered investment advisers disclose personal financial interest in recommended securities under Investment Advisers Act of 1940, 15 U.S.C. §§ 80a-1–80b-21 (1976)).

12. *See, e.g.*, Dirks v. SEC, 103 S. Ct. 3255 (1983) (reaffirming and delineating in the context of a tipping situation the holding in *Chiarella v. United States*, 445 U.S. 222 (1980), that silence is actionable under § 10(b) only in the presence of a duty to disclose); Aaron v. SEC, 446 U.S. 680 (1980) (proof of scienter is required in an injunctive action by the SEC under § 10(b) of the 1934 Act and under § 17(a)(1) of the 1933 Act, 15 U.S.C. § 77q(a)(1) (1976)); Chiarella v. United States, 445 U.S. 222 (1980) (silence is actionable under § 10(b) only in the presence of a duty to disclose); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979) (no implied private cause of action for damages under § 206 of the Investment Advisers Act of 1940,

precise statutory language. It has refrained from engaging in expansive interpretation of statutory provisions without evidence of specific legislative intent. Moreover, it has exhibited a concern for interpreting statutory provisions in the context of the total statutory scheme of which they are a part.[13] In the area of rule 10b-5

15 U.S.C. § 80b-6 (1976)); limited implied private cause of action to void an investment adviser's contract under § 215 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-15 (1976)); Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) (no implied private cause of action under § 17(a) of the 1934 Act, 15 U.S.C. § 78q(a) (1976)); Burks v. Lasker, 441 U.S. 471 (1979) (state corporate law may give independent directors of an investment company power to terminate a shareholder derivative suit against the company's other directors to the extent such law is consistent with the policies of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-64 (1976) and the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21 (1976)); International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979) (employee interest in a compulsory, noncontributory pension plan is not a "security" within the contemplation of the 1933 or 1934 Acts); SEC v. Sloan, 436 U.S. 103 (1978) (under § 12(k) of the 1934 Act, 15 U.S.C. § 78*l*(k) (1976), SEC is limited to one ten-day summary suspension of trading in a security based upon a single set of circumstances); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (absent fraud, misrepresentation, or deception, a breach of fiduciary duty is not actionable under § 10(b)); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977) (defeated tender offeror lacks standing to bring a private cause of action for damages under § 14(e) of the 1934 Act, 15 U.S.C. § 78n(e) (1976)); TSC Indus., Inc., v. Northway, Inc., 426 U.S. 438 (1976) (standard of proof of materiality is heightened in the context of a private cause of action under rule 14a-9 of the 1934 Act, 17 C.F.R. § 240.14a-9 (1983), to require a showing of substantial likelihood that a reasonable shareholder would consider the disputed information important in determining how to vote); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (scienter required in implied private cause of action under § 10(b) and rule 10b-5); Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975) (proof of irreparable harm required for issuance of an injunction against violation of § 13(d)(1) of the 1934 Act, 15 U.S.C. § 78m(d)(1) (1976)); United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975) (shares of stock in a nonprofit housing cooperative are not "securities" within the 1933 or 1934 Acts); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (plaintiff must be a purchaser or seller of securities in order to bring an implied private cause of action for damages under § 10(b)); Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975) (no implied private cause of action under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa–78*lll* (1976)).

There have been a few aberrations in this relatively steady stream of opinions restricting the scope and effect of the federal securities laws. *See, e.g.*, Herman & MacLean v. Huddleston, 103 S. Ct. 683 (1983) (availability of an express remedy under § 11 of the 1933 Act, 15 U.S.C. § 77k (1976), does not preclude implied private cause of action under rule 10b-5; defrauded purchasers bringing an implied private cause of action under rule 10b-5 need prove their claim only by a preponderance of the evidence); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982) (implied private right of action recognized under Commodity Exchange Act, 7 U.S.C. §§ 1-26 (1976)); Rubin v. United States, 449 U.S. 424 (1981) (pledge of stock as collateral for loan is "offer or sale" of security under § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976)); United States v. Naftalin, 441 U.S. 768 (1979) (section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976), applies to a short seller's fraud against brokers and is not limited to new offerings of securities).

13. *See* cases restricting the scope and effect of the federal securities laws cited *supra* note 12; *see also* Freeman, *A Study in Contrasts: The Warren and Burger Courts' Approach to the Securities Laws*, 83 DICK. L. REV. 183, 198 (1979); Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum*

this penchant towards retrenchment has resulted in a series of opinions from the Supreme Court which have consistently tightened the requirements for a prima facie claim under the rule.[14]

Swings, 65 GEO. L.J. 891 (1977); Note, *The Supreme Court's Trimming of the Section 10(b) Tree: The Cultivation of a New Securities Law Perspective*, 3 J. CORP. L. 112, 132 (1977).

14. *See* Dirks v. SEC, 103 S. Ct. 3255 (1983) (reaffirming and delineating in the context of a tipping situation the holding in *Chiarella v. United States*, 445 U.S. 222 (1980), that silence is actionable under § 10(b) only in the presence of a duty to disclose); Aaron v. SEC, 446 U.S. 680 (1980) (proof of scienter is required in an injunctive action by the SEC under § 10(b) of the 1934 Act and under § 17(a)(1) of the 1933 Act, 15 U.S.C. § 77q(a)(1) (1976)); Chiarella v. United States, 445 U.S. 222 (1980) (silence is actionable under § 10(b) only in the presence of a duty to disclose); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (absent fraud, misrepresentation, or deception, a breach of fiduciary duty is not actionable under § 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (scienter required in implied private cause of action under § 10(b) and rule 10b-5); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (plaintiff must be a purchaser or seller of securities in order to bring an implied private cause of action for damages under § 10(b)).

At first blush, the opinion of the Supreme Court in Herman & MacLean v. Huddleston, 103 S. Ct. 683 (1983), may seem to fall somewhat outside the mainstream of recent restrictive opinions in the area of rule 10b-5. *Huddleston* involved the relationship between the implied remedy under rule 10b-5 and the express remedies under the 1933 Act, a somewhat different question than that posed in the restrictive opinions cited above, each of which addressed the substantive scope or the requisite elements of a rule 10b-5 claim. The Court held in *Huddleston* that the availability of a private express remedy under § 11 of the 1933 Act, 15 U.S.C. § 77k (1976), does not bar availability of an implied private right of action under rule 10b-5. *Id.* at 690.

However, on further analysis, the Court's conclusion in *Huddleston* is not necessarily inconsistent with its recent restrictive rule 10b-5 decisions. In concluding that the remedies in the 1933 and 1934 Acts should be construed cumulatively, the Court relied heavily upon the differences in scope and burden of proof under § 11 of the 1933 Act and rule 10b-5. The Court noted that in the wake of such opinions as Ernst & Ernst v. Hochfelder, a plaintiff suing under rule 10b-5 bears a heavier burden of proof than a plaintiff suing under § 11. *Id.* at 687–88. In light of such differences, the Court reasoned that a cumulative construction of the remedies under § 11 and rule 10b-5 does not present nullification problems. *Id.* at 688–89.

See *infra* text accompanying notes 402–418 for a discussion of why the Court's analysis in *Huddleston* argues against the expanded seller cases examined in this Article, which relax the privity requirement in § 12(2) while still allowing the plaintiff to enjoy the reduced burden of proof available under that section.

The analysis in *Huddleston* can be reconciled with the Supreme Court's otherwise restrictive rule 10b-5 opinions, on the ground that it is the increased burden of proof on a plaintiff under rule 10b-5 which permits a cumulative construction. It is nonetheless true that the language of the Court in *Huddleston* is at times reminiscent of the Court's more expansionist days:

> A cumulative construction of the securities laws also furthers their broad remedial purposes . . . . The effectiveness of the broad proscription against fraud in Section 10(b) would be undermined if its scope were restricted by the existence of an express remedy under Section 11. Yet we have repeatedly recognized that securities laws combating fraud should be construed "not technically and restrictively, but flexibly to effectuate their remedial purposes." We therefore reject an interpretation of the securities laws that displaces an action under Section 10(b).

103 S. Ct. at 689–90 (1983) (citations and footnotes omitted). *See also id.* at 690 n.23 (rejecting the maxim of statutory construction, *expressio unius est exclusio alterius*).

In the wake of the Court's restrictive opinions on the scope of rule 10b-5, section 12(2) merits new attention.[15] The weak stepsister may prove to be a potential Cinderella for defrauded purchasers. When the proof required under section 12(2)[16] is compared with the proof now required under rule 10b-5,[17] it becomes apparent that in those factual situations in which either provision may

15. *See generally* Kaminsky, *supra* note 8.

16. The elements of an express action under § 12(2) arise from the face of the statute. *See supra* note 1 and accompanying text. In summary, a purchaser is entitled to rescission from his seller (or in the event the purchaser no longer owns the security, to a measure of damages equivalent to rescission) if the purchaser can establish that (1) the seller used interstate commerce or the mails, (2) to offer or sell a security to the purchaser, (3) by means of a prospectus or oral communication which misstated or omitted to state a material fact, (4) of which the purchaser did not have knowledge, unless (5) the seller establishes that he did not know, and in the exercise of reasonable care could not have known, of the misstatement or omission. *See generally* Kaminsky, *supra* note 8.

17. In contrast to the express action under § 12(2), the elements of an implied claim under § 10(b) and rule 10b-5 do not all arise from the face of the statute or the text of the rule. They are in large part a product of judicial development and thus have changed over time. After characterizing implied private actions under rule 10b-5 as "a judicial oak which has grown from little more than a legislative acorn," Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975), Justice Rehnquist went on to note:

> [A]s we have pointed out, we are not dealing here with any private right created by the express language of section 10(b) or of Rule 10b-5. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. . . . We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question.

Id. at 748–49.

Volumes have been written on the elements, defenses, and measure of damages applicable to an implied action under rule 10b-5. *See generally* 3 L. LOSS, SECURITIES REGULATION 1448–74, 1763–97 (2d ed. 1961); 3 A. BROMBERG & L. LOWENFELS, *supra* note 11, at §§ 8.1–8.9; 4 *id.* §§ 9.1–9.3, 11.2, 11.5; 5 A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5 §§ 36–40.09 (2d ed. revised 1983).

However, stripped to bare essentials, the requirements most frequently mentioned for proof of an implied claim under rule 10b-5 include the following:

(1) Plaintiff must be a purchaser or seller of a security. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733–34 (1975);

(2) While some early decisions limited the scope of parties defendant by a privity requirement, privity is no longer required. *See* 3 A. BROMBERG & L. LOWENFELS, *supra* note 11, at § 8.5(511). Primary liability extends to violative conduct by "any person." *See* text of rule 10b-5, *supra* note 7. Additionally, a plaintiff can sue persons whose involvement in the violative conduct is only secondary under principles of aiding and abetting or conspiracy. *See generally* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972) (distinguishing primary and secondary liability and discussing the elements of an aiding and abetting and conspiracy claim); *see also infra* notes 318–320 and accompanying text. *But see* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CALIF. L. REV. 80 (1981) (rejecting the viability of secondary liability theories in light of recent Supreme Court decisions strictly interpreting the federal securities laws); Comment, *Rule 10b-5*

be used,[18] section 12(2) offers certain decided advantages to a dis-

Liability after Hochfelder: Abandoning the Concept of Aiding and Abetting, 45 U. CHI. L. REV. 218 (1977);

(3) Plaintiff must establish a violation of one of the three prohibitory subsections of the rule. *See* text of rule 10b-5, *supra* note 7. This most typically takes the form of an allegation that the defendant misstated or omitted to state a material fact. Where plaintiff alleges an omission, silence on the part of the defendant is only actionable if the defendant is under a duty to disclose. *See* Dirks v. SEC, 102 S. Ct. 3255, 3261 (1983); Chiarella v. United States, 445 U.S. 222, 230 (1980). Materiality of the misstated or omitted information is tested according to whether there is a substantial likelihood that a reasonable investor or shareholder would consider the information important in deciding to purchase or sell. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976);

(4) Plaintiff must establish use of interstate commerce, the mails or a facility of a national securities exchange in some part of the transaction. *See* text of rule 10b-5, *supra* note 7;

(5) Plaintiff must establish that the violation of the substantive prohibition of rule 10b-5 was "in connection with the purchase or sale of a security." *See* text of rule 10b-5, *supra* note 7. This "in connection with" language was given its broadest scope during the era of expansive interpretation of rule 10b-5 in Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 12–13 (1971);

(6) Plaintiff must establish reliance. *See* 3 A. BROMBERG & L. LOWENFELS, *supra* note 11, at § 8.6(1). This requirement is relaxed in cases involving omissions by a presumption in favor of reliance upon proof of materiality and a duty to disclose. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128, 154 (1972). Some courts have also relaxed the reliance requirement by allowing a plaintiff to establish reliance on the integrity of the market, as opposed to reliance on the disputed information. *See* Shores v. Sklar, 610 F.2d 235 (5th Cir. 1980), *petition for reh'g en banc granted*, 617 F.2d 441 (5th Cir. 1980), *vacated and remanded*, 647 F.2d 462, 469–70 (5th Cir. 1981), *cert. denied*, 455 U.S. 936 (1983); Panzirer v. Wolf, 663 F.2d 365 (2d Cir. 1981), *cert. denied*, 458 U.S. 1107 (1982); Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). *See generally* Rapp, *Rule 10b-5 and "Fraud-on-the-Market"—Heavy Seas Meet Tranquil Shores*, 39 WASH. & LEE L. REV. 861 (1982); Note, *The Fraud-on-the-Market Theory*, 95 HARV. L. REV. 1143 (1982);

(7) Plaintiff must establish scienter on the part of the defendant, *i.e.*, a mental state embracing intent to deceive, manipulate, or defraud. A showing of negligence is insufficient. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The Supreme Court left open the question of whether reckless conduct may subject a defendant to liability in this context. *Id.* at 193–94 n.12. In the wake of *Hochfelder*, numerous courts have held that reckless behavior is sufficient for liability. *See* 3B H.S. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 9.21 [4][f] (1983).

18. Section 10(b) applies on its face to the purchase or sale of any security whether or not registered on a national securities exchange. *See* text of § 10(b), *supra* note 5. This would encompass securities sold by an issuer in a primary distribution, whether or not such securities are registered under the 1933 Act. *See, e.g.*, Herman & MacLean v. Huddleston, 103 S. Ct. 683 (1983), which upheld the existence of an implied claim under rule 10b-5 for alleged fraud in a registration statement, notwithstanding the express remedy for fraud in registration statements provided by § 11 of the 1933 Act, 15 U.S.C. § 77k (1976). Section 10(b) and rule 10b-5 also encompass secondary resales of securities, whether traded on a national securities exchange, in the over-the-counter securities market, or in a private transaction involving the securities of a closely-held corporation. *See generally* R. JENNINGS & H. MARSH, SECURITIES REGULATION 809–10 (5th ed. 1982).

Except for securities covered by § 3(a)(2) of the 1933 Act, 15 U.S.C. § 77c(a)(2) (1976), which are specifically exempted from the reach of § 12(2), § 12(2) on its face applies to the offer or sale of any security. *See* text of § 12(2), *supra* note 1. Thus, satisfied purchaser.[19]

In contrast to rule 10b-5, a purchaser in a section 12(2) action does not have to prove that he relied upon the misstatement or omission in question in making his purchase.[20] A section 12(2) plaintiff is only required to establish that he lacked actual knowledge of the misstatement or omission.[21]

Perhaps more significantly, a plaintiff in an action under section 12(2) does not bear the onus of establishing scienter on the part of the defendant as is now required for a successful 10b-5 claim.[22] The purchaser in a section 12(2) action is relieved of any

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subject to this exception and limited to the sales side of a transaction, § 12(2) is coextensive in coverage with rule 10b-5 in terms of applying to both primary distributions of securities, whether or not registered under the 1933 Act, and secondary resales of securities, whether traded on a national securities exchange, in the over-the-counter securities market, or in a private transaction involving the securities of a closely held corporation.

At least one commentator, however, has questioned whether § 12(2) does in fact cover the aftermarket. *See* Steinberg, *The Propriety and Scope of Cumulative Remedies under the Federal Securities Laws*, 67 CORNELL L. REV. 557, 585 n.179 (1982); Steinberg, *Section 17(a) of the Securities Act of 1933 after* Naftalin *and* Redington, 68 GEO. L. J. 163, 180 (1979). Pointing to the holding in United States v. Naftalin, 441 U.S. 768 (1979) (§ 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976), applies to aftermarket trading), Steinberg queries whether or not the Supreme Court's characterization of § 17(a) as a major departure from the 1933 Act's regulation of initial offerings suggests that § 12(2) applies only to initial distributions. However, the commentator ultimately concludes that the plain language of the statute, coupled with the weight of judicial and scholarly authority, argues against such a construction.

While § 12(2), like § 10(b) and rule 10b-5, potentially applies to both primary distributions and secondary resales, this Article advocates a return to a relatively strict privity requirement for § 12(2), and therefore impacts on the ultimate availability of § 12(2), as compared with rule 10b-5, which does not require privity. For example, in a primary distribution undertaken through a firm commitment underwriting, a strict privity approach to § 12(2) limits each link in the distributive chain to a § 12(2) claim only against his immediate seller. *See* 3 L. Loss, *supra* note 17, at 1719–20. *See, e.g.*, Unicorn Field, Inc. v. Cannon Group, Inc., 60 F.R.D. 217, 222–23 (S.D.N.Y. 1973); Kramer v. Scientific Control Corp., 365 F. Supp. 780, 791 (E.D. Pa. 1973); Dorfman v. First Boston Corp., 336 F. Supp. 1089, 1091–93 (E.D. Pa. 1972). Similarly, while § 12(2) can reach a secondary resale, the privity requirement would undercut its availability in open market purchases since it is usually impossible to trace the actual seller in such transactions. *See* Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 664 (1978). *See, e.g.*, DuPont v. Wyly, 61 F.R.D. 615, 625 (D. Del. 1973).

19. *See infra* text accompanying notes 20–25.

20. *See, e.g.*, Wigand v. Flo-Tek, Inc., 609 F.2d 1028, 1034 (2d Cir. 1980); Alton Box Bd. Co. v. Goldman, Sachs, & Co., 560 F.2d 916, 923 (8th Cir. 1977); Woodward v. Wright, 266 F.2d 108, 116 (10th Cir. 1959). *See generally* 3 L. Loss, *supra* note 17, at 1702–04; *id.* at 3832; Kaminsky, *supra* note 8, at 264–66.

21. *See* text of § 12(2), *supra* note 1. *See generally* Kaminsky, *supra* note 8, at 266–74.

22. *See, e.g.*, Franklin Sav. Bank of New York v. Levy, 551 F.2d 521, 526–27, 529 (2d Cir. 1977); Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1219 (D. Md. 1968), *aff'd in part and rev'd in part on other grounds*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974).

burden of introducing evidence regarding the seller's state of mind.[23] Rather, this burden is allocated to the defendant seller who will be held liable unless he establishes by way of affirmative defense that he did not know, and in the exercise of reasonable care could not have known, of the misstatement or omission.[24] Section 12(2) thus imposes liability on a seller for negligence, a clearly insufficient degree of culpability for liability under rule 10b-5 after the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*.[25]

A defrauded purchaser in a section 12(2) action does face one substantive hurdle not present in a rule 10b-5 claim.[26] This hurdle is the privity requirement arising from the express language of section 12(2), which on its face significantly limits the reach of the statute with respect to potential defendants.[27]

In pertinent part section 12(2) provides as follows:

> Sec. 12 Any person who—
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> . . . .
>
> (2) offers or sells a security . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, upon the tender of such security, or for damages if he no longer owns the security.[28]

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23. Wilko v. Swan, 346 U.S. 427, 431 (1953).

24. *See, e.g.*, Woodward v. Wright, 266 F.2d 108, 116 (10th Cir. 1959); Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1219 (D. Md. 1968), *aff'd in part and rev'd in part on other grounds*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974); Gould v. Tricon, 272 F. Supp. 385, 392–93 (S.D.N.Y. 1967). *See generally*, Kaminsky, *supra* note 8, at 275–78.

25. 425 U.S. 185 (1976). See *supra* note 17 for a discussion of the holding in *Hochfelder*.

26. In addition to the substantive hurdle of privity with which this Article deals, a plaintiff in a § 12(2) action encounters two procedural requirements not encountered in a rule 10b-5 claim. First, a § 12(2) plaintiff is subject to the statute of limitations found in § 13 of the 1933 Act, 15 U.S.C. § 77m (1976) (action must be brought within one year of discovery of the false statement or omission or after discovery should have been made, but in no event more than three years after the sale). This imposes a shorter period of time in many cases than the periods adopted by courts under state statutes of limitation for purposes of implied private actions under rule 10b-5. For a discussion of applicable statutes of limitation in the context of implied actions under rule 10b-5, see 5C A. JACOBS, *supra* note 17, at § 235.02. Second, a § 12(2) plaintiff is subject to the provision in § 11(e) of the 1933 Act, 15 U.S.C. § 77k(e) (1976), under which a court may require an undertaking for the payment of costs, including attorney's fees, or may award such costs to a successful litigant in the event the suit or defense is found to be without merit. Section 11(e) does not relate to implied claims under rule 10b-5. *See generally* 5C A. JACOBS, *supra* note 17, at §§ 293–94, 302.02, regarding security for expenses and costs and availability of attorney's fees in implied actions under rule 10b-5.

27. 15 U.S.C. § 77*l*(2) (1976). For the full text of § 12(2), *see supra* note 1.

28. *Id.*

Except as expanded by the controlling persons provision in section 15,[29] the language of section 12(2) and the rescissory nature of the remedy which it affords seem to contemplate recovery by a purchaser only from his immediate seller.[30]

Under a variety of rationales, a significant number of lower federal court opinions have eroded this privity requirement.[31] Faced with conceptual barriers to the development of secondary liability theories such as are used in the context of rule 10b-5, numerous federal courts have expanded the concept of who may be primarily liable as a seller under section 12(2) to include not only the plaintiff's immediate vendor, but also various collateral participants in a sale.[32]

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29. 15 U.S.C. § 77o (1976) [hereinafter cited as section 15]. Section 15 reads:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Id.

Section 15 as originally enacted contained no defense. H.R. Rep. No. 152, 73d Cong., 1st Sess. 26 (1933). When the 1934 Act was passed, an amendment to § 15 added the defense. Pub. L. No. 73-291, 48 Stat. 908 (1934).

30. *See* text of § 12(2), *supra* note 1. Cases which support this strict interpretation of the privity requirement include Collins v. Signetic Corp., 605 F.2d 110, 113-14 (3d Cir. 1979); Benoay v. Decker, 517 F. Supp. 490, 494 (E.D. Mich. 1981); Kramer v. Scientific Control Corp., 452 F. Supp. 812, 814 (E.D. Pa. 1978); Federman v. Empire Fire and Marine Ins. Co., [1974–1975 Transfer Binder] FED. SEC. L. REP. [CCH] ¶ 94,822 at 96,751 (S.D.N.Y. Oct, 17, 1974); Kramer v. Scientific Control Corp., 365 F. Supp. 780, 791 (E.D. Pa. 1973); Unicorn Field, Inc. v. Cannon Group, Inc., 60 F.R.D. 217, 222 (S.D.N.Y. 1973); Dorfman v. First Boston Corp., 336 F. Supp. 1089, 1091-93 (E.D. Pa. 1972); American Bank & Trust Co. v. Joste, 323 F. Supp. 843, 846 (W.D. La. 1970); Barlas v. Bear, Stearns & Co., [1964-1966 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,674 at 95,477 (N.D. Ill. March 31, 1966); Winter v. D.J. & M. Inv. and Constr. Corp., 185 F. Supp. 943, 946–47 (S.D. Cal. 1960).

31. *See generally* Phillips and Hanback, *Remedies for Defrauded Purchasers*, 12 REV. SEC. REG. 953 (1979); Rapp, *Expanded Liability under Section 12 of the Securities Act: When Is a Seller Not a Seller?*, 27 CASE W. RES. L. REV. 445 (1977); Comment, *Secondary Liability under Section 12(2) of the Securities Act of 1933*, 78 NW. U.L. REV. 832 (1983); Note, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause—Substantial Factor Approach Limited by a Duty of Inquiry*, 36 VAND. L. REV. 361 (1983); Comment, *Attorneys and Participant Liability under § 12(2) of the Securities Act of 1933*, 1982 ARIZ. ST. L.J. 529 (1982); Note, *Securities Regulation—Corporate Attorney Who Actively Negotiated Merger Transaction Held a "Seller" Within Scope of Section 12(2) of the Securities Act of 1933—* Junker v. Crory, *650 F.2d 1349 (5th Cir. 1981)*, 55 TEMP. L.Q. 528 (1982); Note, *An Expanded View of Section 12(2) Liability:* Junker v. Crory, 1982 B.Y.U. L. REV. 991 (1982).

32. The cases which relax the privity requirement by expanding the concept of who besides the immediate vendor may be deemed a seller for purposes of primary liability under § 12(2) are treated *infra* in Sections I and II of this Article, and are

The earliest decisions in this vein held that brokers acting on behalf of principals could be liable as sellers because the statutory definition of the operative term "sell" encompassed actions which could be taken by someone other than the vendor of the security.[33] Later decisions abandon any pretext of statutory definition as the touchstone of their analysis and develop a number of different tests for holding collateral participants primarily liable as section 12(2) sellers. While these tests vary in formulation, each test focuses in some way on the role of the collateral participant in facilitating the sales transactions.[34] Moving full circle, a number of recent opinions, instead of expanding the definition of who may be primarily liable as a section 12(2) seller, use secondary liability theories of aiding and abetting and conspiracy in a section 12(2) action to reach collateral participants in a sale.[35]

The cases expanding the concept of who may be primarily liable as a section 12(2) seller and the cases embracing theories of secondary liability significantly broaden the potential reach of section 12(2). Both lines of authority circumvent the privity requirement and widen the circle of potential defendants in a section 12(2) action. They thus sidestep the principal substantive restriction which constrains the scope of section 12(2) as compared with rule 10b-5. Moreover, the expanded seller decisions accomplish

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sometimes collectively referred to herein as the "expanded seller cases" or the "expanded seller decisions."

33. *See infra* notes 36–100 and accompanying text (the brokerage cases).

34. *See infra* notes 113–185 and accompanying text (the participation theory); notes 186–290 and accompanying text (the proximate cause theory); notes 291–314 and accompanying text (the Eighth Circuit theory). The cases decided under these three theories are sometimes collectively referred to in this Article as the "facilitation cases" or the "later expanded seller decisions," as distinct from the brokerage cases.

35. *See infra* notes 318–350 and accompanying text. A helpful definitional distinction between primary and secondary liability is offered in Ruder, *supra* note 17, at 600:

> In most multiple defendant securities law suits some of the defendants will be primarily engaged in the wrongdoing, while others will be engaged only in a secondary fashion . . . . [P]ersons owing direct duties to the public will be classified as primary wrongdoers. Those whose liabilities arise only because another has violated the law will be called secondary wrongdoers.

Id.

"Secondary liability" is used throughout this Article to refer to judicially-implied civil liability imposed under theories of aiding and abetting and conspiracy upon secondary wrongdoers, as distinct from the statutory secondary liability expressly imposed on controlling persons under § 15 of the 1933 Act, 15 U.S.C. § 77o (1976), and § 20(a) of the 1934 Act, 15 U.S.C. § 77t(a) (1976). *See* Fischel, *supra* note 17, at 80 n.4.

The cases which relax the privity requirement in § 12(2) by embracing theories of secondary liability are discussed *infra* in Section III of this Article and are sometimes collectively referred to herein as the "secondary liability opinions," in contrast to the expanded seller cases. *See supra* note 32.

this while at the same time allowing the plaintiff to enjoy the reduced burden of proof available under section 12(2).

With the possible exception of the early brokerage decisions, however, the analysis of section 12(2) contained in the expanded seller cases and secondary liability opinions fails when examined under the tenets of statutory construction used by the present Supreme Court. The precise statutory language of section 12(2) and the rescissory nature of the remedy provided therein support a relatively strict privity requirement. There is no evidence of specific legislative intent to argue for a more expansive approach. Moreover, an expansive approach does not support a construction of section 12(2) consistent with its place in the statutory framework of antifraud provisions.

This Article examines the origin, development, and varying rationales of the expanded seller cases and the secondary liability opinions under section 12(2). It then analyzes these decisions under the principles of statutory interpretation used by the present Supreme Court. It concludes that while it may be tempting to relax the privity requirement of section 12(2) in order to recoup for purchasers some of the ground lost under the now tightened rule 10b-5, such an approach is an unwarranted extension of the statute.

I. Early Inroads on the Privity Requirement: The Brokerage Decisions

The first incursion on the section 12(2) privity requirement came in cases in which a dissatisfied purchaser sued a broker or other selling agent in lieu of, or in addition to, suing the actual principal.[36] These cases rejected contentions on the part of the

36. *See, e.g.*, Katz v. Amos Treat & Co., 411 F.2d 1046, 1052–53 (2d Cir. 1969) (judgment dismissing complaint under § 12(1) of the 1933 Act, 15 U.S.C. § 77*l*(1) (1976) and under § 12(2) reversed; claim stated against brokerage firm and the individual defendants affiliated with the firm under the analysis of Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940), *infra* notes 39–61 and accompanying text; claim stated against defendant attorney under participation theory, *infra* notes 154–172 and accompanying text); Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1209 (D. Md. 1968), *aff'd in part, rev'd in part on other grounds*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974) (summary judgment under § 12(2) entered against brokerage firm under analysis of Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940), discussed *infra* notes 39–61 and accompanying text); Wall v. Wagner, 125 F. Supp. 854 (D. Neb. 1954), *aff'd sub nom.* Whittaker v. Wall, 226 F.2d 868 (8th Cir. 1955) (judgment under § 12(1) of the 1933 Act entered against selling corporation as principal and against corporate president and a selling agent of the corporation as agents of the seller under analysis of Cady v. Murphy, *infra* notes 39–61 and accompanying text; however, in *Whittaker*, liability of the corporate president is discussed at the appellate level in terms of his status as a control person under § 15 of the 1933 Act, 15 U.S.C. § 77o (1976), rather than in terms of his status as the

broker-agents that they could not be liable under section 12 because they had not functioned as principals selling for their own accounts.[37] While several courts have reached this result,[38] the first case to consider the question offers the most extensive exposition of the analysis involved.

In *Cady v. Murphy*[39] the plaintiff, Murphy, was a small securities broker in Maine. Rhoades & Company, a brokerage firm with whom Murphy had dealt extensively in the past, contacted Murphy. The head trader, Lynch, knew that Murphy was interested in a stock with some speculative possibilities. Lynch apprised Murphy of an investment opportunity in South American Utilities Corporation. During several telephone conversations, Lynch made a number of favorable but false statements about the company to Murphy.[40]

Following these conversations, Murphy purchased voting trust certificates for common stock in South American Utilities Corporation from E.E. Smith & Company, a small unlisted dealer in New York. The purchase was effected through Rhoades & Company, which collected a brokerage commission on the transaction.[41]

The certificates proved to be without substantial value, and

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seller's agent); Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 311 U.S. 705 (1940).

37. *See supra* note 36.

38. *See supra* note 36.

39. 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940).

40. 113 F.2d at 989–90.

41. 30 F. Supp. at 467–68, 113 F.2d at 989–90. There was some conflict in the testimony with respect to whether or not Rhoades & Company functioned as a principal in the transaction, as agent for the seller E.E. Smith & Company, as agent for the buyer Murphy, or as a dual agent. Murphy sought to prove that Rhoades & Company purchased the shares in issue for its own account from E.E. Smith & Company and then resold the shares to him as principal. In contrast, Lynch testified that E.E. Smith & Company contacted him and asked him if he could find a buyer for the stock. He in turn contacted Murphy and quoted to Murphy the market price of the stock. Murphy asked if the stock could be obtained any cheaper, and Lynch indicated that he would try. Lynch testified that he told Murphy that if he was going to buy the stock for Murphy, he would act as an agent in the transaction. The two then agreed upon a commission. 113 F.2d at 990.

The district court chose not to resolve the conflict in evidence, finding that the stock was sold to Murphy by Rhoades & Company either as owner or as broker. 30 F. Supp. at 467. The court found the evidence insufficient to establish that Rhoades & Company sold the stock as principal, and stated that Murphy could only recover if § 12 also applied to brokers when selling securities owned by others. *Id.* at 469. This statement suggested that the court would expand the concept of seller to include a seller's agent, or perhaps a dual agent, but not the buyer's broker. However, the court went on to state that it was immaterial whether a broker functioned as a principal, as an agent for the owner, as an agent for the purchaser, or as a dual agent. If, in the course of soliciting an offer to buy, the broker made a false statement under the cir-

Murphy attempted to tender them back to Rhoades & Company. When the firm refused the tender, Murphy sold the securities at a loss. Murphy sued Rhoades & Company and included a section 12(2) count in his complaint.[42]

The district court found that Lynch had effected the sale by misrepresentation of material facts. It further found that Rhoades & Company had not sustained the burden of proving that Lynch did not know, and in the exercise of reasonable care could not have known, of the falsity.[43] The court then focused on the contentions of Rhoades & Company with respect to the privity requirement.

The brokerage firm argued that section 12(2) applied only to principals selling their own property and that Rhoades & Company did not fall within this category.[44] The firm contended that

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cumstances described in § 12, the district court felt the purchaser had a right to recover. *Id. See infra* text accompanying note 51.

At the appellate level the majority opinion noted the conflict in evidence but found the district court's opinion broader than necessary to support the judgment. The appellate court stated that even in Lynch's version of the transaction, Rhoades & Company was either an agent for the seller or a dual agent. The court concluded that in either case § 12(2) was applicable. 113 F.2d at 991. However, the appellate court found extraneous the reference in the district court opinion to liability of a broker acting solely for a purchaser. It chose not to address whether § 12(2) would be applicable to such a broker if the broker made a misrepresentation in the course of soliciting an order to buy from the purchaser. *Id.* The dissenting opinion argued that the evidence supported a finding that the brokerage firm had functioned solely as an agent for the buyer and, as such, was not a "seller" for purposes of § 12(2). *Id.*

Relying on the district court opinion in *Cady*, a state court has held that a buyer's broker could be liable under § 12(2) for misrepresentations in solicitation of an order to buy. Boehm v. Granger, 181 Misc. 680, 42 N.Y.S.2d 246 (N.Y. Sup. Ct. 1943), *aff'd mem.*, 268 A.D. 855, 50 N.Y.S.2d 845 (N.Y. App. Div. 1944).

42. 30 F. Supp. at 467, 113 F.2d at 990. Murphy's complaint also included a common law count for deceit. The district court found that this count was not sustained by the evidence since Murphy failed to establish that he could not have discovered the falsity of the representations by the exercise of reasonable care. 30 F. Supp. at 468. Such proof is not required for recovery under § 12(2). *See* Kaminsky, *supra* note 8, at 266.

For a discussion of these and other differences between § 12(2) and the common law remedies of deceit and rescission, see generally 3 L. Loss, *supra* note 17, at 1626-28, 1700-05.

43. 30 F. Supp. at 468. There is some ambiguity in the district court's opinion as to Lynch's state of mind with respect to the statements made. Lynch testified that he believed the favorable statements were true when he made them. However, the court did note that another member of the firm referred to the stock as "junk" at about the same time as it was sold. *Id.*

The court pointed out that it was not necessary to prove knowing falsity to sustain an action for fraud. Recklessness would suffice. In any event, the court noted that with respect to the § 12(2) count, the seller bears the burden of establishing that in the exercise of due care he could not have known of the falsity. This the brokerage firm failed to do. *Id.* Thus, it appears that at a minimum the district court found Lynch negligent.

44. 30 F. Supp. at 469.

the express language of section 12(2) mandated this construction. It argued that the term "selling" imports ownership and that the language in section 12(2), imposing a liability upon the seller "to the person purchasing such security from him," referred to "a transaction involving a transfer of title from one person to another."[45]

Noting that the question was one of first impression, the district court conceded that it could find nothing in the legislative history of section 12(2) which addressed this issue.[46] However, it felt that a consideration of the language in other sections of the 1933 Act, coupled with the known purpose of Congress in passing the 1933 Act, dictated against the narrow construction proferred by the brokerage firm.[47]

In determining whether Rhoades & Company had sold the securities in question to Murphy, the district court said that it was not helpful to focus on the ordinary meaning of the term "sell." Rather, it was necessary to focus on the definition and special significance ascribed to that term in section 2(3) of the 1933 Act.[48] The court noted that this definition then included "every . . . attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."[49] The court reasoned that the word, viewed in this context, encompassed activities

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45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* In pertinent part § 2(3) provides:

> Sec. 2. When used in this subchapter, unless the context otherwise requires . . .
> (3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell," "offer for sale," or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

15 U.S.C. § 77b(3) (1976) [hereinafter referred to as section 2(3)].

49. 30 F. Supp. at 469. At the time § 12(2) was originally enacted and at the time *Cady* was decided, § 12(2) was prefaced "[a]ny person who . . . sells" and § 2(3) defined "sell" in the aggregate to include both offers and sales ("The terms 'sale,' or 'sell,' 'offer to sell' or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy a security or interest in a security for value." 15 U.S.C. § 77b(3) (1934)).

In 1954, § 2(3) was amended to its current form to redefine the term "sell" so as to distinguish between offers and sales. Act of Aug. 10, 1954, Pub. L. No. 577, § 1, 68 Stat. 687 (1954). *See* current text of § 2(3), *supra* note 48. This was done to complement changes made in § 5 of the 1933 Act, 15 U.S.C. § 77e (1976), permitting certain offers to be made after a registration statement has been filed but before it becomes effective. Since the term "sell" was redefined in § 2(3) to separate offers from sales, the prefatory language of § 12(2) was amended at the same time to its current form to insert the words "offers or" before the word "sells." Act of Aug. 10, 1954, Pub. L. No. 577, § 9, 68 Stat. 687 (1954). *See* current text of § 12(2), *supra* note 1. The committee reports commenting on the 1954 amendments indicate that this change in § 12(2) was merely a formal amendment to preserve existing law in light of the restructuring of which may be carried on by persons other than the owner of the security itself.[50]

Reading the definition of "sell" in section 2(3) back into section 12(2), the court concluded:

> Whether the seller, being a broker, himself owns the security, or whether he is acting as the agent for the owner, or for the purchaser, or for both, is immaterial. If, in the course of an attempt to dispose of, or solicitation of an offer to buy a security, he makes false statements under circumstances referred to in Section 12, the purchaser is given a right of action to recover any damages he has suffered on account of the false representations.
>
> The ordinary brokerage transaction, merely the execution of orders to buy or sell, does not appear to be affected by Section 12. It is the extra-brokerage activity—solicitations accompanied by false statements—which are made the basis for a cause of action if damage is caused thereby.[51]

In affirming the decision of the district court, the First Circuit stated that it agreed with the trial court's conclusion that section 12(2) could be interpreted as imposing liability for misrepresentations not only upon principals, but also upon brokers selling securities owned by others.[52] It accepted the district court's analysis that in view of the broad definition of "sell" in section 2(3), the solicitation by Rhoades & Company of an offer to buy from Murphy brought the brokerage firm within the meaning of "person who sells a security" for purposes of section 12(2).[53] Moreover, it stated that if Rhoades & Company, though not selling its own property, was a "person who sells a security," it necessarily followed that Murphy was the "person purchasing such security from him" for purposes of the corresponding phrase in section 12(2).[54]

Unlike the district court, the First Circuit found it appropriate to give some consideration to the ordinary meaning of the word "sell."[55] The court reasoned that its conclusion that a broker acting for a principal could be a statutory seller for purposes of section 12(2) did not strain interpretation of the statute since in common parlance a selling agent would describe himself as a "person who sells" even though the principal conveys legal title.[56]

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the definition of "sell" in § 2(3). *See* H.R. Rep. No. 1542, 83d Cong., 2d Sess. 26 (1954); S. Rep. No. 1036, 83d Cong., 2d Sess. 18 (1954).

50. 30 F. Supp. at 469.
51. *Id.* at 469–70.
52. 113 F.2d at 990.
53. *Id.* at 990–91.
54. *Id.* at 990.
55. *Id.*
56. *Id.* The court also felt that a comparison of § 12(1) of the 1933 Act, 15

In a final effort to escape liability through a privity argument, Rhoades & Company argued before the court of appeals that the nature of the remedy provided by section 12(2) limited the scope of liability to principals and precluded recovery against an agent.[57] The brokerage firm pointed out that the relief provided by section 12(2) is essentially rescissory in nature. Since rescission contemplates restoration of the status quo between principals to a transaction, the firm contended that Congress could not have intended to provide such relief against an agent of the seller.[58]

The First Circuit rejected this argument.[59] The court noted that the statute neither used the word "rescission" per se nor indicated that the remedy was limited to rescission in the strict sense of recovery between principals.[60] The court saw no difficulty in applying the statutory remedy to an agent. The court simply stated that having effected a sale by misrepresentations, the agent was required to take the securities from the defrauded buyer and restore the buyer's consideration.[61]

U.S.C. § 77*l*(1) (1976), with § 12(2) reinforced its conclusion that a broker could be liable as a "seller" when selling securities owned by others. *Id.* at 990-91. Section 12(1) provides a purchaser with a rescissory remedy against a seller for securities sold in violation of the registration requirements in § 5 of the 1933 Act, 15 U.S.C. § 77e (1976). Section 12(1) has the same prefatory language with respect to scope of parties defendant, and the same concluding language making the seller liable to the person purchasing from him for a rescissory measure of relief, as does § 12(2).

The court hypothesized that if Rhoades & Company had sold the securities at issue to Murphy without a registration statement, the firm would have been guilty of selling securities in violation of § 5. The court then reasoned that Rhoades & Company, as a person who sold a security in violation of § 5, would be liable to Murphy under § 12(1). Since the operative prefatory language with respect to the scope of parties defendant in both § 12(1) and § 12(2) is the same, the court concluded that if Rhoades & Company could be liable as a seller under § 12(1), that language must mean the same thing in § 12(2). 113 F.2d at 990–91.

However, the court's reasoning in this regard is circular. The court's analogy to § 12(1) assumes as its premise, without authority, the very question in issue—i.e., whether Rhoades & Company would be deemed to have "sold" the securities in violation of § 5 for purposes of liability under § 12(1) where it acted as a broker rather than as a principal.

Admittedly, a broker may be liable in an enforcement context for offering or selling a security in violation of § 5. However, it does not automatically follow that a broker should therefore be liable in an express cause of action under § 12(1). The concluding language in both subsections of § 12 makes the person who offers or sells the security in issue liable to the person purchasing such security from him for a rescissory measure of relief. This language, which is not present in violation provisions such as § 5, arguably establishes a context which circumscribes the terms "offer" and "sell" as used in § 12 to the immediate vendor. *See infra* notes 63–92 and accompanying text.

57. 113 F.2d at 991.

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* The court noted that even apart from the statute there was some common law authority for granting rescission against the agent of a vendor. *Id.*, citing Peter-

Cady v. Murphy is a seminal opinion with respect to the privity requirement in section 12(2). In concluding that brokers functioning as agents may be liable as sellers under section 12(2), the decision carves out a small exception to the general rule that section 12 contemplates an action by a purchaser only against his immediate seller.[62] However, even the relatively narrow confines of the opinion are not without some analytical problems.

No one would quarrel with the conclusion of the trial and appellate courts in *Cady* that a broker who solicits an offer to buy engages in an activity which falls within section 2(3). The definition of "offer" now set forth in section 2(3) admittedly includes solicitation, which is an activity not inherently confined to the actual owner of a security.[63]

However, determining that the activity in question falls within the definition of "offer" or "sell" in section 2(3) is only half of the necessary analysis. The definitions in section 2 of the 1933 Act are preceded by the proviso "unless the context otherwise requires".[64] Thus, courts must apply the definition to the defined term and then examine the defined term in the context in which it appears within a particular provision.[65]

For example, section 5 of the 1933 Act[66] bars any person from offering or selling a security except in compliance with the registration requirements of the 1933 Act.[67] Applying the defini-

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son v. McManus, 187 Iowa 522, 525, 172 N.W. 460 (Iowa 1919). *But see infra* notes 79-92 and accompanying text.

62. *See* cases cited *supra* note 30 supporting the strict privity approach.

63. *See* text of § 2(3), *supra* note 48.

64. 15 U.S.C. § 77b (1976). Professor Loss characterizes this prefatory phrase as an explicit reminder of a tenet of statutory construction which should always be implicit in any event. 4 L. Loss, *supra* note 7, at 2485 (Supp. to 2d ed. 1969).

65. *See generally id.*:

> It is no new idea that "[t]he same words may have different meanings in different parts of the same act . . . ." Holmes, J. in Lamar v. United States, 240 U.S. 60, 65 (1916). "It is not unusual for the same word to be used with different meanings in the same act, and there is no rule of statutory construction which precludes the courts from giving to the word the meaning which the legislature intended it should have in each instance." Atlantic Cleaners & Dyers, Inc. v. United States, 286 U.S. 427, 433 (1932).

66. 15 U.S.C. § 77e (1976) [hereinafter referred to as section 5].

67. Section 5(a)(1), 15 U.S.C. § 77e(a)(1) (1976), prohibits any person from using interstate commerce or the mails to sell a security by prospectus or otherwise unless a registration statement is effective. Section 5(a)(2), 15 U.S.C. § 77e(a)(2) (1976), prohibits any person from carrying a security through interstate commerce or the mails for the purpose of sale or delivery unless a registration statement is effective. Section 5(b)(1), 15 U.S.C. § 77e (b)(1) (1976), prohibits any person from using interstate commerce or the mails to carry a prospectus relating to a security with respect to which a registration statement has been filed, unless the prospectus meets the requirements of § 10, 15 U.S.C. § 77j (1976). Section 5(b)(2), 15 U.S.C. § 77e(b)(2) (1976), prohibits any person from carrying a security through interstate commerce or the mails for sale

tions in section 2(3) to section 5, it is clear that brokers and others besides the actual vendor of a security may violate the prohibitions against offers and sales in section 5 if they engage in solicitation activities which do not comply with the registration process and if they do not have an applicable exemption.[68] To the extent they commit such violations, they may be subject to enforcement action by the Securities and Exchange Commission (SEC) or to criminal prosecution by the Justice Department under other provisions of the 1933 and 1934 Acts.[69]

Three factors support this conclusion: (1) section 5 prohibits any person from offering or selling a security except in compliance with the registration requirements of the 1933 Act; (2) unless the context otherwise requires, section 2(3) defines "offer" to include any solicitation of an offer to buy; and (3) no other language in section 5 establishes a context limiting the manner in which "offer" or "sell" is used so as to exclude solicitation by any person.

However, when applying the statutory definitions in section 2(3) within the context of the express cause of action in section 12, certain operative language appears which is not present in violation provisions such as section 5.[70] This language modifies the words "[a]ny person who . . . offers or sells" as used in section 12(2) and may well limit the context in which those terms are used.

Stripped to its essentials, section 12(2) makes "[a]ny person . . . who offers or sells a security" under the circumstances described therein liable to the "person purchasing such security from him, who may sue . . . to recover the consideration paid . . . ."[71]

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unless it is preceded or accompanied by a § 10(a) prospectus. Finally, section 5(c), 15 U.S.C. § 77e(c) (1976), prohibits any person from using interstate commerce or the mails to offer to sell or to offer to buy any security by prospectus or otherwise, unless a registration statement has been filed.

68. *See, e.g.*, Ned J. Bowman Co., 39 S.E.C. 879 (1960). In *Bowman* the SEC obtained a civil injunction against a broker-dealer firm and subsequently revoked its registration for willful violation of § 5. The broker-dealer firm functioned as best efforts underwriter in an unregistered public offering, for which the broker-dealer firm was unable to establish availability of an intrastate offering exemption under § 3(a)(11) of the 1933 Act, 15 U.S.C. § 77c(a)(11) (1976).

69. *Id.* Section 24 of the 1933 Act, 15 U.S.C. § 77x (1976), imposes criminal penalties upon any person convicted of willfully violating any provision of the 1933 Act. The SEC has authority under § 20(b) of the 1933 Act, 15 U.S.C. § 77t(b) (1976), to commence an action in the appropriate district court to enjoin any person engaged in or about to engage in any act or practice which constitutes a violation of the 1933 Act. Finally, pursuant to §§ 15(b)(1) and 15(b)(4) of the 1934 Act, 15 U.S.C. §§ 78o(b)(1)-(4) (1976), the SEC is empowered after an appropriate hearing to deny or revoke registration of a broker or dealer for willful violation of any provision of the 1933 or 1934 Acts. *See generally* 3A H. BLOOMENTHAL, *supra* note 17, at §§ 8.01-8.03.

70. Compare text of § 12(2), *supra* note 1, with summary of § 5, *supra* note 67.

71. *See* text of § 12(2), *supra* note 1.

When the defined terms "offer" and "sell" are examined in the context in which they appear in section 12(2), this latter modifying language, which is not present in violation provisions such as section 5, can be interpreted as circumscribing the term "[a]ny person who . . . offers or sells" as used in section 12(2) to the plaintiff's immediate vendor.[72]

Admittedly, section 12(2) begins with language encompassing any person who either offers or sells, and unless the context otherwise requires, section 2(3) defines "offer" to include solicitation of an offer to buy and other attempts at disposition which can be performed by non-vendors. The point is that the language of section 12(2) taken in its entirety establishes a "context which otherwise requires." The closing language of section 12(2) rendering the defendant liable to the "person purchasing such security from him" for a rescissory measure of relief limits the breadth of the opening language "[a]ny person who . . . offers or sells" to those situations in which a sale has taken place and confines the scope of parties defendant to the plaintiff's immediate vendor.[73] So construed, only the immediate vendor falls within the reach of a private express action under section 12(2), in contrast to the broader reach of an enforcement or criminal action for violation of a section in which "[a]ny person who . . . offers or sells" is used without the remaining language of section 12(2).[74]

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72. *See supra* note 56.

73. *See supra* note 56. Admittedly, the fact that the opening language of § 12(2) reads disjunctively, "Any person who . . . *offers or sells*" (emphasis added), presents a problem to this interpretation. However, the closing language of § 12(2) clearly supports such a construction.

Commenting on this problem, one commentator has remarked:

> [W]hile the statute expressly includes either an offer or sale, there appears to be no case involving a mere offer . . . . The fact that the statute then goes on to talk of liability "to the person purchasing such security," and especially that it provides only a rescission remedy, would appear to indicate that Congress intended that a sale must have taken place . . . . Nevertheless, the statute does say "offer."

Kaminsky, *supra* note 8, at 253–54.

See also Comment, *Attorneys and Participant Liability under § 12(2) of the Securities Act of 1933*, *supra* note 31, at 533–34, in which the student author argues from the legislative history that the term "offer" is intended to bring pre-sale activities of the seller within the scope of the statute, and is not intended to expand the class of persons considered sellers as interpreted by the *Cady* court.

74. The thesis that the phrase "Any person who . . . offers or sells" may be construed differently within different sections of the 1933 Act finds some general support in the language of the Supreme Court in SEC v. National Securities, Inc., 393 U.S. 453, 465–68 (1969). In that case the Supreme Court rejected the defendants' contention in an SEC enforcement action that because a merger at that time was not deemed a sale for purposes of § 5 of the 1933 Act, it could not be a purchase or sale for purposes of § 10(b) of the 1934 Act. The Court noted:

> Although the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the lan-

The district court in *Cady* focused on the statutory definition

> guage Congress has chosen, ordinary rules of statutory construction still apply. The meaning of particular phrases must be determined in context. Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws; both the 1933 and the 1934 Acts preface their lists of general definitions with the phrase "unless the context otherwise requires." We must therefore address ourselves to the meaning of the words "purchase or sale" in the context of § 10(b). Whatever these or similar words may mean in the numerous other contexts in which they appear in the securities laws, only this one narrow question is presented here.

Id. at 466 (citations omitted).

The Court concluded that for purposes of an SEC enforcement action, which does not raise the standing problems involved in an implied claim under § 10(b), deception in a merger impacts on a shareholder's decision in a manner not unlike that involved in a typical cash sale or share exchange. *Id.* at 467. Thus, the Court held that in light of the broad antifraud purposes of § 10(b), the shareholders of the merged company "purchased" shares in the survivor within the meaning of the statutory language. *Id.* at 467. In 1972 the SEC rescinded the 1933 Act's Rule 133, 17 C.F.R. § 230.133 (1983), which had provided that mergers did not involve offers or sales for purposes of § 5.

But see International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 567 n.22 (1979), in which the Supreme Court noted that while the SEC has sometimes taken the position that the term "sale" can have different meanings in different sections of the 1933 Act, as in SEC v. National Securities, Inc., 393 U.S. 453 (1969), it has on other occasions apparently taken a contrary position. The Court further noted the rescission of Rule 133, the context in which the SEC originally developed its theory as to the bifurcated definition of sale. The Court chose not to resolve the divergent views on this issue. 439 U.S. at 568–71.

See also SEC v. Murphy, 626 F.2d 633, 649–52 (9th Cir. 1980), in which the court discussed the fact that the doctrine of participant liability for registration violations has developed separately in the context of § 12 cases (discussing principally the proximate cause test, *see infra* notes 186–290 and accompanying text) from its development in the context of SEC injunctive actions for violation of § 5. The court noted that while it may seem anomalous to suggest that "sell" may mean different things in different sections of the 1933 Act, in other contexts some courts have persuasively suggested that the standard of liability should be broader in SEC enforcement actions. *Id.* at 649 n.17. The court concluded that the standard of participant liability for violation of § 5 in SEC injunctive actions is theoretically broader than the proximate cause test used in § 12 cases. However, the court felt that in practice the two standards differ little and held that the defendant would be liable under either standard. *Id.* at 652.

SEC v. Murphy obviously does not directly support the thesis of this Article since the court appeared to endorse the approach of the proximate cause cases holding collateral participants liable under § 12. However, the court did recognize the possibility that "offer or sell" may be construed differently in § 12 than in § 5, and that construction for purposes of enforcement of a violation of § 5 may be broader than for purposes of the express action in § 12.

But see Schillner v. H. Vaughan Clarke & Co., 134 F.2d 875 (2d Cir. 1943). In that case the defendant argued that the court lacked jurisdiction over an action under § 12(2) because the alleged misrepresentation did not involve interstate commerce. *Id.* at 877. The first use of interstate commerce occurred when the mails were used to deliver the securities sold. In holding that this delivery was sufficient to invoke the Act, the court rejected the defendant's argument that because the prohibitions of § 5 differentiate in § 5(a)(1) and § 5(a)(2) between sale and delivery after sale, the word "sell" as used in § 12 should be interpreted as not including delivery after sale. The court used the § 2 "unless the context otherwise requires" prefatory language to conof "sell" in section 2(3) without considering the context which the remaining language in section 12(2) might lend to this term.[75] The First Circuit did consider the textual context of the remaining language, but did so in a rather conclusory fashion.[76]

Without analysis or authority the First Circuit assumed that if a broker could be a "person who sells" even though he was not selling his own property when he engaged in solicitation activities which fell within the definition of "sell" in section 2(3), it necessarily followed that the plaintiff must be deemed to have "purchased from him" within the meaning of the corresponding phrase in the statute.[77] However, "purchase" is not a term defined in the statute.[78] There is nothing in the legislation which dictates that it be interpreted as correlative with the broad definition of "offer" in section 2(3), nor does the ordinary meaning of the phrase necessarily support such a construction in every setting. As discussed above, the phrase "liable to the person purchasing such security from him" may narrow the context in which "[a]ny person who . . . offers or sells" is being used in section 12(2).

In addition, the defendant was unable to convince the First Circuit that the rescissory nature of the remedy provided in section 12(2) limits the scope of liability to the actual vendor. Noting that the statute does not use the word "rescission," the court saw no reason not to read the statute in a manner which would force the broker to assume ownership of the securities for the first time.[79]

However, section 12(2) was adapted from the common law action for rescission,[80] which does limit recovery to the principals of the transaction.[81] While numerous modifications were made to the common law action in the process of shaping the statutory right,[82] section 12(2) has always been recognized as according a rescissory measure of relief.[83] Recovery is effected either through the mechanics of an actual rescission or, in the event the security

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clude that the word "sell" has a narrower meaning in § 5 than in § 12 with respect to this issue. *Id.*

75. 30 F. Supp. at 469.

76. 113 F.2d at 990–91.

77. *Id.* at 990.

78. Section 2 of the 1933 Act, the definition section, makes no specific reference to the meaning of the word "purchase." 15 U.S.C. § 77b (1976).

79. 113 F.2d at 991.

80. *See* 3 L. Loss, *supra* note 17, at 1700.

81. *Id.* at 1627 (prerequisite of rescission action is "privity" between the parties).

82. *Id.* at 1700–05, comparing and contrasting § 12(2) with common law rescission. *See also* Peterson, *Recent Developments in Civil Liability under Section 12(2) of the Securities Act of 1933*, 5 Hous. L. Rev. 274, 274–76 (1967).

83. *See generally* 3 L. Loss, *supra* note 17, at 1720–21; Kaminsky, *supra* note 8, at 280–85; Peterson, *supra* note 82, at 284–85, 293.

in question has been sold by the plaintiff, through award of a measure of damages equivalent to a rescission.[84]

This form of relief presents conceptual problems when imposed upon a defendant who was not the actual vendor and who did not beneficially receive the original sale proceeds.[85] As noted above, rescission at common law is generally only available against parties to the transaction.[86] There are some common law cases in which rescission has been granted against an agent who was not privy to the contract and who did not beneficially receive the sale proceeds. In these cases the courts characterized the action for rescission as sounding in fraud rather than in contract.[87] Indeed, the First Circuit in *Cady* relied on one such case.[88]

However, several other common law cases have refused rescission in these circumstances.[89] These latter decisions rely on the general rule limiting rescission to the parties to a contract and point out that the purchaser's recourse against the agent in such circumstances is an action for damages for common law deceit.[90]

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84. *See supra* note 83.

85. *See* Myers v. Da Silva, 1983 FED. SEC. L. REP. (CCH) ¶ 99,166, at 95,627 (E.D. Cal. March 14, 1983), in which that portion of a plaintiff's complaint which alleged a § 12 action against a corporation and various individual defendants was stayed by the corporation's bankruptcy. Since the consideration had been paid to the corporation, the court held that the rescissory relief called for in § 12 could only come from the corporation. Thus, the corporation's bankruptcy stayed the § 12 claim because the corporation was the only proper defendant.

86. *See supra* note 81.

87. *See, e.g.*, Peterson v. McManus, 187 Iowa 522, 545–47, 172 N.W. 460, 468–70 (1919); Pridmore v. Steneck, 120 N.J. Eq. 567, 572–73, 186 A. 513, 516 (Ch. 1936), *aff'd without consideration of the point*, 122 N.J. Eq. 35, 191 A. 861 (1937); Loud v. Clifford, 254 N.Y. 216, 172 N.E. 475 (1930); Mack v. Latta, 178 N.Y. 525, 71 N.E. 97 (1904). *See also* Gordon v. Burr, 506 F.2d 1080, 1083–85 (2d Cir. 1974) (citing common law cases as authority for availability of rescission against brokerage firm and broker in rule 10b-5 action). *See generally* 3 L. LOSS, *supra* note 17, at 1715 & n.100; W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 130(B) (1964).

For a discussion of the duty of an agent to return property to a third party when the agent receives possession of, or title to, the property on behalf of a principal and the third party rescinds the transaction while the agent still holds the property, see Seavey, *supra*, § 127.

88. 113 F.2d at 991 (citing Peterson v. McManus, 187 Iowa 522, 545, 172 N.W. 460 (1919)).

89. *See, e.g.*, Van Looyengoed v. Allencrest Gardens Corp., 265 Mich. 182, 186–87, 251 N.W. 317, 318 (1933); Hafner v. A.J. Stuart Land Co., 246 Mich. 465, 470–72, 224 N.W. 630, 632 (1929); Huffman v. Bankers Auto. Ins. Co., 112 Neb. 277, 284–86, 200 N.W. 994–95 (1924) (on motion for rehearing); Nash v. Minnesota Title Ins. & Trust Co., 163 Mass. 574, 582–83, 40 N.E. 1039, 1041–42 (1895).

90. *See supra* note 89. The rationale of these common law decisions denying rescission against an agent not privy to the contract supports by analogy the premise of this Article. Section 12(2), adapted from common law rescission, makes a seller liable to the person purchasing from him for a rescissory measure of relief. Given the plain language of the statute and the nature of the relief afforded, the term "seller" should be confined to the immediate vendor. A purchaser's recourse against a collat-

Even in those common law cases in which an agent not privy to the contract has been required to account for what the principal received, the courts have granted rescission only after emphasizing that the agent acted with scienter with respect to the misrepresentations involved.[91] As discussed earlier, such state of mind is not necessarily required under section 12(2), which imposes liability upon the seller if he fails to establish his own due care.[92]

While *Cady v. Murphy* does present the analytical difficulties discussed above, the opinion is defensible for the most part if confined to the brokerage situation which it addressed. In holding that the concept of "seller" could be broadened to encompass a vendor's agent or a dual agent who engaged in solicitation of an offer to buy, the court relied on the statutory definition of the key operative term, "sell." It found this interpretation of the statute acceptable in the brokerage context since common parlance would describe a selling agent as a "person who sells," even though the agent is not the vendor in the sense of passing title. Its interpretation of the language in section 12(2) making the seller liable "to the person purchasing such security from him" as correlative with its interpretation of the statutory definition of "sell" is not completely unreasonable. Moreover, when viewed from the standpoint of ordinary usage, the interpretation is easier to accept in the brokerage situation than might be the case in other settings.[93] Finally, the court at least addressed the question of whether section 12(2) could support imposition of a kind of "constructive rescission" on an agent who was not a party to the original sales contract and relied upon some common law authority for doing so in an agency setting. Once again its holding in this regard presents fewer problems than might be the case outside an agency setting. If the broker lacks scienter, he may be able to seek recourse against his principal for indemnification under normal principles of agency.[94]

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eral participant to the sale should be an action under rule 10b-5, the contours of which have been in part shaped by common law deceit.

91. *See supra* note 89.

92. *See supra* note 24 and accompanying text.

93. *See* 3 L. Loss, *supra* note 17, at 1716:

> [Section] 12 makes the seller liable "to the person purchasing such security from him," a phrase which it is perhaps easier to square with the imposition of liability upon a broker (even the buyer's broker) than it is with the imposition of liability upon officers or directors (or other persons connected with the seller) who actively participate in the sale.

Id.

94. *See id.* at 1718–19: "When the broker is the innocent party as between himself and the selling principal, presumably he has a right to be indemnified by the principal under common law agency concepts."

See also Whittaker v. Wall, 226 F.2d 868, 872–73 (8th Cir. 1955). *Whittaker* involved a claim under § 12(1) of the 1933 Act, 15 U.S.C. § 77*l*(1) (1976), which con-

Virtually all that can be said in defense of the analysis in *Cady v. Murphy* is abandoned in the later expanded seller cases.[95] These opinions formulate a variety of tests for determining who can be a seller,[96] none of which is premised on the statutory definitions of the terms "offer" or "sell," much less on any consideration of the application of these definitions in the context of section 12(2).[97] Uncertain in application, these tests have sometimes resulted in the imposition of liability on participants relatively attenuated to the sales transaction, whose activities do not always amount to solicitation within the meaning of section 2(3) and who certainly would not be denominated as sellers in common parlance.[98] Moreover, the opinions do not analyze the propriety of imposing an essentially rescissory judgment on a collateral participant not privy to the original sales transaction in a context other than an agency setting.[99] They thus raise problems regarding the rights of a collateral participant found liable to the plaintiff vis-à-vis the actual vendor.[100]

III. THE EXPANDED SELLER CONCEPT UNBRIDLED: THE FACILITATION CASES

Following the circumvention of the privity requirement in the brokerage cases, further inroads on the literal language of section 12(2) occurred in non-brokerage contexts. From the conclusion in *Cady* that the language of section 12(2) was broad enough to en-

tains prefatory and concluding language identical to § 12(2) making a seller liable to the person purchasing the security from him for a rescissory measure of relief. Under the rationale of *Cady*, the trial court granted the purchasers a rescissory judgment not only against the corporation which issued and sold the security, but also against the corporate president and a selling agent. In addition, the trial court granted the purchasers a lien against certain properties to insure payment of the judgment and granted a similar lien to the selling agent in the event he should pay all or any part of the judgment. Commenting on the propriety of the lien granted to the selling agent, the appellate court noted: "There is, to us, no incongruity in thus enforcing the instant judgment. Wagner is liable as agent and as agent may recover from his principal. Restatement of Agency § 438. The court may use suitable means to insure the reimbursement." 226 F.2d at 873.

See generally W. SEAVEY, *supra* note 87, at § 168 regarding an agent's right to indemnification. *But see* Kennedy v. Josephthal & Co., Inc., 1983 FED. SEC. L. REP. ¶ 99,204 (D. Mass. May 9, 1983). In that case the court denied indemnification to a brokerage firm which acted as a placement agent in connection with an offering of limited partnership interests but allowed the firm contribution from other third-party defendants.

95. *See infra* notes 101–317 and accompanying text.

96. See *infra* notes 113–185 and accompanying text for the participation test; *infra* notes 186–290 and accompanying text for the proximate cause test; and *infra* notes 291–314 and accompanying text for the 8th Circuit test.

97. *See infra* notes 367–369 and accompanying text.

98. *See infra* note 369 and accompanying text.

99. *See infra* notes 370–375 and accompanying text.

100. *See infra* notes 370–375 and accompanying text.

compass a broker or agent who solicits an offer to buy, courts progressed to holding a variety of parties ancillary to a sales transaction liable as sellers under section 12(2).

Three different lines of authority emerge in these later expanded seller cases. In defining the parameters of who may be primarily liable as a seller under section 12(2), some courts adopt a rather ambiguous test geared to a collateral party's participation in the events leading up to the sale in question.[101] The Fifth Circuit has rejected this participation test as overly broad and has developed a proximate cause analysis.[102] Under this theory only those collateral parties whose participation is a substantial factor in causing a transaction to take place may be liable as sellers under section 12(2).[103] The Eighth Circuit has rejected the proximate cause analysis and developed a third approach.[104] Stating that the Fifth Circuit's test fails to adequately implement the underlying policies of the Securities Act, the Eighth Circuit held in *Wasson v. SEC*[105] that the pivotal consideration should be "whether the defendant was uniquely positioned to ask relevant questions, acquire material information, or disclose his findings."[106]

Each of these tests grapples with the problem of determining what relationship a collateral participant must bear to the sales transaction in order to justify imposing primary liability under section 12.[107] While there are important differences in formulation, each of them ultimately resolves this question in favor of a

101. See *infra* notes 113-185 and accompanying text for a discussion of the participation test.

102. See *infra* notes 186-290 and accompanying text for a discussion of the 5th Circuit's proximate cause analysis.

103. *See infra* notes 186-290 and accompanying text.

104. See *infra* notes 291-314 and accompanying text for a discussion of the 8th Circuit test.

105. 558 F.2d 879 (8th Cir. 1977). *See infra* notes 291-314 and accompanying text.

106. *Id.* at 886.

107. *See* Rapp, *supra* note 31, at 466-67. In discussing the participation and proximate cause tests, Mr. Rapp refers to the focus of such tests on the relationship of the defendant to the sales transaction as creating a kind of transactional privity, which the courts use as a substitute for the traditional privity between parties to the transaction:

> The foregoing review of the cases expanding the scope of section 12 supports some generalizations . . . . [P]rimary liability will extend to all persons who play a direct and meaningful role in the circumstances surrounding a sale of securities. As to what constitutes a "meaningful role," these cases suggest that it is direct facilitation of the transaction, and it is this relationship—role to transaction—which has generally replaced the traditional contractual privity relationship that would otherwise operate to limit the scope of permissible defendants.

Id.

In contrast to the thesis of this Article, Mr. Rapp feels that expanding the concept of seller to impose primary liability on some collateral participants involved in the sales transaction may be consistent with the focus of § 12(2).

test designed to measure in some manner the degree to which the collateral participant facilitated the transaction.[108] All three tests, however, address the question of who may be a seller for purposes of section 12(2) quite apart from the relatively clear language of the statute and without any consideration of the place of section 12(2) in the overall statutory scheme of antifraud provisions.[109]

Unlike *Cady v. Murphy*, these later expanded seller cases do not take their focus from the statutory definitions of "offer" and "sell" in section 2(3).[110] Moreover, they are not confined to the agency setting which was so instrumental in reconciling the holding in *Cady* with the language of the statute.[111] While these tests sometimes result in imposition of liability on a collateral participant who would also fit within the *Cady* mode of analysis, their sweep is frequently much broader.[112] To this extent, they are far more problematic than *Cady*.

A. *The Participation Test*

After the holding in *Cady*, the next foray against the privity requirement in section 12(2) came in cases in which purchasers argued that those who participate in sales transactions should be primarily liable as sellers.[113] For example, in *Zachman v. Er-*

108. *See infra* notes 113-317 and accompanying text.

109. *See infra* notes 367-379, 391-418 and accompanying text.

110. *See infra* notes 367-368 and accompanying text. See *also supra* note 48 for text of § 2(3).

111. *See infra* notes 370-375 and accompanying text.

112. *Compare, e.g.*, Lewis v. Walston & Co., Inc., 487 F.2d 617 (5th Cir. 1973), discussed *infra* text accompanying notes 223-227, *with* Plunkett v. Francisco, 430 F. Supp. 235 (N.D. Ga. 1977). In *Lewis* the court used a proximate cause theory to affirm a finding of liability under § 12(2) against a broker who could also have been reached under a *Cady* analysis. In *Plunkett* plaintiffs purchased a cattle lease and calf maintenance agreement from a corporation through a selling agent. The selling agent showed the plaintiffs a so-called warranty letter executed by the president of the corporation and a certain farmer as principals. The letter represented that they had sufficient facilities, personnel, and capital to attain current objectives of management. The court granted summary judgment under § 12(2) against the selling agent, who could have been reached under a *Cady* analysis. Employing a proximate cause analysis, however, the *Plunkett* court also granted summary judgment against the farmer. The court found the farmer's participation in signing the warranty letter sufficient to bring him within § 12 even though he apparently had no personal contact with the plaintiffs prior to their purchase.

113. *See infra* notes 114-181 and accompanying text. *See also* the following cases in which allegations of participation withstood a motion to dismiss: *In re* Home-Stake Production Co. Sec. Litig., 76 F.R.D. 337, 349 (N.D. Okla. 1975); Mincolla v. Arthur Hardgrove Co., [1964-1966 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,608, at 95,283 (S.D.N.Y. Nov. 26, 1965); Bailey v. Huntington Sec. Co., 35 F.R.D. 169, 175 (S.D.N.Y. 1963). *But see also, e.g.*, the following cases in which allegations of participation were held insufficient: Katz v. David W. Katz & Co., 1984 FED. SEC. L. REP. CCH ¶ 99,669, at 97,687-90 (S.D.N.Y. Feb. 14, 1984) (motion for summary judgment granted); Aid Auto Stores, Inc. v. Cannon, 525 F.2d. 468, 471 (2d Cir. 1975)

win[114] the plaintiffs brought an action under section 12(2) for securities purchased in certain primary distributions floated by two insurance companies and their common successor. Plaintiffs alleged that numerous material misrepresentations had been made to them in connection with their purchase. In particular, they alleged the use of false financial statements which concealed the insolvency of the insurance companies.[115]

At the time of the suit, the successor corporation was in receivership in a Texas state court.[116] Presumably for this reason, the plaintiffs named a variety of persons tangential to the sales as defendants in their federal court action under section 12(2). Plaintiffs sued: (1) the officers and directors of the insurance companies involved;[117] (2) certain other corporations which the plaintiffs alleged had a role in falsification of the financial statements; (3) the securities dealer who put the sales force in the field; (4) an insurance reporting firm which had issued trade reports on the insurance companies that were subsequently shown to the plaintiffs;[118] (5) members of an advisory board to the insurance companies who were neither officers or directors of the companies;[119] (6) examiners of the Texas Board of Insurance Commissioners;[120] and (7) an attorney who represented the successor corporation before the Texas Board of Insurance Commissioners.[121]

With the exception of the examiners at the Texas Board of Insurance Commissioners[122] and the attorney who had appeared

(directed verdict granted in favor of defendants); Grimm v. Whitney-Fidalgo Seafoods, Inc., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,029, at 91,609 (S.D.N.Y. Dec. 4, 1973) (motion to dismiss for failure to state a claim granted).

114. 186 F. Supp. 681 (S.D. Tex. 1959) (rulings on motion); 186 F. Supp. 691 (S.D. Tex. 1960) (further rulings on motion).

115. 186 F. Supp. at 684.

116. *Id.* at 683.

117. Plaintiffs alleged that these individuals "caused the transactions that resulted in falsification of the financial statements." *Id.* at 685.

118. Plaintiffs claimed that the reports were deficient in failing to disclose a financial tie between the reporting firm and the insurance companies which may have compromised the independence of the reports. *Id.* at 696-97.

119. The plaintiffs alleged that these individuals either willfully or negligently cooperated with a general plan to defraud the plaintiffs (1) by allowing their names to be used in connection with the sales transaction, (2) by attending board meetings where decisions were made, and (3) by lending their names and rendering advice and assistance to the insurance companies in local operations in return for compensation or the promise of compensation. *Id.* at 686.

120. The plaintiffs claimed that in exchange for gifts and favors these men joined in a conspiracy with the other defendants by compromising their review of the successor corporation, which review should have revealed the insolvency. *Id.* at 686, 695-96.

121. The plaintiffs alleged that the lawyer, a state senator, obtained a lifting of the Texas Insurance Code for his client through improper influence. *Id.* at 696.

122. *Id.* at 686 (defendant Blanchard); *id.* at 695-96 (defendant Noad).

before that board,[123] the district court found the plaintiffs' complaint sufficient to withstand a motion to dismiss for failure to state a claim.[124] The court held that plaintiffs' allegations adequately pleaded participation of the remaining defendants as sellers or as control persons of sellers.[125]

Judge Cashin came to a similar conclusion on the pleadings before him in *Wonneman v. Stratford Securities Co., Inc.*[126] The plaintiff initially sued under sections 12(1) and 12(2) to recover the consideration he paid for shares in a company known as General Oil & Industries Inc.[127] General Oil was a successor by way of recapitalization to a dormant company which had been revived in 1958 on the advice and through the efforts of Josephson, an attorney.[128] The plaintiff had purchased the shares in a secondary transaction from Stratford Securities Co., Inc., a brokerage firm which sold the General Oil shares to the plaintiff and to others as principal for its own account.[129] The plaintiff named as defendants in the action Stratford Securities, a husband and wife who were Stratford's president and secretary-treasurer respectively, the attorney Josephson, General Oil, and two officers of General Oil who allegedly provided information about the company to Stratford.[130]

Judge Cashin denied a motion for summary judgment by the husband and wife.[131] Quite apart from rebutting possible liability under section 15 as control persons of the seller, the court appeared to believe that the defendants had to establish that they did not participate in the sale in order to prevail on their motion.[132] The court stated that it was not sufficient for the defendants to merely show that they did not actually sell the securities.[133]

Judge Cashin readily admitted the uncertainty inherent in using participation as the relevant criterion for determining the boundaries of primary liability under section 12.

The problem is: "What constitutes 'participation' "? Does one

123. *Id.* at 696.

124. *Id.* at 684–86, 691, 694–96, 698.

125. *Id.*

126. [1957–1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 90,923 (S.D.N.Y. June 26, 1959).

127. *Id.* at 92,962–63.

128. [1957–1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034 at 93,460–61 (S.D.N.Y. June 7, 1961).

129. *Id.* at 93,459.

130. *Id.* at 93,460–61.

131. [1957–1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 90,923 at 92,963–64 (S.D.N.Y. June 26, 1959).

132. *Id.* For the text of § 15 see *supra* note 29.

133. *Id.* at 92,963. "They must show that they did not participate in the sale and not merely that they did not actually sell the securities to plaintiff."

> who supervises the selling operations "participate" in an individual sale? Does one who composes advertising material "participate" in the sale? Does a director or an officer "participate" in a sale?[134]

Nonetheless, the court left this question as one of fact for resolution at trial.[135]

Summary judgment was subsequently entered against Stratford Securities, the plaintiff's actual vendor.[136] When execution on the judgment was returned unsatisfied, trial proceeded against the remaining defendants.[137] The section 12(2) count was dismissed,[138] and the case was tried before Judge Murphy for recovery under section 12(1).[139]

Judge Murphy, however, was less receptive at trial to the plaintiff's participation analysis than Judge Cashin had been on the motion for summary judgment.[140] Judge Murphy began with the general rule that except as expanded by section 15, a purchaser's right to sue for return of consideration under section 12 is generally limited to his immediate seller.[141] The court noted:

> [T]he statutes under which plaintiff sues require an element of privity between the plaintiff-purchaser and defendants. The defendants must be, for example, the actual seller or one who negotiated the sale; the owner of the securities sold or a person

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134. *Id.*

135. *Id.*

136. [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034 at 93,459 (S.D.N.Y. 1961).

137. *Id.*

138. *Id.* at 93,458.

139. Section 12(1) of the 1933 Act, 15 U.S.C. § 77*l*(1) (1976) [hereinafter referred to as section 12(1)], provides that any person who offers or sells a security in violation of the registration requirements of § 5 of 1933 Act shall be liable to the person purchasing the security from him for the consideration paid upon tender of the security or, in the event the buyer no longer owns the security, for damages. Section 12 is thus structured in a fashion which makes the privity requirement and remedies common to both §§ 12(1) and 12(2).

The question of whether anyone beyond the immediate vendor may be deemed a seller for purposes of section 12 has been litigated in actions under both §§ 12(1) and 12(2). Some commentators have suggested that the concept of "seller" may be open to a broader construction in the context of § 12(2) than § 12(1), perhaps because § 12(2) provides a due care defense unavailable under § 12(1). *See, e.g.*, 5 A. JACOBS, *supra* note 17, § 3.01[c] at 1-56. However, most courts and commentators treat the question in a unitary fashion. *See, e.g.*, Pharo v. Smith, 621 F.2d 656, 665-68 & nn.6-8 (5th Cir. 1980), discussed *infra* notes 228-242 and accompanying text; Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d. 680, 692 & n. 17 (5th Cir. 1971), discussed *infra* notes 206-219 and accompanying text. Decisions under § 12(1) addressing the "seller" question are thus relevant to this Article and have been included in the textual discussion and notes.

140. [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034 at 93,459-61 (S.D.N.Y. 1961).

141. *Id.* at 93,459.

who in some manner controls the seller.[142]

Judge Murphy held the husband, who was president of Stratford, liable to the plaintiff under section 15 of the 1933 Act as a person controlling the seller.[143] However, he rejected as insufficient the plaintiff's proof against the remaining defendants with respect to the participation allegations in the complaint.[144]

The plaintiff argued at trial that these defendants were primarily liable as sellers under section 12 because they "participated" in the sale within the meaning of that term as used in the venue provision of the 1933 Act.[145] The plaintiff further contended that participation in this context meant "participation in any phase of the overall plan to market securities in violation of the [1933] Act."[146]

While Judge Murphy seemed to stop short of rejecting per se the notion that the concept of participation might be borrowed from the venue statute for purposes of determining liability under section 12, he found the plaintiff's interpretation of that term overly broad.[147] The court characterized the plaintiff's argument as an attempt to embrace as defendants all persons connected with the corporation whose stock is sold, however remote their connection with facilitating the sale.[148] Analyzing the activities of the various defendants, the court held that the plaintiff failed to establish that any of the remaining defendants participated in the sale for purposes of liability under section 12.[149]

The attorney Josephson presented the closest case. He was instrumental in the recapitalization of General Oil and had recommended a transfer agent to the company, all with a view toward sales and transfers of General Oil stock. However, the court noted that his closest contact with the actual sale to the plaintiff

142. *Id.*

143. *Id.* at 93,459-62.

144. *Id.* at 93,460-62.

145. In pertinent part the venue provision of the 1933 Act provides as follows: "Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein . . . ." Securities Act of 1933, § 22(a), 15 U.S.C. § 77v(a) (1976).

146. [1957-1961 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,034 at 93,459 (S.D.N.Y. 1961).

147. *Id.* at 93,459-60.

148. *Id.* at 93,460.

149. *Id.* at 93,460-61. The court characterized the wife who was secretary-treasurer of Stratford as playing a purely passive role in the corporation. It stated that General Oil's only connection to the transaction arose from the fact that it was the company whose stock was traded. It found that the officers of General Oil who were named as defendants did nothing more than implement one step of the recapitalization and furnish information to Stratford, which actions were irrelevant to the plaintiff's claim for failure to register under § 12(1).

had been an oral opinion rendered to the president of Stratford to the effect that resale of the securities by Stratford would be exempt from the registration requirements of the 1933 Act.[150] The plaintiff argued that this opinion induced Stratford to offer the General Oil stock to the public, including the plaintiff. Apparently focusing on the rescissory nature of the relief afforded by section 12, the court held that while these facts may have been sufficient to establish venue against Josephson, they demonstrated that the attorney was "a stranger to the illegal sales to plaintiff" insofar as the statutory remedy sought by the plaintiff was concerned.[151]

The trial court opinion in *Wonneman* cut back on the breadth of the opinion in the motion for summary judgment. However, notwithstanding its references to the privity requirement, the court did not outright reject and, indeed, seemed to inferentially endorse participation as a measure of primary liability under section 12.[152] The trial court refused to accept the plaintiff's interpretation of participation as encompassing anyone involved in the plan to market securities. However, the court's extensive analysis of the relationship between the activities of the various defendants and the sale in question suggests that proof of more direct participation would have been sufficient to establish liability.[153]

The level of participation sufficient to render a collateral party liable as a seller under section 12 remains as fuzzy as when the question was first posed by Judge Cashin on the motion for summary judgment in *Wonneman*. However, the concept articulated in *Zachman* and *Wonneman* that some measure of participation in a sale may render a collateral party liable as a seller has taken root in a number of courts. Under a participation analysis, the attorney in *Katz v. Amos Treat & Co.*[154] fared less favorably than the attorney in *Wonneman*.

In that case a sales representative from the brokerage firm of Amos Treat & Co. approached Dr. Solomon Katz about an opportunity to invest in a company known as Delka Research Corp. The sales representative offered Katz the chance to be an early purchaser in a proposed new issue of Delka stock, to be registered by Delka with the SEC and underwritten by Amos Treat & Co. The salesman enthusiastically promoted the stock, and Katz purchased some shares from Delka.[155]

150. *Id.* at 93,460.
151. *Id.* at 93,461.
152. Mr. Rapp's analysis of the *Wonneman* opinion leads him to much the same conclusion. *See* Rapp, *supra* note 31, at 462.
153. *Id.*
154. 411 F.2d 1046 (2d Cir. 1969).
155. *Id.* at 1050–52.

Earl J. Wofsey was an attorney for Amos Treat & Co. and special counsel to Delka in connection with the proposed underwriting of Delka stock.[156] He apparently had no contact with Katz prior to this first purchase of Delka stock by Katz.[157]

In the months following his initial purchase, Katz inquired several times about the status of the Delka registration statement and was assured by Amos Treat, the president of the brokerage firm, that everything was proceeding normally. Treat indicated that Delka needed more money because business was so good and urged Katz to raise funds among his friends for the purchase of additional shares from Delka. Katz raised the money, but before committing the funds, he sought further assurances about the registration statement. He was referred to the attorney, Wofsey.[158]

Katz contacted Wofsey several times and inquired about the status of the registration statement. He also asked Wofsey's opinion regarding certain favorable statements about the offering which Treat had made to him. After receiving reassurances from Wofsey, Katz purchased the additional Delka shares.[159]

The financial statements prepared for inclusion in the Delka registration statement showed few sales, a large loss, and a negative working capital ratio.[160] The registration statement was never filed.[161] Katz sued the brokerage firm, its president, the sales representative in charge of his account, Wofsey, and two officers of Delka under sections 12(1), 12(2), and 17(a) of the 1933 Act and section 10(b) of the 1934 Act.[162]

The district court dismissed the entire complaint at the end of the plaintiff's case.[163] The court's dismissal of the section 12(1)

156. *Id.* at 1049.

157. *Id.* at 1050–51. Wofsey's only contact with Katz in connection with the initial purchase came in correspondence after the fact. In a letter to Katz, Wofsey described certain escrow arrangements which would pertain to the shares purchased, pending effectiveness of the Delka registration statement.

158. *Id.* at 1051.

159. *Id.* at 1051–52. Specifically, in response to Katz' first inquiry, Wofsey initially told him to wait a few weeks. At that time in response to another call, Wofsey indicated that the registration statement had been worked out in principle such that Katz could put up half the funds. Katz again contacted Wofsey before paying over the balance of the monies. In that conversation he sounded out Wofsey's opinion regarding statements made by Treat that the Delka issue was the greatest offering Treat had ever underwritten. Wofsey responded that he had heard it was a good one and knew it was "okay." In response to Katz' questions regarding the registration statement, Wofsey said that it was ready except for the accountants' report. When Katz asked if it was safe to put up the remaining funds, Wofsey replied that it "would help the registration" and that he thought it "would be all right." *Id.*

160. *Id.* at 1052.

161. *Id.*

162. *Id.* at 1049.

163. The district court did not file an opinion in support of the dismissal. However, the dismissal is discussed in a district court opinion denying defendants' motion

count was apparently premised on the ground that the privity requirement limited Katz to recovery from Delka, his immediate seller.[164]

The Court of Appeals for the Second Circuit affirmed the dismissal of all counts with respect to the two Delka officers but reversed as to the remaining defendants.[165] The court's discussion of the section 12(1) count is the portion of the opinion most pertinent to the seller issue. The court held that the Amos Treat defendants could be liable as sellers under a *Cady* analysis for solicitation of an offer to buy.[166] However, the court could not quite fit Wofsey into this solicitation framework. As noted above, Wofsey was not involved with Katz prior to the first sale, and Katz solicited Wofsey's advice with respect to the second sale.[167]

Despite the fact that Wofsey had not initiated contact with the plaintiff, the court held that Katz had stated a prima facie claim against him as a section 12 seller.[168] The court reasoned that Wofsey had done more than simply respond to Katz's questions. The court characterized Wofsey as having placed Amos Treat & Co. in a position "to tackle Katz for the money."[169] Thus, the court held that a jury could decide that Wofsey was "a party to a solicitation."[170]

The court exonerated the two Delka officers, although one of the officers had picked up Katz's funds and signed the stock certif-

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to assess costs against plaintiff. Katz v. Delka Research Corp. of New Jersey, 295 F. Supp. 647 (S.D.N.Y. 1968). The trial court dismissed the § 12(2) count and other fraud claims because it was dissatisfied with the manner in which plaintiff's counsel responded to questions posed by the court which were designed to pin down the misrepresentations alleged with respect to each of the defendants. *Id.* at 648–49.

164. The appellate court concluded that the district court's dismissal of the § 12(1) claim "appear[ed] to have rested on a belief that only the issuer or immediately previous owner of the shares, in this case Delka, can 'offer or sell' a security, within the prohibition of § 12(1) . . . ." 411 F.2d at 1052.

165. *Id.* at 1056.

166. *Id.* at 1053. The firm conceded that it could be liable under § 12(1) if it acted as a broker for Delka. However, it contended that it was not a broker since it "received no commission and was simply helping Katz to get in on a good thing." *Id.* at 1053. The court rejected this argument. It stated that a jury could have concluded that the firm acted as a broker notwithstanding the absence of a commission, especially in light of the firm's interest in the underwriting. Moreover, citing the trial court opinion in *Cady*, the court reasoned that the firm would be liable if the jury concluded that it actively solicited Katz' offer to buy, irrespective of whether or not the firm functioned as a broker. The *Katz* court thus focused on the trial court's solicitation analysis in *Cady* without regard to the appellate court's focus in that case on the importance of the agency relationship in reconciling the solicitation analysis with the concluding language of § 12. *See supra* notes 39-61 and accompanying text.

167. *See supra* notes 157 and 159 and accompanying text.

168. 411 F.2d at 1053.

169. *Id.*

170. *Id.*

icate on the second sale.[171] The court stated that the officers had played too minor a role in facilitating the transaction to be held liable.[172]

In analyzing the liability of Wofsey and the Delka officers, the *Katz* court uses a participation test as did the courts in *Zachman* and *Wonneman*. All three courts conclude that some measure of participation warrants imposition of primary liability under section 12 but offer no guidelines on the quantity or quality of participation which will trigger "seller" status. Beyond the courts' visceral reaction to the facts, it is difficult to discern from the opinions what made the attorney in *Katz* a party to the solicitation but not the officer who was involved in collecting the funds and issuing the share certificates, or what made the trade reporting firm and advisory board members in *Zachman* potentially liable as participants but the state insurance commissioners and the attorney who appeared before the commission too attenuated from the sale.

The problem arises in large part from the fact that the participation test, like the other two facilitation tests which follow, is purely extra-statutory in nature. In a wholesale fashion the courts in the participation cases substitute the concept of participating in the sale for the words "offers or sells" in section 12(2), even though there is no support in the language of the statute for doing so.[173]

This extension represents a major analytical leap from the holding in *Cady* and creates a gap which is difficult to bridge. The court in *Cady* was able to justify broadening section 12(2) to allow a purchaser to reach a broker because it focused upon the broker's solicitation activities as falling within the definition of "sell" in section 2(3). In addition, the *Cady* court confined its holding to an agency setting through which this statutory definition of "sell" could be somewhat reconciled with the remaining language of section 12(2).[174] The courts in the participation cases do neither.

A participation test certainly includes someone who solicits an offer to buy within the meaning of "offer" as now defined in

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171. *Id.*

172. *Id.* The court's disposition of the § 12(2) count and the other fraud claims followed the same lines as its decision with respect to the § 12(1) count. It affirmed dismissal of the Delka officers but held that the plaintiff had stated a sufficient claim against the remaining defendants that the alleged misrepresentations were made or adopted by or on behalf of each of the defendants. *Id.* at 1055–56.

173. *See* text of § 12(2), *supra* note 1.

174. *See supra* notes 39–61 and accompanying text for a discussion of Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1938), *aff'd*, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 311 U.S. 705 (1940).

section 2(3).[175] However, it also reaches far beyond the solicitation activities encompassed in the statutory definition of "offer."[176] As the attorney in *Katz* could painfully testify, it can encompass someone who does not initiate contact with the purchaser or make the sales pitch, but who merely responds to questions from the purchaser designed to elicit information about the transaction.[177] The trade reporting firm and advisory board members in *Zachman* might even more painfully note that it can also potentially reach parties who have no direct contact with plaintiffs.[178]

Similarly, a participation test encompasses brokers and other agents of a seller who fall within a *Cady* analysis.[179] However, it can also draw within its sweep a collateral participant who has no agency relationship with the actual seller.[180] Denominating such a collateral party as a person who "offers or sells" on the basis of some undefined measure of participation in the transaction is difficult to reconcile with the language making such person liable to the person "purchasing such security from him" for a recovery that is essentially rescissory in nature.[181]

The uncertainty inherent in the participation cases regarding the degree of activity necessary to trigger liability as a seller under section 12(2) gave birth to the proximate cause analysis.[182] Like the participation cases, the proximate cause cases reject a strict privity approach to section 12(2) in favor of an analysis embracing some participants in a sale beyond the immediate vendor.[183] The proximate cause test attempts to delineate the nature of the participation which will result in seller status by narrowing the field of defendants to those participants whose activities are a substantial factor in causing the purchase.[184] However, like its parent, the proximate cause analysis shares the same basic defect of being ex-

175. See, *e.g.*, Zachman v. Erwin, 186 F. Supp. 691, 695 (S.D. Tex. 1959), discussed *supra* in text accompanying notes 114–125, naming the securities dealer as a defendant for his role in putting in the field the sales force which made the false representations to the plaintiffs.

176. For the text of the statutory definition of "offer," see *supra* note 48.

177. *See supra* notes 167 and 170 and accompanying text.

178. *See supra* notes 118–119 and accompanying text.

179. *See supra* notes 39–61 and accompanying text, discussing the analysis of Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir. 1940), *cert denied*, 311 U.S. 705 (1940).

180. See, *e.g.*, Zachman v. Erwin, 186 F. Supp 691, 696 (S.D. Tex. 1959), discussed *supra* in text accompanying notes 114–125, naming the trade reporting firm as a defendant for showing credit reports about the corporate issuer to plaintiffs.

181. See *supra* text accompanying notes 70–92 for a discussion of the impact of the concluding language of § 12 on the scope of the prefatory language "offers or sells."

182. *See infra* notes 186–290 and accompanying text.

183. *See infra* notes 186–290 and accompanying text.

184. *See infra* notes 186–290 and accompanying text.

tra-statutory in nature. It thus presents many of the same problems in application.[185]

B. *The Proximate Cause Test*

Among those courts which reject a strict privity approach to section 12(2), the most popular test for determining seller status is the proximate cause analysis.[186] The roots of this approach can be

185. *See infra* notes 274-290 and accompanying text.

186. *See* cases cited *infra* text accompanying notes 187-290. *See also* Davis v. Avco Fin. Servs., Inc., 1983 FED. SEC. L. REP. (CCH) ¶ 91,569 (6th Cir. July 10, 1984) (trial court judgment affirmed under proximate cause analysis against finance company whose management promoted sales of securities purchased by plaintiffs through finance company loans); Admiralty Fund v. Jones, 677 F.2d 1289, 1294-95 (9th Cir. 1982) (summary judgment in favor of cross-defendant attorney on the cross-claim under § 12(2) reversed; issue of fact presented as to whether the actions of an attorney who wrote an opinion letter, attended meetings at which the transaction was structured, and participated in final arrangements for sale, were substantial factors in plaintiff's purchase); Stokes v. Lokken, 644 F.2d 779, 784-85 (8th Cir. 1981) (summary judgment in favor of attorney on claim of purchasers of interest in coin scam affirmed under proximate cause/aiding and abetting analysis; lawyer who gave a qualifiedly favorable opinion on the non-securities character of a transaction, which opinion became the basis for a clean audit report later quoted in promotional materials, was not liable to plaintiffs); Lawler v. Gilliam, 569 F.2d 1283, 1287-88 (4th Cir. 1978) (defendants' actions in soliciting investment in note scheme were substantial factors in causing plaintiff's purchase, thus making defendants liable as "sellers" under § 12(1)); Ayers v. Wolfinbarger, 491 F.2d 8, 13-14 (5th Cir. 1974) (reversing judgment for plaintiffs on § 12(2) claim where the evidence was insufficient to establish that the defendants were the proximate cause of the plaintiffs' purchase; defendants sold stock in a financial corporation to three individuals who, after gaining control, sold stock in the financial corporation to plaintiffs); McFarland v. Memorex Corp., 1984 FED. SEC. L. REP. CCH ¶ 99,635, at 97,507-08 (N.D. Cal. Jan. 17, 1984) (on motion for reconsideration, earlier opinion at 493 F. Supp. 631, 647-48 (N.D. Cal. 1980), limiting § 12(2) claim to defendant underwriters under strict privity approach, is reconsidered; § 12(2) claim is reinstated under proximate cause analysis against corporate issuer for alleged misrepresentations and omissions in a registered offering sold by underwriters pursuant to a firm commitment underwriting); Frogner v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 1983 FED. SEC. L. REP. CCH ¶ 99,504 (N.D. Cal. Sept. 26, 1983) (motion to dismiss § 12(2) claim against brokerage firm and broker denied under proximate cause analysis); Van Boeckel v. Weiss, 1983 FED. SEC. L. REP. CCH ¶ 99,648, at 97,589 (N.D. Cal. Sept. 12, 1983) (summary judgment on § 12 claims of purchasers of real estate-related investments granted under proximate cause analysis in favor of attorney who represented the companies which sold the investments); Wright v. Schock, 1983 FED. SEC. L. REP. (CCH) ¶ 99,411 at 96,360-61 (N.D. Cal. June 30, 1983) (summary judgment granted under proximate cause analysis in favor of title insurance company and two banks on § 12 claims brought by purchasers of notes secured by deeds of trust); Hibbard, O'Connor & Weeks, Inc. v. Osborne, 1982 FED. SEC. L. REP. (CCH) ¶ 98,815 at 94,174 (S.D. Tex. October 28, 1980) (motion to dismiss granted with leave to amend to plead with greater particularity proximate cause theory with respect to non-privity defendants); In re North Am. Acceptance Corp. Sec. Cases, 513 F. Supp. 608, 619-20, 632-33, 644-45 (N.D. Ga. 1981) (summary judgment granted under proximate cause analysis against purchasers of thrift notes, thrift certificates and term notes on §§ 12(1) and 12(2) claims against issuer's law firm, accounting firm and noteholder trustee); Westlake v. Abrams, 504 F. Supp. 337, 346-47 (N.D. Ga. 1980) (attorney who acted as general counsel to seller of

found in two district court opinions[187] which reached contrary results in applying a causation test to determine whether participants in a sale should be characterized as sellers for purposes of section 12(1).

In *Lennerth v. Mendenhall*[188] the plaintiffs sued under section 12(1) to rescind their purchase of unregistered shares in a corporation which proposed to build an archery center in Cleveland.[189] The plaintiffs sued the corporation, a selling agent for the corporation, a vice-president of the corporation, and its president.[190] The district court granted summary judgment against the corporation as the actual vendor of the shares but also allowed entry of summary judgment against each of the individual defendants as well, on the grounds that they too qualified as sellers.[191]

In its discussion of the liability of the selling agent, the court shaped the initial contours of the proximate cause test. Commenting on the trial court opinion in *Wonneman*, it stated:

> It is implicit in the Court's reasoning . . . that liability must lie somewhere between the narrow view, which holds [liable] only the parties to the sale, and the too-liberal view which would

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commodities futures options was not a "seller" for purposes of § 12 under proximate cause analysis, notwithstanding his knowledge of boiler-room sales tactics used by seller, his arrangements for registration of the options under state securities laws, his acquisition of office space for the seller's activities, and his representation of the seller in proceedings with the telephone company to supply telephones for use in making sales); Woods v. Homes & Structures of Pittsburg, Kan., Inc., 489 F. Supp. 1270, 1294–95 (D. Kan. 1980) (motion for summary judgment by bond counsel, city attorney, and trustee bank on § 12(2) claims of bond purchasers denied under proximate cause analysis); Mendelsohn v. Capital Underwriters, Inc., 490 F. Supp. 1069, 1087–88 (N.D. Cal. 1979) (motion for summary judgment by law firms and accounting firm on § 12(2) claims of purchasers of real estate limited partnership interests granted under proximate cause analysis); Plunkett v. Francisco, 430 F. Supp. 235, 240–41 (N.D. Ga. 1977) (under proximate cause analysis the purchaser of a cattle lease agreement and calf maintenance program from a Florida corporation was granted summary judgment on § 12(2) claim against a farmer; although plaintiff had no contact with the farmer prior to the sale, the selling agent for the corporation showed the plaintiff a warranty letter executed by the farmer which contained various misrepresentations); Eisenberg v. North Am. Leisure Corp., [1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,434 at 95,489 (S.D.N.Y. March 7, 1974) (motion for summary judgment on § 12(1) claim by defendant broker-dealer and registered representative allegedly connected with a financial plan for sale of unregistered securities denied under proximate cause analysis); Canizaro v. Kohlmeyer & Co., 370 F. Supp. 282, 287–88 (E.D. La. 1974), *aff'd per curiam*, 512 F.2d 484 (5th Cir. 1975) (broker, who did no more than act as plaintiff's agent in executing a purchase order and who did not solicit the order or recommend the stock, was not a substantial factor in plaintiff's purchase and thus was not liable as a seller under § 12(2)).

187. Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965); Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964).

188. 234 F. Supp. 59 (N.D. Ohio 1964).

189. *Id.* at 60, 64.

190. *Id.* at 64–66.

191. *Id.* at 65–66.

> hold [liable] all who remotely participated in the events leading up to the transaction. We think that the line of demarcation must be drawn in terms of cause and effect: To borrow a phrase from the law of negligence, did the injury to the plaintiff flow directly and proximately from the actions of this particular defendant? . . . But for the presence of the defendant Roger in the negotiations preceding the sale, could the sale have been consummated?
>
> We so find. . . . In short, he did everything but draw and sign the contract. The hunter who seduces the prey and leads it to the trap he has set is no less guilty than the hunter whose hand springs the snare. We find that the activity of the corporate defendant's agent Roger is tantamount to that of a "seller" within the liberal remedial spirit of the securities laws.[192]

The district court in *Nicewarner v. Bleavins*[193] used a similar causation analysis to exonerate an attorney from liability under section 12(1) in an action brought by dissatisfied buyers seeking to rescind purchase of a fractional royalty interest in an automotive engine timer.[194] The plaintiffs sued the selling royalty holder as their immediate vendor but also named the attorney who drafted the assignment from the royalty holder to the plaintiffs. The court held the selling royalty holder liable under section 12(1) for failure to register the sale of the fractional royalty interest to the plaintiffs.[195] However, it was unwilling to impose liability upon the attorney as a seller.[196]

The court recited facts showing that the attorney had been substantially involved in the engine timer project in his capacity as counsel for the inventor from the very outset of the venture.[197] Moreover, it found that the attorney had advised the inventor and royalty holder with respect to the tax advantages of assigning fractional royalty interests.[198] The court concluded from these facts that the attorney had reason to anticipate a public offering of such

192. *Id.* at 65. In a more abbreviated discussion the court then focused on the liability of the corporate officers. The vice-president assisted the selling agent at one of the meetings with the plaintiffs, informed the plaintiffs that they had been selected as suitable investors, and encouraged them to attend the closing. On the basis of these actions the court found that the vice-president was indispensable to the final outcome and thus was liable as a seller. *Id.* at 65–66. The president's only connection with the transaction was his execution of the sales contract with the plaintiffs on behalf of the corporation. The court summarily stated that this act was sufficient to justify imposition of seller status upon him as well. *Id.* at 66.

193. 244 F. Supp. 261 (D. Colo. 1965).

194. *Id.* at 266.

195. *Id.* at 264–66.

196. *Id.* at 266.

197. "At every turn in the testing of the timer, in the printing of promotional literature, in the negotiation for manufacture or distribution of the timer, in Colorado, in Canada, in Florida, Hudson was present; but always in the capacity of attorney for Lingenfelter." *Id.*

198. *Id.*

interests and should have known that such an offer would violate the registration requirements of the 1933 Act.[199]

Notwithstanding this characterization of the attorney's activities in connection with the sale, the court used a proximate cause analysis to hold that the attorney was not liable as a seller under section 12(1).[200] The court reasoned that the holdings of the early brokerage decisions import a causation test into section 12(1).[201] Citing those decisions for the broad proposition that a person may sell what he does not own, the court concluded that in order to impose liability as a seller upon a non-owner it is necessary to be able to state that "but for" the particular defendant's conduct, there would have been no sale.[202]

Applying this test to the facts before it, the court found that while the sale would not have been consummated without the services of an attorney, the evidence failed to establish that the defendant did more than serve in that capacity.[203] Emphasizing that the attorney's activities were confined to provision of legal services, the court held that the attorney's conduct did not amount to offering or selling a security.[204] Significantly, the court rejected the plaintiffs' attempt to establish causation under a theory of nonfeasance. While the court agreed that the attorney might have acted to prevent the sale, it stated that his failure to do so did not render him an offeror or seller.[205]

In a series of opinions the Court of Appeals for the Fifth Circuit has more fully developed the causation test first articulated in *Lennerth* and *Nicewarner*. In *Hill York Corp. v. American International Franchises, Inc.*[206] the Fifth Circuit used the language quoted earlier from *Lennerth* to hold two developers of a franchise promotion scheme liable as sellers under sections 12(1)

199. "In short, Hudson had reason to anticipate a public offering; he knew that no registration statement was in effect; he should have known that the assignments were securities; he knew the Nicewarners were from Illinois and could have foreseen the use of the mails or of interstate facilities; and he could see that the Nicewarners needed the protection of the [1933] Act."

Id.

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.* The court rejected the plaintiffs' assertions that they had been induced to purchase the fractional interest in the royalty by the attorney's optimistic statements regarding the timer during a visit to the attorney's office. The court found it more likely that the plaintiffs had already agreed to purchase the interest by the time they reached the attorney's office, and that the visit with the attorney merely served to formalize the transaction. *Id.*

204. *Id.*

205. *Id.* "True, he might have prevented the sale, but failure to do so in these circumstances does not render one a seller or an offeror." *Id.*

206. 448 F.2d 680 (5th Cir. 1971).

and 12(2).[207]

The defendants in *Hill York* formulated a plan to sell restaurant franchises through corporations to be established in various geographic areas. One such corporation was organized in Florida. In accordance with their usual mode of operation, the defendants initially sought out a few local investors to form the Florida corporation and to serve as its officers and directors.[208] These officers and directors then caused the Florida corporation to sell its stock to the plaintiffs, using the stock sale funds to purchase from the defendants the right to sell the restaurant franchises in Florida.[209]

The defendants made none of the actual sales of stock in the Florida corporation to plaintiffs. Indeed, they never met the plaintiffs prior to their purchases. However, they assisted the officers of the Florida corporation in the marketing process by instructing them in solicitation techniques and by providing sales literature.[210] The Florida corporation did not register the sale of its stock with the SEC.[211] Officers of the Florida corporation made numerous misrepresentations to the plaintiffs in connection with the sales.[212]

The plaintiffs sued the defendants under sections 12(1) and 12(2) alleging that the defendants' activities amounted to a pyramid scheme to funnel money to themselves from stock sales in the local corporations.[213] Since the plaintiffs had no direct contact with the defendants prior to their purchases, the court might have had difficulty fitting the defendants into a *Cady* solicitation analysis for purposes of holding them liable as sellers under section 12.[214] Perhaps for this reason the court chose a different route.

Affirming the jury verdict in favor of the plaintiffs, the Fifth Circuit cited the early brokerage cases as authority for the broad proposition that the concept of seller is not limited to the person

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207. *Id.* at 695. *See supra* note 192 and accompanying text.

208. 448 F.2d at 684–85.

209. *Id.* at 685.

210. *Id.*

211. *Id.* at 686.

212. Specifically, the officers of the Florida corporation showed the plaintiffs promotional literature prepared by defendants, told the plaintiffs that one of the defendants was an experienced capitalization consultant, and gave glowing reports on the success of similar sales centers organized by defendants. No disclosure was made of state investigations pending against some of these other centers or of an investigation being conducted by the SEC of a predecessor operation run by the defendants. *Id.* at 685. The court found that the officers of the Florida corporation who made the sales to plaintiffs on behalf of the corporation were as ignorant as the plaintiffs concerning the misrepresentations and omissions. *Id.* at 696.

213. *Id.* at 685–86.

214. See *supra* notes 39–61 and accompanying text for a discussion of the analysis in Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940).

who passes legal title.[215] The court adopted the *Lennerth* proximate cause test as the applicable standard for determining imposition of primary liability under either section 12(1) or 12(2).[216] The court viewed the proximate cause analysis as a reasonable middle ground between what it characterized as an antiquated strict privity approach and an overly broad participation test which attempts to hold liable as sellers all those who participate in events leading up to the transaction.[217]

Applying the proximate cause test to the facts before it, the court found that the defendants qualified as sellers.[218] The court stated that the defendants were the motivating force behind the Florida project and reasoned that the plaintiffs would not have purchased stock in the Florida corporation if the defendants had not come to Florida with their bag of promotional tricks.[219]

Lennerth, *Nicewarner*, and *Hill York* all used a "but for" approach to causation in drawing the original parameters of the proximate cause test.[220] However, tort law has long recognized

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215. 448 F.2d at 692.

216. *Id.* at 692–93. The court noted that the term "seller" has sometimes been accorded a broader construction under § 12(2) than § 12(1). *Id.* at 692 & n.17. *See supra* note 139. However, once the court accepted the proximate cause test as the applicable standard for liability under § 12(1), it felt comfortable using this test as the applicable standard for § 12(2) as well, since it found no authority which supported use of a narrower standard of liability for § 12(2) than § 12(1). *Id.* at 695. The court found it unnecessary to decide whether the proximate cause test would be uniformly sufficient for determining liability under § 12(2) or whether seller liability under § 12(2) might sometimes be accorded a broader construction. *Id.* at 695–96 n. 24. The *Hill York* court thus enunciated the proximate cause test as the applicable standard of liability for both §§ 12(1) and 12(2) but left unanswered the question of whether or not it might be appropriate to broaden the definition of "seller" in future § 12(2) cases.

In Pharo v. Smith, 621 F.2d 656 (5th Cir. 1980), *see infra* notes 228–242 and accompanying text, the Fifth Circuit again addressed a case involving claims under both § 12(1) and § 12(2). The court alluded to the question left open in *Hill York*. The *Pharo* court pointed out that subsequent to *Hill York*, the Fifth Circuit used the proximate cause test in Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973), *see infra* notes 223–227 and accompanying text, without any indication that the word "seller" might be given a different reading in § 12(1) than in § 12(2). Therefore, the *Pharo* court concluded that it was appropriate to use the proximate cause test as the standard of liability for both sections. 621 F.2d at 665–68 & nn. 6–8.

217. 448 F.2d at 692.

218. *Id.* at 693.

219. *Id.* at 693–94. With respect to the § 12(1) count the defendants were also held liable as control persons of the officers of the Florida corporation within the meaning of § 15 of the 1933 Act. 448 F.2d at 693. See *supra* note 29 for text of § 15. The court found this alternative basis of liability unavailable as to the § 12(2) count. It felt that since the officers of the Florida corporation were as ignorant of the misrepresentations and omissions as the plaintiffs, the officers could not be found guilty of § 12(2) violations, and thus the defendants could not be secondarily liable as control persons. 448 F.2d at 696–97.

220. Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965); Hill York Corp. v. American Int'l

the inadequacy of a "but for" approach to causation in the face of concurrent causes.[221] Thus, when the Fifth Circuit next addressed the question of seller status under section 12, it refined its formulation of the proximate cause test to the "substantial factor" approach preferred in torts cases.[222]

Lewis v. Walston & Co.,[223] a case similar on its facts to *Katz v. Amos Treat & Co.*,[224] involved a multi-count complaint against a brokerage firm and broker stemming from the broker's activities in encouraging plaintiffs to invest early in a company expected to go public.[225] Affirming the trial court verdict against the broker under a section 12(1) theory, the court stated that although the broker was not a seller within the conventional meaning of the term, i.e., the person who parts with the stock sold in exchange for consideration, this fact was not conclusive of the broker's liability as a seller under section 12(1).[226] The court pointed to the proximate cause test as the proper standard for determining seller status. The court found that the broker's actions were a "substantial factor" in bringing about the plaintiffs' purchases and thus the proximate cause of those purchases.[227]

In *Pharo v. Smith*[228] the Fifth Circuit was once again called

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Franchises, Inc., 448 F.2d 680 (5th Cir. 1971). *See supra* notes 188–219 and accompanying text.

221. *See generally* W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 41 (4th ed. 1971):

> Restricted to the question of causation alone, and regarded merely as a rule of exclusion, the "but for" rule serves to explain the greater number of cases; but there is one type of situation in which it fails. If two causes concur to bring about an event, and either one of them operating alone, would have been sufficient to cause the identical result, some other test is needed . . . .
>
> The defendant's conduct is a cause of the event if it was a material element and a substantial factor in bringing it about . . . .
>
> Such a formula, for it can scarcely be called a test, is clearly an improvement over the "but for" rule . . . .
>
> If the defendant's conduct was a substantial factor in causing the plaintiff's injury, it follows that he will not be absolved from liability merely because other causes have contributed to the result, since such causes, innumerable, are always present.

Id. at 239–40 (footnotes omitted).

222. *Id.* See *infra* notes 223-227 and accompanying text.

223. 487 F.2d 617 (5th Cir. 1973).

224. 411 F.2d 1046 (2d Cir. 1969). See *supra* notes 154–172 and accompanying text for a discussion of the *Katz* opinion.

225. 487 F.2d at 619–20. The jury originally returned verdicts against both defendants. The trial judge granted judgment notwithstanding the verdict in the firm's favor but allowed the judgment against the broker to stand. 347 F. Supp. at 997–98. The appellate court reversed the judgment in favor of the firm and affirmed the judgment against the broker. 487 F.2d at 624.

226. 487 F.2d at 621–22.

227. *Id.* The court also found it significant that the plaintiffs testified that they had relied on the broker. *Id.*

228. 621 F.2d 656 (5th Cir. 1980).

upon to determine the liability of a collateral participant as a seller under sections 12(1) and 12(2). The defendant, Deltec International, Ltd., was a creditor of W.L. Smith Poultry Company, a corporation owned by the Smith family. W.L. Smith Poultry liquidated and reincorporated under the name Smith's Pride Foods, Inc.[229] Shortly after the reincorporation, Deltec accepted a transfer of restricted stock in Smith's Pride from the Smith family in settlement of the preexisting debt. The Smith family agreed to buy back the shares over the course of a year for a price equivalent to the old debt.[230]

Following reincorporation, Smith's Pride began preparations for a public offering. One of the company's officers convinced the plaintiffs, who were customers of the company, to purchase shares in Smith's Pride in advance of the public offering with a view to registering the shares with the public issue and selling out at a profit when the issue came to market.[231]

The sales to the plaintiffs were not registered with the SEC. When the public offering failed to materialize, the plaintiffs filed a multi-count complaint, which included claims under sections 12(1) and 12(2), against Smith's Pride, various affiliated Smith companies, the Smith family, and the corporate officer who promoted the stock.[232] Smith's Pride went bankrupt during the proceedings, and the plaintiffs were granted leave to amend their complaint to add the creditor Deltec as a defendant to each count.[233] The trial court subsequently granted summary judgment in favor of Deltec.[234] The Fifth Circuit affirmed as to the federal claims.[235]

With respect to Deltec's status as a seller under sections 12(1) and 12(2), the plaintiffs argued that Deltec had a motive to encourage sales by the Smiths of their Smith's Pride stock in order to assure that the Smiths had funds for satisfaction of the repurchase obligation to Deltec. The plaintiffs contended that Deltec knew or should have known that the checks it was receiving for payment of the repurchase obligation might have been funded by proceeds from the illegal sales of Smith's Pride stock to the plaintiffs. The

229. *Id.* at 659.

230. *Id.* at 662.

231. *Id.* at 660–61. Plaintiffs' checks for the stock purchase were made payable to Smith's Pride. However, the shares sold to plaintiffs actually came from a block of stock owned by one of the Smith family members. *Id.*

232. *Id.* at 661.

233. *Id.* at 661–62.

234. The lower court opinion in *Pharo* is not reported but is discussed at 621 F.2d 663.

235. 621 F.2d at 675. The appellate court concluded that the district court's grant of summary judgment operated as a dismissal without prejudice of the pendent state claims, which dismissal was properly within the trial court's discretion. *Id.* at 674–75.

plaintiffs maintained that Deltec should have acted to stop the sales.[236] Tracing the development of the proximate cause analysis through the *Hill York*[237] and *Lewis*[238] cases, the court stated:

> We read *Hill York* and *Lewis* as limiting sections 12(1) and (2) sellers (i) to those in privity with the purchaser and (ii) to those whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place . . . . But beyond the words "substantial factor," we have no guideposts other than the factual situations presented in these two cases to assist us in determining whether to impose strict liability in a given case. Accordingly, we shall examine the salient facts before us to determine whether an analogy with *Hill York* or *Lewis* exists.[239]

Reviewing the record before it, the court found no evidence that Deltec knew of the sales to plaintiffs. The court concluded summarily that the facts before it were not analogous to those in *Hill York* or *Lewis* and that the evidence did not demonstrate that Deltec played a substantial or integral role in effecting the transactions in question.[240] As the court in *Nicewarner* had done, the *Pharo* court rejected the plaintiffs' argument that Deltec's failure to stop the sales when it should have suspected that they were taking place was a substantial causative factor in execution of the transactions.[241]

Given Deltec's attenuated connection to the sales in issue and the plaintiffs' convoluted attempts to establish a causal connection based on Deltec's inaction, the holding in *Pharo* is not particularly surprising. The most telling portion of the opinion is the court's admission of the uncertainty connected with application of the proximate cause test.[242] Nowhere is this uncertainty in application more apparent than in the contrary results reached on similar facts in two recent opinions of the Fifth Circuit regarding seller status under section 12.[243]

In *Croy v. Campbell*[244] Dr. and Mrs. Croy consulted Winfield

236. *Id.* at 668.

237. Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971). *See supra* notes 206–219 and accompanying text.

238. Lewis v. Walston, 487 F.2d 617 (5th Cir. 1973). *See supra* notes 223–227 and accompanying text.

239. 621 F.2d at 667 (footnote omitted).

240. *Id.*

241. *Id.* at 668. See Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965), discussed *supra* notes 193–205 and accompanying text. The *Pharo* court also rejected plaintiffs' arguments that Deltec could be liable under § 12 as an aider and abettor or conspirator (*see infra* note 348 and accompanying text) or liable as a control person under § 15 of the 1933 Act. *Id.* at 668–71.

242. *Id.* at 667. *See supra* text accompanying note 239.

243. Croy v. Campbell, 624 F.2d 709 (5th Cir. 1980); Junker v. Crory, 650 F.2d 1349 (5th Cir. 1981).

244. 624 F.2d 709 (5th Cir. 1980).

Campbell, an attorney and certified public accountant, for tax planning advice. Campbell arranged for the Croys to meet with a real estate developer whom he had represented on previous occasions to discuss purchase of a limited partnership interest as a tax shelter. Campbell told the Croys that the project in question was one of the best investments as a tax shelter that he had ever seen. He gave the Croys a sales brochure from the developer which contained financial information about the project. Campbell used the brochure to make estimates and projections with respect to the Croys' potential tax liability. He reviewed the brochure with them and told them the method he had used in calculating projected depreciation. He did recommend that the Croys make an independent business judgment about the advisability of investing in the partnership.[245] The evidence indicated that the developer was to pay Campbell's fee for representation of the Croys.[246] Campbell's depreciation projections proved to be inaccurate because the basis figure which the developer gave him and which Campbell used in his computations was wrong.[247]

Dissatisfied with their purchase, the Croys sued both the developer and Campbell under section 12(2) of the 1933 Act and rule 10b-5.[248] The developer settled, and trial proceeded against Campbell.[249] The district court directed a verdict against the plaintiffs on both counts of the complaint. The court premised its finding with respect to the section 12(2) count on the ground that the attorney did not qualify as a seller for purposes of section 12(2).[250] The Fifth Circuit affirmed the directed verdict on both counts.[251]

With respect to the seller issue, the Fifth Circuit stated that the scope of the term "seller" should be defined with a view to the

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245. *Id.* at 711.

246. *Id.* Dr. Croy testified that he did not learn of this fee arrangement until after he and his wife had invested in the project. Only then did he discover that the fee was contingent upon their decision to invest. Campbell testified that his fee had not been contingent and that he had disclosed the fee arrangement to the Croys prior to their investment. *Id.*

247. *Id.* at 711-12.

248. *Id.* at 712.

249. *Id.* at 711 n.2.

250. The memorandum decision of the district court is unreported but is summarized at 624 F.2d at 712 & n.4. The district court also found that Campbell made no material misstatements or omissions of fact, that his conduct was not reckless, and that the plaintiffs were estopped by their own conduct from contesting the adequacy of Campbell's investigation. *Id.* at 712.

251. 624 F.2d at 716. Specifically, the appellate court let stand the district court findings that Campbell was not a seller for purposes of § 12(2), that he had not made any material misstatements or omissions, and that his conduct was not reckless. Since these findings adequately disposed of both the § 12(2) count and the rule 10b-5 claim, the court found it unnecessary to address the district court's finding regarding estoppel. *Id.*

purpose of the 1933 Act. The court characterized the 1933 Act as being designed to insure that potential investors are provided with all material information concerning public offerings of securities. It stated that the Act accomplishes this purpose by imposing disclosure requirements on those with access to relevant information.[252] Noting that the 1933 Act should be broadly construed to effectuate its remedial purpose, the court reiterated its rejection of a strict privity approach in favor of the proximate cause analysis outlined in *Hill York*, *Lewis*, and *Pharo*.[253]

The court of appeals determined that the district court's findings with respect to Campbell's participation in the sale were not clearly erroneous.[254] Applying the proximate cause analysis to these findings, the Fifth Circuit affirmed the district court's decision that the attorney was not a seller for purposes of section 12(2).[255] In so doing, it again rejected the plaintiffs' attempt to establish a causal connection based on a theory of the defendant's nonfeasance. The court held:

> Applying these findings to the "seller" concept, as we have defined it, we cannot say that the defendant's participation in this transaction proximately caused the plaintiffs' injury, or that they would not have purchased the security "but for" his actions. The injury was caused by the fact that the figures used by Campbell in arriving at the depreciable basis were in error. Plaintiffs contend that he should be held liable for his failure to investigate these matters thoroughly. This failure to investigate, however, was not a substantial factor in the Croys' investment decision, and Campbell cannot, therefore, be held liable under Section 12(2) as a seller of the security.[256]

The court confined its decision to the facts before it, noting that the opinion should not be interpreted to mean that a lawyer who participates in a transaction can never be liable as a seller for purposes of section 12.[257] Faced with similar facts a year later, the Fifth Circuit ruled in *Junker v. Crory*[258] that an attorney's partici-

252. *Id.* at 712.
253. *Id.* at 713-14.
254. *Id.* at 714. In particular, the district court found: (1) that Campbell made no representations regarding the operational or construction aspects of the project; (2) that he did not participate in preparation of the sales brochure; (3) that when he delivered the sales brochure to the Croys he was acting on their behalf and not on behalf of the developer; (4) that he did not attempt to persuade the Croys to purchase the limited partnership interest; (5) that his statement to the effect that the project was the best investment he had ever seen referred only to projected tax results based upon the figures he had seen; and (6) that the plaintiffs made a decision to invest in the project only after viewing the project, talking with the developer and obtaining independent advice. *Id.*
255. *Id.*
256. *Id.*
257. *Id.*
258. 650 F.2d 1349 (5th Cir. 1981).

pation in a sales transaction did render him liable as a seller under section 12.[259]

In 1959 James Junker was a vice president and sales manager of Road Equipment Company, Inc., a corporation engaged in selling construction equipment. The voting stock of Road was owned by Walter Crory. Junker and Mr. and Mrs. Crory were also among the initial shareholders of Reco Investment Corporation. Reco was organized in 1962 to acquire, improve, and lease industrial property. In 1965 Junker terminated his employment with Road and started a competitive business. However, he retained his minority shareholder position in Reco.[260]

In April 1973 Junker received notice that a Reco shareholders' meeting would be held for the purpose of discussing Reco's indebtedness to Road. The Reco debt was largely a product of the fact that Road paid less than market rates on property leased from Reco, and Reco paid excessive management fees to Road.[261]

Frederik Heisler, an attorney who represented both corporations and Walter Crory, served as chairman of the meeting and acted as proxy for the Crorys. Heisler stated that Reco would either have to borrow money to repay Road or liquidate. The Reco shareholders approved liquidation over the opposition of Junker's proxy, who made a number of motions aimed at challenging the lease arrangement.[262]

In July 1973 the Reco shareholders held another meeting. Heisler was again present, this time as proxy for Mrs. Crory and another shareholder. He stated that in the opinion of the real estate experts he had consulted, liquidation was not practicable. Heisler suggested merging Reco into Road on a book value basis as a means of eliminating the debt.[263] Junker voted in favor of terminating the liquidation but against the merger.[264] However, the merger received the requisite approval and was consummated on a book value basis.[265]

Two months after the merger, Crory wrote all Road shareholders, which by reason of the merger included Junker, and indicated that Road's 1973 annual report would show a net loss due to

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259. *Id.* at 1360–61.

260. *Id.* at 1353–56.

261. *Id.*

262. *Id.*

263. *Id.* at 1354.

264. *Id.*

265. *Id.* The district court credited the plaintiff's evidence that Reco's shares had a value in excess of book value due to appreciation in underlying corporate assets, and that Road's shares had a value less than book value based upon net earning capacity. *Id.* at 1354–55.

large purchases of inventory which had not been sold.[266] No one had disclosed either the inventory purchases or their potential impact on Road's net income to the shareholders at the time of the merger.[267]

Junker filed a multi-count complaint against Road, the officers and directors of Reco, and Heisler. The complaint included a claim against all the defendants under section 12 (2) of the 1933 Act.[268] The Fifth Circuit affirmed the trial court's judgment against Road as Junker's immediate seller under section 12(2).[269] It also affirmed the trial court judgment against the officers and directors of Reco for breach of fiduciary duties owed to Junker under state law.[270] However, the attorney Heisler was not an officer, director or shareholder of either Road or Reco. Thus, there was no pendent state claim on which to premise his liability to Junker. For this reason, the court addressed Heisler's liability as a seller under section 12(2).[271]

Applying the proximate cause analysis, the court concluded that the level of Heisler's participation differed from that of the attorney in *Croy v. Campbell*:

> Heisler's role in bringing about the merger in this case differed significantly from the relatively inactive part played by the lawyer in *Croy*. According to Heisler's testimony, he initially suggested the possibility of a merger to Walter Crory. The minutes of the Reco shareholders' meeting at which the merger was discussed reflect that Heisler attended as Chesley Crory's proxy and advanced the merger as the solution to Reco's financial problems. He also prepared the merger documents. Thus, unlike the attorney in *Croy*, Heisler did attempt to persuade the Reco shareholders to make the purchase of Road stock pursuant to the merger. He also made representations at the Reco shareholders' meeting regarding his investigation into possible sales of Reco property and the feasibility of a liquida-

266. *Id.* at 1355.

267. *Id.*

268. *Id.* at 1356.

269. *Id.* at 1361–62. The court noted that since Road issued the shares received by Junker in the merger, Road was Junker's immediate vendor. Thus, no proximate cause analysis as to seller status was necessary. The court found that the plaintiff had established all other elements of his prima facie case under § 12(2) against Road, and that Road had failed to establish the available due care defense. *Id.*

270. *Id.* at 1358. In light of its affirmance of the state law claims, the court did not find it necessary to reach the federal securities law claims asserted against the officers and directors. The court noted that some of these issues, in particular (1) the status of the Reco officers and directors as sellers under § 12(2), (2) the existence of private cause of action under § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976), and (3) whether a minority shareholder who votes against a merger can establish reliance on the officers and directors for purposes of recovery under rule 10b-5, had not been adequately addressed by the parties. *Id.* at n.10.

271. *Id.* at 1358–60.

> tion of Reco as compared with the merger. The evidence of Heisler's involvement in the effort to bring about the merger supports the trial court's finding that he was a key participant in the transaction. His role was not that of a passive advisor as was that of the attorney in *Croy*; rather, he was an active negotiator in the transaction, acting as agent-in-fact as well as attorney-at-law, implementor not counsellor. Therefore, we agree with the trial court's conclusion that Heisler's actions brought him within the scope of the seller definition under Section 12(2).[272]

Fine distinctions can no doubt be drawn between the facts in *Croy* and *Junker*. However, one must question the attempt by the *Junker* court to justify the differing results of the proximate cause analysis in the two cases on the grounds that the attorney in *Croy* was a mere passive advisor playing a relatively inactive role in the plaintiffs' investment, as compared to Heisler's role in the Road-Reco merger. The attorney in *Croy* put the plaintiffs in touch with the developer from whom they purchased their limited partnership interest. That developer was a prior client of the attorney, and he agreed to pay the attorney's fee for representation of the plaintiffs in the transaction in question. The attorney told the plaintiffs that the project was the best tax shelter he had ever seen, and he reviewed the developer's sales literature with them.[273] These facts hardly seem to support the *Junker* court's characterization of the Croys' counsel as passive. This is stated not so much to challenge or defend the holding in either case, but to emphasize that the inconsistency and uncertainty which beset the participation cases plague the proximate cause analysis as well.

As Judge Tjoflat conceded in *Pharo v. Smith*,[274] apart from the words "substantial factor," the Fifth Circuit's proximate cause analysis offers no guidelines for application.[275] As evidenced by the varying results reached by courts which have attempted to apply the proximate cause analysis, a participant whom one court judges to be a substantial factor in causing a plaintiff's purchase might in a slightly different factual setting be denominated as not significant enough to justify characterization as a seller.[276] This was true in the case which first employed the proximate cause test. The court in *Lennerth v. Mendenhall*[277] applied its causation analysis without distinction to impose seller status upon the selling

272. *Id.* at 1360.

273. *See supra* notes 244–257 and accompanying text.

274. 621 F.2d 656 (5th Cir. 1980). *See supra* notes 228–242 and accompanying text.

275. 621 F.2d at 667. *See supra* text accompanying note 239.

276. *See supra* note 186.

277. 234 F. Supp. 59 (N.D. Ohio 1964). *See supra* notes 188–192 and accompanying text.

agent who heavily promoted the investment to the plaintiffs, as well as upon a corporate officer whose sole connection with the transaction was execution of the purchase contract on behalf of the corporate issuer.[278] The absence of workable guidelines is equally apparent in the divergent holdings in *Croy* and *Junker*.

Without any pretext of premise in the statutory definitions of "offer" and "sell" in section 2(3),[279] the Fifth Circuit chooses to define seller in broad policy strokes by borrowing one of the most complicated concepts of tort law with all of its attendant problems.[280] The substantial factor formula is considered in torts a sufficiently intelligible phrase to serve by itself as an adequate guideline for determining the question of causation in fact.[281] However, once it has been established that the defendant's conduct was in fact one of the causes of the plaintiff's injury, tort law has long recognized the inadequacy of the substantial factor test for determining whether the defendant's conduct was so significant and important a cause that the law should extend responsibility for the conduct to the consequences which have occurred.[282] It

278. *Id.*

279. *See supra* note 48 (text of § 2(3)). *See also supra* notes 39-59 and accompanying text (analyzing Cady v. Murphy, 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940), and its use of the definitions of "offer" and "sell" to expand liability under § 12(2)).

280. See *supra* note 221 for a discussion of the substantial factor test.

281. *See* W. PROSSER, *supra* note 221, § 41:

> The defendant's conduct is a cause of the event if it was a material element and a substantial factor in bringing it about. Whether it was such a substantial factor is for the jury to determine, unless the issue is so clear that reasonable men could not differ. It has been considered that "substantial factor" is a phrase sufficiently intelligible to the layman to furnish an adequate guide in instructions to the jury, and that it is neither possible nor desirable to reduce it to any lower terms. As applied to the fact of causation alone, no better test has been devised.

Id. at 240 (footnotes omitted).

282. *Id.* § 42:

> Once it is established that the defendant's conduct has in fact been one of the causes of the plaintiff's injury, there remains the question whether the defendant should be legally responsible for what he has caused. Unlike the fact of causation, with which it is often hopelessly confused, this is essentially a problem of law . . . . [T]his becomes essentially a question of whether the policy of the law will extend the responsibility for the conduct to the consequences which have in fact occurred . . . . This is not a question of causation, or even a question of fact, but quite far removed from both; and the attempt to deal with it in such terms has lead and can lead only to utter confusion.
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> . . . .
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> As applied to the fact of causation alone, the [substantial factor] test is of considerable assistance, and perhaps no better guide can be found. But when the "substantial factor" test is made to include all the ill-defined considerations of policy which go to limit liability once causation in fact is found, it has no more definite meaning than "proximate cause," and it becomes a hindrance rather than a help. It is particularly unfortunate insofar as it suggests that the questions involved are only

is this latter question which is at issue in most of the proximate cause cases discussed above. For purposes of this inquiry, the substantial factor test lacks any definite meaning.

The courts in the participation cases rejected strict privity in favor of holding some participants in a sale liable as sellers. However, they failed to articulate what measure of participation justifies imposition of seller status.[283] The courts in the proximate cause cases attempted to answer this question by narrowing the field to those whose participation is a substantial factor in causing the sale. However, the substantial factor formula without more fails to delineate any guidelines for determining when the defendant's conduct rises to a level of significance sufficient to trigger seller status, as opposed to a finding that the defendant's conduct is not integral to the sale.[284]

The deficiency in both approaches is that the analysis of seller status has been divorced from the clear language of the statute and from an examination of section 12(2) in the context of the total statutory scheme.[285] The plain language of section 12(2) contemplates rescissory relief restoring the status quo between a purchaser and his immediate seller. Thus limited in scope, it imposes liability on the defendant seller for negligence without proof of reliance by the purchaser.[286] Rule 10b-5 affords relief to a plaintiff against a defendant irrespective of any privity between plaintiff and defendant in the transaction in question. However, thus broadened in scope, it requires the plaintiff to prove other elements in order to justify imposition of liability upon the defendant.[287] In particular, the plaintiff must prove that he relied on the misrepresentation or omission alleged and must establish a state of mind on the part of the defendant greater than negligence.[288]

Having departed from the clear language and intended scope of section 12(2) to afford relief against some participants collateral to the sale, it is not surprising that the courts in the participation

> questions of causation, obscuring all other issues, and as it tends to leave to the jury matters which should be decided by the court . . . . [T]he 1948 revision of the Restatement has limited its application very definitely to the fact of causation alone.

Id. at 244, 248 (footnotes omitted). *See also* RESTATEMENT (SECOND) OF TORTS §§ 431, 433 (1965).

283. *See supra* notes 113–185 and accompanying text.

284. *See supra* notes 274–282 and accompanying text.

285. *See infra* notes 357–379, 391–418 and accompanying text.

286. See *supra* note 1 for the text of § 12(2). *See also supra* notes 20–25 and accompanying text.

287. *See supra* notes 16–18 and accompanying text (comparing and contrasting a § 12(2) action with a rule 10b-5 action).

288. *See supra* note 17.

and proximate cause cases have difficulty drawing lines as to which defendants have participated to a culpable degree. The participation and proximate cause cases upset the careful balance between the privity requirement in section 12(2) and the reduced culpability standard contained therein. They deem to be sellers certain collateral participants who should be reachable only under rule 10b-5 with its greater requirements of proof.[289] Indeed, it is significant that many of the courts in the proximate cause cases reach their findings regarding whether the defendant played a causal role in the transaction by importing reliance and scienter elements into the causation inquiry.[290] The Eighth Circuit's definition of "seller" does nothing to shut this Pandora's box.

C. *The Eighth Circuit Test*

In *Wasson v. SEC*[291] the defendant Wasson, a broker-dealer,

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289. *See infra* notes 391–418 and accompanying text.

290. *See, e.g.*, Davis v. Avco Fin. Servs., Inc., 1983 FED. SEC. L. REP. (CCH) ¶ 91,569, at 98,919 (6th Cir. July 10, 1984) (although purporting not to introduce reliance as a part of plaintiffs' prima facie case under § 12(2), court remands as to some members of plaintiff class for findings regarding extent to which purchases were caused by collateral participant's activities); Pharo v. Smith, 621 F.2d 656, 667–68 (5th Cir. 1980), discussed *supra* notes 228–242 and accompanying text (in holding that Deltec was not the proximate cause of plaintiffs' purchases, court emphasized that Deltec had no knowledge of the illegal sales of Smith's Pride stock being made to plaintiffs by the Smith family; all that plaintiffs' proof established was that Deltec should have surmised this and stopped the sales; this was not a sufficient basis for finding that Deltec was a substantial factor in the sales); Croy v. Campbell, 624 F.2d 709, 714 (5th Cir. 1980), discussed *supra* notes 244–257 and accompanying text (in holding that attorney Campbell was not the proximate cause of plaintiffs' purchase, Fifth Circuit noted district court finding that plaintiffs made a decision to purchase their limited partnership interest only after viewing the project, speaking with the developer and obtaining independent advice); Ayers v. Wolfinbarger, 491 F.2d 8, 14 (5th Cir. 1974), *see supra* note 186 (exonerating the defendants who sold their stock in a financial corporation under a deferred payment arrangement to three individuals, who upon gaining control of the financial corporation sold the stock to the plaintiffs; the court emphasized that there was no evidence that the defendants knew or should have known that their purchasers would violate the securities laws in the sale of the secondary issue to plaintiffs); Lewis v. Walston, 487 F.2d 617, 622 (5th Cir. 1973), *see supra* notes 223–227 and accompanying text (in holding broker liable as proximate cause of plaintiffs' purchase, the court pointed to testimony by the plaintiffs that they had relied upon the broker); Plunkett v. Francisco, 430 F. Supp. 235, 241 (N.D. Ga. 1977), *see supra* note 186 (farmer, who had no contact with plaintiff prior to plaintiff's purchase of a tax shelter, was nonetheless a proximate cause of plaintiff's purchase; court noted that plaintiff had relied heavily upon a warranty letter executed by the farmer, as well as upon the selling agent's representations that the farmer was a principal in the corporation promoting the tax shelter program); Nicewarner v. Bleavins, 244 F. Supp. 261, 266 (D. Colo. 1965), *see supra* notes 193–205 and accompanying text (in holding that attorney was not the proximate cause of plaintiff's purchase of fractional royalty interest, court discounted plaintiff's testimony that they did not decide to purchase until after an office visit with the attorney in which he made optimistic statements about the invention).

291. 558 F.2d 879 (8th Cir. 1977).

appealed an SEC administrative order issued under section 15 of the 1934 Act.[292] The order suspended his registration because of violations of section 5 of the 1933 Act.[293] In particular, Wasson was charged with helping to effectuate sale through a straw man of a substantial block of unregistered stock in a company known as S & M. The stock actually belonged to a control person of S & M and was not freely transferable.[294]

Wasson defended the section 5 charges on the ground that he had not personally executed sale of the unregistered securities. He acknowledged that decisions involving violation of section 5 under section 12(1) have in some instances broadened the definition of "sell" to include participants who have no contact with the purchaser. He argued, however, that the section 12(1) cases are inapposite to violations of section 5 when prosecuted under section 15 of the 1934 Act. Wasson reasoned that the expansive definition given to the term "sell" in section 12 cases is attributable to the fact that this section lacks an aider and abettor provision. He argued that such a broad definition is unnecessary under section 15 of the 1934 Act since section 15 expressly allows sanctions against aiders and abettors.[295]

Without drawing any distinction between the SEC disciplinary action before the court and rescission actions under section 12, the Eighth Circuit discussed the participation and proximate

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292. Section 15 of the 1934 Act, 15 U.S.C. § 78o (1976).

293. 558 F.2d at 882.

294. *Id.* The actual mechanics of the transaction were as follows: An officer of S & M was interested in selling certain of his S & M shares in exchange for some automobiles from a Minneapolis dealership. The officer's attorney contacted Howard Davidson, a Minneapolis resident, to locate an interested car dealer. Davidson lined up Samuel Proman, a Minneapolis car dealer, who expressed interest in the exchange. Proman in turn contacted the defendant Wasson and asked him to follow the price of S & M stock for awhile. Subsequently Proman agreed to exchange seven cars for 30,000 shares of S & M stock, which stock he intended to resell on the market immediately. The officer of S & M transferred title to the shares into Davidson's name for purposes of effecting the trade; Proman transferred title to the automobiles, which served as consideration for the shares, into the name of seven out-of-state residents. The shares were to be transferred from Davidson's name to the dealership's name for immediate resale. However, the dealership had no account with Wasson's firm. Wasson, therefore, opened an account in Davidson's name. The shares were resold on the open market in Davidson's name, and the proceeds from the resale were assigned by Davidson to the auto dealership pursuant to an agreement prepared by Wasson. *Id.*

Wasson knew that Davidson was not the legal owner of the S & M stock being exchanged for the cars and knew that Davidson was not the recipient of the cars transferred in the exchange. Wasson apparently did not know that the legal owner of the shares was a control person of S & M subject to resale restrictions. However, he was sanctioned because he failed to discover what a simple inquiry of Davidson would have revealed—that the legal owner was a control person, and because he did not apprise his superiors of sufficient details regarding the transaction to trigger a more cautious investigation on their part. *Id.*

295. *Id.* at 885.

cause tests developed in section 12 actions for determining seller status.[296] Like the Fifth Circuit, the Eight Circuit rejected the participation test as overly broad.[297] However, the Eighth Circuit also criticized the Fifth Circuit's proximate cause analysis for failing to adequately focus on implementation of the disclosure policy behind the 1933 Act.[298] The Eighth Circuit viewed this disclosure policy as pivotal to the determination of whether a defendant's conduct qualifies as a "sale" or "offer to sell".[299]

The court noted that the 1933 Act imposes registration and disclosure requirements on those with access to information and frequently ties applicability of these requirements to the point of sale.[300] The court stated that at least theoretically this is the time at which relevant information can be obtained from the seller and transmitted to the buyer.[301] While conceding that the nature of securities transactions may sometimes make it impossible to identify the sales point at which seller contacts buyer, the court concluded:

> We are not suggesting that a sales point must be identified for each transaction and liability imposed according to each indi-

296. *Id.* at 885-86. The SEC in its own enforcement of § 5 has long used participation theories to hold defendants other than the immediate vendor primarily liable as sellers and has also employed secondary liability theories such as aiding and abetting. *See, e.g.*, SEC v. Holschuh, [1982-1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,000, at 94,623-27 (7th Cir. November 23, 1982); SEC v. Murphy, 626 F.2d 633, 648-652 (9th Cir. 1980).

In *SEC v. Murphy* the court juxtaposed the development of participant liability in SEC enforcement proceedings against the development of the participation and proximate cause theories in rescission actions under § 12. The court concluded that the SEC enforcement participation standard is theoretically broader than the substantial factor test, although it concluded that in practice the standards differ little. 626 F.2d at 651-52. See *supra* note 74 for a discussion of SEC v. Murphy.

The *Murphy* court noted that the *Wasson* case is the only decision which, in the context of an SEC enforcement proceeding, chose to discuss the scope of the term "sale" in light of § 12 cases rather than in light of the SEC enforcement cases. 626 F.2d at 651 n.21.

The fact that the SEC in an enforcement context uses participation theories to broaden the scope of primary liability for violation of § 5, as well as secondary liability theories such as aiding and abetting, is not dispositive of the scope of civil liability under § 12. *See supra* notes 63-92 and accompanying text. *See also* 3 L. LOSS, *supra* note 17: "For example, a newspaper which publishes advertisements in violation of § 5 becomes itself a violator as an aider and abettor, subject to injunctive and criminal proceedings. But it is hardly consistent with the statutory purpose that newspapers be subjected to civil liability under § 12." *Id.* at 1716 n.105 (citations omitted).

For a discussion of the enforcement provisions available to the SEC for violation of § 5, see *supra* note 69. For a discussion of the SEC's use of secondary liability theories in enforcement proceedings, see *infra* notes 318-319 and accompanying text.

297. 558 F.2d at 886.

298. *Id.*

299. *Id.*

300. *Id.*

301. *Id.*

> vidual's proximity to that point. However, we do believe that one factor which ought to be considered in determining the "sale" or "offer to sell" issue is whether the defendant was uniquely positioned to ask relevant questions, acquire material information, or disclose his findings.[302]

The court had no difficulty concluding that Wasson was a seller under the standard articulated above.[303] The court held:

> We believe Wasson should be treated as a seller because of his extensive role in facilitating the sale, because he was made aware of questionable circumstances surrounding the transaction which should have been investigated more fully and revealed in detail to his superiors, and because his position in the flow of information made his failure to fully investigate or disclose all the more serious.[304]

As discussed in the analysis of *Cady v. Murphy*,[305] a finding that someone other than the immediate vendor may be liable in an enforcement context for offering or selling a security in violation of section 5 does not present the analytical difficulties raised in a section 12 action.[306] The additional language in section 12 making the person who offers or sells a security liable to the person purchasing such security from him for a rescissory measure of relief is not present in the enforcement context to circumscribe the terms "offer" and "sell" to the immediate vendor.[307]

However, even in an enforcement setting, the Eighth Circuit's approach of defining "offer to sell" and "sale" in terms of broad policy considerations presents problems. Like the participation and proximate cause tests, the focus of the *Wasson* court on whether the defendant's position in the transaction gave him access to information or an opportunity to disclose removes the analysis of seller status from any reference to the statutory definitions of the operative terms in section 2(3).[308]

The Eighth Circuit seemed to draw no distinction in *Wasson* between analysis of seller status in enforcement proceedings and in section 12 actions. If the Eighth Circuit's approach is applied in the context of a rescission action under section 12, it has the potential of expanding the circle of possible defendants even further than the participation and proximate cause tests. This is be-

302. *Id.*

303. *Id.*

304. *Id.* at 887.

305. 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940). *See supra* notes 63–92 and accompanying text.

306. *See supra* notes 63–92 and accompanying text.

307. *See supra* notes 63–92 and accompanying text.

308. See *supra* note 48 for the text of § 2(3). The *Wasson* court briefly mentions § 2(3): "The 'sale' term in § 2(3) was meant to be interpreted liberally . . . but not so liberally that all participants in a transaction share liability." 558 F.2d at 886 (citations omitted).

cause the Eighth Circuit's emphasis on the defendant's access to information and opportunity to disclose might result in imposition of seller status for nonfeasance.

The courts in *Nicewarner v. Bleavins*,[309] *Pharo v. Smith*,[310] and *Croy v. Campbell*[311] all rejected arguments that the defendants should be held liable as sellers because their failure to investigate further and to halt the transactions in question were a causative factor in the sales. In contrast, the Eighth Circuit held Wasson liable as a seller not only on the basis of his affirmative assistance to the transaction, but also for his failure to make additional inquiries regarding the identity of the actual seller and his failure to disclose suspicious circumstances to his superiors.[312]

At least two district court cases have subsequently applied the Eighth Circuit's access to information and disclosure test in the context of a section 12 rescission action.[313] Both cases absolved the collateral participants from seller status on the grounds that their involvement was incidental to the sales in question and that there was no proof that they were aware of suspicious circumstances warranting investigation or disclosure.[314]

The participation cases, the proximate cause cases, and the Eighth Circuit approach each expand the meaning of the term

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309. 244 F. Supp. 261 (D. Colo. 1965). *See supra* notes 193–205 and accompanying text.

310. 621 F.2d 656 (5th Cir. 1980). *See supra* notes 228–242 and accompanying text.

311. 624 F.2d 709 (5th Cir. 1980). *See supra* notes 244–257 and accompanying text.

312. 558 F.2d at 886–87.

313. Jeffries & Co. v. United Missouri Bank, [1982–1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,257, at 96,140, 96,144 (W.D.Mo. May 24, 1983); Lingenfelter v. Title Ins. Co. of Minnesota, 442 F. Supp. 981, 992–93 (D. Neb. 1977). In Hagert v. Glickman, Lurie, Eiger & Co., 520 F. Supp. 1028, 1035–36 (D.Minn. 1981), *see infra* notes 380–382 and accompanying text, the court granted a defense motion to dismiss but permitted plaintiffs leave to amend their complaint to plead with more particularity the status of certain attorneys and accountants as § 12 sellers under the *Wasson* test. *Id.* at 1035–36.

But cf. Stokes v. Lokken, 644 F.2d 779, 784–85 (8th Cir. 1981), where in connection with a claim by plaintiffs that an attorney had aided and abetted violations of § 5, the Eighth Circuit discussed seller liability in § 12 actions in terms of the proximate cause test without any mention of *Wasson*. *Id.* at 784–85.

314. *See supra* note 313. In Jeffries & Co. v. United Missouri Bank, the court used the *Wasson* test to hold that a bank's role in an insider's sale of stock in his company shortly before its collapse fell short of the involvement needed to transform the bank into a statutory seller under § 12(1) or § 12(2). [1982–1983 Transfer Binder] FED. SEC. L. REP (CCH) ¶ 99,257, at 96,144. The bank held stock securing the insider's personal loan. *Id.* at 96,142. It informed the insider of the number of shares which he would need to sell in order to close out the loan and on the insider's request directed the sale. *Id.* Relying on the *Wasson* standard, the court characterized the bank's activities in this regard as amounting to only incidental involvement in the sale. *Id.* at 96,144. It emphasized that the bank was not aware of any questionable circumstances which should have alerted it to investigate further. The court noted that no one at the

"seller" far beyond the confines of the narrow exception for brokerage situations which the court carved out in *Cady v. Murphy*.[315] In contrast to the analysis in that decision, which was premised on the definition of the operative terms in section 2(3),[316] the courts' analyses in the facilitation cases have no basis in the language of the statute. In the outermost extension of section 12(2), a number of courts import theories of secondary liability into section 12(2).[317] These cases all but sound the death knell of the privity requirement.

IV. THE EXPANDED SELLER CONCEPT MOVES FULL CIRCLE: SECONDARY LIABILITY FOR AIDING AND ABETTING OR CONSPIRACY

Federal securities law cases have often used theories of aiding and abetting and of conspiracy to support imposition of implied secondary civil liablity upon peripheral defendants who have not themselves violated a statute, but who have been connected in some manner with the primary wrongdoer.[318] These doctrines

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bank was a broker, such as Wasson, with a duty to investigate more fully or to report to superiors. *Id.*

Similarly, in Lingenfelter v. Title Ins. Co. of Minnesota, the court used the *Wasson* test to exonerate a title insurance company and its wholly-owned subsidiary from liability as sellers under § 12(2). 442 F. Supp. at 992-93. Plaintiffs purchased investment packages, which consisted of certain evidences of indebtedness relating to real estate interests, accompanied by title insurance and collection services provided by the defendant companies. *Id.* at 987-89. The court held that the provision of such services did not amount to facilitating sales of the investment packages. *Id.* at 991-93. The plaintiffs failed to prove that the defendants were aware of questionable circumstances surrounding the sales which they should have investigated or disclosed. *Id.* at 993.

In both cases the court also held that the collateral participants did not aid and abet violations of § 12(2). Jeffries & Co. v. United Missouri Bank, [1982-1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,257 at 96,144 n.6; Lingenfelter v. Title Ins. Co. of Minnesota, 442 F. Supp. at 993.

315. 30 F. Supp. 466 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir.), *cert. denied*, 311 U.S. 705 (1940). *See supra* notes 39–61 and accompanying text.

316. *See supra* notes 39–61 and accompanying text.

317. *See supra* notes 241-316 and accompanying text; *see infra* notes 318–343 and accompanying text.

318. *See generally* Ruder, *supra* note 17, at 620–44; Fischel, *supra* note 17, at 83-86.

Liability for aiding and abetting generally involves proof of three elements: (1) that an independent wrong exists; (2) that the aider and abettor knows of the wrong's existence; and (3) that the aider and abettor renders substantial assistance in effecting that wrong. *See generally* A. JACOBS, *supra* note 17, § 40.02; Ruder, *supra* note 17, at 620–46.

Securities law cases have not always clearly distinguished between secondary liability imposed under a theory of aiding and abetting and secondary liability imposed under a theory of conspiracy. Ruder, *supra* note 17, at 639–41. However, drawn from the general law of conspiracy, the elements of securities conspiracy have been defined as follows:

first appeared in disciplinary proceedings and injunctive actions commenced by the SEC. Their development in this context relied heavily on precedent from criminal law.[319]

The doctrines of aiding and abetting and conspiracy made their way from use in disciplinary proceedings and injunctive actions brought by the SEC to use in implied private damage actions under rule 10b-5. Development of the doctrines in this context rested in part on the SEC precedents mentioned above, but also upon extension of the general tort law principles on which courts had initially relied in recognizing an implied private action under section 10(b).[320]

> The essential elements of civil and criminal conspiracy are an agreement between two or more persons to accomplish an illegal act or to engage in a legal act by unlawful means, an illegal or fraudulent overt act in furtherance of the conspiracy, and, in a civil case, damage to a person not a member of the conspiracy.

A. JACOBS, *supra* note 17, § 40.03, 2-156-57 (footnote omitted).

Comparing and contrasting liability for aiding and abetting with liability for conspiracy, Professor Ruder concludes that both doctrines involve existence of an independent wrong to which the secondary defendant can attach himself and a showing that the secondary defendant knew of the wrong. *See* Ruder, *supra* note 17, at 628, 630. Professor Ruder distinguishes the two theories by noting that in aiding and abetting the secondary defendant's attachment to the wrong takes the form of substantial assistance to the wrongdoer, whereas under a conspiracy theory the secondary defendant's attachment to the wrong comes from an agreement with the wrongdoer. Ruder, *supra* note 17, at 638-39. For another commentator's comparison and contrast of aiding and abetting and conspiracy, see A. JACOBS, *supra* note 17, at § 40.03, 2-160.

319. SEC v. Timetrust, Inc., 28 F. Supp. 34 (N.D. Cal. 1939), *injunction granted*, 39 F. Supp. 145 (N.D. Cal. 1940), *appeal dismissed on stipulation*, 118 F.2d 718 (9th Cir. 1941), *injunction reversed*, 142 F.2d 744 (9th Cir. 1944), illustrates this reliance on criminal law analogues. In that action the SEC sought to enjoin defendants from aiding and abetting a violation of § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976). 28 F. Supp. at 36. Section 17(a) is the general antifraud provision of the 1933 Act. It is roughly analagous to § 10(b) of the 1934 Act, except that it is directed at fraud in the offer or sale of a security and does not extend to fraud in the purchase of a security.

In denying a defense motion to dismiss the complaint, the court noted that if the action had been brought as a criminal proceeding under the 1933 Act for violation of § 17(a), the defendants could have been named as aiders and abettors since the federal criminal code renders aiders and abettors liable as principals. 28 F. Supp. at 43. The court reasoned that an injunctive action by the SEC is similar in many respects to a criminal prosecution, and thus the doctrine of aiding and abetting should be equally applicable in civil injunctive proceedings. *Id.*

See generally Ruder, *supra* note 17, at 624–28; A. JACOBS, *supra* note 17, at § 40.02, 2-146 & nn.1-3.

320. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D.Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), is perhaps the best example of this reliance on tort law principles. In that case the defendants argued that aiding and abetting should not be available under rule 10b-5 because there is no explicit statutory language in § 10(b) evidencing Congressional intent to hold aiders and abettors liable. *Id.* at 675–76. Rejecting the defendants' position, the court noted that the first case to recognize a private right of action under rule 10b-5, Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), did so not on the basis of explicit statutory language but upon general principles of tort law, in particu-

However, relatively early in the decisional history of section 12(2), the notion of secondary liability for aiding and abetting or conspiracy was summarily rejected by a number of courts and for good reason.[321] The criminal and tort law analogues used to support implication of secondary liability theories in SEC enforcement cases and in implied actions under rule 10b-5 are not present in the express cause of action provided under section 12(2).

With respect to the criminal law origins of the doctrines, section 12(2) stands in marked contrast to other sections of the 1933 and 1934 Acts in which theories of aiding and abetting or conspiracy have been used.[322] Section 12(2) neither defines a violation nor purports to make any act illegal. It merely imposes civil liability on a seller in favor of an aggrieved purchaser. Thus, it cannot serve as a premise for a disciplinary proceeding or civil injunctive action by the SEC.[323] As noted above, SEC actions are the context in which secondary civil liability theories traditionally developed by way of analogy to criminal prosecutions.[324]

With respect to the tort law origins of the doctrines, section

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lar RESTATEMENT OF TORTS § 286 (1939). 259 F. Supp. at 680. The court found it appropriate to continue to use general principles of law to shape the development of federal common law remedies under the rule. The court held that recognition of an aiding and abetting theory as formulated in RESTATEMENT OF TORTS § 876 (1939) and in the SEC precedents mentioned above was a logical and natural complement to the *Kardon* doctrine. *Id.*

See generally Ruder, *supra* note 17, at 620–23; A. JACOBS, *supra* note 17, at § 40.02, 2-146 & nn.4–5.

321. *See, e.g.*, Kramer v. Scientific Control Corp., 365 F. Supp. 780, (E.D. Pa. 1973); 452 F. Supp. 812, 814–15 (E.D. Pa. 1978); Fershtman v. Schectman, [1970–1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 92,996 at 90,678 (S.D.N.Y. April 9, 1971), *aff'd as modified*, 450 F.2d 1357 (2d Cir. 1971), *cert. denied*, 405 U.S. 1066 (1972); Barlas v. Bear, Stearns & Co., [1964–1966 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,674 at 95,477–78 (N.D. Ill. March 31, 1966); Zachman v. Erwin, 186 F. Supp. 681, 686 (S.D. Tex. 1959), discussed *supra* notes 114–125 and in accompanying text.

322. *Compare* § 12(2), *supra* note 1, *with* § 5 of the 1933 Act, 15 U.S.C. § 77e (1976), discussed *supra* note 67 and in accompanying text, *with* § 10(b) of the 1934 Act, the text of which appears *supra* note 5.

323. *See* A. BROMBERG, *supra* note 11 at § 8.5 (315):

> A conceptual barrier to the adoption of aiding-abetting and conspiracy notions for § 12(2) is that the provision merely imposes a liability. It does not (like [Securities Act] § 17(a) or Rule 10b-5) define a violation or make an act unlawful. Aiding-abetting and conspiracy, with their criminal origins, are more conformable to a violation section than to an express liability section.

Id. § 206.7.

See also Rapp, *supra* note 31, at 490 & n.157, in which the author concedes this point but goes on to conclude that pragmatic and policy considerations favor recognition of secondary liability theories in the context of § 12(2). *Id.* at 489–501.

324. *See supra* note 319 and accompanying text.

12(2), unlike rule 10b-5, is an express cause of action.[325]. It derives its existence from the explicit language of the statute, and that language serves to define its scope. Section 12(2) did not originate as an implied cause of action from tort law principles, and it is inappropriate to employ such principles in determining its parameters.[326] The statute contains a privity requirement on its face. This limitation in scope is broadened only by the controlling persons provision in section 15.[327] Given this framework, the absence of explicit statutory language imposing liability for aiding and abetting or conspiracy is controlling in the context of section 12(2), in contrast to the analysis of many courts with respect to rule 10b-5.[328]

The machinations in the expanded seller cases may well have begun as a response to the fact that courts could not rationalize the use of implied theories of secondary liability in the face of the 1933 Act's tightly constructed statutory scheme with its system of express actions explicitly defining the scope of defendants. Faced with conceptual barriers to the development of secondary liability theories in the context of section 12(2), these courts chose instead to reach collateral participants by expanding the concept of who may be treated as a seller for purposes of primary liability under section 12(2).[329] In so doing, the expanded seller cases bring in as

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325. *Compare* § 12(2), *supra* note 1, *with* § 10(b) *and* rule 10b-5, *supra* notes 5 and 7.

326. In contrast, initial recognition of an implied cause of action under rule 10b-5 was premised in part upon tort law principles. The first court to imply a private cause of action under rule 10b-5 relied heavily on the tort law principle that a person injured by violation of a statute designed for his benefit is entitled to a remedy. Kardon v. National Gypsum Co., 69 F. Supp. 512, 513–514 (E.D. Pa. 1946). *See* A. JACOBS, *supra* note 17, at § 40.02, 2–146 & nn.4–5.

327. *See supra* notes 29–30 and accompanying text.

328. *Compare* the analysis of the court with respect to rule 10b-5 in Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), discussed *supra* note 320, *with* the approach of the court in Zachman v. Erwin, 186 F. Supp. 681, 686 (S.D. Tex. 1959), rejecting secondary liability for conspiracy in the context of § 12(2):

> The Securities Act only imposes liability for selling a security under Section 77*l* and for controlling a seller under Section 77*o*. . . . The Securities Act has no provision for liability of parties on the ground of conspiracy. Any allegation of liability of Blanchard on the basis of conspiracy to violate the Securities Act, therefore, is insufficient to state a claim in this action.

186 F. Supp. at 686.

329. This approach is exemplified by the holding in Zachman v. Erwin, 186 F. Supp. 681 (S.D. Tex. 1959). The *Zachman* court dismissed a defendant whom the plaintiffs sought to reach under a conspiracy theory, *id.* at 686. The court rejected secondary liability for conspiracy in light of the structure of § 12(2) and § 15 and the absence of a specific provision in the 1933 Act imposing liability for conspiracy. *See supra* note 328. However, it sustained the plaintiffs' complaint against a variety of other non-privity defendants, who were alleged to have "participated" as sellers or as

primary defendants collateral participants who would frequently be classified as secondary defendants under aiding and abetting or conspiracy theories if rule 10b-5 was involved.[330]

In the most far-reaching extension of section 12(2), the expanded seller concept moves full circle. A number of courts have begun to embrace theories of secondary liability for aiding and abetting and conspiracy in the context of section 12.[331] *In re Caesars Palace Securities Litigation*[332] is the decision most fre-

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control persons of sellers, 186 F. Supp. at 686. *See supra* notes 114–125 and accompanying text.

See Rapp, *supra* note 31:

> The early rejections of purely secondary liability under section 12 probably contributed to the expansion of primary liability under that section through the expanded definition of seller. It seems that a real impetus for that intensified development was the recognition that a basic privity element would remain in section 12. Without a recognition of secondary liability, a broadened interpretation of privity became the only way for the courts to enlarge the scope of section 12 liability.

Id. at 486.

See also Hagert v. Glickman, Lurie, Eiger & Co., 520 F. Supp. 1028, 1033–37 (D. Minn. 1981), discussed *infra* notes 380–382 and in accompanying text, in which the court dismissed the aiding and abetting claim under § 12(2) as inconsistent with the statutory scheme of the 1933 Act, but granted the plaintiff leave to amend that portion of the complaint which sought to reach the same defendants as sellers under § 12(2), *id.*; Wasson v. SEC, 558 F.2d 879, 885 (8th Cir. 1977), discussed *supra* notes 291–312 and in accompanying text, in which the defendant argued that the expansive interpretation given to the concept of "seller" in § 12 actions was attributable to the absence of an aider and abettor provision, *id.*

330. *See* Phillips and Hanback, *supra* note 31:

> The courts' expansionary position with respect to the privity requirement and the definition of "sell" for purposes of section 12 has many of the characteristics of the aider and abettor theory that the courts have used effectively to broaden the scope of potential liability under rule 10b-5 and other provisions of the federal securities laws.

Id. at 956.

See also PLI, *Ninth Annual Institute on Securities Regulation*, *supra* note 8, in which the commentators note in the course of their discussion on erosion of the privity requirement in § 12: "The courts have gone further, however, and have extended liability to persons who were really not much more than aiders and abettors." *Id.* at 350.

331. *See, e.g.*, Brick v. Dominion Mortgage & Realty Trust, 442 F. Supp. 283, 306 (W.D.N.Y. 1977) (denying motion to dismiss); Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 443–44 (N.D. Ohio 1975) (denying motion to dismiss); *In re* Caesars Palace Sec. Litig., 360 F. Supp. 366, 378–83 (S.D.N.Y. 1973) (denying motion to dismiss). *But see* the following recent cases rejecting theories of secondary liability in the context of § 12(2): Hokama v. E.F. Hutton & Co., 566 F. Supp. 636, 641–42 (C.D. Cal. 1983) (rejecting aiding and abetting liability under § 12(2) but accepting possibility of expanded primary liability under proximate cause analysis); Hagert v. Glickman, Lurie, Eiger & Co., 520 F. Supp. 1028, 1033–34 (D. Minn. 1981) (rejecting aiding and abetting liability under § 12(2) but accepting possibility of expanded primary liability under standard of Wasson v. SEC, 558 F.2d 879 (8th Cir. 1977); *In re* Equity Funding Corp. of Am. Sec. Litig., 416 F. Supp. 161, 181 (C.D. Cal. 1976).

332. 360 F. Supp. 366 (S.D.N.Y. 1973).

quently cited for this position. In that case the court used the extension of primary liability in the expanded seller cases as justification for repudiating the early precedents which had rejected secondary liability in section 12 actions.[333]

In *Caesars Palace* the plaintiffs purchased securities in registered offerings made by Lum's Inc. Lum's used the proceeds of the offerings to acquire Caesars Palace.[334] The plaintiffs sued Lum's and numerous individuals affiliated with Caesars Palace in a multi-count complaint which included a claim under section 12(2).[335] The plaintiffs alleged among other things that there were misstatements and omissions in the Lum's registration statements.[336] The plaintiffs further alleged that the defendants associated with Caesars Palace had aided and abetted or conspired with Lum's in this regard.[337] The Caesars Palace defendants moved to dismiss the section 12(2) count on the grounds that such theories of secondary civil liability could not support recovery under section 12(2).[338]

The District Court for the Southern District of New York sustained the sufficiency of the section 12(2) claim against the Caesars Palace defendants.[339] In doing so, the court pointed to the remedial nature of the 1933 Act and the need to adopt a liberal interpretation of the statute in order to effectuate its purposes.[340] It also reasoned that civil liability for aiding and abetting and conspiracy should be recognized under sections 11 and 12 because such theories are used in criminal prosecutions under sections 5 and 17(a).[341]

However, the court rested its analysis most heavily upon the cases expanding the concept of who could be primarily liable as a seller for purposes of the privity requirement in section 12(2). Tracing the development of the seller concept through *Cady v. Murphy*, the participation cases, and the proximate cause decisions,[342] the *Caesars Palace* court concluded:

> Therefore, as a result of *Katz*, *Hill York*, and related decisions in this area, it would be nothing more than an exercise in semantic hair-splitting for this Court to attempt to delineate a legally cognizable distinction between those categories of persons who have previously been exposed to liability under

333. *Id.* at 379–81.
334. *Id.* at 373, 385.
335. *Id.* at 375.
336. *Id.*
337. *Id.* at 378.
338. *Id.*
339. *Id.* at 383.
340. *Id.* at 382–83.
341. *Id.* at 381. *But see supra* notes 322–324 and accompanying text.
342. *Id.* at 379–80.

> § 12(2) and those persons charged with aiding and abetting and conspiring in the violation of § 12(2). No one of these formulations is a "magic word"; in effect, each of them indicates participation to one degree or another. Determination of the extent of this participation and whether or not it is sufficient to impose liability upon the secondary defendants must obviously await discovery.[343]

If one accepts the premise that the expanded seller analysis may have developed because of the difficulties surrounding use of secondary liability theories in private express actions under the 1933 Act, then the court's reasoning in *Caesars Palace* represents the ultimate bootstrap. Faced with obstacles to the development of theories of aiding and abetting and conspiracy in the context of section 12(2), some courts chose to broaden the meaning of seller to encompass various collateral participants as primary defendants.[344] The *Caesars Palace* court then argues that in light of this expansion of primary liability, it would be little more than word games to refuse to recognize liability under section 12(2) for aiding and abetting and conspiracy.[345]

A few commentators applaud the forthright approach of the *Caesars Palace* decision.[346] They admit the conceptual problems surrounding application of secondary liability theories in the context of express actions under the 1933 Act. However, these authors argue that given the penchant of numerous courts to erode the privity requirement through the various facilitation tests, secondary liability represents a more direct and coherent way to approach the problem of collateral participants.[347]

Such arguments, however, beg the question. It is true that by drawing in collateral participants as primary defendants, the expanded seller cases extend the reach of section 12(2) to a point roughly equivalent to that which results from the use of secondary liability theories.[348] However, the fact that the extension of pri-

343. *Id.* at 380 (footnote omitted).

344. *See supra* note 329 and accompanying text.

345. 360 F. Supp. at 380.

346. *See* Rapp, *supra* note 31, at 482–501; Comment, *Attorneys and Participant Liability under § 12(2) of the Securities Act of 1933*, *supra* note 31, at 550–77. *But see* Fischel, *supra* note 17, at 109–10.

347. *See supra* note 346.

348. *See supra* note 330. This rough equivalence between the expansion of primary liability through a broadened interpretation of "seller," and the use of secondary liability theories such as aiding and abetting and conspiracy, is exhibited in a number of cases which seem to equate the two concepts.

The discussion of the Fifth Circuit in Pharo v. Smith, 621 F.2d 656 (5th Cir. 1980), discussed *supra* notes 228–242 and accompanying text, is illustrative in this regard. After finding under a proximate cause analysis that Deltec was not primarily liable as a § 12 seller, the court went on to reject plaintiffs' contention that Deltec could be liable as an aider and abettor:

mary liability in the expanded seller cases often resembles a kind of backdoor aiding and abetting argues not in favor of adopting theories of aiding and abetting or conspiracy, but in favor of recognizing that the expanded seller cases are wrongly decided.[349] Courts long ago correctly recognized that adoption of the concepts of aiding and abetting and conspiracy, in the context of the private express actions under the 1933 Act, would be inconsistent with the language of the statute and the statutory scheme.[350] It is precisely because the courts in the expanded seller cases bring in as defendants individuals who are frequently little more than disguised aiders and abettors that they too distort the language of the statute and the statutory scheme.

V. Analysis of the 12(2) Expanded Seller Cases and Secondary Liability Opinions in Light of Recent Supreme Court Decisions

The Supreme Court's opinions in the area of federal securities law prior to the mid-1970s tended to favor plaintiffs and to expansively interpret the securities statutes in light of their remedial purpose.[351] Since the mid-1970s, however, the Supreme Court has taken a more restrictive approach towards interpretation of the federal securities laws.[352] The decisions of the Burger Court exhibit a concern that the federal securities laws not become a panacea for every disappointed investor. More often than

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> A participant in a sale of stock that transgresses section 12 could be an aider and abettor, as defined at common law . . . . The panel in *Hill York* was faced with fashioning a test for determining which participants, out of the universe of possible participants, in a section 12 sale should be subjected to liability as sellers. A test was developed and, as augmented by *Lewis*, states the law of this circuit. In finding, under that test, that Deltec's participation in plaintiffs['] transactions was insufficient to incur section 12 liability, we have in effect found that Deltec could have no liability as an aider and abettor.

Id. at 669.

The equivalence is also apparent in a number of § 12 decisions which blur their discussions of primary liability under § 12 and secondary liability for aiding and abetting and conspiracy. *See, e.g.*, Stokes v. Lokken, 644 F.2d 779, 784–85 (8th Cir. 1981), discussed *supra* note 313; Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 443–44 (N.D. Ohio 1975) (which is criticized in this regard by Rapp, *supra* note 31, at 474).

But see *infra* note 419 and accompanying text for a discussion of distinctions between the expanded seller approach to § 12(2) and an aiding and abetting analysis.

349. *See* Phillips and Hanback, *supra* note 31, in which the commentators coin the phrase "backdoor" aiding and abetting to describe how the expansionary § 12 cases erode the privity requirement. With a thesis similar to the one underlying this Article, the authors question the validity of these cases in light of the restrictive tenor of the Supreme Court's recent securities law opinions. *See id.* at 956–57.

350. *See supra* note 321 and accompanying text.

351. *See supra* note 11.

352. *See supra* note 12 and accompanying text.

not, recent Supreme Court opinions narrowly construe the coverage and protection of the 1933 and 1934 Acts, displaying a heavy orientation in favor of defendants.[353] To support these narrower holdings, the Court has returned to more traditional principles of statutory construction.[354] The Court tends to focus on the explicit language of the statutory section in question, its legislative history, and its interrelationship with other provisions of the federal securities laws.[355]

The Supreme Court has not yet reviewed any decision expanding the concept of who may be treated as a seller for purposes of primary liability under section 12(2), or any decision purporting to apply theories of aiding and abetting or conspiracy to section 12(2). However, if these cases are examined under the interpretative principles used by the present Supreme Court, their analysis fails.[356]

A. *The Language of the Statute*

The Supreme Court has repeatedly stated that the starting point in every case involving construction of the federal securities laws is the language of the statute itself.[357] The precise language of section 12(2) and the rescissory nature of the remedy afforded therein support the existence of a relatively strict privity requirement. Except as expanded by the controlling persons provision in section 15, the explicit language of section 12(2) contemplates recovery by a purchaser only from his immediate seller.[358]

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353. *See supra* note 12.

354. *See supra* note 13.

355. *See supra* note 13. *See generally* Fischel, *supra* note 17, applying these three tools of statutory construction to conclude that secondary liability under § 10(b) of the 1934 Act is no longer viable in light of recent Supreme Court opinions strictly construing the federal securities laws.

356. *See* cases cited *infra* note 358. *See also* Fischel, *supra* note 17, at 109–10.

357. *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

358. *See supra* notes 29–30 and accompanying text. *See*, in particular, Collins v. Signetic Corp., 605 F.2d 110, 113–14 (3d Cir. 1979) (citing recent Supreme Court decisions, the Third Circuit affirmed under a strict privity approach the trial court finding that a complaint failed to state a claim under § 12(2) against a corporate issuer and its parent for alleged misrepresentations and omissions in a registered offering sold by underwriters pursuant to a firm commitment underwriting; court found that plaintiffs failed to proffer an aiding and abetting case against defendants and thus chose not to deal definitively with its prior decision in Monsen v. Consol. Dressed Beef Co., 579 F.2d 793 (3rd Cir. 1978), in which it had reinstated a jury verdict against a defendant as an aider and abettor over a j.n.o.v.); Benoay v. Decker, 517 F. Supp. 490, 494 (E.D. Mich. 1981) (granting motion to dismiss § 12(2) claim against non-privity defendants under strict privity approach). *But see* McFarland v. Memorex, 1984 FED. SEC. L. REP. (CCH) ¶ 99,635, at 97,507–08 (N.D. Cal. Jan. 17, 1984) (on motion for reconsideration, earlier opinion at 493 F. Supp. 631, 647–48 (N.D. Cal.

There may be some room in the statute for the exception carved out in the early brokerage decisions, which broaden the concept of seller to include brokers or other selling agents who engage in solicitation of an offer to buy.[359] The inroad against the privity requirement in these cases is tied to an analysis of the broker's activities as falling within the statutory definitions in section 2(3).[360]

As discussed earlier, such analysis is not without its problems. Arguably, it focuses on the opening language "[a]ny person who . . . offers or sells" without giving proper weight to the remaining language in section 12(2), which makes the offeror or seller liable to the person "purchasing such security from him" for a rescissory measure of relief.[361] This remaining language may be interpreted as limiting the scope of the phrase "[a]ny person who . . . offers or sells" as used in section 12(2) to the plaintiff's immediate vendor.[362]

However, while not free from question, the expansion of the seller concept to encompass brokers or other selling agents who engage in solicitation of an offer to buy is at least somewhat defensible. The analysis is premised on the statutory definitions in section 2(3).[363] Moreover, so long as it is confined to the agency context in which it was articulated, it does not distort the operative terms "sell" and "purchase" beyond all recognition in ordinary usage.[364] Finally, the agency setting helps undercut some of the theoretical problems involved in granting a purchaser rescission against someone other than the party who actually received the sale proceeds. Common law agency recognized the propriety of imposing rescission on an agent in some circumstances, even though the agent had not beneficially received the sale proceeds.[365] Common law agency may also provide a framework for adjusting the rights between the agent against whom rescission is granted and his principal, the actual vendor.[366]

In contrast, the later expanded seller cases are an unwar-

1980), limiting a § 12(2) claim to defendant underwriter under a strict privity approach, is reconsidered; § 12(2) claim reinstated against corporate issuer under proximate cause analysis for alleged misrepresentations and omissions in a registered offering sold by underwriters pursuant to a firm commitment underwriting).

359. See *supra* notes 39–61 and accompanying text for a discussion of Cady v. Murphy.

360. *See id.*

361. *See supra* text accompanying notes 62–92 (criticizing the holding in Cady v. Murphy).

362. *See supra* text accompanying notes 62–92.

363. See *supra* notes 39–61 and accompanying text.

364. *See supra* note 93 and accompanying text.

365. *See supra* note 87 and accompanying text.

366. *See supra* note 94 and accompanying text.

ranted extension of the clear language of section 12(2). The courts which have developed the facilitation tests approach the issue of who may be primarily liable as a seller under section 12(2) as if they were writing on a *tabula rasa*. They frame the question not as one which should be resolved in terms of statutory construction, but rather as one which may be answered with broad remedial policy strokes.[367]

The courts in the later expanded seller decisions graft onto section 12(2) concepts of participation, proximate cause, and access to information as the relevant tests for determining seller status without any basis in the language of the statute and without any reference to the statutory definitions of the operative terms "offer" and "sell" in section 2(3).[368] While these tests encompass some collateral participants whose activities might survive analysis under the statutory definitions in sections 2(3), they bring in other defendants as well.[369]

Moreover, the facilitation tests give no consideration to the remaining language in section 12 making the offeror or seller liable to the "person purchasing the security from him" for a rescissory measure of relief.[370] As the facilitation tests move outside the brokerage context to include collateral participants who are not selling agents of the vendor, it becomes more and more difficult to square their findings of seller status with the purchase language of the statute.[371] Additionally, the conceptual problems associated with awarding rescission against a non-vendor become more complex. For example, in cases such as *Lennerth v. Mendenhall*,[372] *Hill York Corp. v. American International Franchises, Inc.*,[373] and *Junker v. Crory*,[374] application of the proximate cause analysis resulted in judgments for rescissory relief against the immediate vendor and one or more collateral participants with no indication of the respective rights of the defendants vis-à-vis each other.[375]

When Congress intended that an express action under the

367. *See supra* text accompanying notes 95–100, 109–112, 173–181, 274–290, and 308–312, criticizing the various facilitation tests. See, in particular, the reliance of the courts on policy arguments in Croy v. Campbell, 624 F.2d 709, 712 (5th Cir. 1980), at *supra* notes 252 and 253 and accompanying text; Wasson v. SEC, 558 F.2d 879, 886 (8th Cir. 1977), discussed *supra* notes 297–302 and in accompanying text.

368. *See* Wasson v. SEC, 558 F.2d 879, 886 (8th Cir. 1977).

369. *See supra* note 112.

370. *See supra* note 85 and accompanying text.

371. *See supra* note 93 and accompanying text.

372. 234 F. Supp. 59, 65–66 (N.D. Ohio 1964). *See supra* notes 188–192 and accompanying text.

373. 448 F.2d 680, 685–86, 692–94 (5th Cir. 1971). *See supra* notes 206–219 and accompanying text.

374. 650 F.2d 1349, 1358–62 (5th Cir. 1981). *See supra* notes 259–272 and accompanying text.

375. *See supra* note 94 and accompanying text.

1933 Act encompass various participants in the sales process, it had no difficulty articulating that intention. Section 11 provides an express cause of action for damages to a person acquiring shares pursuant to a registration statement which misstates or omits to state a material fact.[376] Section 11(a) explicitly delineates multiple categories of participants involved in the registration process who may be sued as defendants.[377] Section 11(f) expressly addresses the nature of the defendants' respective liability and their rights to contribution vis-à-vis each other.[378]

The language of section 12(2), making "[a]ny person who . . . offers or sells a security" liable to the "person purchasing such security from him," stands in stark contrast to the multiple defendant scheme of section 11.[379] In expanding the concept of seller in section 12(2) to encompass multiple defendants, the facili-

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376. 15 U.S.C. § 77k (1976) [hereinafter referred to as section 11].

Section 11 provides a civil remedy for false or misleading statements in a registration statement. The remedy is afforded to any purchaser of a registered security who can trace the security to the registration statement in question, whether or not the purchaser acquired the security in the distribution process or in the aftermarket. JENNINGS & MARSH, *supra* note 18, at 757.

The statute expressly states the parties who may be sued as defendants. These persons include: (1) the issuer; (2) all directors of the issuer, including all persons who are named in the registration statement as about to become directors; (3) the chief executive officer, the chief financial officer and the chief accounting officer of the issuer; (4) the underwriters; and (5) any expert who is named as having prepared or certified any part of the registration statement. 15 U.S.C. § 77k(a) (1976).

The purchaser need not establish reliance, unless he purchased after the issuer had made generally available to its security holders an earnings statement covering a period of at least one year beginning after the effective date of the registration statement. Even in this circumstance, the purchaser may establish reliance without proof that he read the registration statement. Any defendant may escape liability if it can be established by way of affirmative defense that the purchaser knew of the untruth or omission at the time of purchase. JENNINGS & MARSH, *supra* note 18, at 757.

Similarly, the purchaser need not establish causation. However, the extent of liability of any defendant may be reduced if that defendant establishes that all or any portion of the damage did not result from the defective registration statement.

Finally, the purchaser is not required to show anything regarding the defendants' state of mind. All defendants but the issuer have a reasonable care defense. *Id.* at 753–57.

377. 15 U.S.C. § 77k(a) (1976). *See supra* note 376.

378. 15 U.S.C. § 77k(f) (1976):

> All or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

Id.

379. Professor Loss acknowledges this problem, although he ultimately appears to embrace some of the expanded seller cases. 3 L. LOSS, *supra* note 17, at 1716.

tation tests torture the plain meaning of the privity requirement in the statute.

Similarly, those cases which import theories of secondary liability into the express cause of action under section 12(2) do violence to the statutory language. As the court stated in *Hagert v. Glickman, Lurie, Eiger & Co.*,[380] in rejecting the position of *In re Caesars Palace Securities Litigation*:[381]

> In recent cases, the Supreme Court has made it clear that a determination of the standard of liability under the various provisions of the federal securities laws must begin with and rest primarily on the language of the statutes . . . . In line with this reasoning, we believe the greater and better weight of authority on the issue of aiding and abetting liability under Sections 11 and 12(2) is that expressed in *In re Equity Funding Corporation of America Securities Litigation*, 416 F. Supp. 161, 181 (C.D. Cal. 1976):
>
> > [W]here a statute specifically limits those who may be held liable for the conduct described by the statute, the courts cannot extend liability, under a theory of aiding and abetting, to those who do not fall within the categories of potential defendants described by the statute. To impose such liability would circumvent the express intent of Congress in enacting these statutes that proscribe narrowly defined conduct and allow relief from precisely defined parties . . . .
>
> Section 11 and 12(2) are express liability provisions, as contrasted to Sections 17(a) and [sic] the 1933 Act and Section 10(b) of the 1934 Act which define violations or make certain acts unlawful. The concept of aiding and abetting, with its origin in the criminal law, is a more proper adjunct to the violation sections.[382]

B. *Legislative History*

Where the language of a statute is sufficiently clear in its context, the Supreme Court has indicated that the language controls and there is no need to resort to tools of statutory interpretation such as legislative history.[383] While somewhat inartfully drafted, the language of section 12(2) is sufficiently clear in its context to be dispositive with respect to the privity requirement.[384] The language of section 12(2) clearly limits a purchaser to an action

380. 520 F. Supp. 1028 (D. Minn. 1981).

381. 360 F. Supp. 366 (S.D.N.Y. 1973). *See supra* notes 332–343 and accompanying text.

382. 520 F. Supp. at 1034 (citations omitted).

383. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 105, 201 (1976).

384. See *supra* note 1 for the text of § 12(2).

against his immediate vendor in the sales transaction.[385] However, even if the legislative history of section 12(2) is examined, it lends no support to the expanded concept of "seller" which has been developed by the lower courts or to implication of secondary liability for aiding and abetting or conspiracy.

In the first case to consider the scope of the term "seller" under section 12(2), the district court in *Cady v. Murphy* conceded that no references in the legislative history of section 12(2) address this issue.[386] Indeed, the original legislative history of section 12(2), in contrast to section 11, is quite sparse.[387] The few specific

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385. *Id.*

386. 30 F. Supp. 466, 469 (D. Me. 1939), *aff'd*, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 311 U.S. 705 (1940), *see supra* note 46 and accompanying text.

387. The House Committee Report discusses civil liability under § 12(2) in only two instances. At first blush the initial reference might appear to support a concept of participant liability. However, on closer reading, it becomes clear that this language is attributable to the fact that the Report was discussing § 11 and § 12 in the conjunctive under the general heading of "Civil Liabilities," and that the references to participant liability refer only to actions under § 11:

> Sections 11 and 12 create and define the civil liabilities imposed by the act and the machinery for their enforcement which renders them practically valuable. Fundamentally, these sections entitle the buyer of securities sold upon a registration statement including an untrue statement or omission of material fact, to sue for recovery of his purchase price, or for damages not exceeding such price, those who have participated in such distribution either knowing of such untrue statement or omission or having failed to take due care in discovering it. The duty of care to discover varies in its demands upon participants in security distribution with the importance of their place in the scheme of distribution and with the degree of protection which the public has a right to expect . . . .
>
> The Committee emphasizes that these liabilities attach only when there has been an untrue statement of a material fact or an omission to state a material fact in the registration statement or the prospectus—the basic information by which the public is solicited. All who sell securities with such a flaw, who cannot prove that they did not know—or who in the exercise of due care could not have known—of such misstatement or omission, are liable under sections 11 and 12.

H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933).

The fact that the references to participant liability are clearly tied to fraud in a registration statement makes it apparent that although §§ 11 and 12 are discussed together, the references apply only to § 11 actions, not to actions under §§ 12(1) and 12(2). Section 11 provides relief against various participants in the registration process for fraud in a registration statement. *See supra* note 376. Section 12(1) provides relief for violation of the registration requirements, including a failure to register. See *supra* note 139 for a discussion of § 12(1). Section 12(2) provides relief for misrepresentations or omissions in the course of a sale whether by means of a prospectus or oral communication and without regard to the registered status of an offering. See *supra* note 1 for the text of § 12(2) and *supra* note 18 for a discussion of the coverage of § 12(2).

The only other reference to § 12 in the House Report speaks of § 12 alone. H.R. REP. No. 85, 73rd Cong., 1st Sess. 23–24 (1933). In this abbreviated explanation of § 12, no mention of participants is made:

> If any person (1) sells a security in violation of section 5, or (2) sells a security, whether or not exempted by section 3, by the use of the in-

references to section 12(2) seem to indicate that Congress used the operative terms "purchase" and "sale" in their ordinary contexts.[388] The references to section 12(2) which appear in the legislative history are at best ambiguous and thus do not support the expansionist theories developed by the lower courts for imposing seller status or secondary liability on collateral participants.[389]

> struments of interstate or foreign commerce or of the mails by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact (the purchaser not knowing of such untruth or omission) and does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, he is made liable to the person purchasing such security from him . . . . The committee has deemed this shift in the burden of proof as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements or the failure of the seller to exercise reasonable care are matters in regard to which the seller may readily testify, but in regard to which the buyer is seldom in a position to give convincing proof.

Id.

Nowhere in the Report is the term "seller" defined, suggesting that the Committee used this word in the above-quoted passage in its ordinary sense. The Report's commentary on § 2(3) discusses the term "sale" as "broadly" defined to include every attempt at disposition. However, the remarks which follow seem to indicate that this is done in an effort to control offers to buy by dealers in the period prior to the effective date of the registration statement, as opposed to any intent to broaden the class of persons considered to be sellers. H.R. REP. No. 85, 73d Cong., 1st Sess. 11–12 (1933). *See also* Comment, *Attorneys and Participant Liability under § 12(2) of the Securities Act of 1933*, *supra* note 31, at 534.

Thus, taken as a whole, the House Committee Report lends no support to the expanded concept of "seller" which has been developed by the lower courts or to implication of secondary liability theories.

The Senate Report on the companion Senate bill, S. 875, 73d Cong., 1st Sess., 77 CONG. REC. 2979-82 (1933), says virtually nothing about § 12(2). The Senate Committee on Banking and Currency seemed concerned only with liability of directors. S. REP. No. 47, 73d Cong., 1st Sess. 4–6 (1933). Under the heading of "Personal Responsibility," the report makes clear that directors who sign an inadequate registration statement may be civilly liable for return of the money which the purchaser paid for the security. *Id.* at 5.

The Conference Committee, which met to reconcile the differences between the House and Senate bills, chose to use the House Bill as their working draft. *See* Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 45 (1959). The Conference Committee Report summarizes the differences between the House bill and the Senate amendments thereto and then reconciles these differences. The Report, in discussing civil liability, makes no reference to the meaning of "seller" in § 12(2). H.R. REP. No. 152, 73d Cong., 1st Sess. 26–27 (1933).

In sum, the legislative history of § 12(2) provides no support for expanding the concept of "seller" beyond its plain and ordinary meaning or for implying theories of secondary liability in the context of § 12(2).

388. *See supra* note 387.

389. *Id.* Moreover, while it is somewhat dangerous to read too much into congressional inaction, it may be of some significance that in 1959 Congress declined to enact a provision which would have expressly prohibited aiding and abetting any violation of the 1933 Act. H.R. 5001 and S. 1178, 86th Cong., 1st Sess. (1959); H.R. 5001 and S. 3770, 86th Cong., 2d Sess. (1960). For differing views on the import of Congress'

In the face of relatively unambiguous language in a statute and without clear evidence of congressional intent in the legislative history to support an expansionist approach, the Supreme Court has been unwilling to extend the reach of a statute beyond its plain meaning.[390] In the analysis of section 12(2), the application of these same principles supports a strict privity approach.

C. *The Statutory Scheme*

When called upon to construe various provisions of the federal securities laws, the Supreme Court in recent decisions has focused not only on the language and legislative history of the particular section in question, but also on its place in the total statutory framework.[391] Viewed under this tenet of statutory construction, the expanded seller cases and secondary liability opinions do not support an interpretation of section 12(2) consistent with its place in the overall scheme of antifraud provisions.

In bypassing the privity requirement, the courts in the expanded seller cases disrupt the statutory scheme because they allow a plaintiff to enjoy the reduced burden of proof available under section 12(2) without the concomitant limitation on who may be a defendant.[392] Where a plaintiff seeks redress against a collateral participant with whom he is not in privity for misrepresentations or omissions in acquisition of a security, the appropriate remedy is an action under rule 10b-5 with its higher burden of proof.[393]

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failure to enact this provision, *compare* Fischel, *supra* note 17, at 98 n.103 (failure significant) *with* Comment, *Attorneys and Participant Liability under § 12(2) of the Securities Act of 1933*, *supra* note 31, at 555 & nn.187–190 (failure insignificant).

390. *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473–74 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976).

391. *See, e.g.*, SEC v. Sloan, 436 U.S. 103, 112–14 (1978); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206–11 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733–36 (1975).

392. *See infra* notes 394–418 and accompanying text.

393. *See infra* notes 399–418 and accompanying text.

Professor Steinberg hinted at this connection between the scope of parties defendant and the relative burden of proof in the context of a comparison of §§ 12(2) and 17(a) of the 1933 Act. *See* Steinberg, *Section 17(a) of the Securities Act of 1933 after* Naftalin *and* Redington, *supra* note 18, at 178–82.

Section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1976), is the general antifraud provision of the 1933 Act. It is roughly analogous to rule 10b-5 of the 1934 Act except that it is limited to fraud in the offer or sale of a security and does not extend to fraud in the purchase of a security.

Professor Steinberg argued that even in the wake of recent restrictive Supreme Court opinions (*see supra* note 12), there may be room for implication of a private cause of action under § 17(a). However, in light of the Supreme Court's admonition in Touche Ross & Co. v. Redington, 442 U.S. 560, 574 (1979), that a court should be reluctant to imply a remedy significantly broader than an express remedy which Congress has provided, Professor Steinberg concluded that implied liability under § 17(a)

On their face section 11 and section 12(2) of the 1933 Act limit the scope of defendants.[394] A plaintiff may bring an action under section 11 for misrepresentations or omissions in a registration statement only against those directly involved in the registration process—the issuer, its board of directors, certain officers signing the registration statement, the underwriters, the accountants and other experts contributing to the registration statement.[395] Section 12(2) limits a purchaser to recovery from his seller.[396] In both cases the narrowness in scope is accompanied by imposition of a relatively minimal burden of proof upon a plaintiff.[397] Both sections generally eliminate any requirement that the plaintiff show reliance, allocate the burden of proof regarding state of mind to the defendant, and impose liability on the defend-

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should require proof by a plaintiff of reckless or intentional conduct in contrast to § 12(2). He found this result necessary because of the difference between § 12(2) and § 17(a) in scope of parties defendant.

> Section 12(2) requires privity between the defendant and the purchaser and specifically provides a defense if the seller proves that he exercised reasonable care; the section, therefore, imposes liability for negligent culpability. Because section 17(a) has no privity restriction, liability should only be imposed under it for misconduct that is more culpable than that addressed in section 12(2), that is, for intentional or reckless misconduct.

Steinberg, *Section 17(a) of the Securities Act of 1933 after* Naftalin *and* Redington, *supra* note 18, at 178–79 (footnotes omitted).

Professor Steinberg noted that given the privity requirement in § 12(2), a contrary rule allowing implied liability for negligent misconduct under § 17(a) would impermissibly broaden the express remedy which Congress provided in § 12(2). *Id.* at 179 n.126. The author spoke of the imposition of liability for negligence under § 12(2) as being balanced by the privity requirement. He thus reasoned that an implied remedy under § 17(a), which has no privity limitation, should require a greater showing of culpability. *Id.* at 182 n.140.

Subsequent to Professor Steinberg's article, the Supreme Court held in Aaron v. SEC, 446 U.S. 680, 695–701 (1980), that the SEC must establish scienter as an element of a civil enforcement action to enjoin violation of § 10(b), rule 10b-5 or § 17(a)(1), 15 U.S.C. § 77q(a)(1) (1976), but need not establish scienter to enjoin a violation of § 17(a)(2), 15 U.S.C. § 77(q)(a)(2) (1976), or § 17(a)(3), 15 U.S.C. § 77q(a)(3) (1976), because of differences in language in the latter two subsections. The Court's decision in *Aaron* leaves unanswered the question of whether a private cause of action may be implied under § 17(a) and, if so, what the required state of mind for liability should be.

However, Professor Steinberg's correlation between the scope of parties defendant and the state of mind requirements can be applied analogously to a comparison of § 12(2) with rule 10b-5. The expanded seller cases upset the careful balance between the privity requirement in § 12(2) and the reduced culpability standard by deeming collateral participants to be sellers who should only be reachable upon a greater showing of culpability.

394. See *supra* note 376 for a discussion of § 11. See *supra* note 1 for the text of § 12(2).

395. See *supra* note 376 for a discussion of § 11.

396. See *supra* note 1 for the text of § 12(2).

397. *See infra* note 398 and accompanying text.

ant for mere negligence.[398]

In contrast, section 10(b) of the 1934 Act and rule 10b-5 encompass any person who engages in the manipulative or deceptive activity proscribed therein in connection with the purchase or sale of any security.[399] Concomitant with this greater sweep, the claim for relief which the courts imply thereunder requires a greater showing of proof by a plaintiff.[400] A plaintiff suing under rule 10b-5 bears the burden of establishing reliance, as well as the burden of proving a state of mind greater than negligence on the part of the defendant.[401]

The analysis of the Supreme Court in its recent decision in *Herman & MacLean v. Huddleston*[402] underscores this relationship between the difference in scope of the express remedies in the 1933 Act compared with rule 10b-5, and the corresponding difference in the burden of proof borne by plaintiffs suing thereunder.[403] In that decision the Court rejected a contention that availability of an express cause of action under section 11 of the 1933 Act bars relief under rule 10b-5.[404] The court focused on the differences between the two provisions to support its conclusion that the statutory framework envisions a cumulative construction of the remedies available under the 1933 and 1934 Acts.[405]

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398. See *supra* note 376 for a discussion of the elements of a § 11 claim and the affirmative defenses thereto. See *supra* text accompanying notes 16–30 for a discussion of the elements of a § 12(2) claim and the affirmative defenses thereto.

399. See *supra* note 5 for the text of § 10(b). See *supra* note 7 for the text of rule 10b-5.

400. *See infra* note 406 and accompanying text.

401. See *supra* note 17 for a discussion of the elements of an implied claim under rule 10b-5.

402. 103 S. Ct. 683 (1983).

403. In *Huddleston* the plaintiffs brought a class action on behalf of themselves and other purchasers of securities in a 1969 registered offering floated by Texas International Speedway, Inc. Plaintiffs sued most of the participants in the offering, including an accounting firm, Herman & MacLean, which had prepared the financial statements and a pro forma balance sheet included in the registration statement. Plaintiffs alleged violations of rule 10b-5. At trial the jury returned a verdict in favor of plaintiffs on certain submitted issues of liability, operating under instructions requiring proof by a preponderance of the evidence. *Id.* at 685.

On appeal, the Court of Appeals for the Fifth Circuit held that a cause of action may be maintained under § 10(b) even though the conduct might also be actionable under § 11 of the 1933 Act. However, the Court of Appeals disagreed with the trial court regarding the appropriate standard of proof. The Court of Appeals held that a plaintiff in an implied action under § 10(b) must prove his case by clear and convincing evidence. Huddleston v. Herman & MacLean, 640 F.2d 534, 540–43 (5th Cir. 1981).

The Supreme Court affirmed the appellate court ruling with respect to the interrelationship between § 11 of the 1933 Act and rule 10b-5. However, it reversed as to the applicable standard of proof. 103 S. Ct. 683, 686 (1983).

404. 103 S. Ct. at 690.

405. 103 S. Ct. at 687–89.

Comparing and contrasting section 11 and rule 10b-5, the Court noted:

> Although limited in scope, Section 11 places a relatively minimal burden on a plaintiff. In contrast, Section 10(b) is a "catchall" antifraud provision, but it requires a plaintiff to carry a heavier burden to establish a cause of action. While a section 11 action must be brought by a purchaser of a registered security, must be based on misstatements or omissions in a registration statement, and can only be brought against certain parties, a Section 10(b) action can be brought by a purchaser or seller of "*any* security" against "*any* person" who has used "*any* manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security. However, a section 10(b) plaintiff carries a heavier burden than a section 11 plaintiff. Most significantly, he must prove that the defendant acted with scienter, i.e., with intent to deceive, manipulate, or defraud.[406]

In light of the differences which exist between section 11 and rule 10b-5, the court in *Huddleston* found no basis for holding that section 11 provided the exclusive remedy available to the plaintiff.[407] The Court noted that its conclusion in this regard was reinforced by the reasoning in its 1976 opinion in *Ernst & Ernst v. Hochfelder*.[408] In *Hochfelder* the Court ruled that private actions under section 10(b) require proof of scienter and do not encompass negligent conduct.[409] The *Huddleston* court pointed out that *Hochfelder* necessarily assumed a cumulative construction of remedies since it rested in part on an analysis that a contrary result would have allowed plaintiffs to nullify the procedural restrictions on the 1933 Act's negligence remedies by suing under rule 10b-5.[410]

The Supreme Court's analysis in *Huddleston* of the relationship between section 11 and rule 10b-5 applies with equal force to section 12(2).[411] Limited in scope by the privity requirement, sec-

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406. 103 S. Ct. at 687–88 (notes and citations omitted, emphasis in original).

407. 103 S. Ct. at 688.

408. 103 S. Ct. at 688 (citing Hochfelder, 425 U.S. at 185).

409. 425 U.S. at 214–15.

410. 103 S. Ct. at 688–89.

411. Indeed, although *Huddleston* addressed only the relationship between § 11 and rule 10b-5, at several points in the decision, the Court in dicta characterized the express remedies of the 1933 Act in the aggregate as being cumulative with the implied remedy available under rule 10b-5. For example, the Court stated:

> This cumulative construction of the remedies under the 1933 and 1934 Acts is also supported by the fact that, when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under Section 10(b) regardless of the availability of express remedies.

Id. at 689.

See also the following post-*Huddleston* decisions in which the courts have relied tion 12(2) imposes a relatively minimal burden of proof upon a plaintiff, as compared with the greater burden required under the broader aegis of rule 10b-5.[412] The courts in the expanded seller cases sidestep the privity requirement in section 12(2) and expose collateral participants in a sales transaction to liability for negligence without proof of reliance by the plaintiff. They thus allow a defrauded purchaser to nullify the difference in scope between section 12(2) and rule 10b-5 and circumvent the reliance and scienter requirements of rule 10b-5.

The courts in the expanded seller decisions frequently justify their extension of section 12(2) on the ground that it is necessary to expand the concept of seller to include collateral participants in order to accomplish the broad remedial purposes of the 1933 Act.[413] This analysis is based on the mistaken assumption that a plaintiff will otherwise be left without redress against such parties. In fact, a plaintiff does have a claim against such parties, but the appropriate cause of action is under rule 10b-5, not under section 12(2).[414] When a purchaser seeks to broaden his reach on defendants and affix liability on someone peripheral to the sales transac-

on the *Huddleston* analysis to hold that the availability of a remedy under § 12(2) does not preclude an implied action under rule 10b-5: Amunrud v. Taurus Drilling Ltd., 1983 FED. SEC. L. REP. CCH ¶ 99,649, at 97,596 (D. Mont. Dec. 23, 1983); *In re* Longhorn Sec. Litig., 1983 FED. SEC. L. REP. CCH ¶ 99,630 at 97,481 (W.D. Okla. Sept. 28, 1983).

412. See *supra* notes 16–27 and accompanying text for a discussion comparing and contrasting the elements of proof under § 12(2) and rule 10b-5.

413. See *supra* note 367 and accompanying text for expanded seller cases exemplifying this broad remedial policy approach. This approach is somewhat open to question in light of the focus of recent Supreme Court opinions on language, legislative history, and statutory structure. *See, e.g.*, Aaron v. SEC, 446 U.S. 680, 695 (1980), in which the Court warned against the use of generalized references to the remedial purposes of the securities laws to justify reading a provision more broadly than the language of the provision, its legislative history, and the statutory scheme reasonably permit. *But see* Herman & MacLean v. Huddleston, 103 S. Ct. 683, 690 (1983), in which the Court cited the need for flexible construction of the securities laws in order to effectuate their remedial purposes in support of its cumulative construction of § 11 of the 1933 Act and rule 10b-5.

414. *Compare* the text of § 10(b), *supra* note 5, and the text of rule 10b-5, *supra* note 7, which apply to "any person" who engages in the conduct proscribed therein, *with* the text of § 12(2), *supra* note 1, which makes "[a]ny person . . . who offers or sells a security" under the circumstances described therein liable to the "person purchasing such security from him."

In a footnote to the decision in Herman & MacLean v. Huddleston, 103 S. Ct. 683, 690 n.22, the Supreme Court makes a somewhat analogous argument. The Court noted that if it accepted the defendant's contention that purchasers in a registered offering were confined to a remedy under § 11 of the 1933 Act, then such purchasers would have no recourse against those individuals who play a part in preparing the registration statement, but who are not among the parties specified in § 11(a) as proper defendants in a § 11 action. The Court stated that a construction of § 11 as exclusive would leave such parties immune from federal liability for their fraudulent conduct even though § 10(b) extends to "any person" who engages in fraud in contion, he should be required to meet the higher proof requirements of rule 10b-5 in order to justify imposition of liability on the collateral participant.

The relationship between the scope of defendants and the reliance/state of mind requirements is vividly demonstrated by the difficulty which the courts in the expanded seller cases have once they abandon the privity requirement and attempt to determine what level of participation by a collateral participant justifies a finding of culpability.[415] A number of courts in the expanded seller cases, in particular those in the proximate cause decisions, ultimately resolve this issue based on findings phrased in terms of a plaintiff's reliance and/or a defendant's scienter.[416] However, there is no statutory basis for importing these elements into section 12(2).[417] Moreover, there is no uniformity among the courts

nection with the purchase or sale of a security. *Id.* The Court's holding implicitly rejects such a result.

Applying the rationale of this footnote in *Huddleston* to § 12(2), if § 12(2) were exclusive, then a purchaser would be without recourse against collateral participants. However, by analogy to *Huddleston*, it appears that the numerous lower court decisions which construe § 12(2) as cumulative with rule 10b-5 because of the increased burden of proof under the latter provision, are correctly decided. See the lower court decisions in this regard collected at 1 A. BROMBERG & L. LOWENFELS, *supra* note 11, at § 2.4(220), (420)-(426). This cumulative construction is further supported by dicta in *Huddleston* which speaks collectively of the cumulative nature of the express remedies in the 1933 Act with rule 10b-5. *See supra* note 411. See also the following post-*Huddleston* decisions in which the courts have relied on the *Huddleston* analysis to hold that the availability of a remedy under § 12(2) does not preclude an implied action under rule 10b-5: Amunrud v. Taurus Drilling Ltd., 1983 FED. SEC. L. REP. CCH ¶ 99,649, at 97,596 (D. Mont. Dec. 23, 1983); *In re* Longhorn Sec. Litig., 1983 FED. SEC. L. REP. CCH ¶ 99,630 at 97,481 (W.D. Okla. Sept. 28, 1983). Thus, while a purchaser may only reach his immediate seller under § 12(2), he has a remedy against his seller and collateral participants in the sale under rule 10b-5, provided that he is able to meet the heavier burden of proof under the rule.

415. *See supra* notes 274–290 and accompanying text.

416. *See supra* note 290 and accompanying text. *See also* 3 L. LOSS, *supra* note 17. Professor Loss concludes:

> There would still be a distinction under § 12 between the liability of the seller proper and the liability of these other persons, in that the seller proper would have the burden under the statute of proving his innocence but the plaintiff obviously would have the burden of proving that the other persons had participated in an unlawful sale, a burden which (at least under § 12(2) as distinguished from § 12(1)) would almost inevitably involve proof by the plaintiff of some sort of scienter on their part.

Id. at 1716.

417. See *supra* notes 16-30 and accompanying text discussing the differences between the elements of a § 12(2) claim and an implied claim under rule 10b-5 and noting that under § 12(2): (1) plaintiff is not required to prove reliance; (2) plaintiff is not required to prove the defendant's state of mind; and (3) the burden of proof regarding state of mind is allocated to the defendant who will be held liable if he fails to establish his own due care.

See also Rapp, *supra* note 31. Mr. Rapp criticizes the decision in Sandusky Land, Ltd. v. Uniplan Group, Inc., 400 F. Supp. 440 (N.D. Ohio 1975), in which the in doing so.[418]

The courts in the expanded seller cases create the dangerous possibility of allowing plaintiffs to circumvent the statutory scheme. The Supreme Court may find that it has tightened the elements of a plaintiff's cause of action under rule 10b-5 only to have lower courts read out the privity requirement in section 12(2) and allow purchasers to recover against collateral participants through the back door of section 12(2) with its reduced burden of proof.

The cases adopting theories of secondary liability in the context of section 12(2) may be less of an end run of the scienter requirement in rule 10b-5 than the expanded seller decisions. Traditionally, aiding and abetting and conspiracy have both entailed proof by the plaintiff of scienter on the part of a secondary defendant.[419] However, the secondary liability opinions are disruptive of the tightly constructed statutory scheme of the 1933 Act.

Section 12(2) is an express liability provision which on its face contains a privity requirement.[420] It is not a violation section or an implied cause of action. It thus lacks the criminal and tort law analogues relied on by courts to support implication of secon-

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court denied a motion to dismiss a § 12(2) claim brought against an accounting firm. Mr. Rapp characterizes the decision as blurring discussion of primary and secondary liability and defining the scope of the term "seller" in terms of a scienter requirement. Mr. Rapp correctly notes that requiring a plaintiff to establish scienter on the part of a collateral participant to prove seller status for purpose of the privity requirement in § 12(2) conflicts with the statutory due care defense in § 12(2). *Id.* at 478–81.

418. Thus, while the cases cited *supra* note 290 made some mention of notions of reliance and scienter in their causation inquiry (generally for purposes of exonerating the collateral participant), numerous other proximate cause decisions do not. *See, e.g.*, Junker v. Crory, 650 F.2d 1349 (5th Cir. 1981), discussed *supra* notes 258–272 and in accompanying text. There, the attorney Heisler was held primarily liable as a seller under a proximate cause analysis (1) where he failed to establish that in the exercise of reasonable care he could not have been aware of the misstatements and omissions, and (2) where the plaintiff's vote against the merger might have presented the plaintiff with difficulties if proof of reliance had been required. *Id.* at 1358 n.10, 1361.

419. See *supra* note 318 regarding the elements of an aiding and abetting claim and the elements of a conspiracy claim. See also Davis v. Avco Fin. Servs., Inc., 1983 FED. SEC. L. REP. (CCH) ¶ 91,569, at 98,917 (6th Cir. July 10, 1984), in which the Sixth Circuit stated in dicta that distinguishing between the expanded seller approach and an aiding and abetting analysis is not a mere semantic exercise, as had been suggested by the court in *In re* Caesars Palace Sec. Litig., 360 F. Supp. 366, 380 (S.D.N.Y. 1973). The court intimated that this is because of the difference in the state of mind requirements associated with the two approaches. 1983 FED. SEC. L. REP. (CCH) ¶ 91,569, at 98,917. In light of the fact that the district court had found neither deliberate fraud nor recklessness on the part of the collateral participant. The court felt that it was doubtful that aiding and abetting could be proven. *Id.* at 98,916. However, the court affirmed the district court judgment against the collateral participant under a proximate cause analysis since the defendant had failed to carry the burden of proof with respect to the due diligence defense. *Id.* at 98,917-19.

420. See *supra* note 1 for the text of § 12(2).

dary liability in the context of rule 10b-5.[421] Courts have long recognized that the tightly knit scheme of the 1933 Act with its system of express actions explicitly defining the field of potential defendants does not support implication of secondary liability for aiding and abetting or conspiracy.[422] As the court held in *In re Equity Funding Corp. of America Securities Litigation*,[423] recognition of such theories offends the scheme of express actions in section 11 and section 12 of the 1933 Act, which proscribe narrowly defined conduct and allow relief from precisely-defined parties.[424]

CONCLUSION

A significant number of lower court opinions have seriously eroded the privity requirement which arises from the plain language of section 12(2) of the 1933 Act. Under a variety of rationales, these cases expand the concept of who may be deemed a "seller" for purposes of primary liability under section 12(2) to include various collateral participants in a sales transaction. In the outermost extension of section 12(2), some courts have recognized the possibility of implied secondary liability in a section 12(2) action for aiding and abetting or conspiracy.

The courts in the expanded seller cases and secondary liability opinions significantly extend the availability of relief under section 12(2) by circumventing what is otherwise the section's most serious substantive limitation—the privity requirement. However, the expanded seller decisions and secondary liability opinions cannot withstand analysis under the principles of statutory interpretation used by the present Supreme Court. The precise language of section 12(2), its legislative history, and its place in the overall scheme of antifraud provisions provide no support for an expansionist approach to the privity requirement.

Section 12(2) on its face creates a tightly knit and internally consistent cause of action. A purchaser can recover from his immediate seller the consideration which he paid to that seller if there were misrepresentations or omissions in the sale with respect

421. *See supra* notes 322–328 and accompanying text.

422. *See supra* note 321 and accompanying text.

423. 416 F. Supp. 161 (C.D. Cal 1976).

424. 416 F. Supp. at 180–81. See *also* the following recent cases in which theories of secondary liability for aiding and abetting and/or conspiracy have been rejected in the context of § 12 actions: Hokama v. E.F. Hutton Co., 1983 FED. SEC. L. REP. (CCH) ¶ 99,415 at 96,382–84 (C.D. Cal. June 15, 1983) (rejecting aiding and abetting liability under § 12(2) but accepting possibility of expanded primary liability under proximate cause analysis); Hagert v. Glickman, Lurie, Eiger & Co., 520 F. Supp. 1028, 1033–34 (D. Minn. 1981) (rejecting aiding and abetting liability under § 12(2) but accepting possibility of expanded primary liability under standard of Wasson v. SEC, 558 F.2d 879 (8th Cir. 1977)).

to which the seller was at least negligent. Because the scope of parties is confined to the vendor and purchaser and because the nature of the relief is limited to rescission, a plaintiff's burden of proof is minimal. The courts in the expanded seller decisions and secondary liability opinions read out the privity requirement and disrupt the internal consistency of section 12(2), as well as its place in the overall statutory scheme.

Without proof of reliance by the purchaser, a collateral participant in a sales transaction who was merely negligent can be required under the expanded seller rationale to repurchase shares which he never owned and the proceeds of which he never received. The secondary liability opinions under section 12(2) presumably require a showing by the plaintiff of a state of mind greater than negligence. However, these decisions still lead to the anomaly of imposing rescission on someone who was not a party to the original sale in the face of a statutory provision which on its face leaves no room for implied theories of liability.

The courts should enforce the privity requirement contained in the plain language of the statute and thus end the inconsistency and uncertainty wrought by the expanded seller decisions and the secondary liability opinions under section 12(2). A dissatisfied purchaser should only be allowed to reach a collateral participant in a sales transaction by suing him as a primary or secondary defendant in an implied action under rule 10b-5.