Comment

CRAFTMATIC SECURITIES LITIGATION: THIRD CIRCUIT ABANDONS PRIVITY REQUIREMENT IN SECTION 12(2) LIABILITY

I. INTRODUCTION

In its recent decision in *Craftmatic Securities Litigation v. Kraftsow*,[1] the Third Circuit adopted a new test of seller liability for the sale of securities through misleading communications under section 12(2) of the Securities Act of 1933 (Securities Act).[2] This new test extends

---

1. 890 F.2d 628 (3d Cir. 1989).

2. *Id.* at 636. The court rejected the Third Circuit's previous test, which required privity between the purchaser and the issuer in order for the purchaser to bring a claim against the issuer under § 12(2). *Id.* The court adopted *Pinter v. Dahl*'s test for seller liability, which states that "although 'the language of § 12(1) contemplates a buyer-seller relationship not unlike traditional contract privity,' its scope is not limited to those who pass title." *Id.* at 635 (quoting Pinter v. Dahl, 486 U.S. 622, 642 (1988)). Now, rather than being limited to titleholders, "seller" also includes those who successfully solicit the purchase motivated by his own or the securities owner's financial interests. *Id.*

Section 12 of the Securities Act provides that:

> [a]ny person who—
>
> (1) offers or sells a security in violation of section 5 of this title, or
>
> (2) *offers or sells* a security (whether or not exempted by the provisions of section 3 of this title, 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 thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Securities Act of 1933, § 12(2), 15 U.S.C. § 77*l*(2) (1988) (codified at 15 U.S.C. §§ 77a-77aa (1988)) [hereinafter Securities Act] (emphasis added). Section 5 of the Securities Act, 15 U.S.C. § 77e (1988), to which § 12(1) refers, prohibits the sale

liability[3] to those who pass title as well as those who "successfully solicit the purchase, motivated by their own or the securities owner's financial interests."[4] The *Craftmatic* test expands the Third Circuit's class of potential defendants who may be liable for section 12(2) violations by including more people in the definition of "seller."[5]

The Third Circuit's decision came about after consideration of the recent United States Supreme Court decision in *Pinter v. Dahl*.[6] *Pinter* held that liability exists if the defendant is motivated by a financial interest other than the buyer's and successfully solicits the purchase.[7] Further, *Pinter* stated that merely being a "substantial factor" in causing the sale of an unregistered security is insufficient

---

of unregistered securities not exempted under § 3 of the Securities Act. Section 5(a) provides in part:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

15 U.S.C. § 77e (1988).

3. Section 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2) (1988). Section 12(2) states that a defendant

> 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.

4. *Craftmatic*, 890 F.2d at 635.

5. Section 2(3) of the Securities Act defines "sell" to "include every contract of sale or disposition of a security or interest in a security, for value." Section 2(3), Securities Exchange Act of 1934, 15 U.S.C. § 77b(3) (1988). Section 2(3) has been construed broadly. *See, e.g.*, United States v. Naftalin, 441 U.S. 708, 773 (1979) (footnotes omitted) ("[t]he statutory terms, which Congress expressly intended to define broadly, . . . are expansive enough to encompass the entire selling process, including the seller/agent transaction"). Section 2(3)'s definition of "sell" was applied to define the term "seller" in *Pinter* to expand the class of § 12(1) defendants. *See infra* notes 82-84 and accompanying text.

Section 12(2) holds persons who "offer to sell" or who "sell a security by use of a misleading prospectus or an oral communication liable for the sales of securities." Section 12(2), 15 U.S.C. § 77*l*(2) (1988). Prior to *Pinter*, the Third Circuit required privity or a special relationship between the defendant-seller and the plaintiff-buyer for seller liability. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979). *See infra* notes 38-41 and accompanying text.

6. 486 U.S. 622 (1988).

7. *Id.* at 641-55.

in itself to render an individual liable as a seller under section 12(1) of the Securities Act.[8]

Prior to *Craftmatic*, the Third Circuit required a special relationship or privity between the purchaser and defendant to bring a claim under section 12(2).[9] More specifically, the Third Circuit only allowed a claim under section 12(2) if the purchaser purchased the securities from the titleholder or his agent.[10] *Craftmatic* rejects this limitation and finds that *Pinter*'s holding also applies to section 12(2) violations for two reasons.[11] First, sections 12(1) and 12(2) use identical language to establish liability.[12] Second, because the Securities

---

8. *Id.* at 654. The Supreme Court only considered the scope of the term "seller" in the context of § 12(1). Section 12(1) of the Securities Act holds liable persons who offer or sell a security in violation of § 5 of the Securities Act. 15 U.S.C. § 77*l* (1988). *Pinter*, 486 U.S. at 642. The *Pinter* Court reasoned that, since

> solicitation of a buyer is perhaps the most critical stage of the selling transaction [because] it is directed at producing a sale, [and since] brokers and other solicitors are well positioned to control the flow of information to a potential purchaser [and to] disseminate material information to investors, . . . solicitation is that stage at which an investor is most likely to be injured, that is, by being persuaded to purchase securities without full and fair information.

Id. at 646-47. The Court went on to say that the

> purpose of § 12(1) suggest[s] that liability extends only to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner. *If he had such a motivation, it is fair to say that the buyer "purchased" the security from him* . . . .

Id. at 647 (emphasis added) (footnote omitted).

9. *Collins*, 605 F.2d at 112. In this case, the purchaser purchased 2,200 shares from members of the company's underwriting syndicate rather than from the corporation. *Id.* at 113. The Third Circuit reasoned in this case that since § 11 gives anyone acquiring a security a specific right of action for misrepresentation against every person who signed the registration statement, who was a director or partner of the issuer, who prepared a certified statement contained in the registration statement, or who was an underwriter with respect to the security, § 12(2) must be interpreted strictly. *Id.*

10. *Id.* at 114. At common law, liability arose out of a misrepresentation cause of action under tort law requiring both reliance on the plaintiff's part and scienter on the defendant's part. RESTATEMENT (SECOND) OF TORTS § 525 (1977) (requiring the element of scienter under fraudulent misrepresentation).

11. *Craftmatic*, 890 F.2d at 635.

12. The language identifying the defendant in §§ 12(1) and 12(2) is "any person who . . . offers or sells a security." *Id.* The possible plaintiff is identified as "the person purchasing such a security from" the seller. *Id.* Finally, the remedy is the recovery of "the consideration paid for such security . . . or . . . damages if he no longer owns the security." *Id.* In *Pinter*, the Supreme Court discussed the scope of § 12(2) in a footnote, but expressly refused to take a position as to whether

Act's overall objective is full and fair disclosure, the scope of "seller" should be identical for both sections.[13]

This comment will review the various definitions of "seller" that have been employed by the federal circuits. Next, the court's decision in *Craftmatic* will be fully analyzed. Third, the Evaluation section will justify the Third Circuit's extension of *Pinter*'s definition of "seller" for section 12(1) to the definition of "seller" in section 12(2).

This comment contends that the extension of the definition of "seller" is consistent with the remedial purposes of the Securities Act as well as the statutory language of section 12(2) for three reasons. First, the language of section 12 infers that the person who solicited the purchase motivated by a personal financial interest, as well as the titleholder, is potentially liable for violations of that section because section 12 sets the terms "sell" and "offer" apart.[14] Second, the Supreme Court was able to consider the case law of *all* the circuits and arrive at an objective, rational test that strikes a balance between all of the circuits.[15] Third, the Third Circuit's extension of *Pinter*'s definition of "seller" to section 12(2) is appropriate because the relevant language of both sections is identical and should, therefore, be interpreted identically.[16]

II. BACKGROUND

Since 1940, the circuit courts have been struggling with the task of defining the term "seller" as used in section 12 of the Securities

---

"seller" should be redefined. *Pinter*, 486 U.S. at 642 n.20. The Court stated:

> The "offers or sells" and the "purchasing such security from him" language that governs § 12(1) also governs § 12(2). . . . Most courts and commentators have not defined the defendant class differently for purposes of the two provisions.
>
> . . . .
>
> The question whether anyone beyond the transferor of title, or immediate vendor, may be deemed a seller for purposes of § 12 has been litigated in actions under both § 12(1) and § 12(2). Decisions under § 12(2) addressing the "seller" question are thus relevant to the issue presented to us in this case. . . . Nevertheless, this case does not present, nor do we take a position on, the scope of a statutory seller for purposes of § 12(2).

Id.

13. *Craftmatic*, 890 F.2d at 635.
14. *See infra* notes 124-38 and accompanying text.
15. *See infra* notes 147-52 and accompanying text.
16. *See infra* notes 152-58 and accompanying text.

Act.[17] The First Circuit, in *Cady v. Murphy*,[18] was the first to define the term "seller" to include a party other than the titleholder of the security.[19] Since then, eight circuits have defined "seller" in various ways.[20] Finally, in *Pinter*, the Supreme Court settled the split among circuits and defined the term "seller" as used in section 12(1). Following *Pinter*, the Third Circuit abandoned its previous definition of "seller" as a person in privity or with some special relationship to the purchaser and applied *Pinter*'s definition of "seller"[21] to section 12(2).

During the fifty years of deliberating over a proper definition of "seller," the courts have developed five tests.[22] Frustrated with limiting liability only to the vendor, courts have developed several tests which find other participants in the sale transaction liable.[23] These tests evolved out of strict statutory interpretation theory,[24] then progressed to tort terminology,[25] and have settled somewhere in between.[26] This section discusses the history of the various tests,

---

17. "[T]he Securities Act nowhere delineates who may be regarded as a statutory seller, and the sparse legislative history sheds no light on the issue. The courts, on their part, have not defined the term uniformly." *Pinter*, 486 U.S. at 642; Note, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause-Substantial Factor Approach Limited by a Duty of Inquiry*, 36 VAND. L. REV. 361, 364 (1983) (stating that the 1933 Act nowhere defines who may be liable as a seller).

18. 113 F.2d 988 (1st Cir. 1940). *See infra* note 41 and accompanying text.

19. Abrams, *The Scope of Liability Under Section 12 of the Securities Act of 1933: "Participation" and the Pertinent Legislative Materials*, 15 FORDHAM URB. L.J. 877, 882-83 (1987).

20. *See infra* notes 40-70 and accompanying text.

21. *Craftmatic*, 890 F.2d at 635. Recall that *Pinter* defined "seller" as not only one who passes title to the purchaser, but also those who successfully solicit the purchase, motivated by their own or the securities owner's financial interests. *Id.* at 647. Therefore, in the Third Circuit, a person who does not qualify as a seller under the *Pinter* standard may not be held liable under section 12(2).

22. These tests are: (1) privity, (2) proximate cause, (3) substantial factor, (4) aiding and abetting, and (5) the new *Pinter* test. *See infra* notes 34-71 & 76-85 and accompanying text.

23. Comment, *Attorneys and Participant Liability Under § 12(2) of the Securities Act of 1933*, 1982 ARIZ. ST. L.J. 529. *See also* O'Hara, *Erosion of the Privity Requirement in Section 12(2) of the Securities Act of 1933: The Expanded Meaning of Seller*, 31 U.C.L.A. L. REV. 920, 922-23 (1984) (stating that § 12(2) was often thought of as a slowly developed remedy as compared to rule 10(b) and regulation 10b-5 of the Securities Exchange Act).

24. *See infra* notes 33-43 and accompanying text.

25. *See infra* notes 44-62 and accompanying text.

26. Abrams, *supra* note 19 (discussing participation liability under § 12); Schneider, *Section 12 of the Securities Act of 1933: The Privity Requirement in the Con-*

with emphasis on the Third Circuit's test. The section concludes with an analysis of the test developed by the Supreme Court, which has now been adopted by the Second,[27] Third,[28] Fifth,[29] Sixth,[30] and Ninth[31] Circuits.[32]

A. *Privity Test*

The privity requirement is derived from the language of section 12 of the Securities Act, which states in part, "Any person who . . . sells a security . . . shall be liable to the person purchasing such security from him."[33] The Supreme Court has stated that the standard of liability must come from the express language of the statute, especially when there is little or no legislative history to identify congressional intent.[34] Consequently, some courts have used a strict

---

temporary Securities Law Perspective, 51 TENN. L. REV. 235 (1984). *See also infra* notes 75-84 and accompanying text.

27. Wilson v. Saintine, 872 F.2d 1124 (2d Cir. 1989). *See also* Capri v. Murphy, 856 F.2d 473, 478-79 (2d Cir. 1988) (adopting *Pinter*'s analysis of § 12(1) for § 12(2)).

28. *Craftmatic*, 890 F.2d at 634. The district courts have also adopted *Pinter*. *See, e.g.*, Scotch v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 709 F. Supp. 95, 96 (M.D. Pa. 1988) (holding that privity is no longer required to be a seller under § 12(2)); Elysian Fed. Sav. Bank v. First Interregional Equity Corp., 713 F. Supp. 737, 750 (D.N.J. 1989) (holding that "seller" in § 12(2) should be interpreted to include those beyond the titleholder); VT Investors v. R.D. Funding Corp., 733 F. Supp. 823, 839-40 (D.N.J. 1990) (applying *Pinter*).

29. Crawford v. Glenns, Inc., 876 F.2d 507, 510-11 (5th Cir. 1989).

30. Craighead v. E.F. Hutton & Co., 899 F.2d 485, 493 (6th Cir. 1990) (supporting the *Pinter* test by holding that plaintiffs failed to establish that defendants were ever affiliated or associated with, or acted as agents of, the issuers of "high-risk stocks").

31. Moore v. Kayport Package Express, Inc., 885 F.2d 531, 537 (9th Cir. 1989).

32. *But see* Schlifke v. Seafirst Corp., 866 F.2d 935, 940 (7th Cir. 1989) (stating that *Pinter* undermines the continuing viability of the strict privity concept under § 12(2)); Mix v. E.F. Hutton & Co., 720 F. Supp. 8, 9 (D.D.C. 1989) (holding that § 12(2) is limited to initial distribution of securities and does not encompass postdistribution trading); Loan v. Federal Deposit Ins. Corp., 717 F. Supp. 964, 968 (D. Mass. 1989) (holding that, notwithstanding *Pinter*, in the absence of any allegation in the complaint connecting the defendants to the actual sale of the securities, the defendants are not sellers within § 12(2)). *Cf.* Ackerman v. Schwartz, 733 F. Supp. 1231, 1244 (N.D. Ind. 1989) (finding that the defendant class under §§ 12(1) and 12(2) should be interpreted in the same manner); Flournoy v. Peyson, 701 F. Supp. 1370, 1378 (N.D. Ill. 1988) (finding that §§ 12(1) and 12(2) should be interpreted identically, according to *Pinter*).

33. 15 U.S.C. § 77*l* (1988).

34. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200 (1976).

privity approach to assist in the difficulty of defining "seller."[35]

The Third Circuit required privity or a special relationship between the purchaser-plaintiff and seller-defendant.[36] In *Collins v. Signetics Corp.*,[37] the Third Circuit required that section 12 be interpreted strictly[38] based on a Supreme Court trend prescribing a literal

---

35. *See, e.g.*, *Collins*, 605 F.2d at 113 ("In interpreting liability provisions of the acts, we must respect recent Supreme Court teachings that militate against excessively expansive readings.").

36. *Id. See, e.g.*, Kramer v. Scientific Control Corp., 452 F. Supp. 812, 814-15 (E.D. Pa. 1978) (holding that because § 12(2) requires that the direct seller be liable and that a control relationship exists, plaintiffs who purchased stock from a brokerage firm that was not an underwriter were not entitled to recover); Dorfman v. First Boston Corp., 336 F. Supp. 1089, 1093 (E.D. Pa. 1972) (requiring that privity and a control relationship under § 15 must exist to bring a cause of action under § 12(2)).

Other district and circuit courts have also utilized the privity test. *See, e.g.*, Sanders v. John Nuveen & Co., 619 F.2d 1222, 1226 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005 (1981) (stating that § 12(2) "explicitly requires privity between plaintiff-purchaser and defendant-seller"); Beck v. Cantor, Fitzgerald & Co., 621 F. Supp. 1547, 1561 n.16 (D.C. Ill. 1985) (stating that "the Supreme Court repeatedly has read the securities laws less expansively"); Federman v. Empire Fire & Marine Ins. Co., [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,822, at 96,751 (S.D.N.Y. Oct. 17, 1974) (requiring privity for § 12(2) liability); Unicorn Field, Inc. v. Cannon Group, Inc., 60 F.R.D. 217, 221-22 (S.D.N.Y. 1973) (stating that § 12(2) requires privity between the buyer and seller); American Bank & Trust Co. v. Joste, 323 F. Supp. 843, 846 (W.D. La. 1970) (stating that a § 12(2) seller must be in privity with the buyer); Winter v. D.J. & M. Inv. & Constr. Corp., 185 F. Supp. 943, 946 (S.D. Cal. 1960) (holding that plaintiff must establish that the direct seller was liable under § 12 and that a control relationship existed between the direct seller and the defendant).

Cf. Wonneman v. Stratford Sec. Co., 23 F.R.D. 281 (S.D.N.Y. 1959) (using a different test and stating that liability for § 12(1) violations turned on "participation" in the sale of securities).

37. 605 F.2d 110 (3d Cir. 1979). This case, for practical purposes, has been overruled by *Pinter*. *Craftmatic*, 890 F.2d at 636. Prior to *Collins*, the Third Circuit determined seller liability by using a *Cady* approach, imposing liability on the titleholder's broker-agent. First Trust & Sav. Bank v. Fidelity-Philadelphia Trust Co., 214 F.2d 320, 324 (3d Cir. 1954). In 1979, however, the Third Circuit in *Collins* rejected the *Cady* approach because of the "recent Supreme Court teachings that militate against excessively expansive readings." *Collins*, 605 F.2d at 113. The Third Circuit determined that § 12(2) could only be read as requiring privity between the plaintiff and defendant because the statute states, "Any person who— . . . (2) offers or sells a security . . . shall be liable to the person purchasing from him." The phrase "purchasing from him" means only those in privity. *But see Pinter*, 486 U.S. at 647 (holding that a person who successfully solicits a purchase motivated by a financial interest can be a seller because it is fair to say that the buyer *purchased* the security from him).

38. *Collins*, 605 F.2d at 113. Plaintiffs purchased Signetics' (defendant's) stock pursuant to a public offering from underwriters for $17 per share. *Id.* They alleged,

approach to the securities acts.[39] The result was that courts allowed a claim only against the transferor of title.

Most other circuits, however, have found this interpretation of "seller" too restrictive and not in accordance with the remedial purposes of the securities acts.[40] In *Cady v. Murphy*,[41] the First Circuit

---

inter alia, that the registration and prospectus failed to disclose information concerning the divesture of Corning of its interests in Signetics, which was 92% of Signetics before the offering and 70% afterwards. *Id.* Eighteen months after the offering, Corning's interest was completely liquidated when Signetics merged into a subsidiary of United States Phillips Corporation, and Signetics shareholders were required to surrender their stock for $8 per share. *Id.* at 112-13. Signetics stock issue was subject to a "firm commitment" underwriting agreement that called for Signetics to sell the entire stock issue to the Lehman Brothers Company, the leading underwriter, and to several other underwriters who participated in the offering. *Id.* at 113. Cillag, plaintiff, purchased his 2,200 shares from members of the underwriting syndicate. *Id.* The court held that absent a relationship between the defendants and the underwriters, plaintiff's claim must fail. *Id.* The court found that no relationship existed between the defendants, Signetics, and Corning, and the underwriters who sold the securities to the plaintiffs. *Id.*

39. *Id.* at 113. "Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the securities acts must rest primarily on the language of that section." *Id.* (quoting *Ernst & Ernst*, 425 U.S. at 200). *See also* International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979) (determining that employees' noncontributory, compulsory pension plan is not a security within the meaning of the Securities Act); SEC v. Sloan, 436 U.S. 103 (1978) (limiting the Commission to suspending trading in a security for no more than one 10-day period on the basis of a single set of circumstances under § 12(k) of the Securities Exchange Act); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (requiring manipulation or deception under § 10(b), not just simple breach of duty to disclose); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 42 (1977) (rejecting implied cause of action for damages for a defeated tender offeror under § 14(e) of the Securities Exchange Act or regulation 10b-5); *Ernst & Ernst*, 425 U.S. at 210-14 (necessitating scienter under rule 10(b)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (confining liability under rule 10(b) to actual purchasers or sellers of securities).

But see SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963) (stating that securities provisions should be construed "flexibly" pursuant to their remedial purposes, not "technically and restrictively").

40. *See, e.g.*, Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 693 (5th Cir. 1971).

41. 113 F.2d 988 (1st Cir. 1940). In this case, the defendants, a brokerage firm, persuaded the plaintiff, a small securities broker-dealer, to purchase voting trust certificates representing 1,700 common shares of South American Utilities Corporation by a misrepresentation of material facts (the stock was without substantial value at any time). *Id.* at 989. During a conversation between the plaintiff and the defendant, the defendant stated that he would "act as an agent in the transaction." *Id.* at 990. When the plaintiff learned of the facts, he returned the securities to the defendants. The defendant refused them. *Id.* The plaintiff then sold the securities at a loss. *Id.* The court found that § 12(2) imposed "liability

expanded the statutory definition of "seller" to include a broker because of the frequency that a situation may arise in which the buyer and a broker, not the actual titleholder, are the parties to the actual transaction.[42] Since *Cady*, the requirement of privity has been eroded.[43]

B. Proximate Cause Test

After the expansion in *Cady*, courts developed tests based on tort principles. The first major court to develop a test based on tort concepts was the Fifth Circuit in *Lennerth v. Mendenhall*.[44] The court created a standard for defining "seller" by stating:

---

for misrepresentations not only upon principals, but also upon brokers when selling securities owned by other persons" because "if [the defendant], though not selling its own property, is a 'person who sells a security' then it follows that [the plaintiff] is 'the person purchasing such security from him' within the meaning of the corresponding phrase in § 12(2)." *Id.* The court went on to say that the liability is imposed whether the broker is acting as an agent for the seller or in a dual capacity for the buyer and seller. *Id.* at 991.

The district court in *Cady* stated that this was a case of first impression and that it could find nothing in the legislative history of § 12(2) that addressed this issue. Murphy v. Cady, 30 F. Supp. 466, 469 (D. Me. 1939). The court felt that consideration of the language in other sections of the Securities Act, coupled with the known purpose of Congress in passing the Securities Act, required allowing an action against the broker as agent of the seller-titleholder. *Id.* The district court concluded that "[t]he ordinary brokerage transaction, merely the execution of orders to buy or sell, does not appear to be affected by section 12. It is the extra-brokerage activity—solicitations accompanied by false statements—which are made the basis for a cause of action if damage is caused thereby." *Id.* at 469-70.

42. *See Cady*, 113 F.2d at 990. *See also* Buchholtz v. Renard, 188 F. Supp. 888 (S.D.N.Y. 1960) (holding that when a seller-principal sells through a broker who acts as his agent, both the seller and the agent can be held liable).

43. *See generally* O'Hara, *supra* note 23, at 986-95 (stating that courts have expanded the definition of "seller," which has eroded the privity requirement expressly required in the language of the statute). The Third Circuit's first interpretation of "seller" was made in *First Trust & Sav. Bank*, 214 F.2d at 324. This case adopted *Cady*'s rationale and held that a titleholder and his broker-agent are the only parties who may be held liable. *Id.* at 322.

44. 234 F. Supp. 59 (N.D. Ohio 1964). In this case, the defendant met the plaintiffs after arranging by telephone to meet. The defendant made the initial overtures which ultimately culminated in the investment by the plaintiffs: He outlined the details of the proposed venture, displayed pictorial resumes showing what the proposed center would look like, introduced the plaintiffs to the vice-president of the defendant corporation, and informed the plaintiffs that they were "suitable investors." *Id.* at 64. The court found that he was an agent and not a broker who would be liable under a *Cady* approach. *Id.* The court found that the "activity of the . . . agent is tantamount to that of a 'seller' within the liberal remedial spirit of the securities laws." *Id.* at 65.

> 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 that defendant, we must find him guilty.[45]

The Fifth Circuit, in *Hill York Corp. v. American International Franchises, Inc.*,[46] was the first court to follow the *Lennerth* approach. The court refined the test to a determination of whether the defendant is the proximate cause of the sale.[47] The court explained 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."[48] The proximate cause test has been utilized by the Fourth,[49] Fifth,[50] and Ninth[51] Circuits to hold liable persons other than the actual titleholder under section 12(2).

---

45. *Id.* at 65. The court recognized the privity test but stated that "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." *Id.*

46. 448 F.2d 680, 693 (5th Cir. 1971). In this case, defendants never met plaintiffs before purchasing the securities but instructed local corporate officers about solicitation techniques and provided sales literature that contained materially misleading information. The court held that defendants were sellers because they were the "motivating force" behind the underlying sales and because each had induced the sale. *Id.*

47. *Id. But see* Abrams, *supra* note 19, at 921-50 (theorizing that § 12(2) only imposes liability on the transferor of title despite the remedial purposes of the Securities Act and despite courts' interpretations based on statutory construction and legislative intent).

48. *Lennerth*, 234 F. Supp. at 65.

49. *See, e.g.*, Lawler v. Gilliam, 569 F.2d 1283, 1288 (4th Cir. 1978).

50. *See, e.g.*, Pharo v. Smith, 621 F.2d 656, 666 (5th Cir. 1980) (determining that a rational and workable standard for imposition of liability under § 12(2) lies between strict privity and participation, which is a line drawn in terms of cause and effect); Lewis v. Walston & Co., 487 F.2d 617, 622 (5th Cir. 1973) (holding brokers liable as sellers under § 12(1) because brokers have been held liable as sellers under § 12(2) under the proximate cause test of *Lennerth* and *Hill York*).

51. Jett v. Sunderman, 840 F.2d 1487, 1491 (9th Cir. 1988) (using substantial-

Courts that have applied this test examined the defendant's actions, not just the transferor's actions.[52] They determined whether the party was a necessary or an insignificant participator in the transaction.[53] The Fifth Circuit applied this test until 1973 when it again altered the test.[54]

C. *Substantial-Factor Test*

In 1973, the Fifth Circuit, in *Lewis v. Walston & Co.*,[55] switched from the proximate cause test to a substantial-factor test.[56] Again using tort terminology, the definition of "seller" was found to include "one whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place."[57] As a result of this case, courts that had previously used the proximate cause test replaced it with the substantial-factor test.[58]

---

factor test); SEC v. Seaboard Corp., 677 F.2d 1289, 1294 (9th Cir. 1980) (using proximate cause test). *But see Moore*, 885 F.2d at 536 (adopting *Pinter* test to define "seller").

52. *Lewis*, 487 F.2d at 622.

53. *Id.*

54. *See infra* notes 57-63 and accompanying text.

55. 487 F.2d 617 (5th Cir. 1973).

56. *Id.* at 622. The court stated that "[t]he jury could permissibly infer from these facts that [the defendant's] actions were a 'substantial factor' in bringing about the plaintiffs' purchases." *Id.*

57. *See, e.g.*, *Pharo*, 621 F.2d at 667 (applying the substantial-factor test, but stating that mere participation in events leading up to the transaction is not enough); *Lewis*, 487 F.2d at 622 (finding that a jury could permissibly infer that defendant's actions were a "substantial factor" in bringing about the plaintiff's purchase and were, therefore, the proximate cause).

58. *Lawler*, 569 F.2d at 1288. In this case, the Fourth Circuit adopted the Fifth Circuit's substantial-factor test. *Id.* Defendants solicited funds from investors by organizing three limited partnerships for Johnson, operator of the fraudulent scheme, who was offering notes with rates of return varying from 30% to 100%. The defendants purported to use the money to import industrial wines that sold at substantial profits. *Id.* This business was found to be a "hoax" as he used money from some investors to pay off others. *Id.* The defendants did not know that the scheme was a hoax. *Id.* at 1286-87. Nevertheless, the court found that the defendants were a substantial factor in causing the plaintiff to invest. *Id.* at 1288.

The Eighth Circuit has also adopted the substantial-factor test. Stokes v. Lokken, 644 F.2d 779, 785 (8th Cir. 1981). In this case, an auditor advised a coin owner that the coins were not securities and need not be registered. *Id.* at 782. The titleholder then published an advertising brochure which included the auditor's results. *Id.* The claim was brought under § 15 of the Securities Act which allows liability under § 12 imposed on those in violation of § 5. *Id.* The court adopted the Fifth Circuit's substantial-factor test, which was set forth in *Pharo*, to define

Under this test, any one who actively solicits the sale, arranges the sale, or participates in the negotiations of the sale may be liable.[59] This definition excludes persons who execute an unsolicited order or whose role in the transaction is so minor that they have no causal connection with it.[60]

Although courts that have applied this test recognize its inherent problems,[61] they are not reluctant to use the test to hold the "hunter who seduces the prey liable."[62]

D. *Aiding and Abetting Test*

In *Katz v. Amos Treat & Co.*,[63] the court held that a defendant could be secondarily liable after another has been found primarily

---

"seller." It held that the auditor was not within this definition but was "two steps removed from the sale." *Id.* at 785.

The Ninth Circuit used the substantial-factor test but added that the defendant's actions must not only be a substantial factor, but its actions must also be necessary to the transaction. *Jett*, 840 F.2d at 1491 (citing SEC v. Murphy, 626 F.2d 633, 649-50 (9th Cir. 1980)).

59. *Lewis*, 487 F.2d at 622.

60. Katz v. Amos Treat & Co., 411 F.2d 1046, 1053 (2d Cir. 1969).

61. Opponents of the substantial-factor test are of the opinion that it would extend § 12(1) liability to participants only remotely related to the relevant aspects of the sale transaction. Abrams, *supra* note 19, at 882-94; Schneider, *supra* note 26, at 239, 259-63. Under the test, securities professionals, such as accountants and lawyers, whose involvement is only the performance of their professional services may be included. *Pinter*, 486 U.S. at 654. Drawbacks of the test are that it provides no guidelines for distinguishing between the defendant whose conduct rises to a level of significance sufficient to trigger seller status, and the defendant whose conduct is not sufficiently integral to the sale. *Pharo*, 621 F.2d at 667.

62. *Pharo*, 621 F.2d at 666. Proponents of this test assert that the Fifth Circuit test is the most reasonable method of determining who may be liable as a seller because it recognizes the remedial purposes of the Securities Act. Note, *supra* note 17, at 395. Although the author of this note agrees that the Fifth Circuit test is the most reasonable method, one proponent suggests the addition of a duty of inquiry in order to narrow the scope of the test. *Id.* Under this suggested approach, a seller would only be liable if he has a duty to ensure that no material misstatements or omissions are made to the plaintiff. *Id.* Further,

> [t]he issue of who has a duty of inquiry is based on a person's relationship to the purchaser or that person's degree of association with the sales transaction. If that relationship or participation is sufficiently close, then that person has a duty to exercise reasonable care and a breach of that duty must be a substantial factor in causing the plaintiff to purchase the securities before liability will attach.

Id. at 396.

63. 411 F.2d 1046 (2d Cir. 1969). *See* Comment, *supra* note 23, at 539 (stating that courts are attempting to define participant liability under § 12 with more certainty by looking to definitions of participation found in other provisions of the securities laws).

provide for aiding and abetting liability, the courts have used an approach that has been utilized in violations of rules 10b and 10b-5 of the Securities Exchange Act.[66] This approach imposes civil liability under section 12(2) in two ways: (1) on persons who have been found criminally liable under other sections that hold an aider and abettor primarily liable; and (2) on the aider and abettor who is found secondarily liable under section 12 when the titleholder has been found primarily liable under section 12.[67]

Proponents of this test rely on the remedial purposes of the Securities Act to support extending section 12(2) liability to those who are aiders and abettors.[68] Those supporting the aiding and

---

Conspiracy in Pari Delicto, Indemnification, and Contribution, 120 U. PA. L. REV. 597 (1972).

65. Section 5 of the Securities Act imposes liability on one who makes use of the mails to deliver an unregistered security. 15 U.S.C. § 77e (1988). In *Katz*, the plaintiff claimed to have purchased shares from a brokerage firm on the basis of assurances given by several individual defendants, including an attorney. *Katz*, 411 F.2d at 1049-52. The assurances proved to be false. *Id.* The Second Circuit allowed a cause of action under § 12(1) against the issuer's brokerage firm, the president of the firm, an employee of a customer of the brokerage firm, and the special counsel for the issuer who also was the attorney for the brokerage firm for selling non-registered securities. *Id.* The court noted that the attorney never initiated conversation with the plaintiff regarding a sale of securities prior to a proposed public issue by the brokerage firm. *Id.* Nevertheless, the court held that he was a "party to a solicitation" because the attorney had reassured the plaintiff that the proposed issue was good and that he should pay the brokerage firm the balance of money for the stock before the public issue. *Id.* at 1053. The court could have held the attorney liable after finding the brokerage firm liable. Although the attorney was not a solicitor, as was the brokerage firm, he was a participant.

66. Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680-81 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970); Ruder, *supra* note 64; Comment, *supra* note 23, at 550-51. *But see* Royal Am. Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1017 (2d Cir. 1989) (allowing no separate aiding and abetting action under § 12 as secondary liability); *Schlifke*, 866 F.2d at 942 ("[W]e see no reason at this time to imply a right of action for aiding and abetting under section 12(2)."); Junker v. Crory, 650 F.2d 1349 (5th Cir. 1981) (concluding that the Fifth Circuit will not apply an aiding and abetting approach). *Cf. Collins*, 605 F.2d at 114 (failing to determine whether liability for aiding and abetting is available under § 12).

67. Ruder, *supra* note 64, at 628-38; Comment, *supra* note 23, at 551. "[M]ost formulations of aiding and abetting liability require a primary violation as a necessary element of the secondary offense. Unfortunately, some courts have failed to recognize this distinction and have synthesized the analysis into a single inquiry for a primary violation." Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440 (N.D. Ohio 1975).

68. Comment, *supra* note 23, at 562-63. "[T]hose who assist another to do a wrongful act should no more be permitted to escape the legal consequences than

who are aiders and abettors.[68] Those supporting the aiding and abetting approach require the satisfaction of three elements in order to impose seller liability: (1) existence of "an independent wrong or . . . violation," (2) "the alleged aider and abettor must be aware of that primary violation," and (3) "the defendant must have rendered 'substantial assistance' in effecting the primary violation."[69]

---

68. Comment, *supra* note 23, at 562-63. "[T]hose who assist another to do a wrongful act should no more be permitted to escape the legal consequences than the principal." *Id.* "[T]hose persons who are aware of and, to some lesser degree, participate in a violation of the securities laws and either enter into an agreement with or give assistance to the primary wrongdoers should not be permitted to escape the imposition of liability." *Id.* at 560 n.232. One court, deciding the issue whether persons who allegedly conspired with or aided or abetted other persons to violate § 12(2) are also subject to liability, determined that the extension of "seller" in the Fifth Circuit coupled with the remedial purposes of the Securities Act is "persuasive authority for the expansion of this concept of privity beyond the narrow bounds which a strict interpretation of the offeror-seller requirement might otherwise dictate." *In re* Caesars Palace Sec. Litig., 360 F. Supp. 366, 379 (S.D.N.Y. 1973). The court continued:

> [A]s a result of *Katz, Hill York,* and related decisions in this area, it would be nothing more than an exercise in semantic hair-splitting for this Court to attempt to delineate a legally cognizable distinction between those categories of persons who have previously been exposed to liability under § 12(2) and those persons charged with aiding and abetting and conspiring in violation of § 12(2). No one of these formulations is a 'magic word,' in effect each of them indicates participation to one degree or another.

Id. at 380.

Professor Loss commented on the general statutory scheme of the federal securities laws stating:

> [The Securities Act of 1933] deals only with disclosure and fraud *in the sale of securities.* It has but two important substantive provisions, §§ 5 and 17(a). Non-compliance with § 5 results in civil liability under § 12(1). Faulty compliance results in liability under § 11. And § 17(a) has its counterpart in § 12(2). It all makes a rather neat pattern. Within the area of §§ 5 and 17(a), §§ 11 and 12 . . . are all-embracing.

3 L. LOSS, SECURITIES REGULATIONS 1785 (1961 & Supp. 1969).

69. Comment, *supra* note 23, at 564. The third element of the aiding and abetting test is the same as the substantial-factor test. *Id.* The only difference between an aiding and abetting approach and a substantial-factor test is the requirement of the first two elements—the independent violation and knowledge of primary violation. *Id. See* Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793 (3d Cir. 1978), *cert. denied,* 439 U.S. 930 (1978); Spatz v. Borenstein, 513 F. Supp. 571, 583 (N.D. Ill. 1981) (finding that the defendant was liable for fraud under §§ 10(b), 12(2), and 17(a), but not aiding and abetting because the defendant was not the substantial factor in the sale).

The elements of tortious aiding and abetting, found in the Restatement (Second) of Torts § 876, are the source of the test used for the purposes of the Securities Act.

For harm resulting to a third person from the tortious conduct of another,

To find a defendant civilly liable, a court must find that a material misrepresentation or omission has made the prospectus or oral communication misleading and that the defendant knowingly or recklessly assisted in the misrepresentation or omission.[70]

*E. Comparison of the Pre-*Pinter *Tests*

Prior to the Supreme Court's decision in *Pinter*, courts used a variety of tests to determine who could be found liable under section 12 as a seller.[71] These tests produced various outcomes. For example, an attorney who highly recommended a certain security to his friend or client and encouraged the friend to purchase such security would not be found liable as a seller under the privity test because he is not the titleholder who transferred title.

The courts applying proximate cause and substantial-factor tests extended liability to those who proximately caused or were a substantial factor in causing the transaction.[72] This broad interpretation of section 12(2) would find those beyond the titleholder liable. Moreover, persons collateral to the transaction may be found liable.[73] This test requires a broad reading of the section and is based primarily on the remedial purposes of the Securities Act and the Securities Exchange Act. Using the same example as above, the attorney would most likely be held liable as a substantial factor in the transaction under either the proximate cause or substantial-factor tests.

---

one is subject to liability if he

a) does a tortious act in concert with the other or pursuant to a common design with him, or

b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or

c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

RESTATEMENT (SECOND) OF TORTS § 876 (1979).

70. deBruin v. Andromeda Broadcasting Sys., 465 F. Supp. 1276, 1280 (D. Nev. 1979). In this case, the court established that, in order for the defendant to be liable as an aider and abettor, the plaintiff had to prove that the defendant had knowledge of the fraudulent scheme or acted so recklessly that knowledge may be imputed to him. *Id.* at 1280. The court held that the defendant was not liable as an aider and abettor because there was no evidence that he knew of the fraudulent scheme. *Id.*

71. *See supra* notes 33-70 and accompanying text.

72. *See supra* notes 44-62 and accompanying text.

73. *Pinter*, 486 U.S. at 651.

Finally, the aiding and abetting approach imposes secondary liability on those who render substantial assistance to the primary violator of section 12 and who have knowledge of this primary violation.[74] This approach would also find those collateral to the transaction liable and would require a broad reading of the section. An attorney who knew or should have known that the titleholder or his broker violated section 10(b) or another security law is likely to be found liable under section 12 using this approach.

F. The Pinter *Test*

Realizing that the circuits were divided on the definition of "seller," the Supreme Court granted *certiorari* to *Dahl v. Pinter*,[75] a Fifth Circuit case.[76] In that case, the Supreme Court adopted a test that is less restrictive than the privity approach but more refined than the substantial-factor or proximate cause approaches. The test requires that the defendant either seek or receive a financial benefit for himself or the securities owner. It also requires that the defendant "successfully solicit" the purchase.[77] In *Pinter*, the Supreme Court found that "[b]eing merely a 'substantial factor' in causing the sale of unregistered securities is not sufficient in itself to render a defendant liable under § 12(1), thereby rejecting the Fifth Circuit's substantial[-]factor test."[78] The Court held that a seller is a person who

---

74. *See supra* notes 62-70 and accompanying text.

75. 787 F.2d 985 (5th Cir. 1986), *cert. granted*, 481 U.S. 1012 (1987).

76. *Id.* The Fifth Circuit, utilizing its own precedent, stated that "a seller is (1) one who parts with title to securities in exchange for consideration or (2) one whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place." *Id.* at 990. The court, despite the fact that it found the defendant's actions to be a substantial factor in causing the transaction to occur, declined to hold the seller liable under § 12(1). *Id.* The Fifth Circuit refined its substantial-factor test to include the requirement that one who acts as a "promoter" be "motivated by a desire to confer a direct or indirect benefit on someone other than the person he has advised to purchase." *Id.* at 991. The court stated that imposing liability on friends and family members without fault or knowledge for giving one another gratuitous advice on investment matters "unreasonably interferes with well-established patterns of social discourse." *Id.* Because Dahl received no financial benefit, he was not liable under § 12(1). *Id.*

77. *Pinter*, 486 U.S. at 647.

78. *Id.* at 654. The Supreme Court stated that the Fifth Circuit was premature in finding that Dahl was motivated entirely by a gratuitous desire to share an attractive investment opportunity with his friends and associates. *Id.* at 654. The case was, therefore, remanded for further proceedings consistent with the opinion. *Id.*

solicits the buyer's purchase in order to serve the financial interests of someone other than the buyer.[79]

The *Pinter* test is consistent with the statutory language of section 12 and furthers the remedial purpose of the Securities Act because the test is based upon the plain language of the section and does not restrict the definition of "seller" to only a titleholder.

The Court stated that the substantial-factor test was not based on statutory language nor did it effectuate congressional intent.[80] The Fifth Circuit's test would extend liability to those participants only "remotely related to the relevant aspects of the sales transaction" and that "[t]he buyer does not, in any meaningful sense, 'purchas[e] the security from' such a person."[81] Thus, the Court found that Congress could never intend section 12 to be so broad.

The Supreme Court based its decision on the plain language of section 12. Section 2(3), a definition section in the Securities Act,

---

79. *Id.* at 654-55. After *Pinter* was decided, the Fifth Circuit set forth a two-prong test to determine whether the defendant was a seller. A court must ascertain: (1) who passed title or solicited the transaction, and (2) from whom the plaintiff bought the security. Abell v. Potomac Ins. Co., 858 F.2d 1104, 1114 (5th Cir. 1988), *judgment vacated on other grounds*, 492 U.S. 914 (1989). The *Abell* court suggested that the first question can be answered "according to the standards of legal parsing and linguistic analysis," but that the second question must be answered according to "common usage" of the terms. *Id.* In this case, all of the plaintiffs bought bonds from brokers or previous owners. None of the investors purchased the bonds from the bond issue or from the bond counsel. Therefore, they were not sellers. *Id.* at 1114. *See also Crawford*, 876 F.2d at 510 (utilizing *Abell*'s two questions to determine seller liability).

80. *Pinter*, 486 U.S. at 651. The courts that have adopted the substantial-factor test "substitute the concept of substantial participation in the sale transaction, or proximate causation of the plaintiff's purchase, for the words 'offers or sells' in § 12." *Id.* The "purchase from" requirement of § 12 focuses on the defendant's relationship with the plaintiff-purchaser. The substantial-factor test, however, concentrates on the defendant's degree of involvement in the securities transaction and the circumstances surrounding the transaction. *Id.* This is consistent with those who are proponents of a literal reading of the section and would require strict privity. Abrams, *supra* note 19, at 925-37.

81. *Pinter*, 486 U.S. at 651 (citation omitted). The Court went on to state that "the substantial[-]factor test introduces an element of uncertainty into an area that demands certainty and predictability" because of the statutory "strict liability nature of the cause of action." *Id.* at 652. In addressing the argument that the term "seller" should include the defendant because of the remedial nature of the securities laws, the Court stated that it "has never conducted its analysis entirely apart from the statutory language." *Id.* at 653. The Court then stressed the importance of giving effect to Congress' intent in enacting the securities laws. *Id.* (quoting Touche Ross & Co. v. Redington, 442 U.S. 560, 578 (1979) ("The ultimate question is one of congressional intent, not one of whether this Court thinks it can improve upon the statutory scheme that Congress enacted into law.")).

sets "sell" and "offer" apart. "Sale" or "sell" is defined to "include every contract of sale or disposition of a security or interest in a security, for value."[82] "Offer" includes "[1] every attempt [to buy] or [2] offer to dispose of, or [3] solicitation of an offer to buy, a security or interest in a security for value."[83] The Court employed these definitions to find that "offer" included one who solicits an offer and "seller" includes one who "successfully solicits" the purchase motivated by a financial interest other than the buyer's.[84] Therefore, the *Pinter* test recognized the remedial purposes of the statute without deviating from its plain meaning by holding the person who is most likely to injure the buyer through solicitation liable. The test does so without finding parties that are collateral to the transaction liable by limiting "seller" to one who is motivated by their own or the securities owner's interest.

III. ANALYSIS

The following is a summary of the Third Circuit's opinion in *Craftmatic*.

A. *Procedural History*

Craftmatic Securities Litigation v. Kraftsow[85] was an appeal from a dismissal of a consolidated class action complaint brought under the Securities Act and the Securities Exchange Act.[86] The complaint was dismissed by the district court for failure to state a claim and for failure to comply with the requirement of pleading fraud with particularity.[87] The district court also dismissed a claim of common law fraud and deceit for lack of subject matter jurisdiction.[88] The court of appeals affirmed many of the district court's holdings but decided to reexamine the section 12(2) claims in order to evaluate the impact of *Pinter* on this area of law.[89]

---

82. 15 U.S.C. § 77b(3) (1982).
83. *Id.*
84. *Pinter*, 486 U.S. at 647.
85. 890 F.2d 628 (3d Cir. 1989).
86. *Id.* at 630.
87. *Id.* The court dismissed the claims under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure.
88. *In re* Craftmatic Sec. Litig., 703 F. Supp. 1175, 1184 (E.D. Pa. 1989), *aff'd in part and rev'd in part*, Craftmatic Sec. Litig. v. Kraftsow, 890 F.2d 628 (3d Cir. 1989).
89. *See Craftmatic*, 890 F.2d at 634.

B. Facts

Defendant Craftmatic/Contours Industries, Inc. (Craftmatic) was engaged in the business of marketing and selling furniture products, including the Craftmatic Adjustable Bed and the Contour Chair Lounge.[90] Stanley Kraftsow was the president, chairman of the board of directors, and chief operating officer of Craftmatic. His wife, Carolyn Kraftsow, was the secretary and a director.[91] In 1987, Craftmatic sustained a loss of more than $3 million (due to a decrease of 14.7% in wholesale sales and advertising commissions) and heavy losses in the two new product lines.[92]

On March 15, 1975, an initial public offering of 1,650,000 shares[93] of Craftmatic Common Stock was made at $8.50 per share. The issuance consisted of 1,000,000 shares issued and sold by Craftmatic, and an additional 650,000 shares sold by Stanley Kraftsow.[94] Advest, a securities brokerage and investment firm, served as Craftmatic's investment banker, adviser, and principal underwriter for the offering.[95] Plaintiffs alleged that Craftmatic received in excess of $7.5 million from the stock sale and that Stanley Kraftsow received in excess of $5 million.[96]

The prospectus for the offering provided financial data and the following representations:

> 1) [T]he company had embarked on an expansion program that could include acquisitions in the water purification and window shutter markets;
> 2) Craftmatic had signed a consent order with the Federal Trade Commission, as well as assurances of voluntary compliance with the State of Florida and the Commonwealth of Pennsylvania; and

---

90. *Id.* at 630. The company used a network of independent distributors and direct sale operations to sell its product. *Id.*

91. *Id.*

92. *Id.* Craftmatic expanded from total assets of $4 million in 1984 to $19 million in 1986, which was allegedly attributable to Craftmatic's September 1983 acquisition of Contour Chair Lounge, Inc. and to an expanded marketing effort. *Id.*

93. This represented nearly 40% of the company's outstanding shares. *Craftmatic*, 890 F.2d at 630.

94. *Id.*

95. *Id.*

96. *Id.*

> 3) Craftmatic believed it was "presently in compliance with consumer protection requirements."[97]

Plaintiff's primary complaint was that the

> serious operational problems known to defendants[98] caused their statements concerning Craftmatic's marketing, expansion, and upgrading programs to be false and misleading [and that] the unexpected revelation of these adverse facts concerning Craftmatic's business, expansion, and profitability caused the price of its stock to plummet from the Initial Public Offering price of $8.50 per share to as low as $1 per share.[99]

The complaint alleged four causes of action for recovery of damages: (1) violation of section 11(a) of the Securities Act, 15 U.S.C. § 77k(a) (1988); (2) violation of section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1988), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b.5 (1988); (3) violation of section 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2) (1988); and (4) common law fraud and deceit.[100]

---

97. *Id.* at 630-31 (citing Complaint ¶ 21). The prospectus contained the following additional representations:

> The Consent Order and Assurances of Voluntary Compliance required the Company to make changes in its procedures and practices, including . . . (1) greater specification of and better compliance with warranty provisions; (b) the establishment of a standard to determine if a price is a reduced price or a special price; (c) instructing sales representatives to correctly state their positions with the Company; and (d) monitoring of the cancellation provisions of sales contracts and the practices for processing cancellations.

Id. at 631 n.2. Craftmatic claimed in the prospectus that these requirements did not have "a material adverse effect on its business." *Id.*

98. *Id.* The defendants were Craftmatic, Stanley Kraftsow, Carolyn Kraftsow, and Advest. *Id.* at 631.

99. The plaintiff class was comprised of all persons who purchased Craftmatic Common Stock during the period from March 5, 1986, through June 11, 1987.

100. *Craftmatic*, 890 F.2d at 631-32. Additionally, plaintiffs alleged "controlling person" liability under § 15 of the Securities Act against Stanley and Carolyn Kraftsow with regard to counts 1 and 3, and under § 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t (1988), with regard to count 2. *Id.* at 632. Counts 1 and 3 were also asserted against Advest. *Id.* Craftmatic moved to dismiss counts 1-3 for failure to state a claim, count 4 for lack of subject matter jurisdiction, and all fraud claims for failure to plead with particularity. *Id.* at 633. In the alternative, Craftmatic moved to strike the complaint as legally insufficient. *Id.* Advest filed its own motion to dismiss for failure to state a claim and, in the alternative, for a more definite statement of count 3. *Id.*

The district court dismissed the complaint for failure to state a claim and failure to plead fraud with particularity.[101] On appeal, the plaintiffs claimed, *inter alia*,[102] that the district court erred in dismissing the claim that the defendants violated section 12(2) of the Securities Act.[103]

C. *The Decision*

The Honorable Judge Scirica, writing for the Third Circuit, reversed the district court's dismissal of the plaintiffs' claims that the defendants were section 12(2) sellers and, therefore, violated the Securities Act.[104] The court held that *Pinter v. Dahl* replaced the privity requirement of *Collins*,[105] even though *Pinter* addressed section 12(1), not section 12(2). The Third Circuit, citing *Pinter*, stated "that although 'the language of section 12(1) contemplates a buyer-seller relationship not unlike traditional contract privity,' its scope is not limited to those who pass title."[106] Judge Scirica continued in agreement with *Pinter* by stating that, "because 'solicitation is the stage at which an investor is most likely to be injured,' the term 'seller' [should] include one 'who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.'"[107]

The Third Circuit then rejected the defendants' argument that the holding in *Pinter* is limited to section 12(1) and should not be extended to apply to section 12(2).[108] The court cited two reasons for this outcome: (1) the two statutes use identical language, which

---

101. The district court specifically dismissed the following: count 1 for all defendants, for failure to state a claim; count 2 for Craftmatic, in part, for failure to state a claim; count 3 for all defendants, in part, for failure to state a claim; and counts 2-3, with leave to amend for failure to comply with the particularity requirement. Because the remaining counts were so few, the district court dismissed the rest of these claims. *Id.* at 633-34.

102. Plaintiffs also claimed that the district court erred in ruling that certain subparagraphs alleged only a failure to disclose mismanagement, that certain allegedly undisclosed information amounted to no more than predictions of future business developments, and that these omissions could not constitute a violation of federal securities laws. *Id.* at 634.

103. *Id.*

104. *Id.* at 637.

105. *Id.* at 636.

106. *Id.* at 635 (quoting *Pinter*, 486 U.S. at 642).

107. *Id.* (citation omitted).

108. *Id.*

the Supreme Court recognized in a footnote;[109] and (2) the Securities Act's overall objective of disclosure seeks to hold persons who are in a position to injure the buyer by misleading disclosures liable.[110] The court, therefore, found that plaintiffs' claim that the defendants were sellers for purposes of section 12(2) could survive a motion to dismiss.[111]

In his analysis, Judge Scirica discussed other circuits' definitions of a section 12 seller. In accord with *Pinter*, the Third Circuit rejected the proximate cause and substantial-factor tests.[112] It cited *Pinter* for the proposition that the term "solicitation" does not encompass all activities related to the purchase transaction.[113]

Second, the court rejected the aiding and abetting approach under section 12(2) by holding that persons who fail to qualify as sellers under the *Pinter* test may not be held liable under section 12(2).[114] The court cited the following three reasons for this conclusion: (1) section 12(2) expressly limits liability to those who sell or offer to sell;[115] (2) it would be anomalous to recognize aider and abetter liability in light of *Pinter*'s clear direction that section 12 liability does not extend to collateral participants;[116] and (3) section 12(2) provides for civil liability and a rescission remedy and, therefore, is not analogous to criminal or tort law, the areas of law in

---

109. *Id.* at 635 (citing *Pinter*, 486 U.S. at 642 n.20).

110. *See id.* at 635 n.8 (stating that the purpose of the Securities Act is "to promote full and fair disclosure of information to the public in the sales of securities").

111. *Id.* at 637.

112. Other circuits have also adopted the *Pinter* definition of "seller" for the purposes of § 12, including § 12(1) and § 12(2). *See, e.g.*, *Moore*, 885 F.2d at 536 (rejecting the substantial-factor test and adopting the *Pinter* test for § 12(2) liability); *Crawford*, 876 F.2d at 510 (reformulating a test for § 12(2) status in light of *Pinter*); *Wilson*, 872 F.2d at 1126 (considering implications of *Pinter* under § 12(2)); *Schlifke*, 866 F.2d at 940 (stating that *Pinter* undermines strict privity concept under § 12(2)); *Abell*, 858 F.2d at 1115, *vacated on other grounds*, 492 U.S. 914 (1989) (stating that *Pinter* interpreted § 12(1) based on plain language and would presumably do the same with § 12(2)); *Capri*, 856 F.2d at 478 (concluding that § 12(2) claim should be considered in light of *Pinter*).

113. *See Craftmatic*, 890 F.2d at 636 (citing *Pinter*, 486 U.S. at 638 n.26) (noting that the Court applied the collateral participation concept of § 11(a), "which enumerates categories of persons in the registration process who may be held liable under that section, including those who participate in activities leading up to the sale"). *Id.* at 636 n.10. Because no such provisions exist in § 12, "Congress did not intend such persons to be defendants in § 12 actions." *Id.* (quoting *Pinter*, 486 U.S. at 651 n.26).

114. *Id.* at 637.

115. *Id.* at 636.

116. *Id.* at 637.

which aider and abettor liability has been traditionally recognized.[117]

Finally, the court set up the following limitations to seller liability: "The purchaser must demonstrate direct and active participation in the solicitation of the immediate sale to hold the issuer liable as a § 12(2) seller."[118] The court noted, however, that "mere performance of professional services without active solicitation of the purchase does not give rise to § 12(2) liability."[119]

Applying the *Pinter* test, the court found that "seller" is no longer restricted to the titleholder.[120] Despite the fact that none of the defendants in this case were the titleholder, the court found that it could not be said that the defendants did not successfully solicit the purchase, motivated by a financial interest other than that of the plaintiffs. The court based this conclusion on the fact that each of the defendants participated, acquiesced, cooperated, encouraged, and assisted in the preparation of the prospectus issued in connection with the public offering, news releases, the company's annual and quarterly reports, and the registration statement.[121] Therefore, the defendants' motion to dismiss for failure to state a claim was denied.

IV. EVALUATION

The Third Circuit's extension of the *Pinter* definition of "seller" to section 12(2) is appropriate in light of the statutory language and the remedial purpose of the Securities Act. Three basic reasons support the decision of the Third Circuit. First, considering the statutory language of the section in connection with the remedial purposes of the Securities Act, "seller" should include those beyond the titleholder, but should exclude those who had no financial interests in the outcome.[122] Second, because the Supreme Court was better

---

117. *See id.* (citing *Wilson*, 872 F.2d at 1127).

118. *Id.* at 636 (citing *Moore*, 885 F.2d at 536-37).

119. *Id.* (citing *Moore*, 885 F.2d at 536-37).

120. *Id.* The district court found that only the immediate seller of securities, and not the company and its officers, could be held liable to the purchaser of securities. Therefore, defendants Stanley and Carolyn Kraftsow, Advest, and Craftmatic, Inc. were not the titleholders and were not sellers of the security. *In re Craftmatic*, 703 F. Supp. at 1185.

121. Plaintiffs' Complaint ¶ 49; *In re Craftmatic*, 703 F. Supp. at 1177 n.3.

122. Congress did not intend for liability to extend to defendants encompassed by the Fifth Circuit's proximate cause, substantial-factor test. Abrams, *supra* note 19, at 880.

Prior to the enactment of the Securities Act, the ABA and the National Conference of Commissioners on Uniform State Laws and Proceedings approved

positioned to consider the other circuits' tests and could act as an objective intercessor in formulating a rational test, its test, which is the basis of the *Craftmatic* test, strikes a balance amongst the circuits. Third, the definition of "seller" in sections 12(1) and 12(2) should be interpreted identically because the pertinent language of both sections is identical.

A. Statutory Language and Congressional Purpose

Craftmatic's decision is consistent with the statutory language and congressional purpose of section 12(2) in its adoption of *Pinter*'s definition of "seller." In its abandonment of the privity requirement, the Third Circuit recognized the remedial purpose of the Securities Act. Based on the language of section 12, the court concluded that section 12(2) should hold those who are most likely to injure a buyer liable but should limit liability to those who are motivated solely by their own or the securities owner's interest.[123]

1. Statutory Language

The *Pinter* test explicitly based its interpretation of section 12(2) upon the plain language of the Securities Act.[124] When defining a statutory term or interpreting a particular section of a statute, courts

---

the 1929 Uniform Act, which expressly imposed liability on the seller and on persons who "personally participated with the seller in making a sale." *See id.* at 902 n.140. Another section of the Act, § 15, authorized state securities agencies 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 . . . ." *Id.* at 880. Congress utilized this act in developing the Securities Act. *Id.* at 879.

The President at the time of enactment also favored "investor friendly" legislation. On March 29, 1933, in a message recommending enactment of the Securities Act, President Roosevelt stated the following:

> 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. (1933).

123. *Pinter*, 486 U.S. at 647.

124. *Id.* at 644-47. *See also Moore*, 885 F.2d at 535 (basing its extension of § 12(1)'s definition of "seller" to § 12(2) on the fact that *Pinter*'s analysis was based on the language of the statute); *Abell*, 858 F.2d at 1115 (following *Pinter*'s interpretation of "seller" in § 12(1) for § 12(2) and rejecting the substantial-factor test because § 12 should be interpreted based upon its plain language).

must first look to the language of the statute.[125] The Act does not specifically define the term "seller" for the purposes of section 12. In addition, there is no legislative history for the section that would provide insight into what Congress intended "seller" to encompass.[126] Therefore, the term "seller" should be given its common definition.[127]

Instead, courts have traditionally defined "seller" in section 12 by utilizing the definitions in section 2(3).[128] 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."[129] The term "offer" includes "[1] every attempt [to dispose]; [2] offer to dispose of; or [3] solicitation of an offer to buy, a security or interest in a security

---

125. *Ernst & Ernst*, 425 U.S. at 200.

126. *Pinter*, 486 U.S. at 642. "[T]he Securities Act nowhere delineates who may be regarded as a statutory seller, and the sparse legislative history sheds no light on the issue." *Id.*

127. McBoyle v. United States, 278 U.S. 41, 48 (1928). "A natural reading of the statutory language would include in the statutory seller status at least some persons who urged the buyer to purchase." *Pinter*, 486 U.S. at 642, 644.

128. *See, e.g.*, *Naftalin*, 441 U.S. at 773. Section 2(3) is a definition section of words or phrases used in the Securities Act. 15 U.S.C. § 77b (1988). The section defines the word "sell" but not "seller." *Id.* § 77b(3). As the *Pinter* Court stated:

> [T]he Securities Act defines the operative terms of § 12(1). 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," and the terms "offer to sell," "offer for sale," or "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." Under these definitions, the range of persons potentially liable under § 12(1) is not limited to persons who pass title. The inclusion of the phrase "solicitation of an offer to buy" within the definition of "offer" brings an individual who engages in solicitation, an activity not inherently confined to the actual owner, within the scope of § 12.

Pinter, 486 U.S. at 643 (citations omitted).

The *Pinter* Court's analysis relied heavily on the language of § 12(1) and the definition in § 2(3). *Moore*, 885 F.2d at 535. Section 12(1) makes a person liable for the offer or sale of an illegally unregistered security, and § 2(3) defines "offer" to include a "solicitation of an offer to buy." *Id.* at 536.

Other courts have similarly relied on the language of the Act. In *Moore*, the court stated:

> [P]ertinent language which is present in and applicable to § 12(2)—"offers or sells" and "purchasing such security from him"—appears by identical language which is present in and applicable to § 12(1). Moreover, the § 2(3) definition of "offers" . . . appears as part of parallel introduction language common to both §§ 12(1) and 12(2). . . . It seems plain from the statute the word "offers" means the same thing in both sections.

Id. (citations omitted).

129. 15 U.S.C. § 77b(3) (1988).

for value."[130] "Offer," therefore, includes engaging in the solicitation of the purchaser.[131] In sections 2(3) and 12, Congress sets "sell" and "offer" apart. Setting these two terms apart means that a seller need not "sell," but can be one who "offers." Thus, "seller" is not limited to a titleholder because persons other than the titleholder can solicit a sale. This conclusion, reached by the *Pinter* Court and adopted in *Craftmatic*, is derived from the language of section 12. Under this statutory interpretation, a defendant is not a seller unless he "would commonly be said, and would be thought by the buyer, to be among those 'from' whom the buyer 'purchased'."[132]

"Had Congress intended liability to be restricted to those who pass title, it could have effectuated its intent by not adding the phrase 'offers or' when it split the definition of 'sell' in § 2(3)."[133] The language of section 12 indicates that a person who performs the activities of a transferor qualifies as a seller,[134] even though he is not the titleholder. The solicitation must be successful because the language in section 12 states that a person is liable "to the person *purchasing* such security from [the buyer]."[135] Therefore, *Pinter*'s requirement that the defendant successfully solicit the purchaser is formulated from the express language of the Securities Act.

The requirement that the person be motivated by a financial interest other than that of the purchaser also comes from the language of the section. Section 12 states that one who "offers . . . a security . . . shall be liable to the person purchasing such security from him," and one who "sells . . . a security . . . shall be liable to the person purchasing such security from him."[136] "Sell" to the purchaser

---

130. *Id.*

131. *Pinter*, 486 U.S. at 643. *See* Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 209 (1934) (stating that the risk of liability is "heightened if he makes a 'solicitation of an offer to buy,' for that falls within the definition of 'sell.'").

132. *Pinter*, 486 U.S. at 645.

133. *Id.* at 650-51. Congress has done so in other sections of the Securities Act. *See, e.g.*, § 5 of the Securities Act, 15 U.S.C. § 77b(11) (1988) (including in the definition of an underwriter those who are direct and indirect participants); § 11 of the Securities Act, 15 U.S.C. § 77k (1988) (expressly stating that certain persons who are collateral to the registration process may be held liable). The Supreme Court concluded that, because there are no similar provisions in § 12, Congress did not intend persons collateral to the transaction to be possible defendants in § 12 actions. *Pinter*, 486 U.S. at 638 n.26.

134. Abrams, *supra* note 19, at 923.

135. 15 U.S.C. § 77*l* (1988) (emphasis added).

136. 15 U.S.C. § 77*l* (1988).

includes only the transfer of title. "Offer" to the purchaser includes those who successfully solicit the purchase, motivated by a financial interest other than that of the buyer.[137] Because of the requirement of buying for value, the seller must receive some value to be liable. Only when a person is motivated by receiving value, a financial interest, will he be held liable as a seller. Thus, section 12 covers both those who offer and those who sell; that is, those who transfer title and those who successfully solicit[138] the purchase, motivated by a financial interest other than that of the buyer.

2. Congressional Intent

Craftmatic's interpretation of section 12(2) is consistent with the goal of full and fair disclosure of information to the public in the sale of securities without finding persons who are collateral to the transaction liable.[139] Because "the solicitation of a buyer is perhaps the most critical stage of the selling transaction," it is the stage at which an investor is "most likely to be injured . . . by being persuaded to purchase securities without full and fair information."[140] Congress intended section 12(2) to prevent such injury but only to the extent that the solicitors intended to benefit someone other than the buyer of the security.[141]

The purpose of the Act was set forth in a Senate Report:

> The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of

---

137. *Pinter*, 486 U.S. at 647.

138. Successfully soliciting requires either a purchase to occur or some other requesting of value. *Pinter*, 486 U.S. at 643-44. If there is no purchase, there is no harm. Section 12 of the Securities Act states that only a purchaser may sue. 15 U.S.C. § 77*l* (1988).

139. *Pinter*, 486 U.S. at 646-47.

140. *Id.*

141. "Given Congress' overriding goal of preventing this injury, we may infer that Congress intended solicitation to fall under the mantle of § 12(1). . . . [But] Congress did not intend to impose rescission based on strict liability on a person who urges the purchase but whose motivation is solely to benefit the buyer." *Pinter*, 486 U.S. at 647.

> the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consumer power.[142]

When courts interpret section 12, this remedial purpose should be considered. The Supreme Court took the purpose of the Act into consideration without going beyond the boundaries marked by Congress when it stated:

> The language and purpose of § 12(1) suggest that liability extends only to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner. If he had such a motivation, it is fair to say that the buyer "purchased" the security from him and to align him with the owner in a rescission action.[143]

If a person is motivated by his own interests and successfully solicits a purchase resulting in harm to the buyer, that person is a seller and should, therefore, be held liable under section 12 because he is the source of the purchaser's harm. A financially motivated person who urges another to purchase a security should be liable for injury caused as a result of his actions. Otherwise, the Securities Act would be meaningless in enforcing its policy of full and fair disclosure of information to the public in the sales of securities.[144]

The Third Circuit adopted this definition after consideration of the Security Act's purpose.[145] This was a sound decision because,

---

142. S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933).

143. *Pinter*, 486 U.S. at 647-48.

The Fifth Circuit has interpreted the *Pinter* test as establishing a two-part inquiry to determine who is a seller. First, the court asks who passed the title to the plaintiff or solicited the transaction in which title passed. Second, the court determines from whom the plaintiff bought the security. *Abell*, 858 F.2d at 1114. This court went on to say, "We may answer the first question according to the standards of legal parsing and linguistic analysis, but to answer the second question, we must refer to common usage." *Id.*

144. *Pinter*, 486 U.S. at 647.

145. *Craftmatic*, 890 F.2d at 635. Prior to *Craftmatic*, the Third Circuit required strict privity. The *Collins* court stated that it had "no difficulty in concluding 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 from him.'" *Collins*, 605 F.2d at 113.

as demonstrated, the Securities Act and the Securities Exchange Act could not intend to preclude recovery under section 12(2) from those who carried out the activities of a transferor, motivated by a financial interest.[146]

B. Pinter *Strikes a Balance*

Although the case was appealed from a Fifth Circuit decision, the Supreme Court analyzed tests utilized by other circuits, including the Third Circuit, to develop the *Pinter* test for seller liability. By examining the ramifications caused by the other circuits' tests, such as finding those collateral to the transaction liable or not finding liable those who actually should be because no privity existed, the Supreme Court was able to formulate a test that satisfied Congress' intent.

The *Pinter* test focuses on the relationship between the buyer and the defendant,[147] as opposed to focusing solely on the activities

---

146. Congress did not contemplate imposing § 12(1) liability under the broad terms of the Fifth Circuit's substantial-factor test. *Pinter*, 486 U.S. at 650. The Court stated:

> There is no support in the statutory language or legislative history for expansion of § 12(1) primary liability beyond persons who pass title and persons who "offer," including those who "solicit" offers. Indeed, § 12's failure to impose express liability for mere participation in unlawful sales transactions suggests that Congress did not intend that the section impose liability on participants collateral to the offer or sale.

Id. In *Collins*, plaintiffs bought Signetics stock from the underwriters, who bought the shares directly from Signetics under a firm commitment underwriting agreement. This agreement intended that the underwriters would buy the stock from the corporation without recourse if they could sell the entire block. *Collins*, 605 F.2d at 113. A strict privity approach would only allow a cause of action against the corporation. Under *Craftmatic*, Signetics would be liable because it was gaining a financial benefit from the purchase.

One commentator has suggested that liability can only extend to the titleholder because of the relief that Congress included in § 12(2). Abrams, *supra* note 19, at 924. The relief granted to a purchaser under that section is rescission, which is restricted to the contracting parties. *Id. But see* Gordon v. Burr, 506 F.2d 1080, 1085 (2d Cir. 1974) (determining that when rescission is based on fraud and not on contract theory, equity requires that privity is not essential because the wrongdoer must restore the injured party to the status quo, regardless of whether the wrongdoer and the injured are in privity). *See also* Randall v. Loftsgaarden, 478 U.S. 647 (1986) (determining that the Securities Act is intended to protect buyers from being exploited and may infer that Congress chose a rescissory remedy when it enacted § 12(2) in order to deter prospectus fraud and encourage full disclosure, as well as to make investors whole).

147. "The 'purchase from' requirement of § 12 focuses on the defendant's relationship with the plaintiff-purchaser." *Pinter*, 486 U.S. at 651.

of the defendant.[148] Therefore, if the relationship is such that the person soliciting the buyer was motivated by a financial interest other than that of the buyer, then this solicitor is a seller even though no privity exists.

Unlike the substantial-factor test, the requirement of a financial motivation will protect those persons who are merely collateral to the transaction. Additionally, the financial motivation requirement will establish that the person actively and directly participated in the solicitation.[149] Alternatively, the substantial-factor test

> divorces the analysis of seller status from any reference to the applicable statutory language and from any examination of § 12 in the context of the total statutory scheme [and] might expose securities professionals, such as accountants and lawyers, whose involvement is only the performance of their professional services, to § 12(1) strict liability for rescission. The buyer does not, in any meaningful sense, "purchas[e] the security from" such a person.[150]

Therefore, the *Pinter* test is more adequate because a person cannot be found liable based solely on his involvement in preparing the prospectus. There must be an understanding that the buyer "purchased" the security from the person. This is present when that person is motivated by a financial interest other than that of the buyer.[151]

Thus, the *Pinter* and *Craftmatic* tests are a compromise between the privity test, which is too limited, and the substantial-factor or proximate cause tests, which are overinclusive in their definition of "seller."

C. *Section 12(1) and 12(2) Definitions Should be Identical*

The term "seller" should be defined identically in both sections because both use identical language when stating who is liable. This conclusion is supported by the fact that the sections share the same

---

148. The substantial-factor test focuses on the "defendant's degree of involvement in the securities transaction and its surrounding circumstances." *Id.*

149. *Craftmatic*, 890 F.2d at 636 (citing *Moore*, 885 F.2d at 536-37).

150. *Pinter*, 486 U.S. at 651 (footnote omitted). Mere performance of professional services without active solicitation of the purchase does not give rise to § 12(2) liability. *Wilson*, 872 F.2d at 1126-27.

151. *Pinter*, 486 U.S. at 647.

purpose.[152] Both sections 12(1) and 12(2) state, "[A]ny person who—(1) offers or sells a security . . . or (2) offers or sells a security . . .—shall be liable to the person purchasing such security from him."[153] Moreover, it has been held that the definitions of section 2(3) apply equally to sections 12(1) and 12(2).[154]

"*Pinter* provides the standard for determining liability as a 'seller' under section 12(2) as well as under section 12(1)."[155] Other circuits have held that sections 12(1) and 12(2) should define "seller" in the same manner because of the shared language and purpose of both sections.[156] Section 12(1) protects investors from purchasing unregistered securities. Section 12(2) protects investors from purchasing securities by relying on a misleading communication. Both of these sections are designed to promote "full and fair disclosure of information to the public in the sales of securities."[157] Thus, for section 12(2), courts should award at least the same, if not greater, protection as in section 12(1).[158]

V. CONCLUSION

The Third Circuit properly adopted the *Pinter* test for seller liability for purposes of section 12(2). *Pinter*'s definition is based in the plain language of the statute and considers the remedial purpose of the Securities Act and the Securities Exchange Act, without finding those collateral to the transaction liable. A person who successfully

---

152. "The shared purpose of [§§ 12(1) and 12(2)] strengthens our conclusion that *Pinter*'s reasoning applies equally to both sections." *Moore*, 885 F.2d at 536.

153. 15 U.S.C. § 77*l* (1988).

154. *Pinter*, 486 U.S. at 651.

155. *Moore*, 885 F.2d at 536.

156. *See, e.g.*, Schillner v. H. Vaughan Clarks & Co., 134 F.2d 875 (2d Cir. 1943). Those other circuits have ruled so in the following decisions: *Moore*, 885 F.2d at 536; *Wilson*, 872 F.2d at 1126; *Abell*, 858 F.2d at 1115; *Capri*, 856 F.2d at 478.

157. *Pinter*, 486 U.S. at 646.

158. In fact, courts have suggested that § 12(2) should be given a broader interpretation than § 12(1). Schneider, *supra* note 26, at 261 n.144 (citing *Pharo*, 621 F.2d at 666 n.7). Section 12(1) is a strict liability statute and § 12(2) is not because § 12(2) relieves the seller of the burden of showing that it did not and could not have known of the misleading statement, and § 12(1) would hold someone liable regardless of his knowledge that the unregistered securities may have been sold. *Pharo*, 621 F.2d at 665-67 nn. 6-8. *See also Schillner*, 134 F.2d at 878 (stating that "[c]learly the word [sell] has the same meaning in subdivision (2) as in subdivision (1) of section 12); Schneider, *supra* note 26, at 261 (stating that "it should be more difficult to justify a judicial enlargement of the statutory language under § 12(1) because a seller under § 12(1) has no defense to liability").

solicits the purchase, motivated by his own or the securities owner's interests, is in a position to harm the buyer by giving misleading information in a prospectus or an oral communication and should, therefore, be found liable under section 12(2).

There will be a larger class of defendants who may be liable under section 12(2) in the Third Circuit by including some who solicit the purchase. Liability will exist, however, only for those who successfully solicit the purchase, motivated by a financial interest other than the buyer's because this person can be fairly considered the one from whom the buyer purchased the security. Thus, the *Pinter* seller includes those who are in a position to injure the purchaser through a misleading communication.

In the final analysis, the adoption of the *Pinter* test, and the rejection of a strict privity test, will enable the Third Circuit to adequately carry out the Securities Act's objective of full and fair disclosure and will justifiably hold those who cause harm to investors liable.

Barbara Snapp Danberg