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Expanded View of Section 12(2) Liability: Junker v. Crory

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CASE NOTES

An Expanded View of Section 12(2) Liability: *Junker v. Crory*

Section 12(2) of the Securities Act of 1933[1] imposes liability upon sellers of securities for certain misstatements or omissions of material facts. Originally, the application of section 12(2) was "limited to the immediate seller or those in a 'controlling person' relationship . . . with the seller."[2] In recent years, however, the scope of section 12(2) has been expanded by some courts to include persons who were not in strict privity with the purchaser of the securities. In *Junker v. Crory*[3] the United States Court of Appeals for the Fifth Circuit extended the scope of section 12(2) to include the seller's attorney. As it had in previous cases, the Fifth Circuit replaced the strict privity requirement with a proximate cause test to determine whether the attorney would be treated as a seller for section 12(2) purposes.

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1. Section 12(2), codified at 15 U.S.C. § 77*l* (1976), provides in relevant part:

Any person who—

. . . .

> (2) offers or sells a security . . ., 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 thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

2. Kaminsky, *An Analysis of Securities Litigation Under Section 12(2) and How It Compares With Rule 10b-5*, 13 Hous. L. Rev. 231, 247 (1976). *See* Nicewarner v. Bleavins, 244 F. Supp. 261, 266 (D. Colo. 1965); Wonneman v. Stratford Sec. Co., [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,034 (S.D.N.Y. 1961).

3. 650 F.2d 1349 (5th Cir. 1981).

I. The Junker Case

The plaintiff, James G. Junker, owned 16.2% of the outstanding shares of Reco Investment Corporation (Reco). The remaining shares were held by five other individuals, who constituted the board of directors and officers both of Reco and of Road Equipment Company, Inc. (Road).[4] One of these individuals, Walter Crory, was the sole shareholder of Road as well as the largest shareholder of Reco.

Reco agreed initially to pay Road an annual management fee. Over a period of eleven years, Reco had become indebted to Road for the management fee and for funds borrowed from Road for various expenses. By April of 1973 the amount owed by Reco to Road had reached $71,735, and a meeting of Reco shareholders was called to discuss this debt. Frederick Heisler, an attorney who represented both Road and Reco, attended the shareholders meeting as proxy for Walter Crory and his wife, whose combined ownership represented 49.6% of Reco's outstanding shares. At the shareholders meeting, Heisler explained that Reco must either borrow the funds to repay Road or liquidate. Over Junker's objection, the shareholders chose to approve a plan of liquidation.

In July of the same year another meeting of Reco shareholders was held at which Heisler was again present as proxy for two of the shareholders.[5] At that meeting, he explained that liquidation was not feasible because of high interest rates. In lieu of liquidation, Heisler suggested a merger of Reco with Road, which would effectively eliminate the debt owed to Road. Junker voted to terminate the liquidation plan, but voted his 16.2% of the shares against the merger. The remaining 83.8% of the shares were voted in favor of the merger. Because Louisiana law provides that a dissenting minority shareholder may claim a right to be cashed out at the fair cash value of his shares only when the action is approved by less than eighty percent of the total voting power, Junker was compelled to go along with the merger.[6] The merger formula, approved by the other shareholders in their capacities as the board of directors of both Reco and

4. *Id.* at 1353. Junker had previously worked as a salesman, vice-president, and general sales manager for Road, but in 1965, eight years before the events giving rise to the present action, he left and began a business that directly competed with Road. *Id.*

5. The shareholders were Chesley Crory and James Carmen, whose combined ownership represented 37.4% of Reco's outstanding shares. *Id.* at 1353-54.

6. La. Rev. Stat. Ann. § 12:131 (West 1969 & Supp. 1982).

Road, was based on a per share value of Road stock of $12.73 and a per share book value of Reco stock of $17.55.[7] However, because the property owned by Reco was located in an area where real estate values had drastically increased, the value of Reco's land and buildings was actually three times the book value used in the merger formula.[8]

Following the merger, Junker filed suit in the United States District Court for the Eastern District of Louisiana, naming Road, all the directors of Reco, and Heisler as defendants. Junker sought derivative recovery based on both federal securities law claims[9] and pendent state law claims.[10] The trial court found that all the defendant directors, as well as Heisler, were "familiar with the financial conditions and the operations" of the corporations and that they "intentionally or recklessly misrepresented or failed to disclose to Junker each corporation's true financial condition, the true values of Reco's property and improvements, and the real value of each corporation's stock."[11] Consequently, both Heisler and the directors were held to have

7. Accordingly, each Reco shareholder received one and one-half shares of Road for each share of Reco held. 650 F.2d at 1354.

8. This was based on the testimonies of Junker's expert witnesses, to which the court gave great weight. The experts' valuations are shown in the following table:

	Book Value Used In Merger Formula In 1973	Valuation by Plaintiff's Experts 1973	1975
3 parcels of land	$100,286.48	$338,700.00	$463,500.00
2 buildings	95,000.00	234,946.00	251,409.00
Totals	195,286.48	573,646.00	714,909.00

Id. at 1354-55.

Another expert testified that the most important factor in appraising the stock of an investment company such as Reco is its assets. The most important factor in appraising stock of a company engaged in sales such as Road is its earning capacity. Based on these factors, the per share value of Reco stock was $392.01 compared to the $17.55 book value used in the merger formula, and the Road stock per share value was $10.44 compared to the $12.73 book value used. *Id.* at 1355.

9. It was alleged that the defendants violated § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (1976); § 15 of the Securities Act of 1933, 15 U.S.C. § 77o (1976); § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1976); § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976); § 20 of the Securities Exchange Act of 1934, 15 U.S.C. § 78t (1976); and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1981). 650 F.2d at 1356.

10. It was alleged that the defendants violated LA. REV. STAT. ANN. § 12:91 (West 1969) (fiduciary duties of officers and directors) and LA. CIV. CODE ANN. art. 1847 (West 1952) (antifraud provision). 650 F.2d at 1356.

11. 650 F.2d at 1356.

violated federal securities laws.[12] The United States Court of Appeals for the Fifth Circuit affirmed the lower court's decision to hold Heisler liable for violations of section 12(2) of the Securities Act of 1933.[13]

II. Analysis

The question presented by the *Junker* case is who is properly included within the proscription of section 12(2) of the Securities Act of 1933. The court of appeals applied section 12(2) to Heisler—a person who was not in privity with the purchaser of the securities. Applying section 12(2) to reach a person who is not the purchaser's immediate seller expands the scope of the section beyond what Congress intended and is not necessary to protect the investing public.

A. *The Section 12(2) Cause of Action*

Section 12(2) has been referred to as "one of the most powerful but least appreciated weapons in the arsenal of a plaintiff in a securities fraud action. Section 12(2) is so potent that both plaintiffs and defendants tend to approach it with a sense of disbelief."[14] However, in recent years plaintiffs have begun to bring section 12(2) causes of action more frequently.

For a plaintiff to establish a section 12(2) cause of action he must show that

> (1) the seller offered or sold a security to the purchaser, (2) by means of a prospectus or oral communication that included either a material misstatement *or* an omission of material fact necessary to make the statements made not misleading under

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12. *Id.* The directors were also held liable for violations of fiduciary duties under state law. *Id.* The trial court did not address the claims under § 20 of the 1934 Act or § 15 of the 1933 Act. *Id.* n.4. Junker having died prior to trial, the court awarded Junker's widow her proportionate share of $392,010, the product of the per share value of Reco's shares multiplied by the number of shares outstanding. *Id.* at 1356.

13. *Id.* at 1362. The corporate defendant, Road, was also held liable under section 12(2). Finally, the court upheld the judgment against the directors for violations of state law fiduciary duties. *Id.* at 1356-62. The court noted that analysis of the federal claims against the directors was not necessary since the directors were liable under state law and the parties had inadequately treated the federal law claims in their briefs. *Id.* at 1358 n.10. While affirming the liability of the defendants, the court of appeals reversed the award of attorney's fees and remanded the case to the trial court to determine a proper amount of reduction of the damages award to reflect Junker's continuing ownership of the Road shares. *Id.* at 1362-65. Apparently Junker had not tendered the shares as required by the statute.

14. Kaminsky, *supra* note 2, at 231.

> the circumstances (3) of which the purchaser did not have knowledge, and (4) the mails or instruments of interstate communication or commerce were used in connection with the transaction.[15]

The statute provides that "[a]ny person who . . . offers or sells a security . . . shall be liable to the person purchasing such security from him."[16] However, section 12(2) expressly relieves the seller from liability if "he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."[17] Thus, recovery is limited to intentional or negligent misrepresentations.[18] In *Junker* the only element of a 12(2) cause of action at issue as to the attorney, Heisler, was whether he qualified as a "seller of a security."[19]

B. *The Fifth Circuit's Interpretation of "Seller"*

Originally, section 12(2) was applied only to the immediate seller or those in a controlling relationship with the seller.[20] Over the years, some courts, while still maintaining that only sellers may be held liable under section 12(2),[21] have expanded the def-

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15. *Id.* at 253.

16. Securities Act of 1933 § 12, 15 U.S.C. § 77*l* (1976).

17. *Id.* § 12(2), 15 U.S.C. § 77*l*(2).

18. Peterson, *Recent Developments in Civil Liability Under Section 12(2) of the Securities Act of 1933*, 5 Hous. L. Rev. 274, 276 (1967).

19. The remaining elements of the cause of action were clearly satisfied in the *Junker* case. First, the exchange of Junker's Reco shares for shares of Road constituted a sale of securities and qualified Junker as a purchaser. *See, e.g.*, SEC v. National Sec., Inc., 393 U.S. 453, 467 (1969) (merger deemed to be a purchase of shares in the new corporation in exchange for the old stock); Smallwood v. Pearl Brewing Co., 489 F.2d 579, 590-91 (5th Cir.), (merger treated as a sale and purchase of securities) *cert. denied*, 419 U.S. 873 (1974); Kaminsky, *supra* note 2, at 254. *See also* Koch, *Attorney's Liability: The Securities Bar and the Impact of* National Student Marketing, 14 Wm. & Mary L. Rev. 883, 888-89 (1973). Second, Heisler's oral communications made at the shareholders meetings failed to fully inform Junker of the material facts concerning the value and financial condition of the two corporations. 650 F.2d at 1360. Third, while Junker had an idea that some of the information he was given was not completely accurate, he was unaware of "at least some of the various untruths or omissions contained in Heisler's statements." 650 F.2d at 1361. Finally, although the *Junker* court did not address the jurisdictional requirement of interstate commerce, it has been held that purely intrastate use of the mails or of the telephone is sufficient. Shaw v. United States, 131 F.2d 476, 480 (9th Cir. 1942); Lennerth v. Mendenhall, 234 F. Supp. 59, 63 (N.D. Ohio 1964). It has also been held that the actual misrepresentation need not have been carried out by use of interstate commerce; it is sufficient if the mails or interstate commerce were used for any part of the transaction. Kaminsky, *supra* note 2, at 240.

20. Kaminsky, *supra* note 2, at 247. *See* Securities Act of 1933, § 15, 15 U.S.C. § 77o (1976). *See also* 3 L. Loss, Securities Regulation 1719 (2d ed. 1961).

21. The leading case is Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d

inition of "seller." In an earlier Fifth Circuit decision, *Hill York Corp. v. American International Franchises, Inc.*,[22] the court enunciated a test to strike a balance "between the . . . 'strict privity' concept and the overbroad 'participation' concept which would hold all those liable who participated in the events leading up to the transaction."[23] Under the Fifth Circuit test, "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 of the plaintiff flow directly and proximately from the actions of this particular defendant?"[24] Later in the *Hill York* opinion, in discussing the element of materiality, the court was careful to point out that proof of causation-in-fact was not necessary in a section 12(2) cause of action. "A plaintiff does not have to prove that the sale would not have occurred absent the misrepresentation or omission."[25] Thus, the court held that a plaintiff need not show actual causation, but must show that the defendant was the "proximate cause" of the plaintiff's injury or a "motivating force" behind the transaction.[26]

680, 692 (5th Cir. 1971). *See also*, Pharo v. Smith, 621 F.2d 656, 665 (5th Cir. 1980).

22. 448 F.2d 680 (5th Cir. 1971).

23. *Id.* at 692.

24. *Id.* at 693 (quoting Lennerth v. Mendenhall, 234 F. Supp. 59, 65 (N.D. Ohio 1964)). *See also* Nicewarner v. Bleavins, 244 F. Supp. 261, 266 (D. Colo. 1965).

25. 448 F.2d at 696. *See also* Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005 (1981); Jackson v. Oppenheim, 533 F.2d 826, 830 (2d Cir. 1976); Gilbert v. Nixon, 429 F.2d 348, 357 (10th Cir. 1970); Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970); Kaminsky, *supra* note 2, at 248-49.

26. 448 F.2d at 693. For other decisions of the Fifth Circuit see Croy v. Campbell, 624 F.2d 709, 714 (5th Cir. 1980) (holding that an attorney was not within the definition of "seller" because it could not be said that the purchasers would not have purchased the security "but for" his actions); Pharo v. Smith, 621 F.2d 656, 667 (5th Cir. 1980) (holding that when participation in a transaction becomes a "substantial" factor in causing the transaction, the participant comes within the definition of "seller"); Lewis v. Walston & Co., 487 F.2d 617, 622 (5th Cir. 1973) (a broker's representative was deemed to be a seller under section 12(1) because her actions were a "substantial factor" in bringing about the plaintiff's purchase and thus the "proximate cause" of those purchases). Other courts also have followed the Fifth Circuit approach. *See* SEC v. Murphy, 626 F.2d 633, 650 (9th Cir. 1980) (applying a two-prong test: (1) a court must find an actual casual relationship between the injury to the plaintiff and the conduct of the defendant, and (2) it must find that the acts of the defendant were a substantial factor in bringing about the transaction); Lawler v. Gilliam, 569 F.2d 1283, 1287-88 (4th Cir. 1978) (applying a substantial factor test similar to that applied by the Fifth Circuit). *But see* Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225-27 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005 (1981); Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979); Wasson v. SEC, 558 F.2d 879, 886 (8th Cir. 1977); Lanza v. Drexel & Co., 479 F.2d 1277, 1298 (2d Cir. 1973).

C. *Flaws in the Extended Definition of "Seller"*

1. *Contrary to congressional intent*

When questions arise about the meaning of a statute, a court should attempt to determine how the legislature intended the statute to be construed. If it is clear that the legislature did not address the question, a court should attempt to determine what the legislature would have intended had it considered the issue.[27] As pointed out by the Third Circuit, recent Supreme Court cases emphasize that courts should avoid "excessively expansive readings" of the liability provisions of the securities acts.[28] "Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the securities act must 'rest primarily on the language of that section.' "[29] Therefore, a court should begin with the presumption that Congress intended to say what it in fact said in the statute. Thereafter, the legislative history and other related statutory provisions should be examined to determine whether they rebut this presumption.[30]

A literal reading of section 12(2) gives rise to a presumption that Congress intended the section to be applied only to those in strict privity with the purchaser. Further, the legislative history accompanying the Securities Act provides no evidence that Congress intended other than a literal interpretation of "seller" in section 12(2). Discussing the provisions of the proposed act section by section, the House Committee on Interstate and Foreign Commerce explained the purpose of section 12: "If any person . . . sells a security . . . [and] includes an untrue statement of a material fact or omits to state a material fact . . ., he is made

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27. J. GRAY, THE NATURE AND SOURCES OF THE LAW 173 (2d ed. 1921). *See also* B. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 14-15 (1921).

28. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979). *See, e.g.*, International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979); SEC v. Sloan, 436 U.S. 103 (1978); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

29. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200 (1976)). *See also* McFarland v. Memorex Corp., 493 F. Supp. 631, 647-48 (N.D. Cal. 1980).

30. *See generally* de Sloovere, *Extrinsic Aids in the Interpretation of Statutes*, 88 U. PA. L. REV. 527 (1940); Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527 (1947); Jones, *The Plain Meaning Rule and Extrinsic Aids in the Interpretation of Federal Statutes*, 25 WASH. U.L.Q. 2 (1939).

liable to the person purchasing the security from him . . . ."[31] The use of language similar to that adopted in the statute gives no indication that the committee intended the definition of "seller" to be expanded beyond the plain and literal meaning.

In another statement discussing civil liabilities under the proposed bill, the committee suggested that "a buyer of securities" is entitled "to sue for recovery of his purchase price . . . those who have participated in such distribution either knowing of such untrue statement or omission or having failed to take due care in discovering it."[32] While this language seems to include all "participants" within the range of potential liability under sections 11 and 12, the statement actually refers only to section 11 liability. As the committee report pointed out, subjecting all "participants" in the distribution to liability applies only to securities sold upon a registration statement.[33] These statements in the legislative history of section 12(2) of the Securities Act are at best neutral and, therefore, do not rise to the level necessary to rebut the presumption that the statute should be given a literal interpretation.

Section 15 of the Act supports a narrow and literal reading of Section 12(2). "Controlling persons" of the issuer are subject to joint and several liability under section 15 when they control "any person liable under section [11 or 12]."[34] Thus, in the instant case, any person controlling Road, the seller, could have been jointly and severally liable under section 15 because Road was held liable under section 12. The Securities and Exchange Commission has defined "control" as follows:

> The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of management and policies of a person, whether

31. H.R. Rep. No. 85, 73d Cong., 1st Sess. 23 (1933). The report on the companion Senate bill, S. 875, 73d Cong., 1st Sess. (1933), 77 Cong. Rec. 2979-82 (1933), in discussing personal liability, refers only to the liability of officers and directors, S. Rep. No. 47, 73d Cong., 1st Sess. 4-6 (1933). The Conference Committee which met to reconcile the differences between the House and Senate bills used the House bill as the basic working unit. Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 45 (1959).

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

33. *Id.* Section 11 of the 1933 Act makes those who have a part in the filing of a registration statement which contains untrue statements or material omissions subject to liability. Securities Act of 1933 § 11, 15 U.S.C. § 77k (1976).

34. 15 U.S.C. § 77o (1976).

> through the ownership of voting securities, by contract, or otherwise.[35]

Congress specified in section 15 which persons, in addition to the actual seller, should be held liable. By implication Congress intended "seller" to be interpreted literally. To read section 12(2) more broadly, as did the court in *Junker,* is to suggest that Congress created section 15 in order to impose liability on an improbable class: controlling persons who somehow do not proximately cause the transaction.

The presumption that Congress intended the definition of seller to be restricted to those in privity with the purchaser is not rebutted either by the legislative history of the Act or by other related provisions of the Act. Absent a contrary showing of congressional intent, the presumption must stand that "Congress intended the unambiguous language of § 12(2) to mean exactly what it says: 'Any person who — . . . (2) offers or sells a security . . . shall be liable to the person purchasing [such security] from him . . . .' "[36] The courts should not "strain for broad readings that stretch beyond congressional intent."[37]

2. *Unnecessary to protect the investing public*

In *Collins v. Signetics Corp.,*[38] the Court of Appeals for the Third Circuit stated that extending liability under section 12(2) beyond the immediate seller "would not only torture the plain meaning of the statutory language but would also frustrate the statutory schema"[39] that Congress provided. In addition to imposing section 12 liability, Congress imposed potential liability under section 11 on those who take part in filing a false or misleading registration statement and under section 15 on those who control persons liable under sections 11 and 12. Further, section 17(a) prohibits "any person" from engaging in a fraudulent or deceptive act "in the offer or sale of any securities."[40] A

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35. 17 C.F.R. § 230.405(f) (1981). This definition has generally been construed broadly and on occasion has been construed to include an attorney who did not own a substantial number of shares of the corporation. Westlake v. Abrams, 504 F. Supp. 337, 348-50 (N.D. Ga. 1980).

36. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979).

37. McFarland v. Memorex Corp., 493 F. Supp. 631, 648 (N.D. Cal. 1980). *See also* Transamerica Mortgage Advisers, Inc. v. Lewis, 444 U.S. 11 (1979); Touche Ross & Co. v. Redington, 422 U.S. 560 (1979).

38. 605 F.2d 110 (3d Cir. 1979).

39. *Id.* at 113.

40. 15 U.S.C. § 77q (1976).

fraudulent or deceptive act includes obtaining money or property by means of an untrue statement or omission of a material fact, as well as making a fraudulent transaction. The section thus applies not only to sellers in privity with their purchasers,[41] but also to any person whose fraudulent act is in some way involved in the offer or sale of a security.[42] These sections, particularly section 17, provide adequate protection to the investing public, making an expanded definition of "seller" unnecessary.

The adequacy of section 17(a)'s protections is buttressed by a proper interpretation of the section to include a private right of action and to require a negligence standard. The language of section 12(2) expressly provides for a private right of action. Although the Supreme Court has not yet determined whether an implied private right of action exists under section 17(a),[43] the majority of the courts of appeals that have considered the issue, including the Fifth Circuit, have either expressed or implied that a private right of action should and does exist.[44]

As noted, *negligent* misrepresentations justify recovery under 12(2).[45] The Supreme Court recently held that a scienter requirement should be read into section 17(a)(1) but not into 17(a)(2) or (3).[46] Although the majority did not expressly rule on the standard to be applied to 17(a)(2) and (3), "the better view lies in adopting a negligence standard."[47] Interpreting section

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41. *See* Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641, 661-66 (1978); Steinberg, *Section 17(a) of the Securities Act of 1933 After* Naftalin *and* Redington, 68 GEO. L.J. 163, 168-70 (1979).

42. *See* Steinberg, *supra* note 41, at 170-71.

43. *See, e.g.*, International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 557 n.9 (1979); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733 n.6 (1975).

44. *See, e.g.*, Lincoln Nat'l Bank v. Herber, 604 F.2d 1038, 1040 n.2 (7th Cir. 1979); Kirschner v. United States, 603 F.2d 234, 241 (2d Cir. 1978), *cert. denied*, 442 U.S. 909 (1979); Newman v. Prior, 418 F.2d 97, 99 (4th Cir. 1975); Kellman v. ICS, Inc., 447 F.2d 1305, 1308 (6th Cir. 1971); Smith v. Jackson Tool & Die, Inc., 419 F.2d 152, 154 (5th Cir. 1969). *But see* Shull v. Dain, Kalman & Quail, Inc., 561 F.2d 152, 159 (8th Cir. 1977), *cert. denied*, 434 U.S. 1086 (1978). In addition to the five circuits that have expressly or impliedly adopted a private right of action, district courts in two other circuits have followed this view. *See* cases cited in Hazen, *supra* note 41, at 651-52 nn.55-57 and accompanying text. Many commentators have suggested that § 17(a) does include a private right of action. *See, e.g.*, Hazen, *supra* note 41; Steinberg, *supra* note 41. *But see* Note, *Implication Under Section 17(a) of the Securities Act of 1933—the Effect of* Aaron v. SEC, 49 FORDHAM L. REV. 1161 (1981).

45. *See supra* text accompanying notes 17-18.

46. Aaron v. SEC, 446 U.S. 680, 697 (1980).

47. Hazen, *supra* note 41, at 676. *See also* Steinberg, *Securities Litigation*, 4 CORP. L. REV. 166, 168-69 (1981); Steinberg, *SEC and Other Permanent Injunc-*

17(a)(2) to allow recovery upon a showing of either intentional or negligent misrepresentations imposes liability on nonsellers for breach of the same standard of conduct applicable to sellers under section 12(2).

A further reason to restrict the application of section 12(2) to cases involving only sellers who are in privity with purchasers is that section 17(a) provides for a more logical remedy in cases where privity does not exist. The remedy to a plaintiff seeking recovery under section 12(2) is generally limited to rescission. Damages are available only if the purchaser no longer owns the security. Expanding section 12(2) to one who did not actually sell the securities to the purchaser may result in the anomalous situation of requiring a repurchase of securities by one who has never owned them, thus allowing a purchaser to "undo by rescission an event that never occurred."[48] That result is avoided by limiting application of section 12(2) to sellers in privity with the purchaser. Under section 17(a), the purchaser is entitled to seek damages from the guilty party without respect to whether he still owns the security.

A private right of action under section 17(a) allowing recovery for intentional or negligent misrepresentations provides investors with adequate remedies against parties who are not actual sellers of securities. For that reason, expanding the scope of section 12(2) to include those not in privity with the purchaser is not necessary to protect the investing public.

III. CONCLUSION

A literal reading of section 12(2) precludes expansion of the definition of "seller" beyond those in strict privity with the purchaser. The presumption in favor of a literal interpretation of section 12(2) is not rebutted by either legislative history or other related provisions of the Act. Moreover, since section 17(a) provides adequate protection to the investing public, expansion of section 12(2) is not necessary. Therefore, the Court of Appeals for the Fifth Circuit erred in expanding the scope of section 12(2) to cover a corporate attorney who was not in strict privity with the purchaser of the securities.

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tions—Standards for Their Imposition, Modification and Dissolution, 66 CORNELL L. REV. 27, 36 (1980).

48. McFarland v. Memorex Corp., 493 F. Supp. 631, 648 (N.D. Cal. 1980).