1987

The Scope of Liability Under Section 12 of the Federal Securities Act of 1933: 'Participation' and the Pertinent Legislative Materials

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Recommended Citation
THE SCOPE OF LIABILITY UNDER SECTION 12
OF THE SECURITIES ACT OF 1933:
‘PARTICIPATION’ AND THE PERTINENT
LEGISLATIVE MATERIALS

Douglas E. Abrams*

I. Introduction

Section 12 of the Securities Act of 1933 creates two private rights of action, each providing in relevant part that “[a]ny person who offers or sells a security . . . shall be liable to the person purchasing such security from him . . .” Because suit may be maintained only by the person who purchases the security from defendant, an offeror may incur section 12 liability only if the offeror also “sells” the security to the plaintiff. Section 12(1) imposes liability on any seller whose offer or sale violates the Act’s registration or prospectus requirements found in section 5; section 12(2) imposes liability on any seller who makes an offer or sale by means of a materially misleading prospectus or oral communication.

At the least, the Act confers seller status on the transferor, the party who transfers title to or other interest in the security for

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I would like to thank my research assistant, Francis Marinelli of Fordham’s Class of 1987, and faculty secretary Mary L. Whelan.

1. 15 U.S.C. §§ 77a-77aa (1982) [hereinafter the 1933 Act or the Act].

2. Id. § 77I. See infra text accompanying note 268 for the section quoted in full.


4. See supra notes 269-72 and accompanying text.


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value. Since 1971, however, seven circuits have adopted the "participation" theory. Courts adopting this theory impose section 12 liability not only on the transferor, but also on any person "whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place."8

This term the Supreme Court may speak about the participation theory for the first time. The Court will review Dahl v. Pinter,9 which held that even where a non-transferor's activities are a substantial factor in causing the underlying sale to take place, the non-transferor incurs section 12 liability as a "participant" in the selling effort only when the non-transferor was motivated by a desire to provide a direct or indirect benefit to someone other than the purchaser.

Part II of this Article traces the participation theory's unusual development in the lower courts. The theory is derived from Lennerth v. Mendenhall,10 a 1964 district court decision that imposed section 12 liability on the issuer that transferred title to unregistered securities, and on three individual defendants who had solicited the purchasers and negotiated the underlying sales for the issuer. Lennerth held that the three individual defendants had "participated to a culpable degree"11 in the issuer's selling effort because, "[t]o borrow a phrase from the law of negligence," the plaintiffs' injury "flow[ed] directly and proximately"12 from the activities of these individual defendants. Except for stating the conclusion that the participation theory was consistent with the securities acts' "liberal remedial spirit,"13 the court did not base the theory on interpretation of section 12's pertinent legislative materials—the section's language and

7. Section 2(3) of the 1933 Act provides that "'[t]he term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value." 15 U.S.C. § 77b(3) (1982). This Article presumes that a sale has taken place and determines who may incur section 12 liability as one who sells the security. It is this Article's thesis that section 12's two subsections impose liability on only the person who, by contract of sale or by disposition, transfers title to or other interest in the security for value. The Article sometimes refers to this person as "the transferor" and sometimes refers to any other person as a "non-transferor."


11. 234 F. Supp. at 63.

12. Id. at 65.

13. Id.; see also id. at 64 (discussing "the spirit of the [securities] acts").
legislative history, the securities acts' legislative scheme, and the 1933 Act's regulatory antecedents. Because Congress enacted each of the seven securities acts as part of a unified regulatory program, the Supreme Court construes the acts as in pari materia—having the same purpose or object—and thus as a legislative scheme yielding persuasive sources of mutual comparison and contrast. When construction of a 1933 Act provision is at issue, the Court frequently seeks comparison and contrast in the 1929 Uniform Sale of Securities Act and the pre-1933 blue sky laws, regulatory antecedents whose strengths and weaknesses influenced the drafters and enactors of the initial federal act.15

In Hill York Corp. v. American International Franchises, Inc. in 1971,16 the Fifth Circuit cited Lennerth and became the first of seven circuits to adopt the participation theory. Except for embracing Lennerth's conclusion that section 12 participant liability is consistent with the securities acts' remedial purposes,17 Hill York and subsequent influential Fifth Circuit decisions did not base the theory on interpretation of the section's pertinent legislative materials.

The other six circuits have adopted the participation theory in much the same cursory manner. Without otherwise interpreting section 12's pertinent legislative materials, the other circuits have adopted the theory by citing Lennerth, by citing one or more of the Fifth Circuit precedents, or by stating conclusions of their own concerning the securities acts' remedial purposes.18 In five of these other six circuits, adoption of the theory came with discussion of two paragraphs or less;19 the sixth engaged in lengthier discussion but based its holding on conclusions concerning remedial purpose and on "[t]he


15. See infra note 152 and accompanying text. This Article sometimes refers to the Uniform Sale of Securities Act as the Uniform Act.


17. 448 F.2d at 692-93.

18. See infra notes 85-88 and accompanying text.

19. See infra notes 89-92 and accompanying text.
better reasoned cases," including Lennerth and several of the Fifth Circuit decisions.  

Lennerth and its progeny thus have assumed proportions as an apparently formidable body of doctrine, a circumstance that sometimes invites ongoing invocation of stare decisis rather than pause for statutory interpretation. Despite their apparent proportions, however, the participation decisions since the early 1970's have not moved significantly beyond Lennerth's reasoning, which was grounded in conclusions concerning remedial purpose otherwise unaccompanied by interpretation of section 12's pertinent legislative materials. The development of participant liability is striking because, as Part II of the Article shows, during this period the Supreme Court has ascertained the meaning of securities provisions by closely interpreting the various sources of congressional intent. The Court has refused to expand the scope of securities remedies beyond the limits indicated by these sources, whether by invoking remedial construction or by applying common law tort principles.

In statutory decisionmaking, the judicial role is to ascertain and apply legislative intent. When dispute concerns the scope of a right of action created by a remedial statute such as the 1933 Act, a court ascertains this scope more accurately by closely interpreting the various sources of intent than by merely stating a conclusion based on remedial purpose. Part III interprets section 12's pertinent legislative materials and presents this Article's thesis that despite the 1933 Act's status as remedial legislation, section 12's two subsections do not impose liability on participants or other nontransferors.

As a threshold matter, Part III establishes that Congress did not intend to impose section 12 liability for "participating" in a selling effort, no matter how courts might determine participation and no matter what an alleged participant's motive might have been. Section 12's language yields no indication of congressional intent to impose liability for participation, and the section's legislative history makes no mention of participation. In the face of this silence, the legislative scheme and the 1933 Act's regulatory antecedents become instructive.

As section 12 did four years later, the 1929 Uniform Act created private rights of action for fraudulent sales of securities or sales in violation of registration requirements. The Uniform Act expressly imposed liability on the seller and on persons who "personally

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20. Davis v. Ayco Fin. Servs., Inc., 739 F.2d 1057, 1065-67 (6th Cir. 1984),
cert. denied, 470 U.S. 1005 (1985). See infra notes 89-96 and accompanying text
for discussion of the decisions in the six circuits.
participated” with the seller in making a sale. By the time Congress began considering federal securities legislation early in 1933, the blue sky laws of twelve states and the territory of Hawaii had created private rights of action that expressly imposed liability on persons who “participated” in making fraudulent or violative sales. Liabilities and obligations expressly grounded in participation are found elsewhere in the 1933 Act and in four of the later five Roosevelt administration securities acts. Section 9 of the 1934 Act, enacted by the same Congress that enacted the 1933 Act, creates a private right of action that expressly imposes liability on participants.

The legislative scheme and the 1933 Act’s regulatory antecedents thus demonstrate that Congress knew of the participation concept and employed it in the Act and throughout the unified program of securities regulation. In this context, section 12’s failure to impose liability expressly for participation supports the conclusion that Congress did not intend that the section impose participant liability.

Part III also establishes that the 1933 Act confers seller status, and thus imposes section 12 liability, on only the person who transfers title to or other interest in the security for value. The Act’s language indicates, but does not conclusively establish, this outcome. The Act’s legislative history does not shed light on who may be a statutory seller. Section 11, however, authorizes and effectuates actions by “any person acquiring [the] security” against a wide array of expressly enumerated defendants, including most of the major non-transferors involved in registered offerings. These non-transferors are among the persons frequently named as “participants” in section 12 actions. Section 12 could have provided a similar enumeration but instead provides that “[a]ny person who offers or sells a security ... shall be liable to the person purchasing such security from him.” Section 11 thus creates a legislative scheme whose contrasts with section 12 support the conclusion that the Act does not impose seller status on non-transferors.

Because transactions in registered and unregistered securities are frequently effected by non-transferors with the transferor playing only a nominal role, limiting section 12 liability to the transferor would significantly diminish the protections afforded by the 1933 Act. The defect lies in the statute itself. The scope of section 12 liability should be determined by congressional reexamination of the extent of protection that best effectuates the securities acts’ remedial

21. See infra notes 292-94 and accompanying text.
23. Id. § 77l.
24. See infra notes 429-32 and accompanying text.
purposes in light of the complexity and variety that characterize present-day securities transactions. Liability should no longer be determined by judicial implication based on a theory that is inconsistent with the section's pertinent legislative materials.

Perhaps because seven circuits impose section 12 liability for substantial participation in a selling effort, courts have not paid significant attention to the question whether liability may be imposed for aiding and abetting in section 12 actions. If this Article’s thesis is adopted, however, non-transferors would no longer be subject to section 12 liability as sellers. In that event, purchasers could be expected to sue some non-transferors as aider-abettors who had substantially assisted primary violations. Part III therefore briefly discusses section 12 aiding and abetting liability. This Article’s analysis provides support for the conclusion that courts may not impose liability under section 12 for aiding and abetting a seller’s section 5 violation or its offer or sale of a security by means of a materially misleading prospectus or oral communication.

II. Judicial Interpretation of Securities Provisions

Section 12 decisions adopting the participation theory since the early 1970’s have not moved significantly beyond Lennerth’s reasoning, which was grounded in conclusions concerning the securities acts’ remedial purposes otherwise unaccompanied by interpretation of section 12’s pertinent legislative materials. By significant contrast, the Supreme Court during this period has ascertained the meaning of securities provisions by closely interpreting the various sources of congressional intent. The Court has refused to expand the scope of securities remedies beyond the limits indicated by these sources, whether by invoking remedial construction or by applying common law tort principles.

A. Of Hunters and Traps: Section 12’s Participation Theory in the Lower Courts

1. The Genesis of Participant Liability

Seven years after the enactment of the 1933 Act, the First Circuit decided Cady v. Murphy, which affirmed imposition of section

25. For the elements of an aiding and abetting cause of action, see infra note 410.
26. 113 F.2d 988 (1st Cir.), cert. denied, 311 U.S. 705 (1940).
12(2) liability on a brokerage firm. The plaintiff had purchased securities after engaging in telephone negotiations with the defendant firm's head trader, who misrepresented material facts concerning the securities and the issuer. At trial, the parties disputed whether the firm had effected the underlying transaction as a principal or as a broker for the transferor. Sitting without a jury, the district court determined that resolution of the dispute was "immaterial" because "section 12 . . . applies to brokers when selling securities owned by other persons." The court found no legislative history or case law regarding the question whether, as the defendant firm argued, Congress intended section 12 to reach only transferors. The court based its holding on an interpretation of the language of the Act.

A divided court of appeals affirmed. The majority concluded that the district court's holding was "not a strained interpretation" of the 1933 Act because section 12's two subsections each imposed liability on "any person who sells a security" and section 2(3) of the Act defined "sell" to include "solicitation of an offer to buy." The panel held that when the defendant firm solicited an offer from plaintiff to buy the securities, the firm was a "person who sells a security." The firm thus incurred section 12(2) liability for material misrepresentations even if it acted only as a broker for the transferor.

Throughout the 1950's and early 1960's, a few decisions approved imposition of section 12 liability on defendants who were not transferors or brokers, but who had involved themselves in a transferor's selling effort. Unlike Cady, these decisions did not base their holdings on interpretation of statutory language. Instead the decisions pin-

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27. 113 F.2d at 989.
29. 30 F. Supp. at 469.
30. Id., quoted in Cady, 113 F.2d at 990.
31. 30 F. Supp. at 469.
32. Id. at 469-70.
33. 113 F.2d at 990. The dissenter concluded that the evidence indicated that the defendant was a broker for the purchaser. Id. at 991.
34. Id. at 990; 1933 Act ch. 38, 48 Stat. 84 (1933). In 1954 Congress redefined the terms "sale" and "sell" in section 2(3) "to exclude offers." See H.R. REP. No. 1542, 83d Cong., 2d Sess. 10 (1954); see also Pub. L. No. 577, ch. 667, 68 Stat. 683 (1954). The 1954 amendments also made a conforming change in section 12. For the full text of amended section 12, see infra note 268 and accompanying text. For discussion of amended section 2(3) with its present distinction between sales and offers, see infra notes 271-72 and accompanying text.
35. 113 F.2d at 990; see also Wall v. Wagner, 125 F. Supp. 854, 858 (D. Neb. 1954) (citing Cady and finding transferor's agent to be section 12(1) seller), aff'd without considering the question sub nom. Whittaker v. Wall, 226 F.2d 868 (8th Cir. 1955).
pointed "participation" as the basis of liability without citing Cady, without identifying the source of participant liability, and without articulating a standard for determining the point at which participation became sufficient to support liability.

In Wonneman v. Stratford Securities Co.,36 for example, the plaintiff on two occasions purchased unregistered securities from Stratford, a brokerage firm that made the sales as a principal after having purchased the securities on the open market. The section 12(1) count named not only Stratford, but also the issuer and some individual employees of the issuer and of Stratford.37

Judge Cashin denied the summary judgment motion made by two individual defendants. Without interpreting section 12's pertinent legislative materials, the court held that to avoid section 12(1) liability, these defendants "must show that they did not participate in the sale and not merely that they did not actually sell the securities to plaintiff."38 The court identified the "problem"39 inherent in determining the quality of the individual defendants' showing:

What constitutes "participation"? Does one 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 the sale?40

After trial, Judge Murphy imposed liability on one individual defendant as a controlling person of the liable Stratford.41 Without interpreting section 12's pertinent legislative materials, he dismissed the complaint against the other individual defendants on the ground that section 12 liability extended only to plaintiff's "seller . . . [and] those in privity with that seller,"42 such as "one who negotiated the sale."43

Without evident limitation, other courts stated the broad view of section 12 participant liability found in the first Wonneman decision.44

37. Id. ¶ 90,923, at 92,963; id. ¶ 91,034, at 93,459. For the full text of section 12(1), see infra text accompanying note 268.
39. Id.
40. Id.
41. See id. ¶ 91,034, at 93,459 (S.D.N.Y. June 7, 1961). For discussion of 1933 Act controlling-person liability, see infra note 229.
43. Id. at 93,459.
44. See, e.g., MacClain v. Bules, 275 F.2d 431, 433 (8th Cir. 1960) (stating
In Freed v. Szabo Food Service, Inc. (Szabo), for example, plaintiffs purchased stock in Chemoil Industries, Inc. (Chemoil) and in the defendant company, the surviving entity of a merger between Chemoil and Szabo Food Service, Inc. (Old Szabo). After the Chemoil and Old Szabo managements reached an informal merger agreement, certain of the companies' employees began a campaign to stimulate the market in Chemoil shares and thus help assure that Chemoil shareholders would approve the merger. These employees disseminated documents containing material misrepresentations concerning the merger and the companies. The price of Chemoil shares doubled, and Chemoil shareholders voted to approve the merger. The plaintiffs alleged that they purchased Chemoil and Szabo shares (apparently from transferors not named in the complaint) at artificially high prices.

The court denied Szabo's motion to dismiss the section 12(2) claim. Except for stating the conclusion that "the securities laws are remedial and are to be construed liberally in order to achieve the congressional purpose," the court did not interpret section 12's pertinent legislative materials. The court held that "[t]he fact that there is no privity will not defeat the action as long as plaintiffs' alleged purchase was in reliance upon misrepresentation and participation in these misrepresentations by the defendant." Nearly seven months later, the District Court for the Northern District of Ohio decided Lennerth v. Mendenhall.

that district court had refused to impose section 12 liability on banker because "the evidence did not sufficiently establish that he had been a participant in" underlying sale); Davidson v. Amos Treat & Co., [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,350, at 94,494 (S.D.N.Y. Mar. 25, 1964) ("[b]oth the seller ... and its employee ... , who participated in the sale, would be liable [under section 12(2)] for any false oral statement made by" employee); Zachman v. Erwin, 186 F. Supp. 691, 695-96 (S.D. Tex. 1960) ("Securities Act only imposes liability for selling a security under Section [12] and for controlling a seller under Section [15]. ... [I]t cannot be said that [defendant] participated in a sale or controlled 'a seller'") (quoting Zachman v. Erwin, 186 F. Supp. 681, 686 (S.D. Tex. 1959)); First Trust & Sav. Bank v. Fidelity-Phila. Trust Co., 112 F. Supp. 761, 769-70, 771 (E.D. Pa. 1953) (plaintiff claimed that defendant bank was section 12 seller because "it participated in the sale of securities"; court held that bank "did not become a seller or participate in the sale of securities by acting as a stakeholder of the collateral and as a forwarding bank for collection of drafts"), aff'd, 214 F.2d 320 (3d Cir.), cert. denied, 348 U.S. 856 (1954).

46. Id. at 94,363-65.
47. Id.
2. Lennerth and the Participation Theory

*Lennerth v. Mendenhall* imposed section 12(1) liability not only on the issuer that transferred title to unregistered securities, but also on the issuer’s president and vice president and another employee. The other employee, one Roger, had solicited the plaintiffs and had met with them on three occasions to discuss the issuer’s condition and to describe the operation that the securities would help finance. The vice president, “who represented the symbol of authority which Roger said he lacked,” had attended the third meeting to assist in the negotiations. The president, for his part, had signed the contract of sale in the issuer’s name.

In resolving “the problem of ‘participation’” raised by such decisions as *Wonneman* and *Szabo, Lennerth* stated that the outer limits of section 12 liability “must lie somewhere between the narrow view, which holds only the parties to the sale, and the too-liberal view which would hold all who remotely participated in the events leading up to the transaction.” *Lennerth* crafted a participation theory grounded in common law tort principles:

> 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? If the answer is in the affirmative, we would hold him liable. But for the presence of the defendant . . . in the negotiations preceding the sale, could the sale have been consummated? If the answer is in the negative, and we find that the transaction could never have materialized without the efforts of [the] defendant, we must find him guilty.

The court imposed section 12(1) liability on the three individual defendants because “as a matter of uncontroverted fact [each had] participated to a culpable degree in either the offer to sell, or the sale, or both.” Reasoning metaphorically that “[t]he 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,” the court held that each individual defendant’s conduct was “tantamount to that...
of a 'seller' within the liberal remedial spirit of the securities laws.'"56 Except for stating this conclusion that its participation theory was consistent with the securities acts’ remedial purposes, the court did not base the theory on an interpretation of section 12’s pertinent legislative materials.

Between 1971 and 1981, a series of Fifth Circuit decisions adopted and then recast Lennerth’s theory for determining the outer limits of section 12 liability.57 These influential Fifth Circuit decisions pinpointed "participation" as the basis of liability.58 Except for embracing Lennerth’s conclusion that the participation theory is consistent with the securities acts’ remedial purposes, the decisions did not base the theory on an interpretation of section 12’s pertinent legislative materials.

The first of the Fifth Circuit series, Hill York Corp. v. American International Franchises, Inc.,59 concerned a pyramid scheme to sell restaurant franchises through corporations established by three individual defendants in defined geographic areas. The defendants solicited local investors to form the corporations and to serve as officers and directors. Each corporation had five directors, two of whom were elected by the defendants. To finance the purchase from defendants of the right to sell franchises, each corporation transferred its unregistered stock to a small number of persons in what were later

56. Id.; see also id. at 64 (discussing “the spirit of the [securities] Acts”).
57. See, e.g., Junker v. Crory, 650 F.2d 1349, 1360 (5th Cir. 1981) (“those ‘whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place’ are classified as sellers under Section 12(2)”) (quoting Pharo v. Smith, 621 F.2d 656, 667 (5th Cir. 1980)); Swenson v. Engelstad, 626 F.2d 421, 426 (5th Cir. 1980) (persons who “participate in the negotiations of or for arrangements for the sale of unregistered securities” are section 12(2) sellers if they meet substantial-factor test); Croy v. Campbell, 624 F.2d 709, 713-14 (5th Cir. 1980) (quoting passage from Pharo, restated supra, in section 12(2) action); Lewis v. Walston & Co., 487 F.2d 617, 621-22 (5th Cir. 1973) (test under section 12(1) “to determine whether a participant in the arrangements for a sale ‘sells’ securities ... is whether the party is the ‘proximate cause’ of the sale”); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 692 (5th Cir. 1971) (in action under subsections (1) and (2) of section 12, rejecting “the overbroad ‘participation' concept which would hold all those liable who participated in the events leading up to the transaction”); see also Huddleston v. Herman & MacLean, 640 F.2d 534, 551 n.27 (5th Cir. 1981) (quoting passage from Pharo, restated supra), aff’d in part, rev’d in part on other grounds, 459 U.S. 375 (1983); Ayers v. Wolfinbarger, 491 F.2d 8, 13-14 (5th Cir. 1974) (quoting Hill York passage, restated supra, in section 12(2) action); Canizaro v. Kohlmeyer & Co., 370 F. Supp. 282, 287 (E.D. La. 1974) (section 12(2) liability extends to persons who “participated in some significant way in a sales effort”), aff’d per curiam, 512 F.2d 484 (5th Cir. 1975).
58. See supra note 57.
59. 448 F.2d 680 (5th Cir. 1971).
determined to be unlawful private placements. The plaintiffs were among the purchasers of one corporation's stock. The defendants never met the plaintiffs before their purchases, but they instructed local corporate officers about solicitation techniques and provided sales literature that contained materially misleading information.

Hill York held that the three non-transferor defendants were "sellers" from whom the plaintiffs had purchased the securities and thus were liable under sections 12(1) and 12(2). After rejecting "the overbroad 'participation' concept which would hold all those liable who participated in the events leading up to the transaction," the panel cited Lennerth and "adopt[ed]" its participation theory as "the proper test" and "a rational and workable standard for imposition of liability under either section." Because the three defendants were "the motivating force" behind the underlying sales and because each had acted as a "hunter who seduces the prey and leads it to the trap," the panel concluded that the three defendants were sellers within the theory's "letter and spirit."

When two causes concur to bring about an event and either, operating alone, would have been sufficient to cause the identical result, tort law recognizes the need for a test other than the but-for test applied in Lennerth and Hill York. The substantial-factor test has won general acceptance. A defendant's conduct is a cause of the event if the conduct was a material element and a substantial factor in bringing about the event. In 1973, in Lewis v. Walston & Co., the Fifth Circuit imposed section 12(1) liability on a non-transferor defendant whose activities were a substantial factor in causing the plaintiffs to purchase unregistered securities.

60. Id. at 684-85.
61. Id. at 686.
62. Id. at 692-93, 695. On their section 12 claims, plaintiffs had won a jury verdict against the corporate issuer and the three individual defendants. The issuer did not appeal. Id. at 686.
63. Id. at 692.
64. Id. at 693.
65. Id.
66. Id. at 692.
67. Id. at 693.
68. Id. (quoting Lennerth, 234 F. Supp. at 65).
69. Id.
70. See W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 41, at 266-67 (5th ed. 1984) [hereinafter PROSSER & KEETON]; see also, 4 F. HARPER, F. JAMES & O. GRAY, THE LAW OF TORTS § 20.6(6), at 180-82 (2d ed. 1986) [hereinafter HARPER, JAMES & GRAY].
71. PROSSER & KEETON, supra note 70, § 41, at 266-67.
72. 487 F.2d 617 (5th Cir. 1973).
The non-transferor defendant in *Lewis* was a registered broker’s representative who, during five months of communication with the plaintiffs, repeatedly touted the unregistered stock of a company that ultimately went into receivership. After touting the stock as a “potential IBM” and after falsely stating that the broker would take a position in the issuer, the defendant arranged meetings with the issuer’s officers at which the two plaintiffs made a series of purchases. The defendant continued touting the stock to the plaintiffs until they made all their purchases, and she procured most of the purchase price for them by selling listed securities in their accounts. Citing *Lennerth* and *Hill York*, the court of appeals affirmed imposition of section 12 liability on the defendant because her “participation in the negotiations . . . [or] . . . arrangements” was “a ‘substantial factor’ in bringing about the plaintiffs’ purchases” of the unregistered securities.

Presently before the Supreme Court is *Dahl v. Pinter*, the Fifth Circuit’s latest section 12 participation decision. Pinter transferred unregistered fractional undivided interests in oil and gas leases to Dahl, who then solicited the other ten plaintiffs, all of whom were either friends or family members. Motivated by a desire to benefit the other plaintiffs, Dahl did not receive or expect to receive any commission in connection with the purchases they later made from the transferor. When the securities proved worthless, Dahl and the other plaintiffs alleged that Pinter had violated section 12(1) by failing to register the securities.

A divided Fifth Circuit panel rejected Pinter’s contention that Dahl was liable under section 12(1) as a participant in the sales to the other plaintiffs. The majority concluded that although Dahl’s activities were a substantial factor in causing the other plaintiffs’ purchases to take place, he was not a seller under the participation

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73. *Id.* at 619.
74. *Id.* at 620.
75. *Id.* at 621.
76. *Id.* at 621-22.
78. *Dahl*, 787 F.2d at 986 & n.1. Dahl knew that the fractional undivided interests were unregistered, but no evidence indicated that he knew that failure to register violated the 1933 Act. *Id.* at 987. The Fifth Circuit affirmed the district court’s judgment rejecting Pinter’s contention that Dahl should be barred from any recovery under the equitable doctrines of *in pari delicto*, estoppel and unclean hands. See *id.* at 987-89.
79. *Id.* at 987.
theory which the circuit's decisions had "created." Because "a rule imposing liability . . . on friends and family members who give one another gratuitous advice on investment matters unreasonably interferes with well-established patterns of social discourse," the majority held that section 12 participant liability may be imposed only on a non-transferor who meets the substantial-factor test and who was "motivated by a desire to confer a direct or indirect benefit on someone other than the person he has advised to purchase." The majority was not persuaded by dissenting Judge John R. Brown, who argued that imposition of section 12 liability premised on motive "is wholly without support in law and flies in the face of the policy underlying the securities registration laws." According to Judge Brown, a distinction based on motive "has no more foundation in securities law and policy than a distinction based on the color of the seller's hair or the size of his tennis shoes."

In adopting the participation theory, the Fifth Circuit has been joined by six of the other eight circuits that have considered the

80. Id. at 991.
81. Id.
82. Id.
83. Id. at 992 (Brown, J., dissenting).
84. Id.; see also Dahl v. Pinter, 794 F.2d 1016, 1017 (5th Cir. 1986) (Jones, J., dissenting from denial of rehearing en banc) (distinction based on motive "has absolutely no foundation in either settled securities law or its underlying policies").
85. The Second, Fourth, Sixth, Eighth, Ninth and Eleventh circuits have adopted the theory. The Second Circuit has not specified application of the substantial-factor test. See Akerman v. Oryx Communications, Inc., 810 F.2d 336, 344 (2d Cir. 1987) ("person who makes a misrepresentation may be held liable as a [section 12(2)] 'participant' even though he is not the immediate and direct seller of the securities . . . [but] only if there is proof of scienter"); Mayer v. Oil Field Sys. Corp., 803 F.2d 749, 756 (2d Cir. 1986) ("when . . . the person who made the misrepresentation is not the immediate and direct seller . . . , the imposition of liability on him under § 12(2) as a participant . . . requires proof of scienter"). The circuit's district courts, however, apply the substantial-factor test. See, e.g., Klein v. Computer Devices, Inc., 602 F. Supp. 837, 840 (S.D.N.Y. 1985) (section 12(2) purchaser may sue "those who substantially participated in the transaction").

The Fourth and Sixth circuits apply the substantial-factor test. See Adalman v. Baker, Watts & Co., 807 F.2d 359, 363 (4th Cir. 1986) ("this Circuit has . . . allowed a plaintiff to sue a defendant under § 12(2) where that defendant is a 'significant participant' in, or one who 'proximately caused,' a sale of securities . . . . [S]tatus . . . as a 'seller' of securities should be determined by whether the entity was a 'substantial factor' in the sale of securities"); Davis v. Avco Fin. Servs., Inc., 739 F.2d 1057, 1067 (6th Cir. 1984) (imposing section 12(2) liability on "participants in the selling effort whose acts meet the substantial factor test").

The Eighth Circuit initially expressed "difficulty" with the Lennerth-Hill York but-for test on the ground that "it fails to elucidate or focus the trier of fact's
theory. In circuits in which the theory remains an open question,

attention on those policies which the [1933] Act was designed to implement.” Wasson v. SEC, 558 F.2d 879, 886 (8th Cir. 1977). In 1981, however, the circuit adopted the substantial-factor test without citing Wasson. See Stokes v. Lokken, 644 F.2d 779, 785 (8th Cir. 1981) (section 12(1) or 12(2) liability extends to “one whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place”). In section 12 decisions since Stokes, district courts in the Eighth Circuit have applied the substantial-factor test. See, e.g., Briggs v. Sterner, 529 F. Supp. 1155, 1173 (S.D. Iowa 1981) (approving imposition of section 12(1) liability on “persons . . . whose participation in the sale of securities was a substantial factor in its ultimate consummation”).

The Ninth Circuit imposes section 12 liability on “‘participants’ whose acts are ‘both necessary to and a substantial factor in the sales transaction.’” Anderson v. Aurotek, 774 F.2d 927, 930 (9th Cir. 1985) (quoting SEC v. Murphy, 626 F.2d 633, 649-50 (9th Cir. 1980), which discussed liability under section 12(1) and 12(2)); accord SEC v. Rogers, 790 F.2d 1450, 1456 n.8 (9th Cir. 1986). Rogers stated that the “necessary” and “substantial factor” prongs require separate showings: “The first prong . . . requires a defendant’s participation to be a ‘but for’ cause of the unlawful sale, and the second requires the participation to be more than ‘de minimus.’” Id. at 1456.

Aurotek and Rogers follow a brief interlude marked by apparent misgivings. In 1982, two years after Murphy, the Ninth Circuit expressed approval of section 12 participant liability but noted that “the broad reading of ‘seller’ may be in some doubt in light of recent Supreme Court cases that prescribe a strict statutory construction approach to the securities acts and reject their expansion with tort and criminal theories.” Admiralty Fund v. Jones, 677 F.2d 1289, 1294 & n.3 (9th Cir. 1982). A month later, in a decision that cited neither Murphy nor Admiralty Fund, a different panel affirmed entry of summary judgment against a purchaser who had failed to establish the “privity . . . required by § 12.” Feldman v. Simkins Indus., Inc., 679 F.2d 1299, 1305 (9th Cir. 1982). Citing Murphy but not Simkins, Rogers stated that “[u]nder section 12, . . . the necessary and substantial participant test has been uniformly applied.” 790 F.2d at 1456 n.8. Ninth Circuit district courts apply the substantial-factor test. E.g., In re Activision Sec. Litig., 621 F. Supp. 415, 420 (N.D. Cal. 1985) (“Ninth Circuit has adopted the ‘substantial participation’ test . . . to analyze ‘seller’ status under § 12,” citing Fifth Circuit precedent).


86. The Third Circuit has held that in the absence of a “special relationship” between the plaintiff and the defendant, section 12(2)’s “unambiguous language” imposes liability on the “immediate seller” only. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979). The Seventh Circuit has stated in dictum that section 12(2) “explicitly requires privity between plaintiff-purchaser and defendant-seller.” Sanders v. John Nuveen & Co., 619 F.2d 1222, 1226 (7th Cir. 1980), cert. denied, 450 U.S. 1005 (1981). Most Seventh Circuit district court decisions apply the Sanders
most district courts have adopted it.87 Like Lennerth and the Fifth Circuit, the other six circuits and the district courts pinpoint “participation” as the basis of liability.88

Five of the other six circuits have adopted the participation theory with discussion of two paragraphs or less. In each of two decisions, the Second Circuit adopted the theory in one sentence.89 The Fourth Circuit’s adoption came in two paragraphs that cited Hill York and Lewis but did not otherwise interpret section 12’s pertinent legislative materials.90 The Eighth Circuit’s adoption came in one sentence that


87. See, e.g., Stone v. Fossil Oil & Gas, No. 84-1465-JB (D.N.M. Mar. 30, 1987) (LEXIS, Genfed library, Dist file) (“those who significantly participate in a sale are liable under § 12 to the same extent as the person who actually passes title”); Quincy Co-Operative Bank v. A.G. Edwards & Sons, Inc., 655 F. Supp. 78, 84, 83 (D. Mass. 1986) (“brokers and others who have a substantial role in a securities sale” are section 12(2) sellers, following circuits that impose liability on “those whose participation in the sale was a ‘substantial factor in causing the transaction to take place’ ”); In re WICAT Sec. Litig., 600 F. Supp. 1236, 1239 (D. Utah 1984) (section 12(2) action imposing “‘participant liability’ ” under substantial-factor test); Woods v. Home-Stake Prod. Co. Sec. Litig., 489 F. Supp. 1270, 1294 (D. Kan. 1980) (requiring “more than mere participation but . . . if the acts of the defendant are a proximate cause of the sale . . . , the defendant meets the seller requirement of Section 12’’); In re Home-Stake Prod. Co. Sec. Litig., 76 F.R.D. 337, 349 (N.D. Okla. 1975) (“significant participation in the sale of securities may be sufficient for § 12(2) liability”). See also Seventh Circuit district court decisions supra note 86.

88. See supra notes 85-87.

89. See Ackerman v. Oryx Communications, Inc., 810 F.2d 336, 344 (2d Cir. 1987); Mayer v. Oil Field Sys. Corp., 803 F.2d 749, 756 (2d Cir. 1986). The sentences are quoted supra note 85. Ackerman and Mayer both cited Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973) (en banc), which did not cite a basis for participant liability in section 12’s pertinent legislative materials. See id. at 1298-99.

cited Fifth Circuit precedent but did not otherwise interpret these materials. In two decisions, the Ninth Circuit's adoption came in one and two paragraphs respectively; each decision cited *Lennerth*, *Hill York* and *Lewis* but did not otherwise interpret the pertinent legislative materials.

In *Davis v. Avco Financial Services, Inc.* the Sixth Circuit came the closest to basing adoption of the participation theory on an interpretation of section 12's pertinent legislative materials. After quoting section 12 and definitions contained in section 2(3) of the Act, the court acknowledged that "if we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because Avco was not in the literal sense the 'seller.' " The panel held, however, that section 12(2) liability reaches participants who meet the substantial-factor test. Without otherwise interpreting section 12's pertinent legislative materials, the panel based its holding on conclusions concerning the securities acts' remedial purposes and on "[t]he better reasoned cases," including *Lennerth* and several of the Fifth Circuit decisions.

In circuits in which the participation theory remains an open question, most district courts adopt the theory by citing precedent without otherwise interpreting section 12's pertinent legislative materials. In *Cronin v. Executive House Realty*, for example, the

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91. See Stokes v. Lokken, 644 F.2d 779, 785 (8th Cir. 1981) (citing Pharo v. Smith, 621 F.2d 656, 667 (5th Cir. 1980)).
92. See Admiralty Fund v. Jones, 677 F.2d 1289, 1294 (9th Cir. 1982) (one paragraph); SEC v. Murphy, 626 F.2d 633, 649-50 (9th Cir. 1980) (two paragraphs). Concerning the binding effect of Fifth Circuit precedent in the Eleventh Circuit, see *supra* note 85.
94. *Id.* at 1064. Plaintiffs secured loans from the defendant finance company to purchase shares in a pyramid scheme. The defendant company apparently was unaware of the scheme when it made the initial loans. Then the scheme's promoters contacted one of the company's managers about making further loans to potential investors. The manager attended three meetings held by the promoters with such investors. At the meetings, the manager provided blank loan application forms, made a speech concerning financing, and represented to some plaintiffs that the scheme was a "good quality investment." *Id.* at 1061. When the manager's superiors learned of the scheme, they prohibited the making of any further loans. *Id.* at 1062. The court of appeals found "abundant evidence" that the manager "allowed himself to be duped by the . . . promoters into facilitating their dubious pyramidal scheme." *Id.* The panel held that because the finance company was a substantial factor in causing plaintiffs to purchase shares in the scheme, the company was a "seller" from whom the plaintiffs had purchased these shares. *Id.*
95. *Id.* at 1064-65.
96. See *id.* at 1065-66.
court's analysis of participant liability consisted of two sentences:

A defendant need not be in privity with the plaintiff in order to be liable as a seller under Section 12(2) . . . . Rather, one whose participation in the transaction is a substantial factor in causing the transaction may be primarily liable under Section 12(2). 48

In decisions adopting section 12's participation theory since the early 1970's, citation and conclusions concerning remedial purpose thus have displaced thorough statutory interpretation. Despite their apparent proportions as a body of doctrine, the participation decisions have not moved significantly beyond Lennerth's reasoning, which was grounded in such conclusions otherwise unaccompanied by interpretation of section 12's pertinent legislative materials. The participation decisions create a marked contrast with the Supreme Court's decisions interpreting securities provisions during this period. As the next section shows, the Court's securities decisions are grounded in close interpretation of the various sources of congressional intent. The Court has refused to expand the scope of securities remedies beyond the limits indicated by these sources, whether by invoking remedial construction or by applying common law tort principles.

B. Securities Interpretation in the Supreme Court


In 1982, in *Marine Bank v. Weaver*, 49 the Supreme Court held that two instruments, a conventional certificate of deposit and a business agreement between two families, were not securities within the meaning of section 3(a)(10) of the 1934 Act. 99 For the unanimous Court, Chief Justice Burger wrote that "Congress, in enacting the securities laws, did not intend to provide a broad federal remedy


for all fraud." In another decision, the Court concluded that Congress enacted "specified civil liabilities." The mere circumstance of securities-related fraud, then, does not necessarily entitle injured plaintiffs to federal securities relief.

Proceeding from this threshold determination that Congress did not intend to federalize all securities fraud claims, the Court ascertains the scope of a securities remedy by closely interpreting the various sources of congressional intent. The Court begins by closely interpreting the remedy's own language and legislative history. In Ernst & Ernst v. Hochfelder in 1976, for example, the Court declined to reach a result that the majority concluded would have been inconsistent with these sources of intent. The Court held that in a private damage action under section 10(b) of the 1934 Act

101. 455 U.S. at 556. This statement was cited with approval in Landreth Timber Co. v. Landreth, 471 U.S. 681, 687-88 (1985). See infra notes 191-232 and accompanying text for discussion of Landreth and a companion decision. Congressional intent not to occupy the field is indicated by sections 16 of the 1933 Act and 28(a) of the 1934 Act, both of which provide that "[t]he rights and remedies provided by this [Act] shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. §§ 77p, 78bb(a) (1982).


104. 15 U.S.C. § 78j(b) (1982) [hereinafter section 10(b)]. Section 10(b) 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 . . . (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.

Id.


See Ruder, Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?, 57 Nw. U.L. Rev. 627, 687-90 (1963) (citing decisions). By the late 1960's, however, 10 of the then 11 circuits had recognized an implied private right of action under the Rule, and the number of reported decisions under the Rule's private right had grown to well over 100 each year. See Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution, 120 U. Pa. L. Rev. 597, 598 n.1 (1972) [hereinafter Ruder]; see also 6 L. Loss, Securities Regulation 3871-73 (Supp. 1969) [hereinafter Loss]. In 1969 the Supreme Court stated that "[section] 10(b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws." SEC v. National Sec., Inc., 393 U.S. 453, 465 (1969). By that time, private plaintiffs were bringing the bulk of the actions under the Rule. As a private remedy, the Rule had become, consistent with the Court's later description, "a judicial oak which has grown from little more than a legislative acorn," Blue Chip, 421 U.S. at 737.

In 1971 the Supreme Court unanimously stated in one sentence that an implied private right of action exists under the Rule. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("[i]t is now established that a private right of action is implied under § 10(b)"). The statement came in a footnote, a circumstance that invites recollection of Justice Frankfurter's tart observation that "[a] footnote hardly seems to be an appropriate way of announcing a new constitutional doctrine." Kovacs v. Cooper, 336 U.S. 77, 90-91 (1949) (Frankfurter, J., concurring) (discussing United States v. Carolene Prods. Co., 304 U.S. 144, 152 n.4 (1938)). Footnotes, however, are also unusual sources for new statutory determinations, particularly in circumstances such as those presented by the Court's post-Bankers Life implied-right decisions.


As it has reaffirmed the existence of a private right of action under Rule 10b-5, the Court has restricted the reach of the Rule. See, e.g., Dirks v. SEC, 463 U.S. 646, 660 (1983) (tippees incur liability under Rule only if they have fiduciary duty to corporation's shareholders not to trade on material nonpublic information; this duty exists only when insider has breached fiduciary duty to shareholders by disclosing information to tippee and tippee knows or should know about breach); Aaron v. SEC, 446 U.S. 680, 687-95 (1980) (Securities and Exchange Commission must establish scienter as element of civil enforcement action to enjoin violation of Rule); Chiarella v. United States, 445 U.S. 222, 230 (1980) (in action based on nondisclosure, criminal liability under Rule "is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction");
mission (the Commission), the plaintiff must allege that defendant's conduct involved an element of scienter and not merely negligence. Because "[t]he starting point in every case involving construction of a statute is the language itself," Hochfelder first turned to the

Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476 (1977) (Rule does not reach breaches of fiduciary duty unaccompanied by manipulation or deception); Hochfelder, 425 U.S. at 193 & n.12 (private damage action under Rule requires allegation of "scienter"—intent to deceive, manipulate or defraud); Blue Chip, 421 U.S. at 730 (only actual purchaser or seller of securities may maintain private damage action under Rule). But cf. Herman & MacLean v. Huddleston, 459 U.S. 375, 387 (1983) (availability of express remedy under section 11 of 1933 Act does not preclude defrauded purchasers of registered securities from maintaining action under section 10(b); plaintiff must prove section 10(b) violation by preponderance of evidence).

According to Justice Blackmun, since the mid-1970's the Court has "pursued a course... designed to transform § 10(b) from an intentionally elastic 'catchall' provision to one that catches relatively little of the misbehavior that all too often makes investment in securities a needlessly risky business for the uninitiated investor." Chiarella, 445 U.S. at 246 (Blackmun, J., dissenting). This course demonstrates "a seeming callousness toward the investing public quite out of keeping... with our own traditions and the intent of the securities laws," Blue Chip, 421 U.S. at 762 (Blackmun, J., dissenting), and "frustrates the congressional intent that the securities laws be interpreted flexibly to protect investors." Dirks, 463 U.S. at 668 n.1 (Blackmun, J., dissenting).

105. 17 C.F.R. § 240.10b-5 (1987) [hereinafter Rule 10b-5]. Rule 10b-5 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,

(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 the 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.

Id.

106. 425 U.S. at 193 & n.12. Hochfelder used the term "scienter" to refer to "a mental state embracing intent to deceive, manipulate, or defraud." Id. The Court has expressly left open the question whether reckless behavior is sufficient for civil liability under the Rule. Id. at 194 n.12; see also Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980). The vast majority of lower courts addressing this question have answered it in the affirmative. See T. HAZEN, THE LAW OF SECURITIES REGULATION 459 & n.14 (1985 and Supp. 1987) (citing decisions) [hereinafter HAZEN].

language of section 10(b). That “catchall”\(^8\) section makes unlawful, in connection with the purchase or sale of any security, the use or employment of “any manipulative or deceptive device or contrivance in contravention of” the Commission’s rules under that section, including Rule 10b-5.\(^9\)

_Hochfelder_ dissected the section’s language phrase by phrase and word by word. The phrase “‘manipulative or deceptive’ used in conjunction with ‘device or contrivance,’” the Court began, “strongly suggest[s] that [section] 10(b) was intended to proscribe knowing or intentional misconduct.”\(^10\) The 1934 Act does not define the words used in these phrases. The Court sought guidance in the definitions of “manipulate,” “device,” “contrivance,” and “contrive”\(^11\) contained in Webster’s New International Dictionary of the English Language. The Court concluded that these words “make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence.”\(^12\)

_Hochfelder_ rejected the Commission’s contention as amicus that because “the overall congressional purpose”\(^13\) of the 1933 and 1934 acts was to protect investors against injury from false and deceptive practices, Congress “must have intended”\(^14\) that section 10(b) reach negligent conduct. This contention, the Court concluded, “ignores the use of the words”\(^15\) in section 10(b) and “would add a gloss to the operative language of the statute quite different from its commonly accepted meaning.” This gloss would be impermissible because “[a]scertainment of congressional intent with respect to the

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\(^9\) See _supra_ note 105 for the text of Rule 10b-5.

\(^10\) See _id._ at 199.

\(^11\) _Id._ at 199 n.21 (citing WEBSTER’S INT’L DICTIONARY OF THE ENGLISH LANGUAGE (2d ed. 1934) [hereinafter WEBSTER’S]).

\(^12\) _Id._ at 199 n.20 (citing WEBSTER’S, _supra_ note 111).

\(^13\) _Id._ (citing WEBSTER’S, _supra_ note 111).

\(^14\) _Id._ (citing WEBSTER’S, _supra_ note 111).

\(^15\) _Id._ at 199.

\(^16\) _Id._ at 198.

\(^17\) _Id._ at 199.

\(^18\) _Id._ at 198.

\(^19\) _Id._ at 198-99.
standard of liability created by a particular section of the [1933 and
1934 acts] must ... rest primarily on the language of that sec-
tion."

Finally, the Court interpreted section 10(b)'s legislative
history and the legislative scheme. The Court found these sources
of congressional intent to be consistent with the result indicated by
the language of the section.

Close interpretation of statutory language and legislative history
remains central to the Court's decisions determining the meaning of
securities provisions. In Aaron v. SEC in 1980, for example,
the Court declined both parties' requests to announce a uniform
culpability requirement for the three subsections of section 17(a) of
the 1933 Act. The Court determined that the section's language
was "simply not amenable to" the announcement the parties had
requested.

Aaron's interpretation of statutory language went further than
Hochfelder's had been required to go. Whereas Hochfelder parsed

120. Id. at 200, quoted with approval in Santa Fe Indus., Inc. v. Green, 430
121. See Hochfelder, 425 U.S. at 201-206.
section 202(a)(1) of Investment Advisers Act of 1940, Court held that interpretation
advanced by Commission would "recast the statutory language" which the Court
"read literally"); Schreiber v. Burlington N., Inc., 472 U.S. 1, 6-7, 13 & n.5 (1985)
in action interpreting section 14(e) of 1934 Act, Court cited WEBSTER'S THIRD
NEW INT'L. DICTIONARY (1971) and held that plaintiff's reading of " 'manipulative'
conflicted with "the normal meaning of the term," with "the use of the term
at common law, and with its traditional dictionary definition"); United States v.
Naftalin, 441 U.S. 768, 772-74 & n.5 (1979) (in action interpreting section 17(a)(1)
of 1933 Act, Court held that phrase found only in section 17(a)(3) may not be
read into all three subsections because "Congress did not write the statute that
way"); cf. Steadman v. SEC, 450 U.S. 91, 97-100 & n.16 (1981) (citing WEBSTER'S
THIRD NEW INT'L. DICTIONARY (1976) in action interpreting standard of proof
required by section 7(c) of Administrative Procedure Act in Commission adjudicatory
proceedings).
124. See id. at 697.
126. 446 U.S. at 697.
127. Hochfelder and Aaron are typical of securities decisions in which the Court
has rejected the Commission's proposed statutory interpretation as yielding a result
beyond the limits indicated by the various sources of congressional intent. See
Aaron, 446 U.S. at 691-95, 699-700, Hochfelder, 425 U.S. at 197-99, 206-14; see
also International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 563-66 & n.20 (1979);
U.S. 1, 29-35 (1977); Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418, 425-
27 (1972).

The Court recognizes that an administrative agency's "consistent and longstanding
interpretation" of the statute under which it operates, "while not controlling, is
phrases and words within a single subsection, Aaron parsed three paragraphs within a subsection and reached an independent result concerning each one. Aaron held that in civil enforcement actions alleging violation of section 17(a), the Commission must establish scienter under subsection 17(a)(1), but not under subsections 17(a)(2) or 17(a)(3). When Aaron interpreted terms not defined in the 1933 Act, the Court again sought guidance from Webster's New International Dictionary.

Aaron concluded that subsection 17(a)(1)—which makes it unlawful for any person “to employ any device, scheme, or artifice to defraud”—“plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct.” On the other hand, subsection 17(a)(2)—which makes it unlawful for any person to obtain money or property “by means of any untrue statement of a material fact or any omission to state a material fact”—“is entitled to considerable weight.” United States v. National Ass'n of Sec. Dealers, 422 U.S. 694, 719 (1975) (citing Udall v. Tallman, 380 U.S. 1, 16 (1965), and adopting Commission's interpretation of section 22(d) of Investment Company Act of 1940). As “the final authorities on issues of statutory construction,” however, courts adopt only administrative interpretations that have “'reasonable basis in law.'” Sloan, 436 U.S. at 118 (citing FTC v. Colgate Palmolive Co., 380 U.S. 374, 385 (1965), and NLRB v. Hearst Publications, Inc., 322 U.S. 111, 131 (1944)). Because courts have an “obligation to honor the clear meaning of a statute, as revealed by its language, purpose, and history,” Daniel, 439 U.S. at 566 n.20, administrative interpretation must “provide . . . a reasonable construction of the statutory language and [be] consistent with legislative intent.” Securities Indus. Ass'n v. Board of Governors, 468 U.S. 137, 142 (1984); see also Clarke v. Securities Indus. Ass'n, 107 S. Ct. 750, 759-60 (1987) (citing Investment Co. Inst. v. Camp, 401 U.S. 617, 626-27 (1971)). On the limits of judicial deference to administrative statutory interpretation, see 5 K. Davis, Administrative Law Treatise § 29.16 (2d ed. 1984).

128. Section 17(a) provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.


129. See Aaron, 446 U.S. at 696 n.13 (citing Webster's, supra note 111); see also supra notes 110-15 and accompanying text.

130. See supra note 128.

131. 446 U.S. at 696.
devoid of any suggestion whatsoever of a scienter requirement." 132

Finally subsection 17(a)(3)—which makes it unlawful for any person "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit"—"quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible." 133 The Court then interpreted section 17's legislative history and found no indication of congressional intent contrary to the intent indicated by the section's language. 134

2. Negative Implication from the Legislative Scheme and Regulatory Antecedents

a. The Legislative Scheme and Regulatory Antecedents

The Supreme Court's interpretation of a securities provision does not necessarily end with close interpretation of the provision's own language and legislative history. Even when congressional intent seems clear or unambiguous, the Court generally interprets extrinsic sources of that intent. Interpretation may proceed to other provisions in the same act 135 or to provisions in one or more of the other securities acts that comprise the federal legislative scheme. When a 1933 Act provision is at issue, interpretation may also proceed to one or both of two antecedent sources of securities regulation, the 1929 Uniform Sale of Securities Act and the blue sky laws. 136

The federal legislative scheme consists of seven securities acts, 137 six of which were enacted during Franklin Roosevelt's administration, and the seventh in 1970. The first two, the 1933 and 1934 acts, are

132. Id.
133. Id. at 697 (emphasis in original).
134. Id. at 697-700.
137. For a list of the federal securities acts, see supra note 14.
statutes of general application, with the former primarily regulating distribution of new securities issues and the latter primarily regulating trading in previously distributed securities on national exchanges and in the over-the-counter markets. The remaining five acts complement the first two by imposing additional regulation on particular persons or particular securities-related activity. The Uniform Act, a model blue sky statute, was approved in 1929 by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association. Blue sky laws, state legislation regu-

138. The 1933 and 1934 acts' spheres of regulation are not mutually exclusive. Overlap is illustrated by United States v. Naftalin, 441 U.S. 768 (1979), which affirmed the defendant's conviction under section 17(a) of the 1933 Act for fraudulent trading activity. Id. at 772-79. Naftalin rejected the defendant's argument that section 17(a) did not reach trading activity because "the [1933 Act] was 'preoccupied with' the regulation of initial public offerings of securities, and ... Congress waited until the [1934 Act] to regulate abuses in the trading of securities in the 'aftermarket.' " Id. at 777. The Court recognized that the 1933 Act was "primarily concerned with the regulation of new offerings," but held that section 17(a) "was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." Id. at 777-78. The Court found it "neither unusual nor unfortunate" that the 1933 and 1934 acts prohibit some of the same conduct. Id. (quoting SEC v. National Sec., Inc., 393 U.S. 453, 468 (1969)).


140. See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings 171, 172, 173 (1929) [hereinafter Handbook]. For discussion of the events that culminated in the Uniform Act's approval, see M. Parrish, Securities Regulation and the New Deal 21-28 (1970) [hereinafter Parrish]. By creating the need to coordinate state securities registration with federal registration requirements, the 1933 Act left the Uniform Act materially deficient. Largely because of this deficiency, no state adopted the Uniform Act after 1933. In 1944, the National Conference withdrew the Uniform Act from its list of recommended acts. See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings 233 (1944). In 1956, the Commissioners and the American Bar Association approved the Uniform Securities Act, another model blue sky statute. Unif. Sec. Act, 7B U.L.A. 510 (1985) (historical note). The 1956 Act, as amended in 1958, has been superseded by the Uniform Securities
lating securities transactions, date from Kansas' comprehensive 1911 statute; by early 1933, forty-seven of the then forty-eight states, plus the territory of Hawaii, had enacted blue sky laws. 

The Court construes provisions within a securities act together because in the absence of contrary intent, the legislature is presumed to intend that a statute be interpreted as a unified whole. Ever since John Marshall's tenure as Chief Justice, the Court has also adhered to the principle that statutes in pari materia—having the same purpose or object—may be "construed together as forming one act" when circumstances fairly demonstrate that Congress legislated with knowledge of the prior related statutes. Consistent with this principle, the Court in 1969 confirmed that "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen." In its interpretation of the federal legislative scheme,
the Court does not restrict analysis to securities acts enacted before the provision being interpreted;\footnote{46} the Court also analyzes subsequently enacted securities acts.\footnote{47} The Court assigns extrinsic securities

Act. Consequently, we are aided in our task by our prior decisions which have considered the meaning of security under the 1933 Act. \footnote{Id. at 335-36 (footnotes and citation omitted); see also Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (quoting Hochfelder, 425 U.S. at 206) (1933 and 1934 Acts “constitute interrelated components of the federal regulatory scheme governing transactions in securities”); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 471 (1977) (1933 and 1934 acts are “related”); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 & n.15 (1972) (six Roosevelt administration securities statutes are “companion legislative enactments”); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (“Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry”), quoted with approval in Lowe v. SEC, 472 U.S. 181, 190 (1985).}

\footnote{146. For decisions analyzing securities acts enacted before the provision being interpreted, see, e.g., Aaron v. SEC, 446 U.S. 680, 690-91 (1980) (in action interpreting section 10(b) of 1934 Act, Court analyzed “structure of the civil liability provisions in the 1933 and 1934 Acts”); id. at 713 (Blackmun, J., dissenting) (criticizing majority for “failure to appreciate the structural interrelationship among equitable remedies in the 1933 and 1934 Acts, and to accord that interrelationship proper weight”); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 20-21 & n.10 (1979) (in action interpreting sections 206 and 215 of Investment Advisers Act of 1940, Court analyzed “each of the securities laws that preceded” that Act); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206-11 (1976) (in action interpreting section 10(b), Court analyzed 1933 Act provisions); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 & n.4, 733-36, 753 (1975) (same); id. at 755-56 (Powell, J., concurring) (same); Tcherepnin, 389 U.S. at 335-36, quoted supra note 145 (same).}


Similarly, examination of subsequently enacted securities acts was central to the Court’s determination that commercial paper is a “security” under the Banking Act of 1933, commonly known as the Glass-Steagall Act. \footnote{See Securities Indus. Ass'n v. Board of Governors, 468 U.S. 137, 143, 150-54, 164, 171-72 (1984); see also Glass-Steagall Act, ch. 89, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12 U.S.C.). Among other things, Glass-Steagall prohibits commercial banks from underwriting “securities or stock” and from marketing “stocks, bonds, debentures, notes or other securities.” 12 U.S.C. §§ 24 (Seventh) 335, 378(a)(1) (1982). Glass-Steagall, however, does not define the term “security.” Because “Congress enacted the Glass-Steagall Act as one of several pieces of legislation collectively designed to restore public confidence in financial markets,” 468 U.S. at 150, the Court analyzed the term’s definitions in related legislation—not only the 1933 Act (passed two weeks before Glass-Steagall), but also the 1934 and 1935 acts. \footnote{Id. at 150-52. On remand the court of appeals also examined the two subsequent statutes. See Securities Indus. Ass’n v. Board of Governors, 807 F.2d 1052, 1062-65 (D.C. Cir. 1986).}
legislation, like other extrinsic sources of congressional intent, the weight that appears warranted under the circumstances.

The realities of the legislative process weaken any assumption that whenever Congress enacts a statute, the lawmakers perforce know of all related federal statutes. Weaker yet is any assumption that the lawmakers know of all related uniform acts and state legislation. Proper application of the in pari materia principle, then, depends on an affirmative demonstration of congressional knowledge. The principle has particular force when, like the 1933 and 1934 acts, the assertedly related statutes were enacted by the same Congress and the later statute refers to the earlier one. The principle is also potent when, like the remaining five federal securities statutes, enactment was accomplished by different Congresses whose lawmakers referred to the earlier statutes throughout the debate and in the statute itself. The Uniform Act and the blue sky laws remain instructive in 1933 Act interpretation because the initial federal act’s drafters and enactors examined these regulatory antecedents and were influenced by the strengths and weaknesses they perceived.

The historical record justifies Professor Loss’ conclusion that the 1933 and 1934 acts are “as closely related as two nominally separate statutes could be.” After an early fruitless effort to draft a se-

148. See, e.g., United States v. Stewart, 311 U.S. 60, 64 (1940); see also 2A SUTHERLAND, supra note 143, §§ 51.03, 51.01, 51.02. The 1933 and 1934 acts were enacted by the 73d Congress. See 1934 Act, ch. 404, 48 Stat. 881 (1934); 1933 Act, ch. 38, 48 Stat. 74 (1933).


150. See infra note 161.

151. See infra note 162.


153. 6 Loss, supra note 104, at 3195 (Supp. 1969). For Supreme Court decisions that have construed the 1933 and 1934 acts as in pari materia, see supra notes 145-47. Lower courts have also construed the two acts in this way. See, e.g., Berger v. Bishop Inv. Corp., 695 F.2d 302, 307-308 (8th Cir. 1982); Lincoln Nat’l Bank v. Herber, 604 F.2d 1038, 1041 (7th Cir. 1979); Ballard & Cordell Corp. v. Zoller & Danneberg Exploration, Ltd., 544 F.2d 1059, 1066 (10th Cir. 1976), cert. denied, 431 U.S. 965 (1977); Lanza v. Drexel & Co., 479 F.2d 1277, 1298 n.65 (2d Cir. 1973).
securities bill that would have regulated both distribution and trading, President Roosevelt settled on separate bills that together served as the foundation of a unified regulatory program. The President stressed this unity in both of his messages to Congress recommending enactment of the acts. Lawmakers in 1933 knew that the securities bill primarily regulating distribution would be followed swiftly by one primarily regulating trading; in turn, lawmakers in 1934 knew of the close relationship of that year's securities bill to the nascent 1933 Act. Indeed, the 1934 Act amended the 1933 Act in significant respects. Finally, as enacted and as amended during the last half-


154. See Parrish, supra note 140, at 42-47; Schlesinger, supra note 152, at 440-41; Seligman, supra note 152, at 50-53.

155. In his March 29, 1933, message recommending enactment of the 1933 Act, the President stated:

This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.

H.R. Doc. No. 12, 73d Cong., 1st Sess., reprinted in 77 Cong. Rec. 937 (1933). The President called attention to these words the following year in his message recommending enactment of the 1934 Act. See 78 Cong. Rec. 2264 (1934).

156. See, e.g., 77 Cong. Rec. 1021 (1933) (remarks of Sen. King) ("Committee on Banking and Currency for some time has been considering important questions dealing with . . . stock exchanges, the sale of securities, investment trusts, and relevant and pertinent matters"); id. at 3223 (remarks of Sen. Norbeck) ("pending bill does not in any way deal with the stock exchange. That matter has been left for subsequent and much-needed legislation").

157. See, e.g., 78 Cong. Rec. 2270 (1934) (statement of Sen. Fletcher) ("bill just introduced for the regulation of securities exchanges is one of the series of steps taken and to be taken for the purpose of bringing safety to the general public in the field of investment and finance"); id. at 7939 (remarks of Rep. Milligan) (calling 1934 bill "a companion bill of the Securities Act"); id. at 7959 (remarks of Rep. Dirksen) (same); id. at 8107 (remarks of Rep. Cox) (discussing "very close and intimate relationship between the Securities Act and this stock-exchange bill"); id. (remarks of Sen. Barkley) (1933 and 1934 acts are "inseparably related"); id. at 2270 (remarks of Sen. Fletcher) (1933 and 1934 acts are "intimately related").

century, the 1934 Act refers to 1933 Act provisions and thus helps cement the intimate relationship between the two statutes. 159

The remaining five securities acts are closely related to the first two and to one another. In his 1933 and 1934 messages to Congress, President Roosevelt anticipated the proposal of subsequent securities legislation. 160 In the debate preceding the enactment of the four subsequent Roosevelt administration securities acts and of the 1970 Act, lawmakers referred to the previous acts and supporters stated that new legislation was necessary to fill existing gaps in federal securities regulation. 161 In filling the perceived gap in each instance,

159. See, e.g., 1934 Act § 13(d)(6), 15 U.S.C. § 78m(d)(6) (1982) (obligation to file and send section 13(d)(1) statement does not apply to “any acquisition or offer to acquire securities made or proposed to be made” by 1933 Act registration statement); id. § 15(d), 15 U.S.C. § 78o(d) (1982) (issuer that files 1933 Act registration statement must file such supplementary and periodic information, documents and reports as Commission may require under 1934 Act § 13); id. § 19(b)(2), (3), 15 U.S.C. § 78s(b)(2), (3) (1982) (regulatory agency for self-regulatory organization authorized to discipline any member or participant who willfully violates, or effects any transaction for person it had reason to believe was violating, 1933 Act provision); id. § 21(g), 15 U.S.C. § 78u(g) (1982) (defining “securities laws” to include 1933 Act).

For most of the last half-century, 1933 Act and 1934 Act disclosure requirements proceeded along different paths and compliance with one act’s requirements did not constitute compliance with the other’s. After several years of study, the Commission recently adopted an integrated disclosure system designed to streamline and coordinate the acts’ respective requirements. See generally HAZEN, supra note 106, at 61-64; R. JENNINGS & H. MARSH, SECURITIES REGULATION 110-20 (6th ed. 1987).

160. See supra note 155 and accompanying text.

161. For comments on the 1935 Act, see, e.g., 79 CONG. REC. 8393 (1935) (remarks of Sen. Wheeler) (“Commission itself feels that the [1933 Act] is not designed to deal with” abuses by public utility holding companies); id. at 8618 (remarks of Sen. Dieterich) (“more than half of this bill is covered by the Securities Exchange Act” and thus would impose “a dual regulation”); id. at 8632 (remarks of Sen. Barkley) (“[n]either [the 1933 Act nor the 1934 Act] covers the situation which is intended to be covered by this measure”); id. at 8777 (remarks of Sen. Dickinson) (“[w]hy is it necessary to duplicate [the 1933 Act]?”); id. at 10,356 (remarks of Rep. Mapes) (“great many of the abuses ... by public-utility holding companies ... have already been corrected ... by the ... Securities and the Stock Exchange Acts”).

For comments on the 1939 Act, see, e.g., 84 CONG. REC. 3108 (1939) (remarks of Rep. Cole) (“[i]n general, the bill will apply only to indentures which are now required to be filed and examined under the Securities Act of 1933”); id. at 5004 (remarks of Sen. Barkley) (“persistence of ... defects ... is not enough”); id. at 5013 (remarks of Sen. Taft) (“existing S.E.C. Act is based on the theory of full disclosure ... But this measure ... provides what shall be in ... trust indentures”); id. at 9513 (remarks of Rep. Mapes) (1939 bill “is a sort of supplement to” the 1933 and 1934 acts); id. at 9530 (remarks of Rep. Rayburn) (discussing the three previous securities acts).

For comments on the 1940 acts, see, e.g., 86 CONG. REC. 2844 (1940) (remarks of Sen. Wagner) (noting that 1940 bills resulted from Commission’s study under
lawmakers expressly wrote the close relationship into the legislation. 162

b. Negative Implication

Since the early 1970's, the Supreme Court's interpretation of the securities acts' legislative scheme has frequently produced negative

1935 Act's authority and direction); id. at 9815 (remarks of Rep. Sabath) ("[i]n conjunction with the Securities Acts of 1933 and 1935, . . . this closes another door on the financial crooks"); id. at 9816 (remarks of Rep. Wolverton) (1933 and 1934 acts "have not been effectual in preventing the type of abuses that have grown up in the investment field").

Concerning the 1970 Act, one Senator observed:

[The 1933 and 1934 acts] are largely successful in accomplishing their purposes. But . . . there still exists a serious gap in our securities laws which neither of these statutes covers. An investor may exercise sound judgment in his choice of stock, and he may place his order with a reputable broker. Nevertheless, he may still lose his entire investment if the broker subsequently fails because of operational or financial difficulty.


162. See, e.g., 1970 Act § 2, 15 U.S.C. § 78bbb (1982) (discussing application of 1934 Act); id. § 78ccc(a) (creating Securities Investor Protection Corp., whose members shall be all persons registered as brokers or dealers under § 15(b) of 1934 Act); id. § 78kkk(f) (discussing inapplicability of § 20(a) of 1934 Act); id. § 78lll(14) (discussing 1933 Act registration statement); Investment Advisers Act of 1940, § 202, 15 U.S.C. § 80b-2(a)(21) (1982) (defining 1933, 1934, 1935 and 1939 acts); id. § 80b-3(e) (authorizing Commission to discipline investment advisers who willfully commit primary or secondary violations of 1933 or 1934 acts or Investment Company Act of 1940); id. § 80b-8(b) (permitting statement that person is registered under 1934 Act); Investment Company Act of 1940, § 2(a)(26), 15 U.S.C. § 80a-2(a)(26) (1982) (referring to exchanges registered under 1934 Act); id. § 80a-2(a)(31) (referring to 1933 Act definition of "prospectus"); id. § 80a-2(44) (defining 1933, 1934, 1935, and 1939 acts); id. §§ 80a-3(c)(8), (11) (exempting companies subject to 1935 Act regulation and certain trusts exempt from 1933 Act regulation); id. § 80a-8 (requiring registered investment companies to file 1933 and 1934 act information and documents); id. § 80a-14 (referring to 1933 Act regulation of investment company offerings); id. § 80a-24 (referring to registration of registered investment company's securities under 1933 Act); id. § 80a-34(c) (permitting statement that person or security is registered under 1933 or 1934 acts); id. § 80a-37(b) (permitting Commission to authorize filing of information or documents required by 1933, 1934, 1935 or 1939 acts); id. § 80a-49 (Act does not affect Commission's jurisdiction or any person's rights and obligations under 1933, 1934, 1935 or 1939 acts); 1939 Act § 303(1)-(3), 15 U.S.C. § 77ccc(1)-(3) (1982) (defining terms by reference to 1933 Act definitions); id. § 77ccc(17) (defining 1933, 1934 and 1935 acts); id. § 77dd(d)(a)-(b) (exempting securities exempted from certain 1933 Act provisions); id. § 77fff (prohibitions affecting securities not registered under 1933 Act); id. § 77hhh (authorizing Commission, by rule, regulation, or order, to integrate 1939 Act filings with 1933, 1934 or 1935 act filings); id. § 77vvv (judicial review of offenses and suits as provided in 1933 Act); id. § 77www(b) (Act's rights and remedies supplement those existing under 1933, 1934 or 1935 acts); id. § 77zzz (Act does not affect Commission's jurisdiction or person's rights and obligations under 1933, 1934 and 1935 acts); 1935 Act § 16(b), 15 U.S.C. § 79p(b) (1982) (Act's rights and remedies supplement those existing under 1933 and 1934 acts); id. § 79u (Act does not affect Commission's jurisdiction under 1933 or 1934 acts).
implication. Where a statutory provision contains a particular designation, negative implication permits an inference that omissions should be understood as exclusions. More than forty years ago in SEC v. C.M. Joiner Leasing Corp.,\textsuperscript{163} the Court stressed that negative implication is an "aid to construction"\textsuperscript{164} whose force depends largely on contextual support.\textsuperscript{165} Persons, including legislators, may say A without necessarily intending to exclude B or C,\textsuperscript{166} and indeed without necessarily even acknowledging the existence of B or C. Negative implication holds particular force, however, when matter omitted from the provision in question appears in another provision in the same statute or in one or more statutes that circumstances fairly demonstrate may be construed as \textit{in pari materia}.\textsuperscript{167}

The Court has drawn negative inferences from other sections of a securities provision's own statute.\textsuperscript{168} Negative inference is particularly compelling when, as in \textit{Touche Ross & Co. v. Redington},\textsuperscript{169} the sections are contiguous to the provision at issue. \textit{Touche Ross} held that Congress did not intend to create a private right of action under section 17(a) of the 1934 Act,\textsuperscript{170} which requires broker-dealers

\begin{footnotesize}
\begin{enumerate}
\item 163. 320 U.S. 344 (1943).
\item 164. \textit{Id.} at 351 n.8.
\item 165. The Court stated:
\begin{quote}
[C]ourts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.
\end{quote}
\item 166. \textit{See, e.g.,} Radin, \textit{Statutory Interpretation}, 43 HARV. L. REV. 863 (1930). The author stated:
\begin{quote}
The rule that the expression of one thing is the exclusion of another is in direct contradiction to the habits of speech of most persons. To say that all men are mortal does not mean that all women are not, or that all other animals are not. There is no such implication, either in usage or in logic, unless there is a very particular emphasis on the word \textit{men} . . . . The question will accordingly be in every case, not whether or not the expression of one thing excludes everything else, but whether we are to deny or affirm this rule in this particular case. We shall evidently deny it or affirm it for some other reason than its axiomatic force, and it will be necessary to search for that other reason.
\end{quote}
\textit{Id.} at 873-74 (emphasis in original).
\item 167. \textit{See 2A SUTHERLAND, supra note 143, §§ 47.23, 51.01; see also R. Dickerson, THE INTERPRETATION AND APPLICATION OF STATUTES 47 (1975).}
\item 169. 442 U.S. 560 (1979).
\item 170. 15 U.S.C. § 78q(a) (1982).
\end{enumerate}
\end{footnotesize}
to keep such records and file such reports as the Commission may
prescribe. The Court stressed that section 17(a) is "flanked" by
sections 16(b) and 18(a), each of which expressly creates a private
right of action. "Obviously . . . ," the Court concluded, "when Con-
gress wished to provide a private damages remedy, it knew how to
do so . . . ."173

Hochfelder174 and Blue Chip Stamps v. Manor Drug Stores175 drew
nenegative inferences from statutes in pari materia. After interpreting
the language and legislative history of section 10(b) of the 1934 Act,
Hochfelder turned to the 1933 Act for confirmation that Congress
intended the section to reach only conduct involving an element of
scienter.176 After stating that "[t]he 1933 and 1934 acts constitute
interrelated components of the federal regulatory scheme governing
transactions in securities," the Court first concluded that section
11 of the 1933 Act, whose due diligence defenses in effect create
a negligence standard, "stands in sharp contrast to the language of
section 10(b)."177 The Court went on to analyze each express 1933 Act
civil remedy that allows recovery for negligent conduct;180 the Court
noted that each is subject to "significant procedural restrictions"
not found in section 10(b).181 To permit private section 10(b) damage
actions based on allegations of only negligence, the majority rea-
soned, would nullify these restrictions by permitting 1933 Act neg-
ligence claims to be brought under that section.182

When Blue Chip held that under section 10(b) and Rule 10b-5,
private damage actions may be maintained only by actual purchasers
or sellers of securities,183 the Court emphasized the contrast between
[section] 10(b).179 The Court went on to analyze each express 1933 Act
civil remedy that allows recovery for negligent conduct;180 the Court

171. 442 U.S. at 571-72.
173. 442 U.S. at 572, quoted in Lewis, 444 U.S. at 21.
174. 425 U.S. 185 (1976). See supra notes 103-21 and accompanying text for
discussion of Hochfelder.
text for discussion of Blue Chip.
177. Id. at 206. For discussion of the 1933 and 1934 acts' close relationship,
see supra notes 153-59 and accompanying text.
diligence defenses).
181. Id. at 209-11 (discussing restrictions).
182. Id. at 210.
183. 421 U.S. at 723.
in section 17(a)—which proscribes fraud "in the offer or sale of securities." In section 17(a)—which proscribes fraud "in the offer or sale of securities."184 "When Congress wished to provide a remedy to those who neither purchase nor sell securities," the Court concluded, in language that Touche Ross would later paraphrase, "it had little trouble in doing so expressly."185

In its interpretation of a 1933 Act provision in Rubin v. United States,186 the Court demonstrated a willingness to draw negative inferences from the Uniform Act and the pre-1933 blue sky laws. Rubin held that a pledge of stock to a bank as collateral for a loan constitutes an offer or sale of a security under section 17(a) of the 1933 Act.187 The Court noted that "[t]he Uniform Sale of Securities Act ... defined 'sale' in language almost identical to that now appearing in [section] 2(3)" of the 1933 Act.188 Pledges had been included in the Uniform Act's definition by pre-1933 decisions under blue sky laws that had adopted that definition.189 The Court found "nothing to suggest that Congress did not intend the broad scope that cases arising under the Uniform Act ... had given the definition of 'sale.' "190

3. Policy Considerations

a. The Landreth Footnote

In a 1985 footnote in Landreth Timber Co. v. Landreth,191 the Supreme Court stated that "it is proper for a court to consider—

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184. Id. at 733-34. For the full texts of section 10(b) and Rule 10b-5, see supra notes 104-105. For the full text of section 17(a), see supra note 128.
185. Blue Chip, 421 U.S. at 734, paraphrased in Touche Ross & Co. v. Redington, 442 U.S. 560, 572 (1979). The Court's decision in Herman & MacLean v. Huddleston, 459 U.S. 375 (1983), comports with Touche Ross, Hochfelder and Blue Chip. Huddleston held that the express cause of action provided by section 11 of the 1933 Act does not bar purchasers of registered securities from suing under section 10(b) and Rule 10b-5. After concluding that sections 11 and 10(b) "involve distinct causes of action and were intended to address different types of wrongdoing," id. at 381, the Court determined that the legislative scheme did not support an inference that the plaintiff's use of section 11's express remedy bars the plaintiff's use of section 10(b)'s implied remedy. Id. at 387 & n.23. In particular, the Court noted that sections 16 of the 1933 Act and 28(a) of the 1934 Act provide that "[t]he rights and remedies provided by this [Act] shall be in addition to any and all other rights and remedies that may exist at law or in equity." Id. at 383 (citing 15 U.S.C. §§ 77p, 78bb(a) (1982)).
188. 449 U.S. at 430.
189. Id.
190. Id.
as we do today—policy considerations in construing terms in [the federal securities acts]."\(^{192}\) The Court had laid the footnote's foundation throughout the previous decade.

The *Landreth* footnote cited *Blue Chip*, which held that only actual purchasers or sellers of securities may maintain private damage actions under section 10(b) and Rule 10b-5.\(^{193}\) To ascertain the meaning of section 10(b)'s critical terms, the *Blue Chip* Court interpreted the section's language and legislative history and the legislative scheme.\(^{194}\) *Blue Chip* then determined that it was "proper"\(^{195}\) to "consider . . . what may be described as policy considerations"\(^{196}\) to "flesh out"\(^{197}\) the terms' meaning, which the Court concluded these sources of congressional intent indicated\(^{198}\) but did not conclusively establish.\(^{199}\) *Blue Chip*’s consideration of securities policy consumed thirteen pages\(^{200}\) despite the dissenters' warning that policy consideration was imprudent.\(^{201}\) With some prescience in light of *Landreth* and its companion decision,\(^{202}\) the dissent warned that the majority’s approach might support policy consideration in future decisions interpreting securities provisions.\(^{203}\)

*Hochfelder* \(^{204}\) and *Aaron*\(^{205}\) are consistent with *Blue Chip*’s approval of policy consideration in the unusual circumstance in which a court concludes that the various sources of congressional intent are not

192. *Id.* at 694-95 n.7.
194. 421 U.S. at 727-30, 733-36.
195. *Id.* at 737.
196. *Id.; see also id.* at 749 (discussing "considerations of policy").
197. *Id.* at 737.
198. *Id.* at 733.
199. *Id.* at 737.
200. *See id.* at 737-49.
201. *See id.* at 771 (Blackmun, J., dissenting, joined by Douglas and Brennan, JJ.).
203. Justice Blackmun explained:
   I am uneasy about the type of precedent the present decision establishes.
   Policy considerations can be applied and utilized in like fashion in other situations. The acceptance of this decisional route in this case may well come back to haunt us elsewhere before long. I would decide the case to fulfill the broad purpose that the language of the statutes and the legislative history dictate. . . .
   421 U.S. at 771 (Blackmun, J., dissenting, joined by Douglas and Brennan, JJ.).
204. For discussion of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), see *supra* notes 102-21, 174-82 and accompanying text.
205. For discussion of *Aaron v. SEC*, 446 U.S. 680 (1980), see *supra* notes 123-34 and accompanying text.
dispositive of a securities term's meaning. Aaron, for example, held that in civil enforcement actions alleging violation of section 17(a) of the 1933 Act, the Commission must establish scienter under subsection 17(a)(1) but not under subsections 17(a)(2) or 17(a)(3). The Court announced this holding after interpreting the section's language and legislative history. In its last footnote, the Court foreclosed policy consideration by distinguishing Blue Chip: "Since the language and legislative history of [section] 17(a) are dispositive, we have no occasion to address the 'policy' arguments advanced by the parties."

Neither the Landreth footnote's broad language nor the reasoning of Landreth and its companion decision restricts policy consideration to Blue Chip's unusual circumstance. Landreth acknowledged that the Court's precedents extending back more than four decades had "not been entirely clear on the proper method of analysis for determining" the meaning of "security," the term at issue in that decision and the companion. The Court also noted that the circuits were divided concerning the term's meaning in the situation at issue in the two decisions. The Court, however, announced its holdings after interpreting statutory language, legislative history and the legislative scheme.

Unlike Hochfelder and Aaron, Landreth and its companion did not stop here. Instead the eight-Justice majorities proceeded to discuss reasons why the holdings comported with "sound policy." The discussions provide support for Justice Stevens' assertion in dissent that, as Landreth's broad footnote stated was "proper," the Court had based its construction of the critical term partly "on its own evaluation of the relevant 'policy considerations.'" As the Court had intimated in Blue Chip, policy considerations might be influential when a court, after interpreting the various sources of congressional

206. See Aaron, 446 U.S. at 680, 695-96.
207. Id. at 700.
208. Id. at 700 n.19; see also Hochfelder, 425 U.S. at 214 n.33.
209. 471 U.S. at 688.
210. See id. at 685. Landreth and its companion concerned the sale-of-business doctrine. See infra notes 221-32 and accompanying text for discussion of this doctrine. The Seventh, Ninth, Tenth and Eleventh circuits had applied the doctrine to the sale of all or part of a business' stock; the Second, Third, Fourth, Fifth and Eighth circuits had rejected the doctrine. See Ruefenacht v. O'Halloran, 737 F.2d 320, 321 n.3 (3d Cir. 1984) (citing cases), aff'd sub nom. Gould v. Ruefenacht, 471 U.S. 701 (1985).
211. See Landreth, 471 U.S. at 685-94; Gould, 471 U.S. at 704.
212. See Landreth, 471 U.S. at 694-97; Gould, 471 U.S. at 704-706.
213. Landreth, 471 U.S. at 700 n.2 (Stevens, J., dissenting).
intent, must choose between competing constructions that each appear within the limits indicated by these sources.\textsuperscript{214}

To be distinguished from policy is legislative purpose. To aid in the ascertainment and application of legislative intent, courts frequently consider the legislature's broad purposes for enacting the provision or statute at issue.\textsuperscript{215} Each federal securities act contains an express statement of purpose, necessity for regulation, or findings.\textsuperscript{216} Landreth itself is typical of securities decisions in which the Court has sought congressional purpose in these and other sources.\textsuperscript{217}

The Landreth footnote, however, approves consideration of more than Congress' purposes for enacting a securities provision or statute. In Landreth and its companion decision, all nine Justices expressly approved consideration of securities policy\textsuperscript{218}—consideration of the

\textsuperscript{214} Blue Chip, 421 U.S. at 731-41.

\textsuperscript{215} See, e.g., A. Lenhoff, Comments, Cases and Other Materials on Legislation 630 (1949) ("purpose of a statute is certainly an excellent guide for the discovery of the legislative intent"); Jones, Extrinsic Aids in the Federal Courts, 25 Iowa L. Rev. 737, 756-64 (1940); see also Blue Chip, 421 U.S. at 771 (Blackmun, J., dissenting) (quoted supra note 203).


\textsuperscript{218} See Landreth, 471 U.S. 681, 695 n.7 (majority of eight) ("proper for a court to consider—as we do today—policy considerations in construing terms in [the federal securities] Acts"); id. at 700 n.2 (Stevens, J., dissenting) ("policy considerations are relevant in construing the Securities Acts"). Approval represented some change of sentiment for Justices Blackmun, Brennan and Stevens. Justice Brennan had joined Justice Blackmun's Blue Chip dissent, which expressed misgivings about the prudence of policy consideration. See supra note 203 and accompanying text. In Santa Fe Indus., Inc., v. Green, 430 U.S. 462 (1977), Justice Stevens concluded that Blue Chip had been wrongly decided "[f]or the reasons stated by Mr. Justice Blackmun in his dissenting opinion" in that earlier decision. Id. at 480-81 (Stevens, J., concurring in part).
result that a congress should favor, without express reference to Congress' purposes for enacting the provision or statute. As Blue Chip had done a decade earlier, the Court first interpreted the various sources of congressional intent. The Court then discussed securities policy without relating that discussion to "the language of the statute, as read in the light of other external manifestations of purpose." 219

b. Securities Policy

Landreth and its companion decision approved a policy of enabling persons, before engaging in business transactions, to determine with optimum certainty whether their conduct implicates the federal securities acts. The two decisions rejected the sale-of-business doctrine, under which four circuits 221 had held that stock transferred to effect the sale of all or part of a business 222 was not necessarily a "security" within that term's 1933 and 1934 act definitions. 223

Both acts define the term "security" to mean, among other instruments, "any . . . stock." 224 In the four circuits that had adopted the sale-of-business doctrine, however, the result had turned on such a sale's "economic reality." 225 The primary question concerned control. Did the purchaser assume control of the business, and thus in reality consummate a "commercial" transaction said to lie outside the purview of the federal securities acts? Or did the purchaser act as a passive investor reasonably expecting profits from the entrepreneurial or managerial efforts of others, and thus in reality consummate a "securities" transaction within the purview of those acts?

Landreth and its companion held that the 1933 and 1934 acts'
respective definitions of "security" include all transactions involving instruments that possess the significant characteristics traditionally associated with stock. These transactions thus implicate the federal securities acts and their respective antifraud remedies. The Court proceeded to explain that this holding is consistent with "sound policy" because the holding minimizes "uncertainties attending the applicability of the [the acts which] would hardly be in the best interests of either party to a transaction." For one thing, the Court stressed, control is an "often elusive" concept whose determination itself frequently resolves uncertainty. Moreover, the sale-of-business doctrine would produce "difficult questions of line-drawing" because its application to the sale of 100 percent of a business' stock would require application to the sale of some lesser percentages. "[T]he acts' applicability . . . would rarely be certain at the time of the transaction," but would "depend on findings of fact made by a court—often only after extensive discovery and litigation."

226. See Landreth, 471 U.S. at 687-88; see also Gould, 471 U.S. at 704.
227. Gould, 471 U.S. at 704; see also Landreth, 471 U.S. at 694 (discussing "strong policy reasons").
228. Landreth, 471 U.S. at 696.
229. Id. at 697. The 1933 and 1934 acts both impose secondary liability on a person who controls a primary violator at the time of the primary violation. See 15 U.S.C. § 77o (1982); 15 U.S.C. § 78t(a) (1982). Section 15 of the 1933 Act, for example, provides:

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 11 or 12 of the Act, 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.


Determining control necessarily requires ascertainment and application of facts in light of judicial precedent, and Commission interpretations and no-action letters. One commentator has aptly concluded that these sources provide "no mathematical standard, no slide rule computation, no certain rule which can infallibly guide counsel and client." Sommer, Who's 'In Control'?—S.E.C., 21 BUS. LAW. 559, 563 (1966).

230. Landreth, 471 U.S. at 696; see also Gould, 471 U.S. at 705 (discussing "arbitrary distinctions between transactions covered by the Acts and those that are not").
231. Gould, 471 U.S. at 705; see also Landreth, 471 U.S. at 696 ("coverage by the Acts would in most cases be unknown and unknowable to the parties at the time the stock was sold").
232. Gould, 471 U.S. at 705; see also Landreth, 471 U.S. at 696-97 ("parties
In the interpretation of section 10(b) a decade earlier, *Blue Chip* approved a policy of avoiding “vexatious litigation” by the adoption of readily ascertainable standards for determining whether a person is within a securities remedy’s litigant class. Writing for the Court, Justice Rehnquist stated:

> [1]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit.

*Blue Chip* concluded that a purchaser-seller limitation on section 10(b)’s plaintiff class has advantages “purely as a matter of policy” because it “separates in a readily demonstrable manner the group of plaintiffs who actually purchased or actually sold . . . from the vastly larger world of potential plaintiffs.” Because one’s status as an actual purchaser or seller is “generally . . . verifiable by documentation,” the Court concluded that the limitation avoids “a shifting and highly fact-oriented disposition” that is not “a satisfactory basis for a rule of liability imposed on the conduct of business transactions.”

4. Refusal to Extend Securities Remedies Beyond Limits Indicated by the Sources of Congressional Intent

The Supreme Court does more than ascertain the scope of securities remedies by closely interpreting the various sources of congressional intent. The Court refuses to extend this scope beyond the limits indicated by these sources, whether by invoking remedial construction or by applying common law tort principles.

to a transaction may never know whether they are covered by the Acts until they engage in extended discovery and litigation”).


234. 421 U.S. at 740.

235. *Id.*

236. *Id.* at 739.

237. *Id.* at 743; see also *id.* at 747 (plaintiffs’ “dealing in the security, whether by way of purchase or sale, will generally be an objectively demonstrable fact”).

238. *Id.* at 742.

239. *Id.* at 755.
a. Remedial Construction

For most of the last half-century, the Court has construed the securities acts “not technically and restrictively, but flexibly to effectuate [their] remedial purposes.”240 The Court’s decisions reflect the canon of statutory construction that remedial statutes—statutes that afford remedies, or improve or facilitate remedies for enforcing rights and redressing injuries241—“should be construed broadly to effectuate [their] purposes.”242 The Court continues to recognize the securities acts’ status as remedial legislation,243 but Hochfelder244 and

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The Court did not stress the securities acts’ remedial purposes until after President Roosevelt made his initial appointment to that bench in 1937. In Jones v. SEC, 298 U.S. 1 (1936), the Court struck down a 1933 Act rule that prohibited withdrawal of a registration statement or amendment without the Commission’s consent. The Court had this to say concerning the Commission’s refusal to consent to withdrawal of the petitioner’s registration statement after the Commission had instituted a stop-order proceeding based on alleged material fraud:

The action of the commission finds no support in right principle or in law. It is wholly unreasonable and arbitrary. It violates the cardinal precept upon which the constitutional safeguards of personal liberty ultimately rest—that this shall be a government of laws—because to the precise extent that the mere will of an official or an official body is permitted to take the place of allowable official discretion or to supplant the standing law as a rule of human conduct, the government ceases to be one of laws and becomes an autocracy. Against the threat of such a contingency the courts have always been vigilant, and, if they are to perform their constitutional duties in the future, must never cease to be vigilant, to detect and turn aside the danger at its beginning . . . .

Arbitrary power and the rule of the Constitution cannot both exist. They are antagonistic and incompatible forces; and one or the other must of necessity perish whenever they are brought into conflict.

Id. at 23-24.

241. See 3 SUTHERLAND, supra note 143, § 60.02.


244. For discussion of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), see supra notes 103-21, 174-82 and accompanying text.
Aaron\textsuperscript{245} are typical of securities decisions in which the Court has specified that statutory language, legislative history, legislative scheme, and regulatory antecedents mark the outer limits of remedial construction.\textsuperscript{246}

\textit{Hochfelder} acknowledged that the 1933 and 1934 acts sought to achieve "broad remedial goals"\textsuperscript{247} that arguably would be served by imposing Rule 10b-5 liability for negligence. The Court held, however, that language, legislative history and the legislative scheme did not permit imposition of such liability in private damage actions under the Rule.\textsuperscript{248}

In \textit{Aaron} the Commission argued that proof of scienter is not required in civil enforcement actions to enjoin violations of section 17(a)\textsuperscript{249} of

\begin{footnotesize}
\textsuperscript{245}For discussion of Aaron v. SEC, 446 U.S. 680 (1980), see \textit{supra} notes 122-34 and accompanying text.

\textsuperscript{246}See also \textit{infra} note 254.

\textsuperscript{247}425 U.S. at 200. According to the statement of purpose, Congress enacted the 1933 Act "[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof." 1933 Act, Pub. L. No. 22, ch. 38, 48 Stat. 74, 74 (1933) (codified as amended at 15 U.S.C. (1982)). This purpose was articulated during debate. \textit{See, e.g.}, 77 \textit{Cong. Rec.} 2918 (1933) (remarks of Rep. Rayburn) ("purpose of this bill is ... to place the buyer on the same plane so far as available information is concerned, with the seller"); \textit{id.} at 2919 (remarks of Rep. Rayburn) ("we seek ... to make available to the prospective purchaser, if he is wise enough to use it, all the information that is pertinent that would put him on notice"); \textit{id.} at 2983 (remarks of Sen. Fletcher); \textit{see also} S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933); H.R. REP. No. 85, 73d Cong., 1st Sess. 3 (1933).

According to the statement of purpose, Congress enacted the 1934 Act "[t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets." 1934 Act, Pub. L. No. 291, ch. 404, 48 Stat. 881, 881 (1934) (codified as amended at 15 U.S.C. (1982)); \textit{see also id.}, ch. 404, § 2, 48 Stat. 881, 881-82 (codified as amended at 15 U.S.C. § 78b (1982)) (discussing necessity for regulation as provided in Act). This purpose too was articulated during debate. \textit{See, e.g.}, 78 \textit{Cong. Rec.} 7862 (1934) (remarks of Rep. Rayburn) ("[t]his measure ... goes a good deal further than the regulation of stock exchanges ... It proposes the protection of the investor against fraud, to give more integrity to securities listed on the exchange"); \textit{id.} at 7869 (remarks of Rep. Maloney); \textit{id.} at 7938 (remarks of Rep. Milligan) ("object of this measure is to control credits, control the unfair manipulating practices, to provide for accurate and honest reports to security holders by the corporations, to control the unfair practices of officers and directors of corporations who use inside information obtained in their position of trust"); \textit{id.} at 8163 (remarks of Sen. Fletcher); \textit{id.} at 8186 (remarks of Sen. Byrnes); \textit{id.} at 8503 (remarks of Sen. Reynolds); \textit{see also} S. REP. No. 792, 73d Cong., 2d Sess. 2-5 (1934); H.R. REP. No. 1383, 73d Cong., 2d Sess. 205 (1934) (bill "seeks to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges").

\textsuperscript{248}See \textit{Hochfelder}, 425 U.S. at 206.

\textsuperscript{249}15 U.S.C. § 77q(a) (1982). See \textit{supra} note 128 for the full text of this section.
\end{footnotesize}
the 1933 Act. The Court, however, parsed the section's three paragraphs and held that the Commission must establish scienter under the first but not the second or third. The language of section 17(a) was "simply not amenable to" the Commission's proposed interpretation, and the legislative history carried no evidence of congressional intent contrary to the intent indicated by that language. The securities acts' status as remedial legislation, the Court specified, "will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'" Rather, "if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history," the Court found it "well settled" that courts may not pass beyond that context and history with "generalized references to" the remedial purposes of these laws.

b. Tort Principles

In Touche Ross in 1979, the Court held that a private right of action for damages is not implicit in section 17(a) of the 1934 Act. "The question of the existence of a statutory cause of action," the Court stated at the outset, "is . . . one of statutory construction

250. See Aaron, 446 U.S. at 699.
251. See supra notes 128-34 and accompanying text.
252. 446 U.S. at 697.
253. See id. at 697-700.
255. 446 U.S. at 695.
256. Id. For previous decisions in which the Court had specified the textual limits of remedial construction, see, e.g., Wong Yang Sung v. McGrath, 339 U.S. 33, 45 (1950) (construing Administrative Procedure Act) ("[i]t is the plain duty of the courts . . . to construe . . . remedial legislation to eliminate, so far as its text permits, the practices it condemns") (emphasis supplied); Northern Pac. Ry. Co. v. Concannon, 239 U.S. 382, 386 (1915) (construing statute validating certain conveyances by railroads) ("a remedial statute, where it is reasonably possible to do so, must be interpreted so as to embrace the remedies which it was obviously intended to afford"); however, courts must not adopt "interpretation which would destroy the express limitations of the statute and cause it to accomplish a purpose which its text plainly demonstrates it was not intended to reach").
257. 446 U.S. at 695 (quoting Touche Ross, 442 U.S. at 578).
258. For discussion of Touche Ross & Co. v. Redington, 442 U.S. 560 (1979), see supra notes 169-73 and accompanying text.
259. See Touche Ross, 442 U.S. at 569 (construing 15 U.S.C. § 78q(a) (1982)).
... limited solely to determining congressional intent.260 Argument "based on tort principles, therefore, is entirely misplaced."261

Touche Ross determined the existence rather than the scope of a securities remedy. Once the majority disapproved of tort principles as a source of congressional intent, however, the Court ascertained this intent by using the approach to securities interpretation that it had used in the other decisions discussed in Part II of this Article. The Court concluded that section 17(a)'s language provided no basis for implying a private right of action.262 The Court also concluded that the 1934 Act's legislative history was silent about whether Congress intended the section to create a private right263 and that the legislative scheme provided further justification for the decision not to imply a private right.264 Remedial construction, the Court stated, would not support a result inconsistent with language, history and scheme.265 "The ultimate question," the Court concluded, "is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law."266

III. Section 12’s Pertinent Legislative Materials

In statutory decisionmaking, the judicial role is to ascertain and apply legislative intent. The Supreme Court's securities decisions illustrate that when dispute concerns the scope of a right of action created by a remedial statute such as the 1933 Act, a court ascertains this scope more accurately by interpreting the various sources of intent than by merely stating a conclusion based on remedial purpose. Part III interprets section 12's pertinent legislative materials and presents the Article's thesis that despite the 1933 Act's status as remedial legislation, section 12's two subsections do not impose liability on participants or other non-transferors. Similarly, the pertinent legislative materials provide support for the conclusion that courts may not impose liability for aiding and abetting in section 12 actions.

260. Id. at 568.
261. Id.
262. See id. at 568-71.
263. See id. at 571.
264. See id. at 571-74.
265. See id. at 576-78.
266. Id. at 578.
A. Section 12 Liability

1. The Language of Section 12

"The starting point in every case involving construction of a statute is the language itself." Section 12 provides in full:

Any person who—
(1) offers or sells a security in violation of section [5 of the Act], or
(2) offers or sells a security (whether or not exempted by the provisions of section [3 of the Act], other than paragraph (2) of subsection (a) of said section), 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 the 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 . . . upon the tender of such security, or for damages if he no longer owns the security.

Because section 12 decisions since *Landreth* and *Hill York* focus on the participation theory rather than on statutory language, these decisions do not aid in the interpretation of that language. The first two italicized phrases above raise the prospect of imposing liability on "any person who offers or sells a security." Because suit may be maintained only by "the person purchasing such security from him," however, an offeror may incur section 12 liability only if the

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268. 15 U.S.C. § 771 (1982) (emphasis added). As enacted in 1933, section 12's two subsections imposed liability on "[a]ny person who sells a security." 1933 Act, ch. 38, 48 Stat. 84 (1933). Section 2(3) provided in relevant part that "[t]he term 'sale,' '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." *Id.* at 74.

In 1954 Congress amended section 2(3) to provide the present distinction between sales and offers. See Pub. L. No. 577, § 9, 68 Stat. 683, 683 (1954); see also infra notes 271-72 and accompanying text. The 1954 legislation also amended section 12 to add the words "offers or." See Pub. L. No. 577, 68 Stat. 683, 686 (1954).
offeror also "sells" the security to the plaintiff. Section 12's language provides no indication of congressional intent, by application of tort principles or otherwise, to impose liability based on one's "participation" in a selling effort. The section's language indicates that a person who performs what Professor Loss has called "mechanical activities" for the transferor—a person denominated a "participant" in most decisions—may qualify as a section 12 offeror. The section's language further indicates that the person who sells the security to the plaintiff—the person from whom the plaintiff purchases—is the transferor of title to or other interest in the security for value.

Section 2(3) of the Act defines "offer," "sale" and "sell." A person other than the transferor may be a "person who offers . . . a security" within the meaning of the Act because section 2(3) defines "offer" to "include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." A person may engage in solicitation or similar activity when the person is not the transferor, and indeed even when no transfer ever takes place.

Section 2(3) defines "'sale' or 'sell' " to "include every contract of sale or disposition of a security or interest in a security, for value." By distinguishing the statutory sale from broadly defined statutory offers, section 2(3) indicates a distinction between the completed sale and prior activities that cause the sale. This distinction is consistent with the conclusion that a person's pre-completion activities may qualify the person as one "who offers . . . a security," but that the person who sells the security to the plaintiff is the person who completes the transaction by transferring title to or other interest in the security for value.

In Blue Chip the Supreme Court recognized congressional intent to distinguish a completed sale from prior activities that cause a

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269. The 1933 Act does not define "purchase," but the term "should be interpreted in a manner complementary to 'sale' which is defined in § 2(3)." SEC v. Guild Films Co., 279 F.2d 485, 489 (2d. Cir), cert. denied sub nom. Santa Monica Bank v. SEC, 364 U.S. 819 (1960); see also L. Loss, supra note 104, at 548 ("term 'purchased,' which is not separately defined in the [1933] Act, presumably is complementary to the word 'sold' or 'sell' ").

270. See Loss, supra note 104, at 544.


sale. The Court held that because section 10(b) and Rule 10b-5 operate against fraud "in connection with the purchase or sale of any security," private damage actions under these provisions may be maintained only by actual purchasers or sellers. In dissent, Justice Blackmun argued for a broader conception of "sale" and thus of "seller." According to Justice Blackmun, "the word 'sale' ordinarily and naturally may be understood to mean, not only a single, individualized act transferring property from one party to another, but also the generalized event of public disposal of property through advertisement, auction, or some other market mechanism." The Court rejected Justice Blackmun's analysis because "extension of the word 'sale' to include offers is quite incompatible with Congress' separate definition and use of the terms in the 1933 and 1934 Acts."

Section 12's provision for rescissory relief is consistent with the conclusion that the 1933 Act confines seller status to the transferor. Scattered common law authority exists for the proposition that a plaintiff might obtain rescission against a defendant who was not a party to the contract in question; the overwhelming weight of common law authority, however, restricts rescission to contracting parties. Congress may expand the scope of rescission by statute. Construing the Act to confine seller status to the transferor, however, is consistent with the conclusion that Congress did not intend section 12 to restore a status quo that never existed by requiring one or more of a wide range of persons (frequently the transferor's officers, directors, employees, brokers, lawyers or underwriters) to accept tender of securities in which they had never held an interest.

274. For the full texts of section 10(b) and Rule 10b-5, see supra notes 104-105.
275. 421 U.S. at 725, 731, 734.
276. Id. at 764 (Blackmun, J., dissenting).
277. Id. at 765 (Blackmun, J., dissenting).
278. Id. at 764 (Blackmun, J., dissenting).
279. Id. at 733 n.5 (citations omitted); see also id. at 756 (Powell, J., concurring) ("1933 Act ... defines 'offer to sell' as something distinct from a sale").
281. See, e.g., 1 H. BLACK, A TREATISE ON THE RESCISSION OF CONTRACTS AND CANCELLATION OF WRITTEN INSTRUMENTS §§ 1, 16, 30 (2d ed. Lee 1929); 5 A. CORBIN, CONTRACTS § 1105 (1964); see also Shulman, Civil Liability and the Securities Act, 43 YALE L.J. 227, 231-32 (1933); Teass, Duty of Directors and Others as Prescribed By Section 11 of the Securities Act of 1933, 20 VA. L. REV. 817, 834 (1934).
282. Section 12 authorizes the purchaser to sue "to recover the consideration
2. The Legislative Scheme and Regulatory Antecedents

a. Participant Liability

Section 12's language arguably does not preclude the interpretation that in some circumstances a plaintiff might purchase a security from a person who engages in mechanical activities for a transferor. In common parlance, a person may lawfully offer or sell property without necessarily being the transferor of title to or other interest in that property. Because the 1933 Act's legislative history does not illuminate the contours of the seller category that Congress intended to create, interpretation proceeds to the legislative scheme and the 1933 Act's regulatory antecedents.

These extrinsic sources support the threshold inference that Congress did not intend to impose section 12 liability for "participating" in a selling effort, no matter how courts might determine participation and no matter what an alleged participant's motive might have been. The 1933 Act's drafters and enactors were influenced by existing blue sky laws and by the Uniform Sale of Securities Act, a model blue sky statute approved in 1929. Like the 1933 Act, the typical blue sky law and the Uniform Act required registration of securities and created private rights of action for fraudulent sales or sales in violation of the registration requirements. The Uniform Act expressly imposed liability on the seller and on persons who "personally participated" with the seller in making a fraudulent or violative sale. By early 1933, the blue sky laws of twelve states and the territory of Hawaii had created private rights of action that expressly paid for [the] security with interest thereon, less the amount of any income thereon, upon tender of the security, or for damages if he no longer owns the security.  See supra text accompanying note 268. Section 12's provision for rescissory relief helps determine the section's defendant class, but membership in that class does not depend on whether the purchaser tenders the security. In the absence of tender, some courts have awarded damages under the section against persons other than the transferor. See, e.g., Junker v. Crory, 650 F.2d 1349, 1362 (5th Cir. 1981). Decisions such as Junker are inconsistent with this Article's thesis that participants and other non-transferors are not proper section 12 defendants and thus may not incur liability under either subsection of that section.

283. See supra note 152 and accompanying text.

284. See UNIF. SALE OF SEC. ACT §§ 6-8 (1929), quoted in Handbook, supra note 140, at 182-92. Sections 4 and 5 of the Uniform Act exempted certain securities and transactions from the registration requirements. See id. at 177-82 (quoting UNIF. SALE OF SEC. ACT §§ 4, 5 (1929)).

285. See UNIF. SALE OF SEC. ACT §§ 15, 16 (1929), quoted in Handbook, supra note 140, at 198-200. The Uniform Act's antifraud provisions and registration requirements reached offers or sales made "in" or "within" the state.

286. See infra note 293 and accompanying text.
imposed liability on persons who “participated” in making fraudulent or violative sales. Liabilities and obligations expressly grounded in participation are found elsewhere in the 1933 Act and in four of the later five Roosevelt administration securities acts. Section 9 of the 1934 Act, enacted by the same Congress that enacted the 1933 Act, creates a private right of action that expressly imposes liability on participants.

The legislative scheme and the 1933 Act's regulatory antecedents thus demonstrate that Congress knew of the participation concept and employed it in that Act and throughout the unified program of securities regulation. In this circumstance, section 12's failure to impose express liability for participation supports the inference that Congress did not intend that the section impose participant liability. Lower courts have imposed participant liability ever since the Lennerth decision by applying tort principles. This negative inference thus is consistent with the conclusion, indicated by section 12's language, that Congress did not intend to impose section 12 liability based on such principles.

i. The Uniform Sale of Securities Act and the Blue Sky Laws

Section 16(1) of the Uniform Act authorized a purchaser to sue "the person making [a] sale [fraudulently or in violation of that Act's registration requirements] and every director, officer or agent of or for such seller, if such director, officer or agent shall have personally participated or aided in any way in making such sale." By the time Congress began considering federal securities legislation early in 1933, the blue sky laws of twelve states and the territory of Hawaii expressly imposed liability on persons who “participated”

287. See infra note 294 and accompanying text.

288. See infra notes 295-374 and accompanying text.

289. Both acts were enacted by the 73d Congress. See supra note 148.

290. See supra notes 49-98 and accompanying text.

291. See supra notes 268-70 and accompanying text.

292. See UNIF. SALE OF SEC. ACT § 16(1) (1929), quoted in Handbook, supra note 140, at 200. Section 15 of the Uniform Act authorized the state securities agency to seek injunctive relief against direct violators and “any other person or persons . . . in any way participating in or about to participate in . . . fraudulent practices or acting in violation of this act . . . .” UNIF. SALE OF SEC. ACT § 15 (1929), quoted in Handbook, supra note 140, at 199. By early 1933, the blue sky laws of three states and Hawaii had adopted section 15 verbatim. See 1931 Fla. Laws 819-21; 1931 Haw. Sess. Laws 350-52; 1929 Iowa Acts 24-25; 1929 Vt. Laws 120-21.

293. UNIF. SALE OF SEC. ACT § 16(1) (1929).
in making fraudulent or violative sales. Against this backdrop,

294. The blue sky laws created defendant classes that were the same, or nearly the same, as the defendant class created by section 16(1) of the Uniform Act. See 1931 Ala. Acts 799-800 ("every agent of or for such seller who shall have participated or aided in any way in making such sale"); 1931 Ark. Acts 308-309 ("every director or officer of the issuer ... who shall have participated in making such sale"); 1931 Fla. Laws 821 (same as section 16(1)); 1931 Haw. Sess. Laws 352 (same); 1925 Ind. Acts 106 (same); 1929 Iowa Acts 25-25 (same); 1929 Kan. Sess. Laws 232-33 (same); 1926 Ky. Acts 238-39 (same); 1929 Mich. Pub. Acts 316 ("every agent of or for such seller who shall have participated or aided in any way in making such sale"); 1929 Mo. Laws 409-10 (same as section 16(1)); 1927 N.C. Sess. Laws 473-74 (same); 1929 Utah Laws 140 (same); 1929 Vt. Laws 121 (same).

A thirteenth state, Wisconsin, adopted participant liability on May 23, 1933, four days before the 1933 Act's enactment. See 1933 Act, Pub. L. No. 22, ch. 38, 48 Stat. 74 (1933); 1933 Wis. Laws 404-406 ("any issuer, dealer, or other person ... who shall have participated or aided in any way in making such sale").


The blue sky laws of 19 states presently create private rights of action that expressly impose participant liability. See ARIZ. REV. STAT. ANN. § 44-2003 (1967) ("any person ... who ... participated in ... the unlawful sale or purchase ..."); CAL. CORP. CODE § 25500 (West 1977) ("[a]ny person who willfully participates in" manipulative act or transaction); FLA. STAT. ANN. § 517.211(1) (West Supp. 1987) ("every director, officer, partner, or agent of or for the seller [who] has personally participated ... in making the sale"); id. § 517.211(2) (same); GA. CODE ANN. § 10-5-14(b) (1982 & Supp. 1987) ("every dealer, limited dealer, salesman, or limited salesman who participates in any material way" in fraudulent or violative sale); HAW. REV. STAT. § 485-20(a) (1985) ("every director, officer, or agent of or for the seller [who] has personally participated ... in any way in making the sale"); IDAHO CODE § 30-1446(2) (1980) ("every broker-dealer or salesman who participates ... in the sale"); ILL. ANN. STAT. ch. 121 1/2, para. 137.13(A) (Smith-Hurd Supp. 1987) ("each underwriter, dealer or salesperson who shall have participated ... in any way in making [the] sale"); IOWA CODE ANN. § 502.502(4) (West Supp. 1987) ("[a]ny person who willfully and knowingly participates" in manipulative act or transaction); LA. REV. STAT. ANN. § 51.714(B) (West Supp. 1987) ("every dealer or salesman who participates in any material way" in fraudulent or violative sale); MONT. CODE ANN. § 30-10-307(2) (1985) ("every broker-dealer or salesman who participates" in fraudulent or violative sale); N.M. STAT. ANN. § 58-13B-40(E) (1986) ("[a] person who willfully participates" in manipulative act or transaction); N.D. CENT. CODE § 10-04-17 (1985) ("every director, officer, salesman, or agent of or for [the] seller who shall have participated ... in any way in making [the] sale"); OHIO REV. CODE ANN. § 1707.43 (Anderson 1985) ("every person who has participated in ... making ... [the] sale or contract for sale"); OKLA. STAT. ANN. tit. 71, § 408(b) (West 1987) ("[e]very person who materially participates ... in a sale"); OR. REV. STAT. § 59.115(3) (1985) ("every person who participates ... in the sale"); PA. STAT. ANN. tit. 70, § 1-501(c) (Purdon Supp. 1987) ("[a]ny person who willfully participates in any act or transaction"); S.D. CODIFIED LAWS ANN. § 47-31-133 (1983) ("each underwriter, broker or agent who shall have participated ... in any way in making [the] sale, and
Congress imposed section 12 liability on persons who sell securities, but not on participants.

**ii. The 1933 Act**

Without imposing participant liability in section 12, Congress made participation central to the 1933 Act’s regulation of securities distribution. Issuers rarely seek access to the securities markets through direct financing; rather, they ordinarily distribute securities through investment banks, promoters or other underwriters. Consistent with its investor-protection purpose, the Act defines a wide range of intermediaries. Section 2(11)’s definition of “underwriter” provides in relevant part:

The term “underwriter” means any person who [1] has purchased from an issuer with a view to, or [2] offers or sells for an issuer in connection with, the distribution of any security, or [3] participates or has a direct or indirect participation in any such undertaking, or [4] participates or has a participation in the direct or indirect underwriting of any such undertaking ....

In 1933, the House Committee on Interstate and Foreign Commerce stated that the section 2(11) definition reaches persons “who may be termed participants in the underwriting ... who may or may not be formal parties to the underwriting contract.” Congress deliberately pinpointed participation as the standard. In the bill initially approved by the House, the definition had reached any person “who ... has an interest in [a distribution], or engages or participates in the direct or indirect underwriting of any such undertaking.” The conference committee amended the definition.

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295. See supra note 247.

[B]ut such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Id.

298. Id.
Congress enacted section 2(11) in the amended form, which deleted reference to interest and then expanded participation's ambit. The conference committee was explicit: "The test is one of participation in the underwriting rather than that of a mere interest in it." 299

Underwriters are subject to civil 300 and criminal 301 liability for violating the registration or prospectus requirements of section 5 of the Act. Section 5 prohibits any person from directly or indirectly offering or selling any security in violation of the section's requirements. 302 Section 4(1), however, states that section 5 "shall not apply to . . . transactions by any person other than an issuer, underwriter, or dealer." 303

Three Commission rules have helped shape the meaning of "participation" under section 2(11). 304 Courts otherwise determine participation on a case-by-case basis. 305 The question is whether the would-be underwriter "engaged in steps necessary to the distribution of security issues." 306

Participation reaches a broad range of intermediaries. In SEC v. Culpepper, 307 for example, the Second Circuit affirmed a judgment that found an individual defendant to be an underwriter and enjoined him from offering or selling unregistered securities. The corporate issuer had exchanged shares of its unregistered stock for a Canadian

300. See 15 U.S.C. §§ 77l(1), 77t (1982). Underwriters are also subject to civil liability under section 11 arising from materially misleading registration statements. See id. § 77k(a)(3) (1982).
301. See id. § 77x (1982).
302. Id. § 77e (1982).
303. Id. § 77d(1) (1982).
304. See 17 C.F.R. § 230.137 (1987) (regarding certain publications or distribution of information); id. § 230.142(a) (1987) (terms "participates" and "participation" in section 2(11) shall not include the interest of person who is not in privity of contract or in control relationship with issuer, who has no association with any principal underwriter, and who merely purchases for investment some or all of distribution's securities that remain unsold after specified time period); id. § 230.143 (1987) (terms shall not apply to foreign governments in specified circumstances).
307. 270 F.2d 241 (2d Cir. 1959).
company’s assets. The Canadian company in turn had transferred these shares to its thirty-one stockholders. Twenty-six of the stockholders had granted one Herschorn, irrevocable powers of attorney to effect sales of their respective shares. The district court found that the Herschorn group was in common control with, or under the control of, the corporate issuer. Accordingly, under section 2(11)’s last sentence, Herschorn and other group members themselves were issuers for purposes of determining underwriter status of subsequent persons in the chain of distribution. Herschorn effected sales of several thousand unregistered shares to various brokers and dealers who later resold the shares. The district court found that these brokers and dealers were underwriters because they had purchased from the Herschorn group (and thus, by operation of section 2(11)’s last sentence, from an issuer) with a view to distribution. Defendant Grayson, however, had purchased from other persons and not from an issuer (the corporate issuer, Herschorn, or any other member of the control group). In the Commission’s civil enforcement action, the district court found that Grayson had ongoing relations with members of the control group and thus apparently knew their intentions. Citing the 1933 Act’s purpose “of protecting the investing public through the disclosure of adequate information,” the Second Circuit held that Grayson was an underwriter because he had “participated” in the underwriting if that word is to be given a reasonable interpretation.

iii. The 1934 Act

Section 9 of the 1934 Act creates a private right of action that expressly imposes liability on participants. The section contains “several clear ... provisions reinforced by penal and civil sanctions, aimed at those manipulative ... practices which had been demonstrated to fulfill no useful function.” Section 9(a) makes it unlawful for any person, acting with the purposes stated in that section, to engage in enumerated manipulative acts or transactions in securities registered on a national securities exchange. Sections 9(b)-(d) au-
authorize the Commission to promulgate rules concerning manipulative practices in put and call options but not in registered warrants, rights or convertible securities.

Section 9(a) operates against two broad categories of acts or transactions in or concerning securities covered by the section. The first category consists of acts or transactions that, by the section’s express terms, may be done either by one person or by joint action of more than one person. Section 9(a)(2) prohibits any person, “alone or with one or more other persons,” from effecting a series of transactions that create actual or apparent active trading or raise or depress a security’s price. Section 9(a)(6) prohibits any person, “either alone or with one or more other persons,” from effecting a series of transactions for the purpose of pegging, fixing or stabilizing a security’s price in violation of Commission rules.

Section 9(a)’s second category consists of acts or transactions that, by their nature, are frequently done by one person. Section 9(a)(1) prohibits wash sales and matched orders. Section 9(a)(3) prohibits the circulation or dissemination of manipulative information by any broker, dealer or other enumerated person. Section 9(a)(4) prohibits any such person from making any statement that the person knew or had reasonable ground to believe was materially false or misleading. Section 9(a)(5) prohibits any person from circulating or disseminating such information or from making any such statement for consideration received from a broker, dealer or other enumerated person.

Section 9(e) creates a private right of action for damages in favor of purchasers or sellers injured by any willful manipulative act or transaction prohibited by section 9. Based on testimony before

316. Id. § 78i(b), (c) (1982). The Commission has not promulgated prohibitory rules concerning these options, but has promulgated Rule 9b-1, which requires option disclosure documents. See 17 C.F.R. § 240.9b-1 (1987).
318. Id. § 78i(a)(2) (1982).
319. Id. § 78i(a)(6) (1982).
320. Id. § 78i(a)(1)(A) (1982) (wash sales); id. § 78i(a)(1)(B), (C) (matched orders). Wash sales are transactions that involve no change in beneficial ownership. Matched orders are orders for purchase/sale of a security, entered with knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of that security. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 n.25 (1976).
322. Id. § 78i(a)(4) (1982).
323. Id. § 78i(a)(5) (1982).
324. Id. § 78i(e) (1982). For the text of section 9(e), see infra text accompanying note 326.
the Senate Committee on Banking and Currency, section 9(e) imposes liability on participants. The section provides:

Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue . . . to recover the damages sustained as a result of any such act or transaction.

Section 9(e) imposes liability on more than defendants who "participate" in the sense that they act jointly with one or more other persons to do an act or transaction. By authorizing suit against defendants who willfully participate in "any" violative act or transaction, the section also imposes liability on defendants who, like section 12 participants, perform mechanical activities in an act or transaction done by another person.

iv. The 1939 Act

Congress continued participation's express role in the Trust Indenture Act of 1939 and in the two securities acts enacted the following year. Closely integrated with and codified in the same

325. The Committee's report discussed testimony about "a financial writer on a great New York newspaper [who] was discovered to have been a regular participant in the profits of a free-lance trader, without obligation except to publicize the stocks of the trader." S. REP. No. 792, 73d Cong., 2d Sess. 8 (1934).
327. See supra note 270 and accompanying text. Two commentators have noted that reported section 9(e) decisions are "conspicuously scarce." 3 BROMBERG & LOWENFELS, supra note 104, § 8.4(410). Indeed, in 1961 Professor Loss could find only six reported decisions touching on section 9(e) in its first 27 years. 3 Loss, supra note 104, at 1748. By 1969, he counted 15. 6 id. at 3860 (Supp. 1969).

Section 9(e)'s relative disuse, which does not bear on congressional intent to impose participant liability in 1934, stems partly from the unanticipated development of implied private rights of action, particularly section 17(a) of the 1933 Act (in circuits that recognize a private right under that section) and section 10(b) and Rule 10b-5. Relative disuse also stems from section 9's own limited scope and difficulties of proof. Section 9(a) applies only to manipulation in securities registered on a national securities exchange and requires proof of manipulative purpose; section 9(e) reaches only willful misconduct and contains a causation requirement, permitting only damages "sustained as a result of" the manipulative act or transaction and requiring the plaintiff to show that the purchase or sale occurred "at a price which was affected by" the act or transaction.
329. See infra notes 347-74 and accompanying text.
chapter as the 1933 Act, the 1939 Act defines “underwriter” in exactly the same terms as the initial act.

The 1939 Act regulates distribution of notes, bonds, debentures and other evidence of indebtedness (whether or not secured) and certificates representing these interests. To qualify a non-exempt distribution of debt securities, the issuer-obligor must appoint one or more independent trustees to “protect and enforce the rights and to represent the interests” of the debt securityholders. At least one trustee (the “institutional trustee”) must be a corporation that is organized and doing business under the laws of the United States or of a state and that has combined capital and surplus of at least $150,000.

To help assure independence under the indenture, each trustee must be free of enumerated “conflicting interests,” several of which implicate underwriters. A would-be trustee is disqualified: (1) if the trustee or any of its directors or executive officers is an underwriter for an obligor on the debt securities; (2) if the trustee directly or indirectly controls, is directly or indirectly controlled by, or is under direct or indirect common control with an underwriter for such an obligor; (3) if with certain exceptions, the trustee or any of its directors or executive officers is a director, officer, partner, employee, appointee or representative of an underwriter (other than the trustee itself) for such an obligor who is currently engaged in the business of underwriting; (4) if more than enumerated percentages of the trustee’s voting securities are beneficially owned by an underwriter for such an obligor, or by any of the underwriter’s directors, partners or executive officers; or (5) if the trustee owns, beneficially or in a representative capacity, more than enumerated

331. Id. ch. 2A (1982).
332. H.R. REP. No. 1016, 76th Cong., 1st Sess. 3 (1939); S. REP. No. 248, 76th Cong., 1st Sess. 13 (1939); S. REP. No. 1619, 75th Cong., 3d Sess. 7 (1938). For discussion of the 1933 Act’s definition, see supra notes 296-312 and accompanying text.
334. See id. § 77ddd (1982) (exempting certain securities and transactions from 1939 Act’s provisions).
335. Id. § 77bbb(a)(1) (1982).
336. Id. § 77jjj(a)(2) (1982).
337. Id.
338. Id. § 77jjj(b) (1982).
339. Id. § 77jjj(b)(2) (1982).
340. Id. § 77jjj(b)(3) (1982).
341. Id. § 77jjj(b)(4) (1982).
342. Id. § 77jjj(b)(5) (1982).
percentages of any class of securities of an underwriter for such obligor.343

Congress determined that although "[i]t is difficult in many cases quantitatively to estimate the effect of too close affiliations . . . with underwriters of [the obligor's] securities, . . . [i]t is clear . . . that the existence of such relationships does have a tendency to dilute the loyalty of the indenture trustee."344 By adopting the 1933 Act's "underwriter" definition, including its participation categories,345 the 1939 Act provides broad protection to debt securityholders. The 1939 Act preserves trustees' independence not only against conflicting interests involving underwriters who enjoy contractual or other direct relations with an issuer-obligor, but also against conflicting interests involving other persons who engage in steps necessary to distribution.346

v. The Investment Company Act of 1940

The Investment Company Act of 1940347 regulates most issuers that engage, or propose to engage, in the business of investing, reinvesting or trading in securities.348 Investors typically purchase shares in investment companies, such as mutual funds, to secure greater diversification and professional management than they could readily secure individually. Non-exempt investment companies349 must register with the Commission350 and provide periodic disclosure.351 A registered investment company is subject to the Act's provisions

343. Id. § 77jjj(b)(6) (1982).
346. Courts have not had occasion to construe the "underwriter" definition's "participation" categories in actions arising under the 1939 Act or either of the 1940 acts. For discussion of the categories' reach in actions arising under the 1933 Act, see supra notes 305-12 and accompanying text.
348. "Investment company" is defined in 15 U.S.C. § 80a-3(a) (1982). Exemptions from that definition are found in subsections (b) and (c) of that section. See id. § 80a-3(b), (c) (1982).
349. See id. § 80a-6 (1982) (exempting certain investment companies from Act's provisions).
350. Id. § 80a-8 (1982).
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regulating pricing and distribution of the company's securities, prohibiting enumerated conflicts of interest, and regulating the company's internal governance structure.

To achieve its investor-protection purpose, the Act regulates both investment companies and their intermediaries. Certain of the Act's provisions operate against only "principal underwriters," which the Act defines as persons who as principals purchase securities from the issuer for distribution. To reach other persons who engage in steps necessary to distribution, however, other provisions operate against "underwriters." Section 2(a)(40) adopts the 1933 Act's "underwriter" definition, including the participation categories.

Participation thus plays a role not only in the Investment Company Act's registration and periodic disclosure requirements, but also in its ongoing regulation of registered companies. Section 6(a)(3) exempts from the Act's provisions certain investment companies that have been reorganized under court supervision unless, among other things, any security of the reorganized company thereafter is offered or sold to the public by the issuer or "by or through any underwriter." Section 6(d) authorizes the Commission to promulgate rules exempting closed-end investment companies, none of whose securities have been or are proposed to be publicly sold, by the issuer or "by . . . any underwriter," to persons not residents of the state under whose laws the company was created. Section 31(a) requires "every underwriter" of a registered investment company to maintain, in accordance with the Commission's rules, the accounts

351. Id. § 80a-29 (1982).
352. See id. § 80a-1(b) (1982) (stating that Congress sought to protect "the national public interest and the interest of investors").
353. Id. § 80a-2(a)(29) (1982). For Investment Company Act provisions that operate against principal underwriters, see, e.g., id. § 80a-9 (1982) (persons ineligible to serve as principal underwriter); id. § 80a-10 (restrictions on employing registered investment company's directors, officers or employees as principal underwriter); id. § 80a-11 (restrictions on offers by principal underwriter to exchange securities); id. § 80a-15 (requiring written contracts between company and any principal underwriter); id. § 80a-17 (prohibiting certain transactions by principal underwriters).
354. See id. § 80a-2(a)(40) (1982). For discussion of the 1933 Act's definition, see supra notes 296-312 and accompanying text. The Investment Company Act "declared that the national public interest and the interest of investors are adversely affected . . . when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of . . . underwriters . . . rather than in the interest of all classes of such companies' security holders." 15 U.S.C. § 80a-1(b)(2).
355. Id. § 80a-6(a)(3) (1982).
357. Id. § 80a-6(d) (1982).
and records necessary to satisfy the Act's periodic disclosure requirements.\textsuperscript{358}

The Act further makes it unlawful for any registered diversified company\textsuperscript{359} “to make any commitment as underwriter” unless the company meets enumerated financial-stability requirements.\textsuperscript{360} A registered investment company may not “underwrite securities issued by other persons” unless the underwriting is authorized by a majority of the company’s outstanding voting securities.\textsuperscript{361} No voting-trust certificate relating to any security of a registered investment company may be offered, sold or delivered after sale by the company, the issuer or “any underwriter” of the certificate.\textsuperscript{362} In connection with public offerings of securities of certain registered investment companies, the Act prohibits distribution of sales literature by the issuer or “any underwriter” unless copies of the literature are filed with the Commission.\textsuperscript{363} The Act makes it unlawful for registered investment companies to issue and sell, directly or through “any . . . underwriter,” periodic payment plan certificates that fail to meet pricing standards mandated by the Act.\textsuperscript{364}

\textit{vi. The Investment Advisers Act of 1940}

The Investment Advisers Act of 1940\textsuperscript{365} was enacted simultaneously with, and is codified in the same chapter as,\textsuperscript{366} the Investment Company Act. The Advisers Act regulates persons who, for compensation, engage in the business of advising others, either directly or through publications or writings, concerning the value of securities or the advisability of investing in, purchasing or selling securities.\textsuperscript{367} Section 202(a)(11) excludes certain persons from this definition and thus from the Advisers Act’s regulation;\textsuperscript{368} section 203 exempts certain

\begin{itemize}
  \item \textsuperscript{358} \textit{Id.} § 80a-31(a) (1982).
  \item \textsuperscript{359} \textit{Id.} §§ 80a-4(3), 80a-5(b) (1982) (defining “diversified company”).
  \item \textsuperscript{360} \textit{Id.} § 80a-12(c) (1982).
  \item \textsuperscript{361} \textit{Id.} § 80a-13(a)(2) (1982).
  \item \textsuperscript{362} \textit{Id.} § 80a-20(b) (1982).
  \item \textsuperscript{363} \textit{Id.} § 80a-24(b) (1982).
  \item \textsuperscript{364} \textit{Id.} § 80a-27 (1982).
  \item \textsuperscript{365} \textit{Id.} §§ 80b-1 to 80b-21 (1982). On the Investment Advisers Act and its background, see, e.g., SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-92 (1963); \textsc{Hazen}, supra note 106, at 626-37; \textsc{Seligman}, supra note 152, at 222-31.
  \item \textsuperscript{366} See 15 U.S.C. ch. 2D (1982).
  \item \textsuperscript{367} See \textit{id.} § 80b-2(a)(11) (1982).
  \item \textsuperscript{368} \textit{Id.}
\end{itemize}
investment advisers from the Act's registration provisions but not from its antifraud provisions. The Advisers Act requires non-exempt investment advisers to register and file periodic reports with the Commission. The Commission may impose sanctions, ranging from censure to suspension or revocation of registration, on advisers who are found after a hearing to have committed specified crimes or securities law violations. Sanctions may be imposed on an adviser who "is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an . . . underwriter, . . . or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security."

The Advisers Act adopts the 1933 Act's "underwriter" definition, including the participation categories. The Advisers Act thus authorizes the Commission to sanction an adviser enjoined for misconduct in facilitating securities distribution, even if the adviser did not enjoy contractual or other direct relations with an issuer at the time of the misconduct.

b. 1933 Act Seller Status

In its interpretation of the legislative scheme in *Touche Ross*, the Supreme Court drew a negative inference from contrasts created by sections that "flanked" the 1934 Act provision at issue but that concerned matters largely unrelated to that provision. In similar fashion, section 11 of the 1933 Act creates contrasts with the adjacent section 12. Section 11's effect, however, transcends the textual contiguity present in *Touche Ross* because the two 1933 Act sections are closely related in delimiting the express private relief available under the Act. The significant contrasts created by section

369. Id. § 80b-3(b) (1982).
370. Id. § 80b-3 (1982).
371. Id. § 80b-4 (1982).
372. Id. § 80b-3(e) (1982).
373. Id. § 80b-3(e)(3) (1982).
376. 442 U.S. at 571.
378. The circuits are divided on the question whether section 17(a) of the Act, 15 U.S.C. § 77q(a) (1982), supports an implied private right of action. When presented with the question, most lower courts have answered it in the affirmative. See HAZEN, supra note 106, at 507 & nn.10-11 (citing decisions).
11 support the inference that, as the Act’s language indicates, the Act does not impose seller status on non-transferors. 379

Section 11(a) authorizes actions by “any person acquiring [the] security” against a wide array of expressly enumerated defendants, including most of the major non-transferors involved in registered offerings. 380 Plaintiffs may sue the issuer and every other person who signed the registration statement; the issuer’s principal officers and its directors or partners; persons named with their consent in the registration statement as being or about to become directors or partners; persons named with their consent as experts; and every underwriter. 381 These non-transferors are frequently among the persons named as “participants” in section 12 actions. Section 12’s failure to provide a similar express enumeration supports the inference that Congress did not intend to include non-transferors as sellers in sections 12’s provision that “[a]ny person who offers or sells a security . . . shall be liable to the person purchasing such security from him.” 382

Section 11 reinforces this negative inference by establishing a framework that is consistent with a multimember defendant class that includes non-transferors. Section 11(f) 383 specifies joint and several liability and expressly provides for contribution. The 1933 and 1934 acts expressly provide for contribution in provisions which create private rights of action that contemplate multiple defendants. 384 Speaking about section 11(f), Professor Loss has written that the “obvious purpose” 385 was to avoid the common law rule that in the absence of statute, no right to contribution existed among joint tortfeasors. 386 Section 12’s failure to provide for contribution is consistent with the conclusion that Congress intended suit under that section to reach only one defendant.

Section 11(e) supports the conclusion that, as section 11(a) indicates, this one defendant is the transferor. 387 Section 11(e) authorizes

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379. See supra notes 267-82 and accompanying text.
381. Id. The issuer and its principal officers are section 11 defendants because under section 6(a), id. § 77f(a) (1982), they must sign the registration statement.
382. Id. § 77l (1982), quoted in full supra text accompanying note 268.
384. In addition to section 11, see id. §§ 78i(e), 78r(b) (1982).
385. 3 Loss, supra note 104, at 1737.
plaintiffs to recover damages based on the difference between: (1) the amount paid for the security; and (2) the security's value when suit is brought, or the price at which the security is disposed of before suit or before judgment.388 As enacted in 1933, section 11(e) and section 12 provided for identical rescissory relief.389 In the months before enactment of the 1934 Act, section 11 was among the 1933 Act's most criticized provisions.390 Among other criticism, some commentators stated that by authorizing rescissory relief against remote defendants, section 11 unnecessarily departed from the common law rule restricting rescission to contracting parties.391 Other commentators speculated that although Congress was free to depart from the common law rule, rescissory relief might prove ineffective against many of the non-transferor defendants enumerated in section 11(a).392 In response to this criticism, the 1934 Act amended section 11(e) to eliminate rescissory relief and establish the present damage remedy.393 The 1934 Act left section 12 untouched, a circumstance consistent with the conclusion that the section imposes liability on only the transferor.

388. Id. Section 11(e) provides in relevant part:
The suit authorized under subsection (a) of the section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable.

Id.
Because sections 11 and 12 are closely related and not merely contiguous, their significant contrasts cannot be dismissed as happenstance. Section 11 authorizes and effectuates actions against expressly enumerated non-transferor defendants in a manner that section 12 could have emulated but did not. The significant contrasts support the inference that the Act does not confer seller status on non-transferors.

3. Policy Considerations

In the 1985 Landreth footnote, the Supreme Court stated that “it is proper for a court to consider—as we do today—policy considerations in construing terms in [the federal securities acts].” When Landreth and its companion decision rejected the sale-of-business doctrine, the Court approved a policy of enabling persons, before engaging in business transactions, to determine with optimum certainty whether their conduct implicates the federal securities acts.

The majority stressed that the sale-of-business doctrine maximized “uncertainties attending the applicability of the acts” and encouraged “difficult questions of line-drawing” whose resolution normally would “depend on findings of fact made by a court—often only after extensive discovery and litigation.”

In Blue Chip a decade earlier, the Court intimated that policy considerations might be influential when a court, after interpreting the various sources of congressional intent, must choose between competing constructions that each appear within the limits indicated by these sources. Blue Chip approved a policy of avoiding “vexatious litigation” by the adoption of readily ascertainable standards for determining whether a person is within a securities remedy’s litigant class. Because status as an actual purchaser or seller is “generally verifiable by documentation,” Blue Chip concluded that the purchaser-seller limit on section 10(b)’s plaintiff class avoids “a

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396. Id. at 696.
397. Id.
400. 421 U.S. at 740.
401. Id. at 742.
shifting and highly fact-oriented disposition" that is not "a satisfactory basis for a rule of liability imposed on the conduct of business transactions."

It is this Article's thesis that section 12's pertinent legislative materials, without more, are sufficient to establish that only the transferor may incur liability under either of the section's two subsections. Insofar as this thesis would preclude imposition of participant liability based on the substantial-factor test, the thesis is consistent with the policy considerations the Supreme Court articulated in Landreth, its companion decision, and Blue Chip.

As the Ninth Circuit recently acknowledged, "'substantial participation' is a concept without precise bounds." Participant liability depends on a determination of whether a defendant's activities were a substantial factor in causing the underlying sale to take place, a determination that generally requires line-drawing and may turn on fine distinctions. By considering the would-be participant's

402. Id. at 755.
403. Id.
404. SEC v. Rogers, 790 F.2d 1450, 1456 (9th Cir. 1986) (Commission enforcement action alleging that defendant was substantial participant in violation of section 5 of 1933 Act).
405. Compare Junker v. Crory, 650 F.2d 1349, 1360 (5th Cir. 1981) (lawyer liable as section 12(2) seller because he was "key participant in the transaction") with Croy v. Campbell, 624 F.2d 709, 714 (5th Cir. 1980) (lawyer not liable as section 12(2) seller because "we cannot say that [his] participation in this transaction proximately caused the plaintiffs' injury"); however, "[t]his conclusion should not be interpreted to mean that a lawyer who participates in the transaction can never be a seller for purposes of section 12. Each case naturally turns upon its own facts"); see also SEC v. Rogers, 790 F.2d 1450, 1458 (9th Cir. 1986) ("[w]here we reviewing this case de novo, we might reach a different conclusion [concerning substantial participation] based on the evidence presented . . ., but [we] must abide by the clearly erroneous rule when reviewing a district court's findings"); Anderson v. Aurotek, 774 F.2d 927, 930 (9th Cir. 1985) (section 12 substantial-factor test "usually involves a question of fact for the jury"); Admiralty Fund v. Jones, 677 F.2d 1289, 1294 (9th Cir. 1982) (summary judgment in favor of section 12(2) cross-defendant reversed because material issues of fact remained concerning "the extent of [his] participation in the transaction"); Pharo v. Smith, 621 F.2d 656, 667 (5th Cir. 1980) ("beyond the words 'substantial factor,' we have no guideposts other than the factual situations presented in [precedent] to assist us in determining whether to impose strict liability in a given case"); Scharp v. Cralin & Co., 617 F. Supp. 476, 478 (S.D. Fla. 1985) ("[a]t this stage of the discovery process, the Court cannot say that the [alleged participant] is, or is not, deemed a seller under § 12(2)"); In re Home-Stake Prod. Co. Sec. Litig., 76 F.R.D. 337, 349 (N.D. Okla. 1975) ("'participation' is a conclusory term and has little meaning without the facts underlying such conclusion"); Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 443 (N.D. Ohio 1975) ("each case must be determined upon the facts which are established by the parties").
motive in *Dahl*, the Fifth Circuit has factored yet more imprecision into the formula. When liability rests on application of the substantial-factor test, the inherent imprecision enables plaintiffs to name a wide range of defendants, subject to judicial factfinding. The result is "a shifting and highly fact-oriented disposition," which *Blue Chip* concluded is not "a satisfactory basis for a rule of liability imposed on the conduct of business transactions."  

**B. Section 12 Aiding and Abetting Liability**

Perhaps because seven circuits impose section 12 liability for substantial participation in a selling effort, courts have not paid significant attention to the question of whether secondary liability may be imposed for aiding and abetting in section 12 actions. If non-transferors were no longer subject to section 12 liability as sellers, however, purchasers could be expected to sue some non-transferors as aider-abettors who had substantially assisted primary violations.

The first decision approving imposition of aiding and abetting liability under section 12 was *In re Caesars Palace Securities Litigation*,

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407. *Blue Chip*, 421 U.S. at 755; see supra notes 236-39 and accompanying text.

408. See supra notes 85-88 and accompanying text.

409. The Commission and private plaintiffs have raised aiding and abetting claims under various securities provisions, notably section 10(b) and Rule 10b-5. See Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CALIF. L. REV. 80, 83-85 (1981); Ruder, supra note 104, at 598 n.1. The Supreme Court has expressly reserved decision on the question whether civil liability may be imposed for aiding and abetting violations of section 10(b) and Rule 10b-5. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192 n.7 (1976). The Court has not discussed the question whether aiding and abetting liability may be imposed in section 12 actions. For an argument that courts may not impose secondary liability for aiding and abetting securities violations, see Fischel, *supra*, passim.

410. Two commentators have written that "[n]o case has yet come up with a very meaningful definition of aiding-abetting." 3 BROMBERG & LOWENFELS, supra note 104, § 8.5, at 530. Courts generally state three elements of an aiding and abetting cause of action: (1) violation by the primary (as opposed to the aiding and abetting) party; (2) the aider-abettor's knowledge of this primary violation; and (3) substantial assistance by the aider-abettor in achieving the primary violation. See, e.g., *Bloor v. Carro*, Spanbock, Londin, Rodman & Flass, 754 F.2d 57, 62 (2d Cir. 1985); *ITT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Rolf v. Blyth*, Eastman Dillon & Co., 570 F.2d 38, 47-48 (2d Cir.), cert. denied, 439 U.S. 1039 (1978). On the knowledge and substantial assistance elements generally, including the question whether silence or inaction may support imposition of aiding and abetting liability, see, e.g., *HAZEN*, supra note 106, at 208-10.
in 1973. The plaintiffs alleged that in the sale of Caesars Palace to Lum's Inc., certain defendants had aided and abetted section 12(2) violations arising from dissemination of a registration statement and prospectus that contained materially misleading information about Caesars Palace's financial condition. Several defendants moved to dismiss the section 12(2) count on the ground that they were not within the category of persons covered by section 12. The court denied the motion because "persons who do no more than . . . aid and abet a violation . . . are not necessarily excluded from . . . section 12(2) liability."

Judge Weiner concluded that because courts had imposed aiding and abetting liability in civil enforcement actions alleging violations of sections 17(a) of the 1933 Act and 10(b) of the 1934 Act, "logic" indicated that persons "should similarly be subject" to aiding and abetting liability in actions under section 12. The court found section 12 aiding and abetting liability to be consistent with "the broad, remedial nature of the 1933 Act and the need to adopt a liberal interpretation of the statute in order to best effectuate the congressional purpose." The court recognized the tort basis of aiding and abetting liability by citing section 876 of the Restatement of Torts.

Courts have not accorded section 12 aiding and abetting liability the same degree of positive reception that they have accorded participant liability. The Second Circuit has approved imposition of aiding and abetting liability in a section 12 action, but the Fifth and Eighth circuits have held that aiding and abetting liability may not be imposed under section 12. The law remains uncertain in...

412. Id. at 378 & n.8.
413. Id. at 378.
414. Id. at 381.
415. Id. at 382-83.
416. Id. at 380 n.11 (citing Restatement of Torts § 876 (1939) ("Persons Acting in Concert")). On the tort basis of aiding and abetting liability generally, see, e.g., Prosser & Keeton, supra note 70, § 46, at 323 & n.9; Prosser, Joint Torts and Several Liability, 25 Calif. L. Rev. 413, 429-30 & n.109 (1937). Aiding and abetting is also grounded in criminal law. See, e.g., R. Perkins & R. Boyce, Criminal Law 722-25, 767-69 (3d ed. 1982); see also 18 U.S.C. § 2(a) (1982) ("[w]hoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal").
417. See Mayer v. Oil Sys. Corp., 803 F.2d 749, 756 (2d Cir. 1986) (section 12(2)).
418. See Stokes v. Lokken, 644 F.2d 779, 785 (8th Cir. 1981); Huddleston v. Herman & MacLean, 640 F.2d 534, 551 n.27 (5th Cir. 1981), aff'd in part, rev'd in part on other grounds, 459 U.S. 375 (1983); Croy v. Campbell, 624 F.2d 709, 713 n.5 (5th Cir. 1980).
the Third Circuit. In circuits in which the question of section 12 aiding and abetting remains open, district courts are closely divided. The Supreme Court has not determined whether civil liability may be imposed for aiding and abetting securities violations. The outcome under such provisions as section 17(a) of the 1933 Act and section 10(b), however, does not necessarily determine the outcome under section 12. The former sections are general antifraud provisions that operate against specified conduct but do not expressly state the types of persons who may be defendants. On the other hand, Congress specifically imposed section 12 liability on only a person who sells a security.

This Article's focus has been on the scope of seller liability imposed by section 12. The Article's analysis, however, provides support for the conclusion that courts may not impose secondary liability for aiding and abetting in actions under either subsection of the section. The section's language imposes liability on sellers and provides no indication of congressional intent to impose liability on anyone else, including aider-abettors. The section's legislative history makes no mention of aiding and abetting liability. In this context, the legislative scheme and the 1933 Act's regulatory antecedents once again become instructive.

419. In Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793 (3d Cir.), cert. denied sub nom. First Pa. Bank, N.A. v. Monsen, 439 U.S. 930 (1978), the jury found the Bank "liable as an aider-abettor to Consolidated for its securities violations." 579 F.2d at 798-99. According to the panel, "Consolidated committed underlying securities violations of sections 12(1) & 12(2) of the 1933 Act and of section 10(b) of the 1934 Act." Id. at 801. A year later, a different panel rejected section 12 participant liability without reaching the question of whether aiding and abetting liability may be imposed under the section. The latter panel's dictum stated that Monsen had not "specifically discuss[ed] whether there can be aider-abettor liability under section 12(2) as distinguished from § 10(b), on which the jury's verdict also rested." Collins v. Signetics Corp., 605 F.2d 110, 114 (3d Cir. 1979).


421. See supra note 409.

422. For argument that aiding and abetting liability may not be imposed under section 12 even if it may be imposed under provisions such as sections 17(a) and 10(b), see HAZEN, supra note 106, at 210-11.
By early 1933 the Uniform Act and the blue sky laws of eleven states and the territory of Hawaii had created private rights of action that expressly imposed primary liability on the seller and on persons who “aided in any way in making [a] sale” of securities fraudulently or in violation of registration requirements.\footnote{423} Section 15 of the 1933

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Act expressly imposes secondary liability based on a person's control relationship with a liable section 12 defendant but on no other basis. 424

The legislative scheme and the 1933 Act's regulatory antecedents thus demonstrate that when Congress considered the Act's private

dealer, issuer-dealer or agent who materially aids in the sale’); NEV. REV. STAT. § 90.200(2) (1985) ("an employee . . . who materially aids in the sale, and a broker or employee of a broker or dealer who materially aids in the sale’); N.H. REV. STAT. ANN. § 421-B:125(III) (1983) ("every employee . . . who materially aids in the act or transaction . . . , and every broker-dealer or agent who materially aids in the acts or transactions’); N.J. STAT. ANN. § 49:3-71(b) (West 1970 & Supp. 1987) ("every employee . . . who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale’); N.M. STAT. ANN. § 58-13B-40(F) (1986) ("an employee . . . [who] materially aids in the act, omission or transaction . . . and a broker-dealer or sales representative who materially aids in the act, omission or transaction’); N.C. GEN. STAT. § 78A-56(c) (1985) ("every employee . . . who materially aids in the act or transaction, and every dealer or salesman who materially aids in the sale’); N.D. CENT. CODE § 10-04-17 (1985) ("every director, officer, salesman, or agent of or for [the] seller who shall have . . . aided in any way in making [the] sale’); OHIO REV. CODE ANN. § 1707.43 (Anderson 1985) ("every person who has . . . aided the seller in any way in making [the] sale or contract for sale’); OKLA. STAT. ANN. tit. 71, § 408(b) (West 1987) ("[e]very person who materially . . . aids in a sale’); OR. REV. STAT. § 59.115(3) (1985) ("every person who . . . materially aids in the sale’); S.C. CODE ANN. § 35-1-1500 (Law. Co-op. 1987) ("every employee . . . who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale’); S.D. CODIFIED LAWS ANN. § 47-31-133 (1983) ("each underwriter, broker or agent who shall have . . . aided in any way in making [the] sale, and . . . each of its officers and directors . . . who shall have . . . aided in making [the] sale’); TENN. CODE ANN. § 48-2-122(g) (1984) ("every employee . . . who materially aids in the act or transaction . . . , and every broker-dealer or agent who materially aids in the act or transaction’); TEX. REV. CIV. STAT. ANN. art. 581-33(F)(2) (Vernon Supp. 1987) ("[a] person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller . . . or issuer of a security’); UTAH CODE ANN. § 61-1-22(2) (1986) ("every employee . . . who materially aids in the sale . . . , and every broker-dealer or agent who materially aids in the sale’); VT. STAT. ANN. tit. 9, § 4225 (1984) ("every director, officer or agent of or for [the] seller who shall have . . . aided in any way in making [the] sale’); VA. CODE ANN. § 13.1-522(c) (Supp. 1987) ("every employee . . . who materially aids in the conduct . . . , and every broker-dealer, investment advisor, investment advisor representative or agent who materially aids in the conduct’); WASH. REV. CODE ANN. § 21.20.430(3) (Supp. 1987) ("every employee . . . who materially aids in the transaction, and every broker-dealer, salesperson, or [exempt] person . . . who materially aids in the transaction’); W. VA. CODE § 32-4-410(b) (1982) ("every employee . . . who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale’); WIS. STAT. ANN. § 551.59(4) (West 1982) ("every employee [sic] . . . who materially aids in the act or transaction . . . , and every broker-dealer or agent who materially aids in the act or transaction’); WYO. STAT. § 17-4-122(b) (1987) ("every employee . . . who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale’).

liability provisions, the lawmakers knew that primary or secondary liability might be imposed for aid given to a seller. In this context, Congress' failure expressly to impose liability for aiding a section 12 seller supports the inference that Congress did not intend that such liability be imposed. Together with section 12's language, this inference provides support for the conclusion that aiding and abetting liability may not be imposed in section 12 actions. The inference is consistent with the Supreme Court's determination that Congress did not intend to impose securities liability based on tort principles.425

IV. Denouement: Section 12 Liability Does not Extend to Participants or Other Non-Transferors

Congress did not intend to impose section 12 liability for "participating" in a selling effort, no matter how courts might determine participation and no matter what an alleged participant's motive might have been. Section 12's language yields no indication of congressional intent to impose liability for participation, and the section's legislative history makes no mention of participation. In the face of this silence, the securities acts' legislative scheme and the 1933 Act's regulatory antecedents become instructive.

As section 12 did four years later, the 1929 Uniform Sale of Securities Act created private rights of action for fraudulent sales of securities or sales in violation of registration requirements. The Uniform Act expressly imposed liability on the seller and on persons who "personally participated" with the seller in making a sale. By early 1933 the blue sky laws of twelve states and the territory of Hawaii had created private rights of action that expressly imposed liability on persons who "participated" in making fraudulent or violative sales. Liabilities and obligations expressly grounded in participation are found elsewhere in the 1933 Act and in four of the later five Roosevelt administration securities acts. Section 9 of the 1934 Act, enacted by the same Congress that enacted the 1933 Act, creates a private right of action that expressly imposes liability on participants.

The legislative scheme and the 1933 Act's regulatory antecedents thus demonstrate that Congress knew of the participation concept and employed it in that Act and throughout the unified program of securities regulation. In this context, section 12's failure expressly

425. See supra notes 258-66 and accompanying text.
to impose liability for participation supports the inference that Congress did not intend that the section impose participant liability.

Section 12's pertinent legislative materials also establish that the section imposes liability on only the person who transfers title to or other interest in the security for value. The Act's language indicates, but does not conclusively establish, this outcome. The Act's legislative history does not shed light on who may be a seller. Section 11, however, authorizes and effectuates actions by "any person acquiring [the] security" against a wide array of expressly enumerated defendants, including most of the major non-transferors involved in registered offerings. These non-transferors are frequently among the persons named as "participants" in section 12 actions. Section 12 could have provided a similar express enumeration but instead provides that "[a]ny person who offers or sells a security . . . shall be liable to the person purchasing such security from him." Section 11 thus creates a legislative scheme whose contrasts with section 12 support the inference that the Act does not impose seller status on non-transferors.

Perhaps because seven circuits impose section 12 liability for substantial participation in a selling effort, courts have not paid significant attention to the question of whether liability may be imposed for aiding and abetting in section 12 actions. If non-transferors were no longer subject to section 12 liability as sellers, however, purchasers could be expected to sue some non-transferors as aider-abettors who had substantially assisted primary violations. The Article's analysis provides support for the conclusion that courts may not impose liability under section 12 for aiding and abetting a seller's section 5 violation or its offer or sale of a security by means of a materially misleading prospectus or oral communication.

V. Conclusion

Section 12 of the Securities Act of 1933 creates two private rights of action, each providing in relevant part that "[a]ny person who offers or sells a security . . . shall be liable to the person purchasing such security from him . . ."426 Because suit may be maintained only by the person who purchases the security from defendant, an offeror may incur section 12 liability only if the offeror also "sells" the security to the plaintiff. At the least, section 12 imposes liability on the person who transfers title to or other interest in the security for value. Since 1971, however, seven circuits have adopted the participation theory. Courts adopting this theory impose liability not

only on the transferor, but also on any person whose participation in the transferor's selling effort makes the person's activities a substantial factor in causing the underlying transaction to take place.

The participation theory is derived from *Lennerth v. Mendenhall*, a 1964 district court decision. Except for stating the conclusion that the theory is consistent with the securities acts' "liberal remedial spirit," *Lennerth* did not base the theory on interpretation of section 12's pertinent legislative materials.427 Except for embracing *Lennerth's* conclusion concerning the securities acts' remedial purposes, the seven circuits in turn have not based the theory on interpretation of these materials.428

This Article has interpreted section 12's pertinent legislative materials and has presented the thesis that the section does not impose liability on participants or other non-transferors. The Article's analysis also provides support for the conclusion that courts may not impose secondary liability for aiding and abetting under section 12.

Because transactions in registered and unregistered securities are frequently effected by non-transferors with the transferor playing only a nominal role, limiting section 12 liability to the transferor would significantly diminish the protections afforded by the 1933 Act. Brokers and other non-transferors who play substantial roles in selling efforts would no longer be subject to section 12 liability in connection with section 5 violations or offers or sales of securities by means of materially misleading prospectuses or oral communications. The transferor might prove insolvent or otherwise unable to satisfy the injured plaintiff's judgment.

The defect lies in the statute itself, a circumstance that recalls the Second Circuit's 1967 suggestion in *Barnes v. Osofsky*.429 The panel rejected the claim that the plaintiff class created by section 11(a) of the 1933 Act430 includes some persons who could not trace their securities to the offering covered by the materially misleading registration statement. The panel recognized that its construction of section 11(a) might deny relief to some injured persons, but it declined to "depart from the more natural meaning" indicated by the various sources of congressional intent.431 Writing for the panel, Judge Henry J. Friendly suggested that "the time may have come for Congress to reexamine [the 1933 and 1934 acts] in the light of thirty years' experience."432 Similarly, section 12's reach should be determined

427. *See supra* notes 10-13, 49-56 and accompanying text.
428. *See supra* notes 57-98 and accompanying text.
429. 373 F.2d 269 (2d Cir. 1967).
431. 373 F.2d at 273.
432. *Id.*
by congressional reexamination based on deliberative study. The focus should be on the scope of liability that best effectuates the securities acts’ investor-protection purposes in light of the complexity and variety that characterize present-day securities transactions. Liability should no longer be determined by judicial implication based on a theory that is inconsistent with the section’s pertinent legislative materials.