



Warning! The Government May Not Have To Tell You The Truth When It Sells Securities

October 7, 2011 By [Keith Paul Bishop](#)

Last month, the [U.S. Treasury](#) issued this [press release](#) announcing a secondary public offering of warrants to acquire the common stock of a financial services holding company. The company originally issued the warrants to the Treasury in a private placement under the Capital Purchase Program established by the Treasury as part of its Troubled Asset Relief Program (“TARP”) as authorized by the Emergency Economic Stabilization Act of 2008.

When Buying From The Government, It’s *Caveat Emptor*

Being intrigued by the idea of the government as a selling security holder, I took a look at the prospectus. This risk factor caught my eye:

The Selling Security Holder is a Federal Agency and Your Ability to Bring a Claim Against the Selling Security Holder Under the Federal Securities Laws May Be Limited.

The doctrine of sovereign immunity, as limited by the Federal Tort Claims Act (the “FTCA”) provides that claims may not be brought against the United States of America or any agency or instrumentality thereof unless specifically permitted by act of Congress. The FTCA bars claims for fraud or misrepresentation. At least one federal court, in a case involving a federal agency, has held that the United States may assert its sovereign immunity to claims brought under the federal securities laws. In addition, the selling security holder and its officers, agents, and employees are exempt from liability for any violation or alleged violation of the anti-fraud provisions of Section 10(b) of the Exchange Act by virtue of Section 3(c) thereof. Accordingly, any attempt to assert such a claim against the officers, agents or employees of the selling security holder for a violation of the Securities Act or the Exchange Act resulting from an alleged material misstatement in or material omission from this prospectus supplement, the accompanying prospectus or the registration statement of which this prospectus supplement and the accompanying prospectus are a part or resulting from any other act or omission in connection with the offering of the warrants by the selling security holder or the shares of common stock issuable upon the exercise thereof would likely be barred.

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In other words, what's good for the goose (all other sellers of securities) is not good for the gander (the U.S. Government and its officers, agents and employees). I understand that the government doesn't want to be sued. After all, it's a real bother to get dragged into court and be forced to argue about materiality, scienter and the like.

A Few Good Reasons Why The Government Should Not Want Immunity

If asked why the government should have immunity, I'm sure that the government would claim that if it would cost the taxpayers a lot of money if the government could be sued for securities fraud. However, it is always unsettling to see the government play by a different set of rules than οι πολλοί. I can also think of some good reasons why there should be no governmental immunity. The government is likely to be the cheapest cost avoider.^[1] Not only is it the owner and seller of the securities, it is the regulator of the issuer of the securities. This puts the government in a far better (indeed, unique) position to know what's what than a prospective purchaser. Although the government will incur costs if it is subject to suit, it may actually save money. Also, by waiving immunity, the government would in effect signal to investors that disclosures are accurate and complete. Therefore, investors should be willing to pay more when they know that the seller can be held liable for misstatements and omissions. Finally, imposing liability will also deter any incentive on the part of the government to mislead investors.

California

It doesn't appear that the rules are much different here in California. In July, I [wrote](#) about Judge Susan Ilston's decision in *In re Nuveen Funds/City of Alameda Securities Litigation*, 2011 U.S. Dist. LEXIS 52135 (N.D. Cal. May 16, 2011). She concluded that the City of Alameda enjoyed absolute immunity under California Government Code Section 818.8 which provides: "[a] public entity is not liable for an injury caused by misrepresentation by an employee of the public entity, whether or not such misrepresentation be negligent or intentional."

^[1] Remember, [Guido Calabresi](#) and his idea that costs should be allocated to the person in the best position to assess and avoid those costs. See *The Costs of Accidents: A Legal and Economic Analysis*.