Section 11 of the Securities Act of 1933 gives persons purchasing securities offered under a registration statement containing material false statements or omissions a cause of action against signatories, directors, underwriters, authors of expertised portions, and the issuing corporation. Section 11 (b) distinguishes between the duty of reasonable verification imposed on all defendants with respect to statements made on the authority of an expert and the duty with respect to statements not made on expert authority. Expertised statements need be verified only by the experts who make them; other defendants may rely on the affirmative defense that they had no reasonable ground to believe, and did not believe, that the expert's statement was false or contained a material omission. However, with regard to any statement made on a defendant's own authority, or any statement made without expert authority, the defendant must establish that he held a reasonable belief, "after reasonable investigation," that the statement was true at the time the registration statement became effective. This defense, known as the "due diligence" defense, is not available to the issuer.

The duties of defendants under section 11 to adequately verify information contained in a registration statement were recently examined at length by the District Court for the Southern District of New York in Escott v. BarChris Construction Corp. BarChris, the

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2 The cause of action under §11 is available to all persons who have purchased the actual shares of stock covered by the misleading registration statement, Barnes v. Osofsky, 373 F.2d 269 (2d Cir. 1967), unless it can be shown that the purchaser was aware of the untruth or omission at the time he acquired the stock. Securities Act of 1933, §11(a), 15 U.S.C. § 77k(a) (1964). The registration statement provided for in §6(a) of the Act, 15 U.S.C. §77f(a) (1964), must contain the information set forth in §7, 15 U.S.C. §77g (1964), and schedules A and B of the Act. Such registration is required in situations set forth in §§3, 4 & 5 of the Act, 15 U.S.C. §§77c, d, & e (1964).
3 An expertised portion of a registration statement is one that purports to be made on the authority of an expert within the meaning of 15 U.S.C. §§77k(b)(3)(B) & (C) (1964). In BarChris, Judge McLean rejected the view that a lawyer's responsibility for the registration statement's preparation made the entire document expertised. Escott v. BarChris Construction Corp., 283 F. Supp. 643, 683 (S.D.N.Y. 1968). Instead, he found that the accountants were the only defendants who contributed data that purported to be made on their authority as experts. Id.
4 The amount of damages recoverable is prescribed by §11(e), 15 U.S.C. §77k(e) (1964).
first case to examine the diligence required by section 11, has been variously described as "a legal blockbuster that is standing the financial community on its ear," a "landmark case," and a decision that has "upset allegedly established business practices." As these reactions suggest, BarChris has been widely viewed as requiring significantly higher standards of care in the preparation of registration statements than prevailed before the decision. Especially troublesome to the financial community is the suggestion that "nearly everyone involved in a registration must check every material fact himself by plodding through company records." This Comment will examine the requirements of reasonable investigation set forth in BarChris and suggest means, largely within the broad guidelines set forth in the opinion, by which participants might most easily meet their burdens under section 11.

BarChris Construction Corporation built and sold bowling alleys. For a small down payment it entered into contracts to build the alleys and, when construction was completed, received the balance of the purchase price in the form of customer notes payable over several years. To obtain its working capital BarChris discounted these notes with a factor and received part of their face amount in cash. So long as the industry prospered, customers paid their notes and BarChris's method of financing provided the capital for expansion. Between 1956 and 1960 sales mushroomed from $800,000 to over $8,500,000. In 1961, BarChris issued convertible subordinated debentures under a registration statement that became effective May 16, 1961. But when the bowling industry was hit by oversupply in the early sixties, BarChris failed. In 1962 the corporation defaulted on the interest payments due on the debentures, and, in October, entered bankruptcy.

Several purchasers of the debentures subsequently brought suit under section 11 against the signers of the May 16 registration statement, each underwriter, and the corporation's accountants. The debenture holders alleged that the registration statement contained material false statements and omissions, and claimed damages under section 11.10

8 Wall St. J., May 14, 1968, at 1, col. 6 (comment of a Wall Street lawyer).
9 BarChris Symposium 224 (remarks of Stephen J. Weiss).
10 Comment, BarChris: Due Diligence Refined, 68 Colum. L. Rev. 1411, 1423 (1968).
11 See, e.g., Address by Carlos L. Israels, in BarChris Institute 537; Address by F. Arnold Daum, in BarChris Institute 553; BarChris Symposium 238 (remarks of Carlos L. Israels); Comment, 43 N.Y.U. L. Rev. 1030, 1038 (1968).
The court found that the audited 1960 figures, the unaudited 1961 figures and some passages in the prospectus's text did contain material false statements and omissions. In the audited 1960 figures, net operating income and earnings per share were overstated by approximately 16 per cent ($246,605, or $10 per share). This error stemmed from a misapplication of the percentage-of-completion method of accounting, and from including, as sales, transactions that were actually intercompany transfers. Contingent liabilities had been understated by more than 33 per cent. In the 1961 unaudited figures, contingent liabilities were understated by 43 per cent ($618,853), net sales overstated by 32 per cent ($519,810) and customer backlog orders overstated by 185 per cent ($4,490,000). Testimony with respect to customer backlogs revealed that BarChris had included unfilled orders for which there were no enforceable contracts.

The court also found errors in several factual statements made in the prospectus. While the prospectus represented that there were no outstanding loans from directors, BarChris was actually indebted to three officers in the amount of $386,615. In addition, it was falsely stated that some loans from officers had been repaid; in fact, the officers had received checks that they had agreed not to deposit until BarChris could make payment out of the proceeds of the financing. Over 60 per cent of the proceeds were used in a manner not described: repayment of these loans and other debts. Furthermore, the prospectus suggested that BarChris had minimal problems with customer payments, when in fact by May 16, 1961, defaults had resulted in a liability of $1,350,000 payable to the factor on demand. Significantly, the document stated only that BarChris was engaged in the construction and manufacture of alleys and equipment, and failed to disclose that as a result of these defaults BarChris now found it necessary to operate alleys.

In determining whether the misstatements described above met the materiality requirement of section 11, the court used the SEC's reading of "material" to include "those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." 13 All the errors in the 1961 unaudited figures and the statements concerning officer loans, the application of proceeds, customer defaults, and the operation of alleys were considered materially misleading. In the 1960 audited figures, only the balance sheet errors were found material. Correct data would have reduced the ratio of current assets to current liabilities from 1.9 to 1, to 1.6 to 1. The court concluded that, unlike the other 1960 errors, knowledge of the true ratio would not have made a difference to a growth-oriented investor. It reasoned that since the debentures were rated "B" and thus speculative, an investor would have been interested in the securities primarily for their growth potential. Had the prospectus pre-

sented correct 1960 sales and earnings figures, BarChris's growth would still have been striking. These errors were not material, nor was a 30 per cent understatement in contingent liabilities, since the stated figure—$4,719,835—was still "huge" for a company with reported total assets of $6,101,085. Thus, any potential investor likely to have been deterred by high liabilities was likely to have been sufficiently warned even by the understated figures.

I. THE DUE DILIGENCE DEFENSES

The directors, accountants and underwriters all pleaded due diligence: that after reasonable investigation they had reasonable grounds to believe, and did believe, that the statements in the prospectus, aside from those made by others as experts, were true. The court considered the diligence of each defendant's investigation separately, citing a host of checks that could have made the investigations more satisfactory. Since most defendants had made little or no investigation, the exact requirements of due diligence after BarChris remain obscure. But the court's differing treatment of each defendant indicates that the investigative burden will vary with a defendant's particular profession and responsibilities in the registration process.

A. Inside Directors and Officers

No inside director or officer offered any evidence of investigation into the facts in the registration statement. Thus their due diligence defense failed at the outset since they had no ground—much less a reasonable ground—to believe in the truth of the prospectus. In fact, Judge McLean found that the officers knew of facts at variance with the registration statement. For example, some officers were familiar with the officer loans and the use of financing proceeds to pay these and other debts, the temporary release of factor reserves to inflate the corporation's cash position, the inflated backlog figure, and the customer defaults. Judge McLean also imputed to the officers knowledge of some inaccuracies, finding, for example, that as members of the executive committee the president and vice-president "must have known what was going on." The financial officer and his assistant, because of their familiarity with BarChris's financial affairs, were presumed to have had reason to doubt the accuracy of the accountant's audit and,

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15 While it has been generally acknowledged that the standard of diligence required by BarChris will vary from defendant to defendant, see Address by Thomas G. Meeker, in BarChris Institute 574; Address by Kenneth J. Bialkin, in BarChris Institute 622; BarChris Symposium 243 (remarks of Donald E. Schwartz), there has been considerable confusion about when and how the standards differ.
16 An inside director is a director who is also an officer of the corporation. See 283 F. Supp. at 687.
17 Id. at 684.
therefore, could not rely on it. Even the house counsel was held to have been "necessarily informed . . . to a considerable extent about the company's affairs," although he had attended his first executive committee meeting less than two months before the effective date of the registration statement. Despite his limited exposure to the corporation's activities, the court concluded that, as keeper of the corporation's minutes for a few months preceding registration, he "must . . . have appreciated" some of the inaccuracies.

Since the inside directors and officers made no investigation, the court had no occasion to give an affirmative definition of the scope of their duties. It is apparent that officers and inside directors are charged with a knowledge of company affairs according to their job responsibility. All, of course, must read the registration statement. In addition, members of the executive committee must read the minutes of meetings they did not attend. A financial officer is expected to compare a professional audit with his own knowledge of his company's finances. It appears much more difficult to justify failure to correct a misstatement in an area with which a defendant has some special reason to be familiar. Moreover, if a director's position in the corporation does not give him the knowledge with which to evaluate statements in the prospectus, the statements must be verified, not merely by asking others on the board, but by some examination of the written corporate records.

B. Outside Directors

The corporation had three outside directors, two of whom had been elected less than a month before the effective date of the registration statement. One of the two new directors had asked several brokers about BarChris's management and growth record. The other had conducted a general credit check with BarChris's banks and factor. Responses to these inquiries were favorable. But the court found the inquiries to be inadequate investigations, pointing out that they had been directed toward "comparative strangers" and made with no specific reference to the statements in the prospectus. Each new

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18 Id. at 685-86.
19 Id. at 687. The house counsel here referred to was a lawyer employed full time by the company, not the director mentioned in the text accompanying note 25 infra.
20 283 F. Supp. at 687.
21 In its discussion of the inside directors, the court merely alluded to the duty of verification, concentrating its analysis on facts that these defendants were presumed to know. The scope of the required verification is therefore particularly unclear. See Comment, BarChris: Due Diligence Refined, 68 Colum. L. Rev. 1411, 1416 (1968). Methods of verifying written records will be suggested in the text accompanying notes 41-57 infra.
22 An outside director is a director who is not an officer of the corporation. 283 F. Supp. at 687.
23 Id. at 688-89.
outside director had relied upon assurances of several of the corporation's officers that the corporation was financially secure and neither of the two had even read the prospectus in its final form. The court held that they had not satisfied the due diligence requirements of section 11.

The third "outside" director was, in fact, extremely familiar with the corporation's affairs. As counsel to BarChris and director since 1960, he had prepared an earlier registration statement and had initial responsibility for drafting the May 16 registration statement. The court held that because of his position as company counsel and his involvement with the registration statement, "more was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work." The lawyer-director's due diligence defense failed because he, too, relied on officer assurances and did not check matters that were "easily verifiable." He read no financing agreements or minutes of subsidiaries. Nor did he ask to see customer contracts supporting the backlog figure or insist that unwritten executive committee minutes be completed. He was satisfied by assurances that loans from officers had been repaid despite insistence by the corporation's treasurer that a clause be included in the indenture giving loans from individuals priority over the debentures. This danger signal, the court concluded, should have led him to investigate officer loans further. Finally, the lawyer-director did not examine BarChris's record of customer delinquencies or its correspondence with the factor. The court concluded that there were "too many instances in which [he] failed to make an inquiry which he could easily have made which, if pursued, would have put him on his guard."

The court explicitly stopped short of requiring an audit by the lawyer-director, calling only for him to "test oral information by examining the original written record." However, while a single statement may be "easily verifiable," the verification of many such statements becomes a heavy burden. The requirements imposed upon this uniquely involved defendant should not be applicable to all outside directors.

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24 The newly arrived outside directors had signed a separate signature sheet after having seen only preliminary drafts of the registration statement. Signatures present a special problem because "it may be extremely inconvenient if not impossible to have all the necessary parties manually sign the completely printed and bound registration statement—at least not without incurring substantial delays." Address by Carl W. Schneider, in BarChris Institute 559. But there seems to be little objection to signing a separate signature sheet or appointing a common "attorney-in-fact" to sign for individual defendants, so long as the defendants are kept informed of any changes made in the registration material. Id.

25 283 F. Supp. at 690, 692. Here, "company counsel" means a member of a law firm that was counsel to BarChris.

26 Id.
27 Id. at 691.
28 Id. at 692.
29 Id. at 690.
directors, and the court seemed to recognize this. The lawyer-director was the only outside director cited for failing to examine written records. On the other hand, the court implied that specific inquiries of brokers and banks would have aided the defense of the other two outside directors who were elected less than one month before the registration statement's effective date. Beyond this minimal check and the duty to read the prospectus in its final form, no specific due diligence obligations were set forth for these relatively uninvolved defendants.

C. Accountants

The court concluded that the 1960 audit had been presented on the authority of Peat, Marwick, Mitchell & Co. as experts. Section 11 requires an expert to prove, with respect to statements made upon his expert authority, that he made a reasonable investigation and reasonably believed his statements to be true at the time the registration statement became effective. Thus, Judge McLean considered not only the audit ending in 1960, but also the accountant's S-1 review of events after certification and up to the registration statement's effective date. Such a limited review customarily follows every audit and is intended to disclose whether subsequent events have made the certified figures misleading. In considering the accountant's audit and S-1 review,

30 See text accompanying note 25 supra.

31 Other commentators have read BarChris to require outside directors to inform themselves fully about their corporation's activities and condition by a detailed examination of corporate documents, see Comment, BarChris: Due Diligence Refined, 68 Colum. L. Rev. 1411, 1420 (1968), or, at least, by frequent briefings throughout the life of the corporation by those insiders executing corporate activities. See Address by Allen E. Throop, in BarChris Institute 625; BarChris Symposium 243 (remarks of Donald E. Schwartz). However, some have questioned whether BarChris's command to the outside director goes beyond "Don't just do nothing." BarChris Symposium 231 (remarks of Stephen J. Weiss); id. 250 (remarks of Harry Heller). It has been convincing argued that the effect of keeping outside directors informed of details of the corporation's day-to-day activities will be to increase their risk of liability by enabling a court later to charge the outside director with a greater knowledge of corporate affairs and, therefore, a higher standard of diligence. Address by Thomas G. Meeker, in BarChris Institute 576-77; id. 632 (remarks of Thomas G. Meeker).

32 Securities Act of 1933, § 11(b) (3) (B) (i), 15 U.S.C. § 77k(b) (3) (B) (i) (1964).

33 See COMMITTEE ON ACCOUNTING PROCEDURE, A.I.C.P.A., STATEMENTS ON AUDITING PROCEDURES No. 33, AUDITING STANDARDS & PROCEDURES 78 (1965). In reference to an audit performed to meet registration requirements, the committee has said:

To sustain the burden of proof that he has made a "reasonable investigation" the auditor should supplement his audit procedures by performing certain additional procedures with respect to subsequent events up to, or reasonably close to the effective date.

Id. 78; see id. 78-80, where the committee recommends in detail the procedures constituting an S-1 review performed in accordance with generally accepted auditing standards. Such procedures include comparing recent financial statements with corresponding earlier ones, taking minutes of stockholders' and directors' meetings and investigating changes in material contracts, bad debts and newly discovered liabilities. In BarChris, Judge McLean stated that the 20% hours Peat, Marwick spent on the S-1 review were not adequate. 283 F. Supp. at 701, 703.
Judge McLean invoked standards of general accounting practice to assess Peat, Marwick's due diligence.  

The court found that the accountants had erroneously listed a still-owned bowling alley as sold, and mistakenly included in current assets reserves that would not be entirely released within the year. Insufficient weight was given to the fact that some debtors' notes were already substantially overdue. Moreover, the court held that Peat, Marwick's failure to discover the 1961 errors during their S-1 review made the 1960 audit misleading. Since Peat, Marwick's errors stemmed from failure to follow general accounting principles as reflected in their own S-1 procedures, the court, in holding the accountants to the standards of their profession, did not impose an excessively burdensome test of due diligence.

D. Underwriters

The underwriters' investigation was conducted by the lead underwriter, Drexel & Co., on behalf of itself and seven "participating" underwriters. A partner of Drexel was in charge until one month before the effective date of the registration statement, at which time he became a director of BarChris. A partner of counsel for the underwriter then took over the work.

The investigation was conducted as follows. The Drexel partner read reports and prospectuses of competitors and made general inquiries of BarChris's banks and factor. He read BarChris's past prospectuses and the 1960 annual report. Two months before the effective date, he and counsel for the underwriting syndicate attended three meetings with BarChris's officers and attorneys. At these meetings, the BarChris officers gave deliberately false answers to questions concerning various statements in the prospectus later found to be misleading. These answers, however, were accepted by Drexel without investigation. The underwriters' counsel subsequently sent a junior associate to examine BarChris's minutes and major contracts. The associate discovered a reference indicating that customer defaults might force BarChris to operate some alleys itself. One week before the effective date of the registration statement, underwriters' counsel mentioned this danger signal but, again, accepted assurances from the company's officers without investigating further.

The court concluded that "underwriters' counsel made almost no attempt to verify management's representations" and held this to be insufficient. Counsel's examination of minutes and contracts for the underwriting syndicate had been inadequate. He had examined only a few of the minutes of subsidiaries and executive committee meetings and did not insist that incomplete minutes be written up. Nor, Judge McLean pointed out, had he examined BarChris's financing agreements,

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34 283 F. Supp. at 701, 703.
35 Id. at 697.
its schedule of delinquencies, its correspondence with the factor or the customer contracts supporting the backlog figure. Finally, the court took notice that counsel for the underwriters had not examined any accounting records. Drexel was bound by their counsel's failure to make a reasonable investigation, as were the other underwriters who took no action and simply relied on Drexel.

In summary, while the common theme that emerges is that a section 11 defendant must not accept management's representations without verification, it is evident that the burden of reasonable investigation in BarChris fell most heavily on the two defendants who had drafted the registration statement and who, therefore, had the greatest occasion to investigate: that is, the outside lawyer-director and the lead underwriter. Finding liability against the corporation's officers, who had made no investigation whatsoever and presuming their knowledge of facts discussed at executive meetings, can hardly be thought to establish an unreasonably high standard. The two new outside directors were fairly cited for not having read the prospectus in its final form and for relying upon officer assurances without directing specific inquiries to investment bankers and banks, and the accountants were simply held to the standards of their own profession. Only the outside lawyer-director and the lead underwriter, who shared responsibility for drafting the registration statement, were cited for not examining written records. With minor exceptions, they had not attempted to verify management's representations and the court quite appropriately held this to be insufficient.

Although the result reached in the case is clearly supportable, the court's opinion does present some problems. The difficulties emerge from the opinion's tendency to mention ways of checking information without ever clearly defining what would constitute an adequate investigation. The decision has therefore provoked wide-ranging debate in the securities industry and, in association with other recently decided cases, has caused some apprehension. Nonetheless, the open-ended

36 Id. The underwriters had contended that the lawyers were experts within the meaning of § 11(b) (3) (B) and, thus, that they had no duty to investigate the lawyers' statements under § 11(b) (3) (C). The court rejected this argument, finding that the attorneys had presented facts, not legal opinions. 283 F. Supp. at 683, 697. For a suggestion that dicta in SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), may portend a cause of action against lawyers based on negligence, see BarChris Symposium 246-47 (remarks of Donald E. Schwartz).

37 Of course, the standards set forth in the case would require resort to the written record by other defendants: the accountants must use written records as sources for their figures, and the officers might have to inform themselves of discussions they missed by examining executive minutes. But the court seems to place only on the drafters of the registration statement the duty to examine written records to verify facts that they would not have known even from the proper performance of their corporate function.


reasoning of the court was tied to basic principles derived from section 11: the requirement of independent verification of information in the registration statement and of management’s representations, and the investigation of the same statements by statutory defendants possessing contrasting interests, knowledge and abilities. This Comment will suggest a number of investigative techniques that might meet these underlying concerns without making the burden of investigation too heavy to be feasibly borne. While the methods suggested might best be endorsed by SEC rules in order to establish certainty in the requirements of section 11, they nonetheless should fully satisfy a court that due diligence under section 11 has been observed.

II. Verification Under Section 11

A. Delegation

Under section 11, statements made by an expert are to be investigated by the expert himself and may be relied upon by non-expert defendants without an investigation of their own. Section 11 does not, however, allow any reliance on non-expert statements. The Act, therefore, does not define the limits within which a defendant may rely upon another’s reasonable investigation of a non-expertised statement. In BarChris the responsibility for investigating the accuracy of the non-expertised portion of the registration statement was intentionally delegated at least two times: first, by the participating underwriters to the lead member and second, by the lead underwriter to counsel for the underwriting syndicate. In discussing the lead underwriter’s due diligence defense, the court held Drexel bound by its counsel’s failure to make a reasonable investigation. Participating underwriters were in turn bound by the lead underwriter’s inadequate investigation. Thus, BarChris holds that a defendant is not protected when his non-expert agent fails to investigate with “due diligence.” BarChris did not, however, decide whether the delegating defendant is protected by his agent’s adequate investigation. In short, is the duty to make a reasonable investigation delegable?

The statute says “no person . . . shall be liable . . . who shall sustain the burden of proof— . . . (3) that . . . he had, after reasonable investigation, reasonable ground to believe . . . .” in the accuracy of the registration statement. While the language does not explicitly state whose reasonable investigation must be the ground for

41 The defense of reliance on an expert’s investigation is inapplicable where the defendant believed, or should reasonably have believed, the expert’s statement to be false. Securities Act of 1933, § 11(b) (3) (C), 15 U.S.C. 77k(b) (3) (C) (1964).
42 Securities Act of 1933, § 11(b) (3) (A), 15 U.S.C. § 77k(b) (3) (A) (1964) (emphasis added).
a reasonable belief, it implies that the particular defendant must investigate for himself. Yet the legislative history indicates Congress did not intend to make the duty of reasonable investigation totally non-delegable. A rule that permits limited delegation of the duty to verify non-expertised portions of a registration statement would recognize the practical burdens of verification without necessarily compromising the protection offered to investors by the Act. The outside director customarily serves on several boards and must often discharge his directing responsibilities by taking time from another full-time job. Delegation should also be available to participating underwriters. These non-leading underwriters do not possess the time or resources necessary to verify management's representations personally in each distribution they enter. Thus, the demands upon outside directors and participating underwriters mean that these defendants will necessarily rely upon others in the investigation of the issuing company. Section 11 should be interpreted to recognize these practical constraints.

The extent to which a defendant ought to be accorded protection by his agent's reasonable investigation must be defined with reference to the dominant interest at stake—investor protection. Separate investigations by statutory defendants whose expertise and perspective in the registration process differ significantly improve the quality of disclosure. This suggests two considerations in defining the permissible scope of delegation. First, delegation that results in substantially fewer aggregate investigations under the statute violates the apparent legislative scheme and may result in significantly less protection to investors. Second, a defendant's particular expertise or perspective as an investor was expressly recognized at the time of passage that some delegation of responsibilities was permissible under the standards of § 11. The conference report on the bill which became the Securities Act of 1933 stated that under § 11 a fiduciary need not "individually perform every duty imposed upon him," but may delegate to others "the performance of acts which it is unreasonable to require that the fiduciary shall personally perform," especially "where the character of the acts involved professional skill or facilities not possessed by the fiduciary himself." H.R. Rep. No. 152, 73d Cong., 1st Sess. 26 (1933). The conference report as quoted referred to the original standard expressed in the Act: "a person occupying a fiduciary relationship." Congress subsequently changed this formulation to "a prudent man in the management of his own property" in order to incorporate the accepted common law definition of a fiduciary's duty. H.R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934).

It seemed impossible to define in statutory language the extent to which a fiduciary might lawfully delegate his duties to others. In lieu of such an effort, resort was made to general language in the report to indicate that a goodly measure of delegation was justifiable, particularly insofar as corporate directors are concerned.


44 See 283 F. Supp. at 696, where Judge McLean suggests that because of the danger of the issuing corporation's self-serving statements, the positions of the underwriters and the corporation's officers are adverse. "If [underwriters] may escape ... responsibility by taking at face value representations made to them by the company's management, then the inclusion of underwriters among those liable under section 11 affords the investors no additional protection." Id. at 697.
gator may afford investors unique protection and is, therefore, to be considered in defining the limits of permissible delegation.

When a section 11 defendant delegates his duty to someone other than a statutory defendant, the overall number of investigations remains unaffected. And if the defendant's agent is judged by the standard imposed upon the defendant himself, delegation would not negate the value of a defendant’s particular expertise or perspective. Thus, the greater a defendant’s unique capabilities, the greater the risk of liability he would incur by delegating his responsibilities to one who could not hope to enjoy such special competence. Judging the agent's investigation by the judgment and requirements expected of the defendant himself would thus inhibit delegation by those defendants—such as the accountants, inside directors, officers and the lead underwriter—who stood to offer the public the most protection. On the other hand, it would facilitate delegation by outside directors, participating underwriters and those with relatively little unique investigative capability.

Whether a section 11 defendant who relies on the non-expert investigation of another defendant should be protected poses a more difficult question. In such cases the total number of investigations is reduced. Nevertheless, reliance by outside directors and participating underwriters upon the investigation of inside directors and the lead underwriter may be justified as not being prejudicial to the protection afforded by section 11. Outside directors and participating underwriters are chosen respectively by the inside directors and the lead underwriter. If they are not disposed toward their benefactors, their perspectives certainly are not adverse. Nor are outside directors and participating underwriters likely to possess more information or a different skill than inside directors and the lead underwriter. If these defendants are not permitted to rely on the adequate investigation of inside directors and the lead underwriter, they will duplicate their efforts without adding measurably to the competence already present. Protecting these defendants against liability when inside directors and the lead underwriter have made an adequate investigation would not eliminate any unique investigative capability represented in the constellation of section 11 defendants.\footnote{While no unique investigative capability would be eliminated by protecting outside directors and participating underwriters from liability when their respective agents, the inside directors, and the lead underwriter have made an adequate investigation, the reduction in the total number of investigations performed would reduce the degree of cross-checking between defendants. To this extent a margin of protection would be sacrificed.}

B. Reliance Among Non-Experts According to Their Relative Capabilities

While section 11 envisions separate investigations, the extent of overlap in investigative effort depends upon the court's construction of what is “reasonable” for any particular defendant. Verification of
the same records by more than one participant in the registration process may either justifiably add a significant check on another's efforts, or may constitute an unreasonable burden on a defendant whose lack of skill or knowledge would limit the value of his investigation.

The examination of the financial data accumulated after the certified audit of the corporation's books is an example of an area where overlap can occur. In BarChris, Judge McLean cited the syndicate's counsel and, through it, all the underwriters for failing to examine BarChris's accounting records.46 "Accounting records" undoubtedly refers to the unaudited figures since the audited figures were held to be expertised and, therefore, beyond the underwriters' responsibility.47 It is not, however, clear what the court meant by "examination" of the accounting records. In relation to supporting contracts, Judge McLean implied that to "examine" was to verify the existence of contracts to support stated backlog figures.48 Presumably, examination of accounting records means more than merely checking to see that the figures exist. The question is, to what extent ought underwriters, or any defendants other than accountants, be required to verify the accuracy of unaudited financial data when the court places the prime burden of such verification on professionally trained accountants? 49

BarChris leaves undefined the extent to which defendants who are not accountants can rely on the accountant's S-1 review. While the case clearly held that the S-1 review was not expertised,50 and, therefore, that the conclusions could not be accepted without some attempt at verification, BarChris did not set forth the amount of technical checking and interpretation of financial data that would be required of non-accountant defendants. In resolving this question, it is reasonable to require the non-accountant to read the unaudited figures that will appear in the registration statement and to compare these figures with the information gleaned in the rest of his due diligence investigation. However, a non-accountant should not be, and under BarChris is not, required to look into the accounting methods chosen or the

46 See 283 F. Supp. at 694.
47 Id. at 683, 684.
48 Id. at 694.

49 Although the accountants in BarChris were held responsible as experts only for the audited figures ending in 1960, the court required them to perform a professionally competent S-1 review into unaudited data (see note 33 supra) by judging the accountant's belief in the accuracy of the registration statement as of the effective date of the registration statement, 283 F. Supp. at 698, and by judging the audit as a whole by the standards of general accounting practice. Id. at 703. An adequate S-1 review is also required in order to support the "comfort letter" to underwriters. See COMMITTEE ON ACCOUNTING PROCEDURE, A.I.C.P.A., STATEMENTS ON AUDITING PROCEDURE No. 35, LETTERS FOR UNDERWRITERS 9-10 (1965). Underwriters consider receipt of the "comfort letter" to be a condition to their contract with the issuer. Id.

50 283 F. Supp. at 698; Address by Jack M. Whitney, II, in BarChris Institute 586-87. But see Professor Loss's curious reading of the case on this point, id. 568.
actual calculation of these interim figures. He is properly required to question only those figures which conflict so sharply with his other information that the discrepancy is apparent even to a layman who is unable to evaluate the S-1 review.

Such a limitation of the non-accountant's duty is consistent with the reasoning of the BarChris court, which considered the individual background and competence of each defendant in defining the diligence required of him. The suggested limitation of the layman's duty does not significantly compromise the protection to investors intended by section 11. The unaudited figures will still be subjected to the S-1 review which, while not conferring the same reliability as would a full certification, nonetheless, constitutes an examination conducted by an expert according to his profession's standards. The professional quality of such a review is required by BarChris.

The non-accountant cannot realistically be expected to add a significant check on the technical work of professional accountants. Collusion between the issuing company and public accountants seems relatively unlikely, and, in any event, an additional non-accountant investigation into the figures would rarely uncover what an accountant has worked to conceal. Non-accountant defendants who have made a reasonable investigation in other areas, and who have read the unaudited data, should not be held liable for material misstatements in the unaudited data unless their investigation discloses information casting doubt upon the unaudited figures that they did not bring to the accountant's attention during the S-1 review. This principle should also apply in other situations where the skill or knowledge necessary to a meaningful verification is possessed by only one defendant; such a limitation ought to be inherent in the concept of a reasonable investigation.

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51 However, although arguing that such a technical verification is an "unreasonable" requirement to place on an underwriter, Jack M. Whitney, II, has concluded that the citation of underwriters for not examining the unaudited data means that such an effort is required. Address by Jack M. Whitney, II, in BarChris Institute 586-87.

52 One commentator has suggested the possibility of requesting accountants to provide the figures that underlie unaudited data in the prospectus, presumably so that non-accountant defendants might compare such supporting data with information learned in the general investigation. Address by Carl W. Schneider, in BarChris Institute 559.

53 See text accompanying notes 14-31 supra.

54 See note 49 supra.

55 For example, the executive committee minutes revealed that BarChris was beginning construction on 12 alleys for which there were no contracts. 283 F. Supp. at 691. Yonkers Lane was one such alley and its inclusion in net sales resulted in an overstatement in gross profits in the 1961 unaudited figures of $105,000. Id. at 668, 694. Under the rule suggested, a defendant would not be held liable for this error in the unaudited data unless he failed to disclose to the accountants a reference in the minutes alluding to the construction of alleys without enforceable contracts which either was, or should have been, discovered as part of the defendant's general investigative effort.
A third possibility for easing the burden of due diligence without substantially impairing investor protection might be to establish a registration statement “data index.” The individuals who drafted the prospectus could easily assemble and index in one location the source material supporting the statements made. All section 11 defendants would then check the indexed record directly to avoid preliminary legwork and duplication of effort. In order to discover evidence not in the cited data which contradicts or supplements the registration statement, defendants who were not officers of the corporation would randomly divide the source material not cited in toto. Thus, all source materials will have been checked at least once against the registration statement. After examination, such defendants would inform the other participants of information discovered that cast doubt upon the prospectus. Admittedly, BarChris indicated that reliance upon the assurances of the corporation’s officers without examining the original record did not satisfy the requirements of a reasonable investigation. However, the case did not deal with the situation where non-officer participants placed a limited reliance upon each other’s investigative efforts. Verifying officer assurances is especially crucial in light of the danger of self-serving statements by the issuing company. But such a danger is not as likely among accountants and underwriters, for example, or those outside the sphere of management. Since officers are presumed to be aware of information integral to the individual’s job responsibility, inside directors would still have to read the minutes of executive committee meetings not attended, checking those minutes and the indexed record against the registration statement. But insofar as a reasonable investigation required them to examine records not within their area of job performance and not cited in the index, they too might rely upon the efforts of non-officer participants to discover information contradictory to the registration statement.

III. Conclusion

It should be remembered that a “reasonable investigation” is not the only way to avoid section 11 liabilities from a securities registration. The most effective insurance against liability is an accurate registration.

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56 This is the type of verification that is intended in the customary “due diligence meeting”: all of the statutory defendants meet prior to the effective date of the registration (preferably after the SEC has commented on the registration statement) to review the prospectus line by line, with management providing verification for all assertions and submitting to cross-examination by all present. See Address by Carlos L. Israels, in BarChris Institute 542-43. Such meetings, however, often tend to be perfunctory and are frequently held simply to encourage the underwriting syndicate by announcing recent earnings figures to them. Id. In any event, the meeting would seem to add little to the procedures outlined in the text.

57 See 283 F. Supp. at 696.
statement, regardless of the verification procedures employed by any defendant. Accordingly, some law firms, in addition to counselling their clients on due diligence verification procedures, check the accuracy of registration statements by having senior partners unconnected with the drafting of the material carefully check the final product for internal consistency. Although such a procedure would be of questionable value to the client if a misstatement went undiscovered and a section 11 suit were brought, such checks have turned up many overlooked errors. Certain other safeguards against liability may also be employed. It is clearly inadvisable for any potential director to accept, or even informally agree to accept, a directorship immediately prior to a registration. Where possible, the corporation should require those preparing expertised statements for a registration to assume responsibility as experts for a larger body of information. Efforts should be particularly directed toward persuading accountants to undertake added responsibilities for financial data beyond the scope of the full-scale, certified audit.

The precautions and investigative techniques outlined in this Comment are intended to minimize both the risk of inaccuracies and the practical burden of verifying the registration statement against written records. Neither section 11 nor BarChris ought to be read as imposing any investigative burden under the concept of "reasonable investigation" that is not justified by an increase in the protection accorded to investors.

58 See BarChris Symposium 226 (remarks of Stephen J. Weiss).
59 Address by Thomas G. Meeker, in BarChris Institute 578; BarChris Symposium 250 (remarks by Harry Heller); BarChris Symposium 231-32 (remarks of Stephen J. Weiss). The risk of liability might suggest to some that broad membership at any time should be avoided in favor of an informal "advisory" role in the corporation. See Comment, 43 N.Y.U. L. Rev. 1030, 1033, 1040 (1968); BarChris Symposium 249 (remarks of Harry Schwartz).
60 Address by F. Arnold Daum, in BarChris Institute 555-56.
61 See Address by Carlos L. Israels, in BarChris Institute 542; BarChris Symposium 237-38 (remarks of Carlos L. Israels).