SECURITIES REGULATION: LIABILITY FOR ALLEGEDLY FALSE REGISTRATION STATEMENT LIMITED TO THE PARTICULAR SECURITIES ISSUED UNDER THE STATEMENT

Colonial Realty Corp. v. Brunswick Corp.[1] has now firmly established that under section 11 of the Securities Act of 1933[2] a purchaser of securities may not successfully sue on the basis of misstatements in a registration statement when the securities which he purchased, while of the same class, were not those which were the direct subject of the registration statement. In the instant case, Brunswick Corporation, pursuant to a registration statement and prospectus filed with the Securities and Exchange Commission, issued a series of convertible subordinated debentures. After the effective date of the registration statement, the plaintiff purchased a quantity of the common stock of the corporation on the open market, none of which, however, had been issued upon the conversion of the debentures. The purchaser maintained that it had suffered a substantial loss as the result of a subsequent decrease in the market value of the stock and therefore asserted a right to relief based upon, *inter alia,* section 11 of the Securities Act of 1933. Plaintiff's contention was that the registration statement and prospectus contained untrue statements of material facts and omitted material facts concerning the long-term financing of the corporation. The defendants moved for summary judgment on the section 11 count of the complaint, and the motion was granted by the court.[3]

The Securities Act of 1933[4] and the Securities Exchange Act of 1934[5] sought to prevent fraud and deceit in the purchase and sale of securities by compelling disclosure of all material facts concerning the transaction.[6] Accordingly, section 11 of the Securities Act creates

---

[1] 257 F. Supp. 875 (S.D.N.Y. 1966).

[2] 48 Stat. 82, as amended, 15 U.S.C. § 77k (1964).

[3] 257 F. Supp. at 884.

[4] Ch. 38, 48 Stat. 74, as amended, 15 U.S.C. §§ 77a-aa (1964).

[5] Ch. 404, 48 Stat. 881, as amended, 15 U.S.C. §§ 78a-jj (1964).

[6] See Columbia Gen. Inv. Corp. v. SEC, 265 F.2d 559, 563 (5th Cir. 1959). See generally Cohen, *"Truth in Securities" Revisited,* 79 HARV. L. REV. 1340 (1966); Douglas & Bates, *The Federal Securities Act of 1933,* 43 YALE L.J. 171 (1933); Hanna, *The Securities Exchange Act of 1934,* 23 CALIF. L. REV. 1 (1934); *Symposium—Three Years of the Securities Act,* 4 LAW & CONTEMP. PROB. 1 (1937).

civil liability if any part of a registration statement contains an untrue statement of a material fact or omits any material fact required to be stated to render the information therein not misleading.[7] The primary innovation provided by the section was the extension of the permissible class of defendants to include the issuer, directors of the issuer, accountants and similar experts, and the underwriters, thereby destroying the common law requirement that there be privity of contract between the plaintiff and defendant.[8] Another significant departure from the common law was the provision for reasonable belief in the truth of the statements as an affirmative defense available to those other than the issuer, thus eliminating the element of scienter required in an action for deceit.[9] The motivation apparently supporting these two variations is the policy that the burden of proof should be placed on the defendant as to those facts peculiarly within his own knowledge.[10] Consistent with this notion, the original version of section 11[11] did not require any showing of causation or reliance by the plaintiff. The Exchange Act, however, amended the section to require that reliance upon the registration statement be established when the issuer had made an earnings statement generally available covering a period of at least twelve months beginning after the effective date of the registration statement.[12] In addition, the amendment permitted damages to be reduced to the extent that the defendant could show that the misstatements or omissions in the prospectus or registration statement did not contribute to the plaintiff's loss.[13]

The relief afforded by section 11 results, however, only when the plaintiff is able to establish that he is within the class of persons

[7] See 3 Loss, SECURITIES REGULATION 1721 (2d ed. 1961); Shulman, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 247 (1933); Simpson, *Investors' Civil Remedies Under the Federal Securities Laws*, 12 DE PAUL L. REV. 71, 72 (1962); Legislation, 48 HARV. L. REV. 107, 111 (1934); Comment, 38 WASH. L. REV. 627, 628 (1962); Annot., 37 A.L.R.2d 649, 653 (1954).

[8] *Compare* Securities Act of 1933, § 11 (a), 48 Stat. 82, as amended, 15 U.S.C. § 77k (a) (1964), *with* Ultramares Corp. v. Touche, Niven & Co., 255 N.Y. 170, 189, 174 N.E. 441, 448 (1931).

[9] *Compare* Securities Act of 1933, § 11 (b) (3), 48 Stat. 82, as amended, 15 U.S.C. § 77k (b) (3) (1964), *with* Derry v. Peek, 14 App. Cas. 337, 340 (1889).

[10] Simpson, *supra* note 7, at 71.

[11] Securities Act of 1933, § 11, 48 Stat. 82.

[12] Securities Act of 1933, § 11 (a), as amended by Securities Exchange Act of 1934, § 206 (a), 48 Stat. 907, 15 U.S.C. § 77k (a) (1964).

[13] Securities Act of 1933, § 11 (e), as amended by Securities Exchange Act of 1934, § 206 (e), 48 Stat. 907, 15 U.S.C. § 77k (e) (1964).

which the section seeks to protect. Thus, as to those who may invoke the statute, section 11 (a) provides that

> In any case any part of the registration statement . . . contained an untrue statement of a material fact or omitted to state a material fact . . . necessary to make the statements therein not misleading, *any person acquiring such security . . . may . . . sue . . . .*[14]

Prior to the instant case, the class of permissible plaintiffs established by the words "any person acquiring such security" had never been definitively delineated. The question thus arises whether the words should be construed to extend the privilege to sue only to the purchasers of the *registered* securities or whether persons who purchase securities of the identical class as those registered should also have a cause of action. A still broader interpretation, one which apparently has never been considered by the courts, would extend protection to the purchasers of *any* securities issued by the firm that filed the registration statement. The few cases that have considered the problem of possible plaintiffs have adopted the most narrow construction of the section[15] although no case has squarely faced the issue. For example, the court in *Fischman v. Raytheon Mfg. Co.*[16] stated, without any effort to substantiate its determination, that a suit under section 11 may be maintained only by those who purchase securities that are the direct subject of the registration statement.[17] The precedential value of the case is limited, however, because the owners of the securities not issued under the registration statement abandoned their section 11 claim in the district court.[18] Likewise, the court in *Barnes v. Osofsky*[19] adhered to the same limited construction, but it did not definitively settle the question since the case involved the approval of a settlement rather than the determination of a litigated controversy.[20] The commentators also seem to adhere to a similar position although few of them directly treat the issue of proper plain-

[14] Securities Act of 1933, § 11 (a), 48 Stat. 82, as amended, 15 U.S.C. § 77k (a) (1964). (Emphasis added.)

[15] See, *e.g.*, Hoover v. Allen, 241 F. Supp. 213, 223 (S.D.N.Y. 1965); Rudnick v. Franchard Corp., 237 F. Supp. 871, 873 (S.D.N.Y. 1965); Montague v. Electronic Corp. of America, 76 F. Supp. 933, 935 (S.D.N.Y. 1948).

[16] 188 F.2d 783 (2d Cir. 1951), 38 VA. L. REV. 232 (1952).

[17] 188 F.2d at 786.

[18] *Ibid.*

[19] 254 F. Supp. 721 (S.D.N.Y. 1966).

[20] *Id.* at 726.

tiffs under section 11.[21] Furthermore, strict interpretation is suggested by the legislative history of the act.[22]

Notwithstanding this seemingly unanimous construction of the section, the purchaser in *Colonial Realty* argued that the misleading registration statement affected the market value of all the outstanding shares of common stock of the company, not merely those issued under the registration statement, and consequently that all purchasers of this class of stock should have a remedy under section 11.[23] The plaintiff also stressed that by adopting a limited statutory construction the court would be allowing blind chance to determine the applicability of section 11 since the open market purchaser had no way of ascertaining whether the shares he would receive would be those covered by the registration statement.[24] The court, seemingly in sympathy with the plaintiff, acknowledged the economic soundness of these arguments; however, when it surveyed the general pattern of the legislation, the relevant case law, the views of the commentators, and the legislative history of the statute, it concluded that each of these considerations prompted the determination that the availability of the remedies under section 11 was restricted to purchasers of the securities issued under the registration statement in question.[25] Consequently, it noted that the plaintiff's arguments only served to illuminate the shortcomings of the statute, a problem which it felt should be corrected by the legislative process. However, in an effort to palliate the result reached, the court observed that the purchaser probably had a remedy under other sections of the act.[26]

The court's decision was evidently dictated by the language of the statute, which seems very clearly to limit the remedies of the section to purchasers of the securities issued under the registration statement. Nonetheless, the plaintiff's position was not untenable. Assuming that the legislative objectives were to prevent the practice of fraud in the purchase and sale of securities and, as an appropriate

[21] See, *e.g.*, 3 LOSS, *op. cit. supra* note 7, at 1731 n.160; Simpson, *supra* note 7, at 72; Legislation, 48 HARV. L. REV. 107, 110 (1934); Comment, 38 WASH. L. REV. 627, 628 (1963).

[22] See H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933). *But see id.* at 21-22; S. REP. No. 47, 73d Cong., 1st Sess. 6-7 (1933).

[23] 257 F. Supp. at 880-81; Brief for Plaintiff, p. 34.

[24] 257 F. Supp. at 881; Brief for Plaintiff, p. 21.

[25] 257 F. Supp. at 880, 884.

[26] *Id.* at 881.

means to the end, to compensate investors for losses incurred,[27] a construction of section 11 which would make the spectre of liability more ominous would be more likely to yield the desired prohibitory effect. Furthermore, to the extent that the information contained in the prospectus affected the price at which the plaintiff purchased his stock, he seemingly should have a remedy if that information proves to be false and a consequent readjustment in price takes place. Of course, a possible result of this position is that the liability imposed would be ruinous; however, the probability of such a consequence is minimal since the act provides a number of positive restraints on the limits of liability, such as the abbreviated statute of limitations which restricts the time within which an action may be brought to one year after discovery of the untrue statement or to a reasonable time for discovery not to exceed three years from the date of the offer to the public.[28] Thus the plaintiff's arguments accord with the objectives sought to be realized by the statute. Nevertheless, the terms of section 11 appear to present an insuperable barrier to recovery. The language could have been strained to have allowed the plaintiff to prevail and thus to reach what is perhaps the more desirable result. Such a construction, however, would be so evidently tortured that few, if any, courts would be likely to follow such a precedent. Thus it appears that any result different from that reached in *Colonial Realty* must be accomplished by statutory amendment rather than judicial reformation.

[27] See authorities cited note 6 *supra;* Shulman, *supra* note 7, at 227.

[28] Securities Act of 1933, § 13, 48 Stat. 84, as amended, 15 U.S.C. § 77m (1964).