Practical Guidance

Section 12(a)(2) Elements and Defenses under the Securities Act

A Practical Guidance® Practice Note by
Peter B. Morrison and Virginia F. Milstead, Skadden, Arps, Slate, Meagher & Flom LLP

Peter B. Morrison
Skadden, Arps, Slate, Meagher & Flom LLP

Virginia F. Milstead
Skadden, Arps, Slate, Meagher & Flom LLP

This practice note discusses Section 12(a)(2) (15 U.S.C. § 77l) claims under the Securities Act of 1933, as amended (Securities Act), for false or misleading statements in a prospectus or oral communication. Section 12(a)(2) creates potential liability for a person who offers or sells securities by means of a prospectus or oral communication that includes a materially false statement 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. Section 12(a)(2) provides a primary remedy of rescission to the direct purchasers of such securities who have been damaged by the statement. This note reviews the elements of a Section 12(a)(2) claim and defenses you may use if your clients encounter such claims.

For additional information and practical guidance on Section 12(a)(2) and other liability provisions and potential defenses under the Securities Act and the Securities Exchange Act of 1934, as amended (Exchange Act), see Securities Act and Exchange Act Liability Provisions, Section 11 Elements and Defenses under the Securities Act, Control Person Liability, Reliance in Securities Fraud Actions, Materiality in Securities Fraud Actions, Scienter Defenses in Securities Fraud Actions, Special Litigation Committees, Securities Litigation under the Private Securities Litigation Reform Act (PSLRA), U.S. Supreme Court Securities Litigation Decisions, Defense Strategies under the Securities Act, Jurisdictional Defenses under the Exchange Act, Jurisdictional Defenses under the Securities Act, Liability under the Federal Securities Laws for Securities Offerings, U.S. Securities Laws, and Liability for Securities Offerings Checklist.

Elements of a Section 12(a)(2) Claim

Section 12(a)(2) of the Securities Act creates a private cause of action against a person who offers or sells a security by means of a prospectus or oral communication that includes a false or misleading statement. The elements of a Section 12(a)(2) claim are:

- An offer or sale of a security
- By the use of a means or instrumentality of interstate commerce
- By means of a prospectus or oral communication
- That includes an untrue statement of material fact or omits to state a material fact that is necessary to make the statements, in light of the circumstances under which they were made, not misleading

See Miller v. Thane Int'l, Inc., 519 F.3d 879, 885 (9th Cir. 2008).

Under Section 12(a)(2), plaintiffs do not bear the burden of showing intent, reliance, or causation. Plaintiffs need not plead or prove scienter (i.e., that defendant intentionally,

recklessly, or negligently made the alleged misrepresentation or omission). Plaintiffs also need not prove that they relied on the challenged statement when purchasing the securities. Unlike claims under Section 10(b) (15 U.S.C. § 78j) of the Exchange Act, plaintiffs further need not prove that their loss was caused by the false or misleading statement. Instead, defendants carry the burden of establishing, as an affirmative defense, the absence of loss causation (i.e., that all or part of the decline in the price of the security was caused by factors other than the alleged misrepresentation or omission). See {Loss Causation in Securities Fraud Actions} and Securities Act and Exchange Act Liability Provisions.

Offer or Sale of a Security: The Statutory Seller Requirement

Section 12(a)(2) claims may be asserted only against a defendant who "offers or sells a security." Thus, an investor may only obtain recovery from the defendants who sold securities to, or successfully solicited purchases from, that investor. See Endo v. Albertine, 147 F.R.D. 164, 172 (N.D. Ill. 1993). Courts generally dismiss Section 12(a)(2) claims where the plaintiff fails to identify a direct link between the defendant's conduct and the plaintiff's purchase. See, e.g., In re UBS Ag Sec. Litig., No. 07 Civ. 11225(RJS), 2012 U.S. Dist. LEXIS 141449, at *86 (S.D.N.Y. Sept. 28, 2012). Therefore, when defending Section 12(a)(2) claims, you should carefully scrutinize the plaintiffs' allegations, if any, about how the plaintiffs came to own the securities at issue, including whether the plaintiffs had any communications or interactions with your client. You may be able to bring a motion to dismiss arguing that the plaintiffs failed to allege a link between themselves and your client. Even if the court concludes that the plaintiffs sufficiently alleged at the pleading stage that a defendant sold securities to, or solicited purchases from, the plaintiffs, counsel should develop a record in discovery about communications or interactions between the plaintiffs and your client. If discovery reveals that your client did not sell to, or sufficiently solicit a purchase from, the plaintiffs, you should consider a motion for summary judgment on this basis. See also "Seller Who Passes Title," "Seller Who Solicits," and "Whether an Issuer Is a Statutory Seller in a Firm Commitment Underwriting under Rule 159A" below.

The Supreme Court has provided two primary ways to establish that someone is a statutory seller under Section 12:

- By directly passing title –or–
- By actively soliciting the sale

See Pinter v. Dahl, 486 U.S. 622, 642–43 (1988).

Seller Who Passes Title

Section 12(a)(2) imposes liability on the "owner who passed title, or other interest in the security, to the buyer for value" (i.e., the direct seller). Pinter, 486 U.S. at 642. Liability extends only to "the buyer's immediate seller; remote purchasers are precluded from bringing actions against remote sellers. Thus a buyer cannot recover against his seller's seller." Pinter, 486 U.S. at 643 n.21.

In a typical initial public offering (IPO) accomplished through a firm commitment underwriting, the underwriter purchases the shares from the issuing company and then sells those shares to the market. In that case, the underwriter is potentially liable to the persons who purchased securities from it, as the direct seller of the security. See Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., 104 F. Supp. 3d 441, 555 (S.D.N.Y. 2015). However, if you represent the issuer in a firm commitment underwriting, you may consider bringing a motion to dismiss or a motion for summary judgment arguing that the issuer did not directly pass title to market purchasers—it is instead the seller's seller—and therefore cannot be liable unless the plaintiffs prove the issuer actively solicited their purchases. See, e.g., Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1215 (1st Cir. 1996) (affirming dismissal); Lone Star Ladies Inv. Club v. Schlotzsky's Inc., 238 F.3d 363, 369–70 (5th Cir. 2001) (remanding for district court to consider motion to dismiss or motion for summary judgment). The same argument may apply to the issuer's officers and directors, who may have not passed title in the securities at all. See Shaw, 82 F.3d at 1215–16 (affirming dismissal of officers and directors); but see "Seller Who Solicits" and "Whether an Issuer Is a Statutory Seller in a Firm Commitment Underwriting under Rule 159A" below.

Seller Who Solicits

Liability may also extend to a person who actively participated in the solicitation of the sale. Mere participation in a solicitation or sale does not create liability because the language of the statute "focuses on the defendants' relationship with the plaintiff-purchaser." Pinter, 486 U.S. at 650–51. Accordingly, soliciting does not include "urg[ing] another to make a securities purchase . . . merely to assist the buyer" or "the giving of gratuitous advice, even strongly or enthusiastically." Pinter, 486 U.S. at 647. Rather, the language and purpose of Section 12 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." Pinter, 486 U.S. at 647.

Courts have concluded that the defendant must have some direct role in the solicitation of the plaintiff buyer. See, e.g.,

Sparling v. Daou (In re Daou Sys.), 411 F.3d 1006, 1029 (9th Cir. 2005). However, such courts have been less clear in defining what exactly constitutes such a direct role.

Some courts have found sufficient allegations that defendants signed or assisted in the preparation of the registration statement and participated in marketing events. See Mallen v. Alphatec Holdings, Inc., 861 F. Supp. 2d 1111, 1132 (S.D. Cal. 2012); In re Vivendi Universal, S.A. Sec. Litig., 381 F. Supp. 2d 158, 187 (S.D.N.Y. 2003) (finding adequate allegations that CEO was statutory seller where he "regularly appeared before investors and financial news agencies to tout the financial vitality of Vivendi and thereby encourage investors to purchase Vivendi's securities"). Other courts have held such activity insufficient because it constitutes mere participation. Instead, there must be a "direct communication [between defendant and] Plaintiffs." See, e.g., Me. State Ret. Sys. v. Countrywide Fin. Corp., 2011 U.S. Dist Lexis 125203, at *37–39 (C.D. Cal. May 5, 2011); Rosenzweig v. Azurix Corp., 332 F.3d 854, 871 (5th Cir. 2003) ("To count as 'solicitation,' the seller must, at a minimum, directly communicate with the buyer."). Courts have noted the importance of an allegation that the defendants had a financial motivation behind any of their actions. See Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 383 (N.D. Cal. 2020).

Particularly when defending issuers or their officers and directors, you may be able to bring a motion to dismiss based on the plaintiffs' failure to allege sufficient facts showing your client solicited the plaintiffs' purchase of securities. Complaints asserting Section 12(a)(2) claims are often conclusory or boilerplate in this regard, or they group all defendants together, failing to distinguish among the roles or actions of each defendant. Carefully scrutinize what the complaint says your client did with respect to the offering at issue, if anything, and consider whether or not it amounts to allegations of actual solicitation under the law.

Whether an Issuer Is a Statutory Seller in a Firm Commitment Underwriting under Rule 159A

In a firm commitment underwriting, the underwriters commit to purchasing all securities directly from the issuer for sale to the public. As discussed earlier, under *Pinter*, the issuer would not be the direct seller for purposes of Section 12(a)(2) liability because the issuer passes title to the underwriter who then passes title to the investing public. See Lone Star Ladies Inv. Club, 238 F.3d at 370. ("In sum, in a firm commitment underwriting, such as this one, the public cannot ordinarily hold the issuers liable under section 12, because the public does not purchase from the issuers," but rather from the underwriters and buyers "cannot recover against [the] seller's seller").

In 2005, the Securities and Exchange Commission (SEC) promulgated Rule 159A, which provides that an issuer of securities is considered a statutory seller for purposes of Section 12(a)(2) regardless of the form of underwriting. See 17 C.F.R. § 230.159A(a). Under Rule 159A, an issuer qualifies as a statutory seller because, according to the SEC, by "offering or selling its securities in a registered offering pursuant to a registration statement containing a prospectus that it has prepared and filed," the issuer "can be viewed as soliciting purchases of the issuer's registered securities." Securities Offering Reform, Securities Act Release Nos. 33–8591; 34–52056, 2005 SEC LEXIS 1789, at *308–09 (July 19, 2005).

Several courts have found SEC Rule 159A dispositive in holding that an issuer in a firm commitment underwriting is a statutory seller under Section 12(a)(2). See, e.g., Dimensional Emerging Markets Value Fund v. Petroleo Brasileiro S.A. (In re: Petrobras Sec. Litig.), 152 F. Supp. 3d 186, 195 (S.D.N.Y. 2016); Mallen, 861 F. Supp. 2d at 1132.

However, a majority of courts have declined to apply Rule 159A when determining whether an issuer is a statutory seller. See, e.g., Me. State Ret. Sys., 2011 U.S. Dist Lexis 125203, at *37–39 (rejecting reliance on Rule 159A and dismissing the Section 12(a)(2) claim against the issuer defendants); Baker v. Seaworld Entm't, Inc., 2016 U.S. Dist Lexis 72409, at *54–55 (S.D. Cal. Mar. 31, 2016) (same). Those courts have held that Rule 159A is contrary to the *Pinter* holding that mere participation in a public offering is insufficient to satisfy the statutory seller requirement of Section 12(a)(a) and that SEC Rules "cannot countermand a contrary Supreme Court holding." Mass. Mut. Life Ins. Co. v. Residential Funding Co., LLC, 843 F. Supp. 2d 191, 207 (D. Mass. 2012). Such courts hold that notwithstanding Rule 159A, in order to hold an issuer liable as a statutory seller in a firm commitment underwriting, the plaintiff must follow the principles of *Pinter* and sufficiently allege direct solicitation. See Me. State Ret. Sys., 2011 U.S. Dist Lexis 125203, at *37–39; Fannie Mae v. Countrywide Fin. Corp. (In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.), 932 F. Supp. 2d 1095, 1118 (C.D. Cal. 2013) (holding "*Pinter* was unambiguous, and there were no statutory gaps for the SEC to fill," thus "[t]he SEC's rule exceeded the statutory language of Section 12(a)(2) and cannot apply").

When representing an issuer, consider whether your case is pending before a district court that has taken a position on Rule 159A and if such position may affect any argument concerning whether the issuer is a statutory seller. See also "Seller Who Passes Title" below.

Use of Communication in Interstate Commerce or Mails

A plaintiff in a Section 12(a)(2) action must prove that the offer or sale of securities was made "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails." 15 U.S.C. §77l(a)(2); Creswell-Keith, Inc. v. Willingham, 264 F.2d 76, 80 (8th Cir. 1959).

Courts have considered whether an "integral part of the sale" is transported by interstate commerce or mail. See Blackwell v. Bentsen, 203 F.2d 690, 693 (5th Cir. 1953). Each of the following have been found to satisfy this requirement:

- Mailing securities or mailing a letter confirming a prior sale (Franklin Sav. Bank v. Levy, 551 F.2d 521, 524 (2d Cir. 1977); Colon v. Diaz-Gonzalez, 2009 U.S. Dist. LEXIS 12780, at *31 (D.P.R. Feb. 19, 2009))
- Intrastate phone calls (Ingraffia v. Belle Meade Hosp., Inc., 319 F. Supp. 537, 539 (E.D. La. 1970))
- Use of the internet or email to distribute a prospectus (Rensel v. Centra Tech, Inc., 2018 U.S. Dist. LEXIS 106642, at *15–16 (S.D. Fla. June 25, 2018); Wu v. Tang, 2011 U.S. Dist. LEXIS 4489, at *11–12 (N.D. Tex. Jan. 14, 2011))

In many cases, the plaintiffs' ability to satisfy the interstate commerce or mails requirement is not at issue. However, you should consider whether your case presents any facts—such as, for example, a transaction that takes place entirely in person—that would allow you potentially to challenge the plaintiffs' ability to meet this requirement. See also Jurisdictional Defenses under the Securities Act.

Prospectus or Oral Communication Requirement

Only offers or sales of securities made "by means of a prospectus or oral communication" are actionable under Section 12(a)(2). In Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 584 (1995), the Supreme Court held that "the word 'prospectus' is a term of art referring to a document that describes a public offering of securities by an issuer or controlling shareholder." The Court further held that the only oral communications actionable under Section 12(a)(2) are those that relate to a prospectus. See Gustafson, 513 U.S. at 567–68.

This understanding of the relevant terms—prospectus and oral communication—has two important consequences. First, because the term prospectus as used in Section 12(a)(2) refers only to documents that describe public offerings, private sales (by definition) are not made "by means of a prospectus or oral communication" related to a prospectus; thus, Section 12(a)(2) does not reach private offers or sales of securities. See, e.g., Yung v. Lee, 432 F.3d 142, 148–49 (2d Cir. 2005) (collecting cases).

Second, by limiting the term prospectus to documents describing public offerings, the Securities Act narrows the class of investors who may bring suit under Section 12(a)(2). When the Securities Act was passed, "the term 'prospectus' was well understood to refer to a document soliciting the public to acquire securities from the issuer." Gustafson, 513 U.S. at 575. Because aftermarket securities transactions (such as purchases on a national stock exchange) do not directly result from a solicitation of the public by an issuer making a public offering, such transactions are not made by means of a prospectus. Accordingly, aftermarket purchasers lack standing to bring Section 12(a)(2) claims. See, e.g., Ballay v. Legg Mason Wood Walker, Inc. 925 F.2d 682, 689 (3d Cir. 1991); First Union Discount Brokerage Servs. v. Milos, 997 F.2d 835, 843–44 (11th Cir. 1993).

See also Securities Act and Exchange Act Liability Provisions.

If you are defending a claim arising from an offering of a security that later traded on the secondary market, compare the dates of the offering to the dates that plaintiffs allege to have purchased the securities at issue. If the plaintiffs purchased the securities after the offering was completed, this likely indicates that they purchased the securities in the aftermarket, making the claims subject to dismissal.

Materially False or Misleading Statement of Fact or Omission

To prevail on a Section 12(a)(2) claim, a plaintiff must demonstrate that, in either a prospectus or an oral communication, the defendant made "an untrue statement of a material fact or omit[ted] 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."

Materiality

There can be no liability under Section 12(a)(2) unless the statement made or fact omitted is material. See, e.g., Miller v. Thane Int'l, Inc., 519 F.3d 879, 888 (9th Cir. 2008). Courts apply the same materiality standard to those actions brought under Section 12(a)(2) as those brought under other provisions of the securities laws. See e.g., Austin v. Loftsgaarden, 675 F.2d 168, 179 (8th Cir. 1982); City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 182–83, 188 (2d Cir. 2014). A fact is material if there is a substantial likelihood that the fact "'would

have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'" Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011).

Generally, no bright-line rule governs materiality. Matrixx Initiatives, Inc., 563 U.S. at 30. It is well established, however, that so-called corporate puffery is immaterial as a matter of law. See, e.g., City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 183 (2d Cir. 2014) ("It is well-established that general statements about reputation, integrity, and compliance with ethical norms are inactionable 'puffery,' meaning that they are 'too general to cause a reasonable investor to rely upon them.'"). Arguments that the challenged statements are corporate puffery are suitable for a motion to dismiss. See also Materiality in Securities Fraud Actions. For more information on materiality in various other contexts, see Materiality: Relevant Laws, Guidance, and Determination Guidelines, Disclosure of Material Nonpublic Information, and Materiality Determination for Disclosure Checklist.

Types of Actionable Misstatements

There are generally three categories of false or misleading statements or omissions:

- Affirmatively false statements
- Misleading omissions
- Omissions of information that SEC regulations require to be disclosed

See Lindsay v. Morgan Stanley (In re Morgan Stanley Info. Fund Sec. Litig.), 592 F.3d 347, 360 (2d Cir. 2010).

Affirmatively False Statements

Affirmatively false statements are representations that are incorrect. See Glassman v. Computervision Corp., 90 F.3d 617, 624 (1st Cir. 1996) (characterizing claim as one of affirmative misrepresentation when defendant allegedly stated the offering price was set after the underwriters exercise due diligence, but the due diligence was then incomplete). For example, financial statements not prepared in accordance with generally accepted accounting principles may misrepresent the company's financial position and therefore be misleading. See 17 C.F.R. § 210.4-01 ("Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided."). See also Section 11 Elements and Defenses under the Securities Act.

If you are defending a Section 12(a)(2) claim in which the plaintiffs allege affirmative misrepresentations, consider whether the plaintiffs have sufficiently alleged contemporaneous circumstances showing that the statement was false at the time it was made. A statement that is true at the time it is made, but that later becomes false after circumstances have changed, is not actionable under Section 12(a)(2). Also consider whether the plaintiffs have sufficiently alleged facts that contradict the challenged statement, as opposed to the mere conclusion that the statement was false. If the plaintiffs allege only conclusions or circumstances consistent with the company's disclosures, you may be able to bring a motion to dismiss on that basis.

Misleading Omissions

Misleading omissions are statements that may be literally true but omit information necessary to make the statement not misleading. Importantly, there is no "affirmative duty to disclose any and all material information." Matrixx, 563 U.S. 27 at 44. Therefore, "[n]ot all relevant or material omitted facts are actionable omissions." Boston Ret. Sys. v. Uber Techs., Inc., No. 19-CV-06361-RS, 2020 U.S. Dist. LEXIS 141724, at *11 (N.D. Cal. Aug. 7, 2020). Rather, to be actionable, "an omission must be misleading; in other words, it must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." Brody v. Transitional Hosps. Corp., 280 F.3d 997, 1006 (9th Cir. 2002). If you are defending a Section 12(a)(2) claim in which the plaintiffs allege omissions, you should carefully review the company's prospectus and other public filings. Oftentimes information that a plaintiff alleges was omitted was in fact disclosed in various ways, and courts may take judicial notice of these disclosures when ruling on a motion to dismiss.

Omission of SEC-Required Disclosure

SEC Regulation S-K describes certain information that an issuer must include in a registration statement and, by extension, a prospectus. See 15 U.S.C. § 77j(a)(1); 17 C.F.R. § 229.10(a)(1). Therefore, Regulation S-K may create an affirmative duty of disclosure for the issuer in a prospectus. If the issuer fails to disclose the required information, the seller may be subject to claims under Section 12(a)(2) for a materially misleading omission.

If you are defending a Section 12(a)(2) claim that alleges a violation of Regulation S-K, consider whether the plaintiffs have alleged all the circumstances that would have made disclosure mandatory under the regulation. Also, carefully review the company's prospectus to determine whether, notwithstanding the plaintiffs' allegations, the company in

fact adequately disclosed the allegedly required information. See Section 11 Elements and Defenses under the Securities Act.

Relief Available under Section 12(a)(2)

Plaintiffs who successfully prove their Section 12(a)(2) claims by establishing the elements discussed above can either rescind the transaction or, if they no longer own the security, recover rescissory damages. See 15 U.S.C. §77l(a)(2).

Rescission and Tender Requirement

Section 12(a)(2) "prescribes the remedy of rescission except where the plaintiff no longer owns the security." Randall v. Loftsgaarden, 478 U.S. 647, 655 (1986). A plaintiff seeking rescission as a remedy must tender the security back to the seller. 15 U.S.C. § 77l(a)(2).

The text of Section 12(a)(2) does not specify the time, place, or manner of the tender requirement. See Deckert v. Independence Shares Corp., 311 U.S. 282, 288 (1940); Wigand v. Flo-Tek, Inc., 609 F.2d 1028, 1034 (2d Cir. 1979). This has led courts to develop various approaches to the tender requirement. See, e.g., Chapman v. Dunn, 414 F.2d 153, 160 (6th Cir. 1969) (making tender offer in complaint satisfies requirement); Wigand, 609 F.2d at 1035 (finding implied tender); Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., 104 F. Supp. 3d 441, 583–84 (S.D.N.Y. 2015) (describing constructive tender doctrine); Metz v. United Counties. Bancorp, 61 F. Supp. 2d 364, 379 (D.N.J. 1999) (rejecting constructive tender, holding that "to make an offer to tender in a complaint which will satisfy Section 12, the plaintiff must make an explicit demand for rescission, an offer to tender, in the complaint"); Stadia Oil & Uranium Co. v. Wheelis, 251 F.2d 269, 274 (10th Cir. 1957) (language conditioning tender upon payment in full of any judgment acceptable).

After tendering the security, the plaintiff can recover "the consideration paid for such security with interest thereon, less the amount of any income received thereon." 15 U.S.C. § 77l(a)(2); Randall v. Loftsgaarden, 478 U.S. 647, 655 (1986). Rescission may not be available when the remedy would result in a loss for plaintiff. See Merzin v. Provident Fin. Group., Inc., 311 F. Supp. 2d 674, 684 (S.D. Ohio 2004) (dismissing Section 12(a)(2) claim when plaintiffs' purchase price was $25 per share, and the stock was now trading in excess of $30 per share).

Rescissory Damages

If the plaintiffs no longer own the security, then they can seek rescissory damages. 15 U.S.C. § 77l(a)(2); Junker v. Crory, 650 F.2d 1349, 1362 (5th Cir. 1981).

Generally, when rescissory damages are available, a plaintiff is entitled to the purchase price, plus interest, less the sale price and any income received from the security. See Randall, 478 U.S. at 656–57; Junker, 650 F.2d at 1352, 1362 (remanding for reduction in damages because the trial court "failed to consider the value of the stock received by the minority shareholder in the merger").

Plaintiffs are not entitled to damages if they profited from the sale of the security (i.e., the sale price exceeded their purchase price). See In re Broderbund/Learning Co. Sec. Litig., 294 F.3d 1201, 1205 (9th Cir. 2002) (affirming dismissal of plaintiff's claim because plaintiff did not suffer a net loss; he disposed of stock at a price higher than his purchase price).

Defenses to Liability

There are a number of affirmative defenses often used with respect to Section 12(a)(2) claims. These defenses are:

- Statutory safe harbor or bespeaks caution defense
- Plaintiffs' knowledge of the allegedly false or misleading statement
- Defendants' use of reasonable care
- Plaintiffs' alleged losses caused by factors other than the allegedly false or misleading statements
- Statute of limitations or repose

Safe Harbor and Bespeaks Caution Defense

The Private Securities Litigation Reform Act of 1995 (PSLRA), 104 P.L. 67, provides a safe harbor for certain written or oral forward-looking statements made by companies subject to SEC reporting requirements. In the context of the Securities Act, the PSLRA is codified in Section 27A of the Securities Act (15 U.S.C. § 77z-2). The safe harbor shields a seller from civil liability for predictive statements about future events that do not come to fruition, when those statements are accompanied by meaningful cautionary language "identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 77z-2(c)(1)(A)(i); see Rombach v. Chang, 355 F.3d 164, 173 (2d Cir. 2004); Asher v. Baxter Int'l Inc., 377 F.3d 727, 729 (7th Cir. 2004). The safe harbor may be used as

a defense in claims brought under Section 12(a)(2), with certain exceptions (e.g., the safe harbor does not apply to statements made in a financial statement prepared in accordance with generally accepted accounting principles or statements made in connection with an IPO). See 15 U.S.C. § 77z-2(b)(2)(A), (D). For more information on the PSLRA, see Securities Litigation under the Private Securities Litigation Reform Act (PSLRA), Safe Harbors for Forward-Looking Statements, and Forward-Looking Statements Safe Harbor Checklist.

When the statutory safe harbor does not apply, the judicially created bespeaks caution defense—a defense that also protects against liability for forward-looking statements accompanied by cautionary language—may still apply. See In re Alliance Pharm. Corp. Sec. Litig., 279 F. Supp. 2d 171, 192–93 (S.D.N.Y. 2003); Miller v. Pezzani (In re Worlds of Wonder Sec. Litig.), 35 F.3d 1407, 1413–14 (9th Cir. 1994); In re Nokia Corp. Sec. Litig., 1998 U.S. Dist. LEXIS 4100 (S.D.N.Y. Mar. 31, 1998). Given the substantive overlap between the two defenses, defendants and courts often raise and apply them both.

If you are defending a Section 12(a)(2) claim, consider whether the challenged statements use words such as will, anticipate, expect, or otherwise point to future developments instead of describing present circumstances. The use of such language may indicate that the safe harbor or bespeaks caution doctrine applies. Both the safe harbor and the bespeaks caution doctrine are available as defenses in the context of a motion to dismiss. See 15 U.S.C. § 77z-2(e); I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 763 (2d Cir. 1991); Saltzberg v. TM Sterling/Austin Assocs., Ltd., 45 F.3d 399, 400 (11th Cir. 1995). See also Securities Litigation under the Private Securities Litigation Reform Act (PSLRA).

Purchaser's Knowledge of Untruth or Omission

Under Section 12(a)(2), a purchaser with knowledge of the alleged untruth or omission at the time of the purchase or acquisition of the securities cannot recover. 15 U.S.C. § 77l(a)(2). Plaintiffs therefore must affirmatively plead—as an element of a Section 12(a)(2) claim—that they were not aware of the untruth or omission at the time of purchase. Courts are not uniform in deciding how plaintiffs satisfy this requirement. Some courts require that a plaintiff allege excusable ignorance while others merely require actual ignorance. Compare Gilbert v. Nixon, 429 F.2d 348, 356 (10th Cir. 1970), with Parkhurst v. North Am. Fin. Servs. Cos., 919 F. Supp. 270, 275 (E.D. Mich. 1996); Miller v. Thane Int'l, Inc., 519 F.3d 879, 887 (9th Cir. 2008).

Defendants may also assert the defense of actual knowledge by making a factual showing that plaintiff was actually aware of the untruth or omission at issue. Circumstantial evidence may be enough to make out a successful actual knowledge defense. See Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., 873 F.3d 85, 122 (2d Cir. 2017).

Reasonable Care

Section 12(a)(2) defendants may also assert a reasonable care defense. Under the statute, a seller is not liable for untrue statements of fact if he or she "sustain[s] the burden of proof that he [or she] did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." 15 U.S.C. § 77l(a)(2). Because the Securities Act does not define reasonable care, courts apply the common law meaning. See Demarco v. Edens, 390 F.2d 836, 842 (2d Cir. 1968). Under the common law, reasonable care "'is the degree of care which a reasonably prudent person would use under like circumstances.'" In re MetLife Demutualization Litig., 262 F.R.D. 217, 234 (E.D.N.Y. 2009) (quoting Densberger v. United Techs. Corp., 297 F.3d 66, 69 (2d Cir. 2002)). Thus, Section 12(a)(2) effectively imposes negligence liability on sellers. See In re Fuwei Films Sec. Litig., 634 F. Supp. 2d 419, 435 n.10 (S.D.N.Y. 2009).

The level of care required to satisfy the reasonable care standard "depends on a variety of factors, including the manner of sale, the nature of the relevant security, and the nature of the seller." In re MetLife, 262 F.R.D. at 235. The reasonable care standard of Section 12(a)(2) "is less demanding than the duty of due diligence imposed under Section 11." In re WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628, 663 (S.D.N.Y. 2004).

If a court does not grant your client's motion to dismiss in a matter, you should search for facts in discovery that will enable you to prove that your client acted with reasonable care for purposes of a potential summary judgment motion and otherwise. See also Section 11 Elements and Defenses under the Securities Act.

Negative Causation

"Section 12 liability may be avoided by way of an affirmative defense of lack of loss causation," also known as negative causation. Miller v. Thane Int'l, Inc., 615 F.3d 1095, 1100 (9th Cir. 2010). Under this defense, a defendant cannot be held liable for any drop in stock price that is not attributable to the alleged misstatements or omission at issue. In particular, the statute provides that if

a defendant "proves that any portion or all of the amount recoverable . . . represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication . . . not being true or omitting to state a material fact . . . then such portion or amount . . . shall not be recoverable." 15 U.S.C. § 77l(b).

Because loss causation is not an element of a Section 12(a)(2) claim, "Section 12 places the burden on defendants to prove that something other than the subject of the misrepresentations or omissions was responsible for any decrease in value of the" securities at issue. Fed. Housing Fin. Agency v. Nomura Holding Am., Inc., 104 F. Supp. 3d 441, 585 (S.D.N.Y. 2015). See also {Loss Causation in Securities Fraud Actions}.

Since negative causation is an affirmative defense, a defendant can prevail at the pleading stage where the "'facts supporting the defense appear on the face of the complaint, and it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief.'" In re Britannia Bulk Holdings Inc. Sec. Litig., 665 F. Supp. 2d 404, 418 (S.D.N.Y. 2009) (quoting United States v. Space Hunters, Inc., 429 F.3d 416, 426 (2d Cir. 2005)). Courts have dismissed cases based on negative causation at the pleading stage. Schuler v. NIVS Intellimedia Tech. Group., Inc., 2013 U.S. Dist. LEXIS 34200, at *29–32 (S.D.N.Y. Mar. 12, 2013) (plaintiff sold shares before the alleged corrective disclosure); In re Merrill Lynch & Co. Research Reports Sec. Litig., 272 F. Supp. 2d 243, 255 (S.D.N.Y. 2003) (decline in security price "occurred before public disclosure of the allegedly concealed information"); In re Britannia, 665 F. Supp. 2d at 419 (quoting Lentell v. Merrill Lynch & Co., 396 F.3d 161, 175 n.4 (2d Cir. 2005)) (alleged corrective disclosure "did not reveal to the market the falsity of" alleged misstatements).

If you are not able to establish the negative causation defense at the pleading stage, it may still be available at later stages of the litigation. At later stages, you should consider offering expert testimony, whether in the form of an event study or otherwise, to establish the factors that affected the price of the security.

Statute of Limitations / Repose

Claims brought under Section 12(a)(2) are subject to a one-year statute of limitations and a three-year statute of repose. Under the statute of limitations, claims must be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m. Thus, the statute is triggered "not only once a plaintiff actually discovers the facts, but also when a hypothetical reasonably diligent plaintiff would have discovered them." In re Bare Escentuals, Inc. Sec. Litig., 745 F. Supp. 2d 1052, 1082 (N.D. Cal. 2010) (citing Merck & Co. v. Reynolds, 559 U.S. 633 (2010)).

A corrective disclosure puts plaintiffs on constructive notice of the alleged misstatement as a matter of law, and therefore the one-year clock on a Section 12(a)(2) claim starts no later than the date of the corrective disclosure. See, e.g., Freidus v. Barclays Bank PLC, 734 F.3d 132, 138 (2d Cir. 2013).

Under the statute of repose, no action may be brought "more than three years after the sale" of the security at issue. 15 U.S.C. § 77m. The statute of repose "serves as an absolute bar . . . regardless of when a plaintiff discovered or could have discovered that he had a claim." Del Sontro v. Cendant Corp., 223 F. Supp. 2d 563 (D.N.J. 2002) (citing Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 363 (1991)). It is also not subject to equitable tolling. See, e.g., John Hancock Life Ins. Co. U.S.A. v. JP Morgan Chase & Co., 938 F. Supp. 2d 440, 445 (S.D.N.Y. 2013).

Practical Considerations

Under the PSLRA, all discovery is stayed prior to the court ruling on a motion to dismiss. 15 U.S.C. § 77z-1(b)(1). Therefore, you should consider bringing a motion to dismiss a complaint asserting Section 12(a)(2) claims. As set forth above, you should consider whether the plaintiffs have adequately pleaded each of the required elements, including, in particular:

- That your client was a statutory seller, meaning that your client either directly passed title of the subject security or actively participated in the solicitation of the sale of the security
- That the plaintiff purchased the security through a public offering, rather than as an aftermarket purchaser
- That the prospectus or oral communication at issue contained a materially false or misleading statement of fact

In addition, you should consider whether any of the affirmative defenses to a Section 12(a)(2) claim are apparent on the face of the complaint, and therefore can be argued on a motion to dismiss. Specifically, focus on the following:

- Whether any of the alleged misstatements are forward-looking statements accompanied by meaningful cautionary language, and therefore potentially subject to the safe harbor or bespeaks caution defenses

- Whether the plaintiff sold shares before the corrective disclosure, the price of the security declined before the alleged corrective disclosure, or the alleged corrective disclosure did not reveal the falsity of the alleged misstatement, such that a negative causation defense can be asserted at the pleading stage
- Whether the complaint was brought more than one year after the plaintiff should have discovered the claim, or three years after the sale of the security

Should your case proceed past the pleading stage, you should ensure that your discovery plan will allow you to investigate evidence to support any potential arguments regarding the elements of the claim. In addition, your discovery plan should allow you to investigate evidence to support all of the applicable affirmative defenses, including, in addition to those listed above, whether the purchaser had knowledge of the alleged untruth or omission, and that the seller could not have known, in the exercise of due care, of the alleged untruth or omission.

Assistance provided by Winston Hsiao, Zachary Faigen, Kasonni Scales, Raza Rasheed, Danielle Dankner, Candace Ross, and Sydney Wright, Skadden, Arps, Slate, Meagher & Flom LLP.

Peter B. Morrison, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

Peter B. Morrison is the leader of the Los Angeles Litigation Group, co-head of the West Coast litigation practice and one of the hiring partners for Skadden's Los Angeles office. He has a broad litigation practice with a particular emphasis on securities, M&A and tax litigation.

Mr. Morrison advises corporations on matters involving both federal and state securities laws, duties of corporate directors, SEC and stock exchange inquiries and investigations, contests for corporate control and tax reporting. In 2022, Mr. Morrison was named among *Daily Journal*'s Top 100 attorneys, in addition to being named a Top Litigator and Trial Lawyer in Los Angeles by the *Los Angeles Business Journal* in 2021 and 2019. In 2018, Mr. Morrison was named Lawyer of the Year for Litigation – Securities, Los Angeles by *The Best Lawyers in America*. Mr. Morrison has been selected for inclusion in *Chambers USA: America's Leading Lawyers for Business* since 2016 and *The Best Lawyers in America* since 2014. For three consecutive years (2011-13), Mr. Morrison was named to *Law360*'s list of Rising Stars.

Virginia F. Milstead, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

Virginia F. Milstead has a broad commercial litigation practice, representing clients in both federal and state courts, with a particular emphasis on securities and M&A litigation, shareholder derivative litigation and related claims.

Ms. Milstead has advised clients on matters involving federal and state securities laws, duties of corporate directors, civil RICO, unfair business practices, and various other contract and tort claims.

In 2022, Ms. Milstead was named a Leader of Influence — Litigators and Trial Attorneys by the *Los Angeles Business Journal*, which also has selected her to its lists of leading professionals who are Thriving in Their 40s and who are Women of Influence. She also has been recognized by *The Best Lawyers in America* and repeatedly in *Chambers USA*, in which she has been described by clients as "a gifted litigator and a strong oral advocate ... [with an] ability to cut through complexity and focus on the critical issues." She also received the Distinguished Alumna Award from Pepperdine Caruso School of Law in 2021. Ms. Milstead is a frequent speaker at, and organizer of, legal education events. Among other roles, Ms. Milstead has taught constitutional law at the Pepperdine Caruso School of Law, has been a regular panelist for the annual Federal Court Boot Camp and Superior Court Boot Camp presented by Pincus Professional Education, has served as co-chair of the Litigation Committee of the Women Lawyers Association of Los Angeles and has organized WLALA's annual Litigators' Forum. Ms. Milstead also served as a panelist at the Third Annual William French Lecture at the Pepperdine Caruso School of Law, featuring retired Supreme Court Justice Sandra Day O'Connor.

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