



January 1966

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Recommended Citation

J. B. Wolens, *"Hidden Gold" in the Blue Sky Laws*, 20 Sw L.J. 578 (1966)
<https://scholar.smu.edu/smulr/vol20/iss3/7>

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"HIDDEN GOLD" IN THE BLUE SKY LAWS

by

J. B. Wolens*

EVERYONE is familiar with the proverbial "pot of gold at the end of the rainbow"; however, judging from the paucity of reported cases, not many "potential" litigants or their counsel are cognizant of the latent opportunities presented by the blue sky laws and court decisions thereunder which could mean recoupment of what would otherwise be a substantial investment loss. I speak advisedly of the "paucity of reported cases." There is no practical way to determine, in fact, how many suits are brought under state blue sky law civil liability sections and settled either prior to or after judgment in the trial court.¹ Hence, it is conceivable that investors in fact have discovered more hidden gold in the blue sky laws than one would imagine from reading the reported decisions.² It is my purpose to explore the civil liability cases which have been brought not against those knowingly and wilfully violating blue sky law provisions but rather against those persons on the periphery of the transaction who have subsequently been held liable as a participant therein.

Let us construct a little drama of our own. Mr. B.I.G. Plunger, a substantial and seasoned investor in the security markets, purchases an unregistered security in No Chance Electronics, Inc. No Chance looks reasonably good on paper and has several government contracts pending which could mean substantial business and profits. No Chance prospers; the value of its stock soars; Mr. Plunger would not think of selling his shares of No Chance stock; and all parties to the illegal transaction are delighted with their deal—for a time. Then successive bad deals cause a reversal of No Chance's prior good fortune. The corporation has trouble meeting its government contracts and loses money on them; the value of its stock plummets; and Mr. Plunger begins to have grave reservations concerning the wisdom of his purchase. To compound the problem, the man from whom Mr. Plunger purchased the No Chance stock is no longer in the country, and No Chance commences bankruptcy proceedings. However, our little drama could have a happy ending for its leading man. Mr. Plunger

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¹As Professor Louis Loss has written, "the vice of studying litigation on the basis of formal adjudications is all too apparent: the curtain is rung down on many of these little dramas long before the last act, and none can tell what finally happened at trial or by way of settlement." Loss, *SECURITIES REGULATIONS* 1689 (temp. student ed. 1961).

²Other possible explanations for case scarcity are suggested in the "Conclusion," *infra*.

still might emerge unscathed from the transaction by consulting an attorney well versed in the blue sky laws, Mr. I. M. Smart.

Mr. Smart might advise our now sadder but wiser Mr. Plunger that all is not lost. Mr. Plunger may yet recover his invested capital, and conceivably he can recover up to double such amount plus interest on the purchase price (which will earn a handsome fee for Mr. Smart). Not a bad day's work for what was otherwise a very poor investment.³

To determine how this apparently benevolent turn of events (for Messrs. Plunger and Smart, at least) is possible, we turn to the other side of the coin. The money that flows into the pockets of our heroes must come from somewhere; all good little dramas must have their villains. In this instance such label may be pinned on an unwary, but wealthy, officer or director of No Chance or conceivably, a similarly well-fixed "link in the chain" of the sale of No Chance shares to Mr. Plunger. Fraudulent activity of a person involved in such sale is beyond the scope of our inquiry, as his liability reasonably could be predicted either under an appropriate securities statute or at common law (tort liability). Rather, we shall inquire into the strange and seemingly incongruous liabilities incurred by virtue of official capacity or good samaritanism and which can result under statutory language or judicial gloss thereon.

It is assumed that the stock being considered has been sold in violation of one or more provisions of a given blue sky law. The violation may arise because of an assumed exemption from registration which fails, such as the private offering exemption, where it is proven subsequently that the stock was offered to more than the limited number specified in the exemption. Or the violation may result simply from lack of knowledge on the part of the issuer and its counsel that registration was required. A glance at the Uniform Securities Act indicates the numerous ways in which civil liability may be incurred. For example, under the Uniform Securities Act⁴ civil liability arises when a person offers or sells a security in violation of the act's provision making it unlawful for him (1) to transact business as a broker-dealer or agent unless registered under the act;⁵ (2) to offer or sell a security not registered under the act unless the

³ Hopefully, the little drama evolved herein will not imply that a market-seasoned investor would invest in fact in the unregistered securities of such an unseasoned company as No Chance. It must be understood that this is an atypical situation, constructed solely to illustrate what in the writer's opinion is possible under present law and court decisions. It is not intimated that actual situations will occur with any frequency where this result would be possible.

⁴ UNIFORM SECURITIES ACT § 410(a). As an example of the exemplary damages available for willful violation see The Texas Securities Act, TEX. REV. CIV. STAT. ANN. arts. 581-33.

⁵ UNIFORM SECURITIES ACT § 201(a).

security or transaction is exempt;⁶ (3) to represent that the registration of the security means that the statements made in the registration are true and not misleading or that approval of the security constitutes a recommendation or determination of the merits of the investment;⁷ (4) to use sales literature before it is affirmatively approved;⁸ (5) to make such sale without the use of a prospectus when required;⁹ (6) to violate the terms of stock or proved escrow agreements required by the administrator pursuant to the act;¹⁰ and (7) to use a form or contract for sale other than the one prescribed by the administrator as permitted under the act.¹¹ In addition, of course, civil liability can arise where a security is sold or offered for sale by means of an untrue statement or omission which in effect is material and fraudulent and misleading to the purchaser.¹²

More particularly in point for the purposes of this discussion is the act's provision making every person controlling the seller; every partner, officer, director or employee of the seller; and every broker-dealer or agent who materially aids in the sale jointly and severally liable with and to the same extent as the seller unless such person sustains the burden of proof that he did not know and in the exercise of reasonable care could not have known of the facts upon which his liability is predicated.¹³ This is the section of the uniform act which is directed to those herein labeled as the persons "peripherally liable."

One must be hesitant in drawing any conclusions based upon judicial decisions of more than one state and even of the same state where different statutory requirements are involved. However, if any relatively meaningful conclusions are to be drawn, some classification within the varying statutory format must be attempted.

As indicated above, civil liability for a securities sale results from a violation of the registration, licensing, or fraud provisions of a blue sky law (or federal security act) and/or regulations thereunder.

I. STATUTORY ANALYSIS OF BLUE SKY LAWS

A. *No Civil Liability Section—Illegality As Basis For Liability*

Some courts have found civil liability in this peripheral area of an illegal security sale even under a statute which does not purport to

⁶ UNIFORM SECURITIES ACT § 301.

⁷ UNIFORM SECURITIES ACT §§ 405 (a), 405 (b).

⁸ UNIFORM SECURITIES ACT § 403.

⁹ UNIFORM SECURITIES ACT § 304 (d).

¹⁰ UNIFORM SECURITIES ACT § 305 (g).

¹¹ UNIFORM SECURITIES ACT § 305 (h).

¹² UNIFORM SECURITIES ACT § 410 (a) (2).

¹³ UNIFORM SECURITIES ACT § 410 (b).

impose any civil liability upon anyone. Statutes of this type are found in varying form. The blue sky laws of Minnesota and Nebraska in effect provide only criminal penalties for violations.¹⁴ The California act declares simply, "Every security of its own issue sold or issued by any company without a permit of the commissioner then in effect authorizing the issuance or sale of the security is void."¹⁵ The rationale for civil liability of persons peripherally connected with such sales under these statutes normally proceeds with the premise that any sale in violation of a penal statute is void (as is expressly stated in the California act). Furthermore, a principal violating the statute commits a criminal act for which he and all his accomplices are liable to the state. From this criminal liability the courts then impose remedial civil liability not only upon the principal but also upon his accomplices because they all are co-conspirators under the penal statutes of the state.¹⁶

B. *Civil Liability Section—Persons Liable Expressly Named In Statute*

The majority of the blue sky laws do impose civil liability upon certain classes of persons. Such statutes vary substantially in format but may be generalized by the form of the Ohio provision which reads, "Every sale or contract for sale made in violation of [appropriate sections of this act] . . . is voidable at the election of the purchaser. The person making such sale or contract for sale, and every person who has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to such purchaser."¹⁷ Though similar in format to the Ohio provision, the statutes of Iowa and Oregon purport to predicate such liability upon *personal participation and knowledge of the violation*. Finally, there are those states which have now adopted the Uniform Securities Act with various modifications.¹⁸ Blue sky law liability provisions as classified above represent the present laws of the specified jurisdictions which are culminations of statutory development in this area for each such state.¹⁹

¹⁴ MINN. STAT. ANN. § 80.37(1) (1946); NEB. REV. STAT. § 81.333 (1943).

¹⁵ CAL. CORPS. CODE § 26100.

¹⁶ *Mary Pickford Co. v. Bayly Bros.*, 12 Cal.2d 501, 86 P.2d 102 (1939); *Noll v. Woods*, 231 Mich. 224, 203 N.W. 848 (1925); and cases cited in notes 40-44, *infra*.

¹⁷ OHIO REV. CODE ANN. § 1707.43. Also applicable are those of Georgia, Illinois, and Florida.

¹⁸ States in this final category which are considered herein and have now adopted the Uniform Securities Act in more or less standard form are Alabama, Alaska, Arkansas, Colorado, Hawaii, Indiana, Kansas, Kentucky, Maryland, Michigan, Montana, Nevada, New Jersey, Oklahoma, South Carolina, Utah, Virginia and Washington. 9 C. UNIFORM LAWS ANN. (1965 Supp.).

¹⁹ It must be recognized that the statutory schemes as classified herein represent the *current* law of the jurisdictions listed and not the statutes in effect at the time of the case decisions hereinafter discussed.

Consider now the court development under language analogous to that of the Ohio act which makes the illegal sale voidable and every person who has *participated* or *aided* in the sale jointly and severally liable to the purchaser.

II. PARTICIPATING AND AIDING

A. Agents

1. *Civil Liability Where Agency for the Seller Is Established* It should be noted at the outset that normally the person selling a security in violation of a blue sky law is liable to the purchaser. Statutes which expressly set forth liability for officers, directors, and agents usually require that these parties be *legally related* to the seller before there is civil liability to the purchaser. The thrust of the majority of the blue sky laws, then, is toward the person who *sells* in violation of the act rather than just the issuer thereof; and unlike the federal acts in no instance is an attempt made to regulate the purchaser of the security.

In the early case of *Lewis v. Bricker*,²⁰ the Michigan court held the defendant liable because of his "assistance" in selling unregistered securities. The facts disclosed that the defendant was simply a good samaritan who became ensnared by introducing the plaintiff to men selling the stock of an Ohio company. The introduction was made in Michigan. The defendant invited the plaintiff to go to Cleveland to look at the company. The defendant was present but apparently did not take part when the salesmen made their pitch in Michigan. He did accompany the plaintiff on the Cleveland trip, paying for a dinner along the way. The sale was actually consummated in Ohio. The Michigan statute in force at that time made it unlawful for any company or representative thereof to sell or in any manner negotiate for the sale of an unapproved security. The Ohio company's stock had not been approved in Michigan, and hence the Michigan statute was violated. In holding the defendant civilly liable, the court found it was unnecessary to show that the defendant had made representations as to the stock itself or that his actions had been a procuring cause of the sale. It was sufficient that the defendant's activity had assisted in the unlawful enterprise and that a part of such assistance had taken place in Michigan. By virtue of his actions, the good samaritan was made a representative and agent of the Ohio company (albeit unauthorized) and a *participant* in the sale.

Again in Michigan, the court found that a trustee of a real estate

²⁰ 235 Mich. 656, 209 N.W. 832 (1926).

syndicate, by accepting purchase payments for participating interests therein and acting as trustee of the syndicate, had joined with the promoters in carrying out the enterprise and was chargeable with knowledge of the fact that such interests were not registered as required by the Michigan Blue Sky Law. It made no difference whatever that the trustee did not actually profit from such activity.²¹

In *Cleland v. Smart* under an unusual fact situation a corporate president was held to be a selling agent.²² The defendant was introduced to the plaintiff by the company's secretary. Several days after such introduction, the defendant wrote the plaintiff advising her that she had been "nominated and voted on unanimously for membership in the corporation." Such letter further advised the plaintiff that certain shares of stock had been reserved for her and welcomed her "into the organization." The court held that such letter constituted an active inducement and persuasion intended to cause plaintiff to complete the purchase of the shares of stock. Though the defendant purported to act only as president of the company, such fact did not insulate him individually from being held a selling agent of the company.

In another instance a plaintiff's own regular attorney who recommended the purchase of securities in a company in which the attorney was an officer and director was held to have been such an active participant in the ultimate sale of such stock to the plaintiff so as to render the attorney civilly liable under the California act.²³

In the Oregon case of *Adamson v. Lang*²⁴ the court held a creditor liable to purchasers of securities for lending money to an officer of the selling corporation. The court held the creditor knew (or should have known) that the funds so loaned were to be used by the corporation to avoid an escrow requirement of the Oregon Corporation Commissioner. The loaned funds were used to purchase sufficient shares to meet the escrow requirements, and the subsequently released escrowed funds were used by the corporation to pay off its officer's debt. The court held that the statutory language, which referred only to persons making the sale, was sufficiently broad to include any person who *aids* another in making the sale.

The agency concept of participation was probably carried to its extreme in the Texas case of *Brown v. Cole*.²⁵ The facts showed that

²¹ *Freeze v. Smith*, 254 Mich. 386, 236 N.W. 810 (1931). See also under analogous facts *Frenzel v. Lonquist Co.*, 304 Ill. App. 377, 26 N.E.2d 687 (Ill. Civ. App. 1940).

²² 321 Mich. 46, 32 N.W.2d 42 (1948).

²³ *Strangman v. Arc Saws, Inc.*, 123 Cal. App. 2d 620, 267 P.2d 395 (Dist. Ct. 1954).

²⁴ 236 Ore. 511, 389 P.2d 39 (1964).

²⁵ 155 Tex. 624, 291 S.W.2d 704 (1956).

the defendant Brown approached one Gould with information concerning a venture which contemplated a loan by Brown and others. Those participating in the loan were to receive, proportionately, all the shares of a Mexican corporation which, in turn, owned a quarter interest in certain Mexican mining properties. It was Gould who initially advised and discussed this matter with the plaintiff. The plaintiff, not being satisfied with the representations made to him by Gould, sent his auditor to visit the mining site itself. The defendant Brown planned and paid the expenses for the trip. Payments for the security interest were made to Brown as agent per Brown's instructions. A letter written by Brown acknowledged receipt of the payment and plaintiff's participation in the venture. The court, in holding Brown liable, found that there need not be only one seller in a given transaction. "Clearly there may be more than one [seller]. As we interpret the Act [Texas Blue Sky Law] the seller may be any link in the chain of the selling process or in the words of the Act he is one who performs 'any act by which a sale is made.'"²⁶

The court recognized that Brown had acted as the agent for the purchasers at a certain stage in the transaction and by virtue of such activity alone could not be liable to the purchasers under the Texas act. Nevertheless, the court stated that Brown also had acted as an agent for the *seller* at the instant the sale of the unregistered securities was made:

Granting that Brown was the agent of respondents [Cole and Gould], as he must have been in the transmittal of the funds to Cain, that was only a part of and resulted from dealings had theretofore with respondents. The respondents had agreed to participate in the deal prior to the time that the letters of acknowledgment were written. Petitioner could not, by designating himself as agent, escape his responsibility for the negotiations with Gould and Cole leading up to their purchase.²⁷

The court founded participation by Brown on his following activities: (1) initially discussing the proposal with the plaintiff; (2) writing Gould further information in regard thereto; (3) displaying letters relative to such transaction to plaintiff's auditor; (4) writing further details concerning the venture; (5) making the trip to Mexico at his own expense; and (6) giving instructions as to how the checks were to be made and money remitted.²⁸

²⁶ *Id.* at 708. (Emphasis added.)

²⁷ *Id.* at 708-709. (Emphasis added.)

²⁸ It should be noted that the court rejected the defense of joint venture which is somewhat analogous to cases discussed hereinafter where the courts have found that those who participate in the initial formation of a business venture stand on "equal footing" with all others so participating and hence there is no civil liability between them. *Brown v. Cole*, 155 Tex. 624, 291 S.W.2d 704 (1956).

2. *No Liability Where No Agency for the Seller Is Established* A comparison of cases from other jurisdictions with the foregoing runs the hazard of contrasting cases decided under differing statutory schemes. With this initial caveat, which may be unnecessary in view of the extremely limited amount of participation allowed within any jurisdiction, consider the following limited instances in which potential "agents" were found to have no liability.

It could be presumed that the official designated by a particular blue sky law to issue the permit authorizing the sale of securities within the jurisdiction incurs no liability for the issuance of such permit. In the only case found on the subject, the South Carolina court denied such liability relying upon the legend, which was required by statute to be printed upon the face of the Commissioner's certificate to the effect that the certificate was not to be construed as a recommendation of the security for purchase.²⁹

Likewise, it has been held that under a statute imposing liability on anyone who shall have personally "aided in any way in making the sale" a bank which was used to deposit sales proceeds and which was named in sales literature was not liable to a purchaser of unregistered securities.³⁰

In two companion cases under an Oklahoma statute making sales voidable at the election of the purchaser, the Oklahoma Supreme Court found that the bank, acting as registrar of stock whose sole duty was to register any certificate of stock in the corporation upon presentation to it by the transfer agent, was not liable to the purchasers thereof. In one case the court reasoned that there was no duty upon the bank to ascertain any information from the corporation other than the number of shares originally authorized and the number then outstanding. The registration of the certificate was held to imply nothing more than that it was within the limits authorized by the corporate charter.³¹ In the other case, the court, under the statutory definition of an "agent" as a "salesman," decided that since

²⁹ *Minter v. McSwain*, 126 S.C. 371, 119 S.E. 901 (1923).

³⁰ If it be assumed . . . that the bank was aware that . . . prospective purchasers were being asked to send their checks made payable to the bank, *this is not enough* to establish an agency. Nor does the willingness of a bank to become the depository of funds amount to a personal participation or an aid in making the sale. The Supreme Court of Florida has held that the statutory language . . . 'implies some activity in inducing the purchaser to invest.' *Nicholas v. Yandre*, 151 Fla. 87, 9 So. 2d 157, 160 . . . *the permission of the bank, whether express or tacit to the use of its name was not part of the taking of an active part in influencing the appellant to purchase.*

Sorenson v. Elrod, 286 F.2d 72, 74 (5th Cir. 1960). (Emphasis added.)

³¹ *Dunham v. Chemical Bank & Trust Co.*, 180 Okla. 534, 71 P.2d 468 (1937). Note that this case was decided under a 1921 statute, which has been repealed, and is not to be considered conclusive on this subject at this time. *Cf.*, notes 71 and 72 *infra* and accompanying text.

a corporation was not a natural person it could not be a "salesman" within the meaning of the act, and therefore could not *personally* participate or aid in making a sale. Dicta in such opinion also tended to show that the Oklahoma court placed some reliance upon the knowledge of the participant of the violation, or, alternatively, at least required circumstances which imposed upon the participant a duty to learn of the violation.³²

3. *No Liability Where Agency Is for Purchaser Only* One of the major contentions of the defendant in the *Brown* case was that he acted as an agent for the purchaser in acquiring the security. As noted above, the Texas court rejected such contention, holding that while the defendant acted generally as an agent for the purchaser, in one instance he nevertheless acted for the seller. Some instances are found where liability has been denied because sales were consummated by a person (in most instances a broker-dealer) acting solely as an agent for the purchaser. As noted, none of the blue sky laws herein considered attempt to regulate purchasers or the purchase of a security as distinguished from the federal statutes which purport to regulate both buyers and sellers. In a typical case a stock broker executing an unsolicited order for a security which was not registered within the jurisdiction was not held liable in part because throughout the transaction the broker had acted as agent for the purchaser, and at no time had he bought or sold for his own account.³³

Similarly, an Illinois court in *Weisbrod v. Lowitz*³⁴ found the defendant stock broker not liable to the plaintiff on the theory that the broker had acted solely as an agent for the buyer and the actual sellers of the security were the undisclosed principals of the New York brokers who had made the sale to the defendants on the floor of the New York Exchange. It was not determinative that the defendant's salesman advised the plaintiff that the stock was a "good buy," because the plaintiff was seeking such information at the time. The court took pains to distinguish the situation from those where a defendant broker would actively solicit a purchaser to buy a specific security or where a broker would buy for his own account and then resell at a profit without charging the purchaser a fee. This latter situation did in fact result in broker liability where, instead of acting as an agent for the purchaser of the security and charging a commission thereon, the broker had purchased the security and then had

³² "The theory of the bank's liability is dispelled by the absence of any proof of scienter and the admitted and obvious fact that it was not a natural person." *Braniff v. Coffield*, 199 Okla. 604, 190 P.2d 815, 820 (1947).

³³ *Fine v. Bradford*, 136 S.E.2d 147 (Ga. Civ. App. 1964).

³⁴ 282 Ill. App. 252 (1935).

resold it, making a profit on the resale.³⁵ Thus, in the area of broker-client relations some guidelines may be drawn on the basis of non-solicitation and a commission charge.

4. *No Liability Between Co-Organizers* Though the problem of registration requirements for pre-incorporation subscriptions is beyond the scope of this Article, nevertheless it is necessary to mention at least briefly the problems necessarily involved where a party is induced to invest in a business which has not yet been organized. This was in part the problem of the *Brown* case,³⁶ where the contention of joint venture in the business formation was rejected by the Texas court. The states are divided as to whether or not such subscriptions should be registered and therefore subject to civil liability penalties. Findings of no liability have been predicated upon the fact that no method for registering pre-organization subscriptions has been provided by the statutes under consideration. (This may even be true where the term "security" is defined by the act to include pre-organization subscriptions.) Other theories for nonliability emphasize that all those initially forming the organization are equally responsible for complying with the blue sky laws and, to the extent such laws are violated, the parties are considered to be *in pari delicto*.

A plaintiff who was involved in all initial discussions and organizational meetings of a corporation being formed to continue an existing poultry business and who subsequently signed the articles as an original subscriber was not permitted to recover against his co-incorporators.³⁷ The court buttressed its holding by finding upon both theories of non-liability—that is, there was no provision in the state's law requiring registration, and, further, each co-subscriber was equally obligated to register the security if such were required.³⁸

In another case the defendants actually solicited the plaintiffs to join in the business venture and to take an active part therein. The plaintiff proposed the corporate form and engaged in all meetings

³⁵ *Taft v. Orte & Co.*, 274 Ill. App. 280 (1934).

³⁶ *Brown v. Cole*, 155 Tex. 624, 291 S.W.2d 704 (1956).

³⁷ *Guyann v. Shulters*, 223 Miss. 232, 78 So.2d 114 (1955).

³⁸ In *Watkins v. Public Serv. Life & Accident Co.*, 188 Wash. 280, 62 P.2d 464, at 465, the court said, "here, the respondent's services were rendered as a step in the creation or organization of a corporation. He produced subscriptions to the capital stock, . . . his services were all rendered prior to the time that the prospective corporation could legally issue securities, the sale and disposition of which would be regulated by the Securities Act." In *Gannon v. Grayson Water Co.*, 254 Ky. 251, 71 S.W.2d 433, at 434, the court said: "though the act provides that 'security' shall include 'pre-organization subscriptions', it is at once apparent that, when subscriptions are taken prior to filing of articles of incorporation, no method is provided for the registration of such subscriptions."

Id. at 110. (Emphasis added.)

leading up to the actual incorporation. The plaintiff signed one set of articles as an incorporator (though such articles were rejected by the Secretary of State and a new set was filed which the plaintiff did not sign). Plaintiff accepted positions as secretary-treasurer and director of the corporation. The California court held that all of the parties stood on an "equal footing" as entrepreneurs of the business and that there was no reason why the defendants should reimburse the plaintiff for his loss when the business became insolvent.³⁹

Some guidelines may be possible in this area of pre-incorporation subscriptions. Barring a statutory requirement of registration, no registration should normally be required where the parties *in the creation* of the business invest or agree to invest therein. Once the business has been legally formed, other problems arise; and certainly the safest course then is to register.

B. Officers And Directors

1. *Liability Under Common Law—Criminality of Act as Basis* As seen in the *Cleland* case,⁴⁰ officers and directors have often been subjected to personal liability despite their protests that they acted only in an official corporate capacity. Liability has been predicted upon various theories which may be loosely classified under common law concepts or statutory language. Common law concepts may further be subdivided by the theories upon which liability is predicated. One such theory holds that officers and directors participating in a sale which is made illegal under the statutes of the jurisdiction are co-conspirators under the penal statutes of the state and, as such, are liable to the same extent as would be a principal. Most such statutes impose civil liability upon the seller, and the courts reason that co-conspirators violating a criminal statute are civilly liable as would be the principal.⁴¹ Common law liability also has been predicated upon an implied representation by the officers and directors of the issuer that the security sold is properly issued, that is, that a permit or registration has been obtained therefor. Where such is not the case, there is a negligent misrepresentation which is actionable fraud at common law for which all participating persons are liable.⁴²

We should distinguish at the outset those cases involving officers and directors who, knowingly and intentionally, perpetrate a fraud upon the prospective or actual purchaser of an unregistered security

³⁹ *Holmberg v. Marsden*, 39 Cal. 2d 592, 248 P.2d 417 (1952). Compare *Smith v. Turner*, 47 Cal. Rep. 582 (Dist. Ct. 1965).

⁴⁰ See note 22 *supra* and accompanying text.

⁴¹ *Noll v. Woods*, 231 Mich. 224, 203 N.W. 848 (1925).

⁴² *Gormly v. Dickinson*, 179 Cal. App. 2d 92, 2 Cal. Rep. 650 (Dist. Ct. 1960).

and those cases where officials are the actual "salesmen" of the security. Such cases are not within the scope of this discussion which concentrates only upon officer-director liability based upon *implied* knowledge by virtue of official duties or position in the corporate seller.

The Michigan Supreme Court, in holding a corporate president civilly liable even prior to its present blue sky law, relied upon a penal statute which made it unlawful for any investment company or representative thereof to negotiate in any manner for the sale of an unregistered security. The court determined that a civil action to recover money was not based on fraud but rather upon the fact that a sale made in violation of a penal statute is void, and that all persons aiding and assisting in the commission of such violation are principals. Thus, where the defendant aided in the purchase of unregistered securities in a company in which he was president and signed the certificate for the shares so purchased, he was liable to the purchaser for having assisted those who sold the security—regardless of whether or not he personally profited by such sale.⁴³

In the above case the securities, though previously sold, were not issued until after the approval of the Michigan Security Commissioner had been obtained. The court held that the illegal sale was not vitiated by the approval. To like effect is the ruling of the California court:

This illegality [criminal penalties for violation of the Securities Act] infects the final act in the transaction, the issuance of the shares of stock, even though that act occurs after the issuance of a state permit . . . It is the validity of the sale, not the validity of the shares or their issuance, which is the crucial question. The collection of the money, a significant part of a sale for value . . . occurred at a time when there could be no legal sale.⁴⁴

2. *Liability Under Common Law—Implied Misrepresentation as Basis* Under general corporate law, a corporate director or officer may not profit at the expense of the corporation, and where such officials actively participate in a fraud which results in a loss to purchasing shareholders, such shareholders may rescind the transaction.⁴⁵ Some jurisdictions however, would hold that silence alone will not render a director liable to a prospective purchaser. For example, a director was held not liable where his sole activity was approval of a prospectus which omitted a material fact and where the plaintiff

⁴³ See note 16 *supra*. More recent Michigan cases have reached similar results under various versions of the "standard liability provision." See *Nelson v. O'Dell*, 335 Mich. 50, 55 N.W.2d 723 (1952); *Veenstra v. Associated Broadcasting Corp.*, 321 Mich. 679, 33 N.W.2d 115 (1948). *Accord*, *Mosley v. Unruh*, 150 Kan. 469, 95 P.2d 537 (1939).

⁴⁴ *Randall v. Beber*, 107 Cal. App. 2d 692, 237 P.2d 994, 999 (Dist. Ct. 1951).

⁴⁵ *Holloway v. Ostcograf Co.*, 240 Ala. 507, 200 So. 197 (1941).

did not prove that there was fraudulent concealment on the part of the director.⁴⁶

The theory upon which officer-director liability often is predicated was probably most succinctly stated by the California court in *Gormly v. Dickinson*,⁴⁷ where the court buttressed its holding under the illegal sale theory with a concurrent holding upon the actionable fraud theory in the following language:

While it has long been settled that the purchaser of securities issued in violation of the Corporate Securities Law may recover in an action for money had and received on the theory that the sale and the securities are void, [citations omitted] . . . it is also the law that a person who sells a security impliedly represents that a permit therefor has been secured when one is required by law for such a sale, and if this implied representation is false, then it is a negligent misrepresentation which is actionable fraud . . . and, where, as here, the action is for damages for fraud, recovery may be had against *all persons participating in the fraud*, whether they receive a portion of the money paid or not.⁴⁸

The Nebraska court in the case of *Davis v. Walker*,⁴⁹ in effect held its local blue sky law inapplicable to officers and directors but nevertheless held such officers and directors liable under the common law responsibilities and duties of corporate officers and directors stating that a corporation must act through individuals who are chargeable with knowledge of the law.⁵⁰ Though the Nebraska court did not feel constrained to rely upon the terms of its statutes which purport to make any person selling a security in violation of the statute liable, there is authority to sustain the proposition that such statutory language is sufficiently broad to include officers and directors of a company selling unregistered securities in violation of a local blue sky law.⁵¹

3. Liability Under Statute—Officers and Directors Generically

⁴⁶ Lovell v. Smith, 232 Ala. 626, 169 So. 280 (1936).

⁴⁷ 179 Cal. App. 2d 92, 2 Cal Rep. 650 (Dist. Ct. 1960).

⁴⁸ *Id.* at 656. (Emphasis added.) *Accord*, Elzarian v. Wiser, 216 Cal. App. 2d 506, 31 Cal. Rep. 126 (Dist. Ct. 1963); Adkins v. Wyckoff, 152 Cal. App. 2d 131, 313 P.2d 592 (Dist. Ct. 1957); Ogier v. Pacific Oil & Gas Dev. Corp., 132 Cal. App. 2d 496, 282 P.2d 574 (Dist. Ct. 1955); Taormina v. Antelope Mining Corp., 110 Cal. App. 2d 314, 242 P.2d 665 (Dist. Ct. 1952).

⁴⁹ 170 Neb. 891, 104 N.W.2d 479 (1960).

⁵⁰ [A] corporation has no thought or will of its own, and its every act is the act of those individuals who are running it; that where the duty of knowing facts exist, ignorance due to neglect of duty on the part of a director creates the same liability as actual knowledge and a failure to act thereon; and that where fraud is committed by a corporation, which is the situation in the case at bar, it is time to disregard the corporate fiction and hold the persons responsible therefor in their individual capacities.

Davis v. Walker, *supra* note 49, at 489.

⁵¹ Miller v. Griffith, 28 Ohio App. 2d 278, 196 N.E.2d 154 (1961).

Named As noted, a majority of the blue sky laws purport in one way or another to make all persons selling securities in violation of their provisions jointly and severally liable to the purchasers thereof. These statutes take various forms, but most are couched in terms which make any sale in violation of the statute voidable at the election of the purchaser. Most statutes also subject any person who sells or participates in such sale to joint and several liability to the purchaser. Despite differences in statutory language, court decisions have brought the various statutory forms into very close accord when measured by the results achieved. Thus, even though a statute may speak in terms of "any person" and may not expressly name officers or directors of the corporate seller as persons civilly liable, the courts have had no difficulty in holding an officer or director liable to the purchaser though the officer's or director's participation may have been only in his official capacity.

Our inquiry then must turn to a consideration of what facts have, or have not, been deemed sufficient to hold an officer and/or director of a corporation personally liable to a purchaser of securities sold in violation of the local blue sky law. It is assumed that in all instances the officer and/or director is not the motivating factor in such sale but rather incurs such liability because of some peripheral participation therein. Again, note the basic assumption that there has been a violation of the local blue sky law so as to bring the civil liability provisions into effect.

Certainly we will have no difficulty in finding participation where a corporate officer: (1) was in sole charge of the only corporate office which was maintained in his building; (2) took reports of the salesmen authorized by the corporation to sell its unregistered securities; (3) deposited proceeds from such sales in the company account; (4) paid commission to the salesmen on such sales; (5) signed the certificates issued pursuant to such sales in his official capacity; (6) permitted sales to be conducted in his presence; and (7) wrote letters to prospects recommending investments in the company.⁵² The problem becomes one of determining how few of these criteria may be involved without releasing, as it were, the officer or director from liability as a *participant*. Remembering that all generalizations are subject to exceptions, one may conclude that the chances are very good that an officer or director will be held civilly liable to a purchaser where there is *any* degree of participation by such officer or director in an illegal sale.

Under a statute purporting to make all sales in violation of the

⁵² Drees v. Minnesota Petroleum Co., 189 Minn. 608, 250 N.W. 563 (1933).

statute voidable and "all actively engaged in making such sales" liable to the purchaser, the Michigan Supreme Court has held that recommending the purchase, accepting checks for the purchase price, and signing the stock certificates as president of the company is sufficient participation to render a corporate president liable to the purchaser.⁵³

The Michigan court went further in the somewhat strange fact situation presented in *Cleland v. Smart*,⁵⁴ where the court apparently held that the writing of a letter by the corporate president to a prospective purchaser stating that such prospective purchaser had been "nominated and voted on unanimously for membership" and advising the purchaser that stock had been reserved in her name was sufficient participation in the resulting sale to render the president liable thereon.⁵⁵

Some courts have been tempted to draw a distinction between the actual sales transaction as consummated between purchaser and seller and the ministerial or official duties of a corporate officer in the issuance of the share certificate. Thus, the Utah Supreme Court found no liability in *Willis v. Spring Canyon Copper Co.*,⁵⁶ where the secretary of the corporation accepted the purchase price and signed the certificate for the shares as secretary of the corporation. The court concluded that the sale was complete upon payment to the authorized salesman and became binding at that time before the certificate was issued, "as evidenced by daily stock brokers' transaction." The court added:

The receipt of the money by [the corporate secretary] . . . and his signing of the certificate, *being acts unnecessary to complete the sale*, the only fact called to our attention . . . that might point to . . . [the secretary's] participation in the sale, was his vote for the resolution giving the agent . . . authority to sell the stock—a fact we have held would not constitute participation or aiding in the sale under the statute where otherwise it appeared that the officer approving the resolution *took no active part in effecting the sale*.⁵⁷

The concurring opinion stressed that such acts are only ministerial and do not establish the officer as a participant in the sale of unregistered securities.

The Kansas Supreme Court reached an opposite result in *Daniels*

⁵³ *Chambers v. Beckwith*, 247 Mich. 255, 225 N.W. 605 (1929). *Accord*, *Ferar v. Hall*, 330 Mich. 214, 47 N.W.2d 79 (1951).

⁵⁴ 321 Mich. 46, 32 N.W.2d 42 (1948). See also note 22 *supra* and accompanying text.

⁵⁵ As noted previously, however, such liability was predicated as much on the activity alone as on the fact that it was performed by the corporate president.

⁵⁶ 4 Utah 2d 211, 291 P.2d 878 (1956).

⁵⁷ *Id.* at 879. (Emphasis added.)

v. Craiglow,⁵⁸ holding that a corporate officer who received the purchase payment for unregistered corporate shares and who subsequently signed such certificate and mailed it to the purchaser was liable thereon as a participant in such transaction.⁵⁹ It may be noted that the Kansas court reinforced its rejection of the "ministerial duty" theory by relying also upon the implied misrepresentation doctrine in that through authenticating and issuing the share certificates the president and secretary represented that the sale was not "tainted with illegality," by failing to procure a blue sky permit.⁶⁰

Directors have been held to have *personally aided* in sales of unregistered securities by permitting or knowingly not objecting to the use of their names, pictures, and financial statements in various forms of advertising literature used by corporate agents in selling unregistered securities.⁶¹ The most strained interpretation of "participation" may have been adopted by those courts which have held a corporate president liable for doing nothing more than signing the share certificates in his official capacity as president.⁶²

4. *Liability Under Statute—Officers and Directors Expressly Named*

An interesting situation arose under an Oregon statute which purported to make an officer or director of the selling corporation liable if he personally participated in making the sale *with knowledge of the violation*.⁶³ Two of four directors were actively involved in the sale of the corporation's unregistered securities. The other two participated only indirectly in that one supplied the selling literature prepared by others and the other examined proofs of the sales literature and approved the contents. The Oregon Supreme Court held that sufficient "knowledge" was established with respect to the latter directors by proof that they knew the security was unregistered. It was unnecessary to prove, in addition, that they knew the law required the security to be registered.⁶⁴ Thus the court effectively evaded the express statutory requirement of knowledge.

Further judicial extensions of statutory language may be seen

⁵⁸ 131 Kan. 500, 292 P. 771 (1930).

⁵⁹ "[P]ayment of price and issuance of share certificate are normal concomitants of a sale of shares. . . . Plaintiff could not enjoy to the full extent all her privileges as a shareholder until she received a share certificate. The share certificates she did receive were the tangible evidence of what she bought, and her transaction with the company took the form of payment of price followed by symbolical delivery. The treasurer received the money, and the president and secretary made the delivery." *Id.* at 772-73. (Emphasis added.)

⁶⁰ For a more recent Kansas decision, see *Dalton v. Lawrence Nat'l Bank*, 169 Kan. 401 219 P.2d 719 (1950).

⁶¹ *Braniff v. Coffield*, 199 Okla. 604, 190 P.2d 815 (1947).

⁶² *Miller v. Griffith*, 28 Ohio App. 2d 278, 196 N.E. 154 (C.P. 1961).

⁶³ ORE. REV. STAT. § 59.250(1).

⁶⁴ *Spears v. Lawrence Sec., Inc.*, 399 P.2d 348 (Ore. 1965).

in *Harper v. Tri-State Motors, Inc.*⁶⁵ Under a statute apparently requiring officer/director participation to establish liability for an illegal sale, the Utah Supreme Court first espoused the doctrine of participation, then reached the position that an officer or director is virtually liable per se:

He [the corporate president] cannot be held liable merely because he happened to be president of the corporation at the time, or because he signed the stock certificate which Richards delivered to the purchaser, or because he proposed and voted for the resolution passed by the board of directors . . . under which Richards claimed to act, nor because of all of these things. These facts if not explained . . . might well be regarded . . . as evidence proving that he did have some part in the transaction. The fact that he *signed the stock certificate is alone strong evidence to that effect, and in the absence of other proof might be sufficient to support a finding against him.*⁶⁶

On the other hand, the Colorado Supreme Court determined that the signing of the stock certificate by the corporate secretary was a ministerial duty by which the secretary merely attested to the president's signature. Such activity did not constitute participation by the secretary in the sale of shares represented thereby.⁶⁷

The Florida Supreme Court concluded that directors who voted to affirm a sale previously concluded had not participated therein so as to render them personally liable since "the language [of the statute] implied some activity in inducing the purchaser to invest."⁶⁸ The Alabama court also held that a director who voted only as to the disposition of the purchase price (in this case the sale of liberty bonds received in exchange for unregistered corporate securities) was not personally liable for participating in the illegal sale which gave rise to such proceeds. The court likened such action to that of a corporate treasurer who deposits cash received for the sale of unregistered securities, implying thereby that the treasurer would not be liable in such instance.⁶⁹ The Oklahoma Supreme Court now is in substantial agreement with the majority view that officers and directors of the selling corporation are civilly liable to the purchasers of unregistered securities under the terms of Oklahoma's 1931 Blue Sky Law.⁷⁰ The decision in *Dunham v. Chemical Bank & Trust Co.*⁷¹ decided under

⁶⁵ 90 Utah 212, 58 P.2d 18 (1936).

⁶⁶ *Id.* at 23. (Emphasis added.)

⁶⁷ *Holland v. American Founders Life Ins. Co.*, 151 Colo. 69, 376 P.2d 162 (1962).

⁶⁸ *Nichols v. Yandre*, 151 Fla. 87, 90 So. 2d 157, 160 (1942). (Emphasis added.) See also *Scott v. Novick*, 172 So. 2d 516 (Fla. App. 1965).

⁶⁹ *Westerhaver v. Dunnivant*, 225 Ala. 400, 143 So. 823 (1932).

⁷⁰ *Coffield v. Ernsberger*, 187 Okla. 79, 101 P.2d 251 (1940).

⁷¹ 180 Okla. 534, 71 P.2d 468 (1937).

the 1921 Oklahoma Blue Sky Law is no longer controlling law in this area.⁷²

5. *Official Capacity as Basis for Liability* Absolute liability of a corporate officer or director based solely on his official capacity with the selling corporation is the next logical extension of peripheral liability. Such an extension would result in the liability of every officer and director of a corporation participating in an illegal sale. In view of the extent to which courts have gone to find *participation* by an officer-director, it should come as no surprise that some courts have taken the final step and have held officers and directors liable to purchasers for sales of unregistered securities seemingly on the sole basis of the officer's or director's official connection with the issuing corporation.⁷³

Attention may again be called to the case of *Harper v. Tri-State Motors, Inc.*,⁷⁴ in which the Utah court, though purporting to require participation, indicated that the mere signing of a stock certificate in an official capacity may be sufficient participation to render an officer liable. The decision buttressed a prior decision of the Utah court, *Buttery v. Guaranteed Sec. Co.*,⁷⁵ which, like the *Harper* case, was based upon a Utah Blue Sky Law provision making any sale in violation of the law void and providing that every officer and director of any investment company, and every dealer or agent would be liable to the purchaser in a civil action for the purchase price paid.⁷⁶ While paying lip service to the proposition that the clause would not be applied indiscriminately to all directors of a corporation, the court nevertheless said in speaking about the statute:

It relates . . . only to officers, directors and agents who are such at the time of the transaction, the officers and directors being charged with the duty of seeing to it that their corporation has complied with the law . . . and the agent as well as the officers and directors who sell securities being charged with the duty of knowing that such sale has been authorized by the commission and only to those who participate directly or indirectly in the sale.⁷⁷ . . . [I]t was intended that good faith concerning that matter should be no defense. Finally, if the liability be limited to those who actually participated, either directly or in-

⁷² It is doubtful too that the Oklahoma court would again refuse to hold a corporation liable as an agent as it did in *Braniff v. Coffield*, 199 Okla. 604, 190 P.2d 815 (1947).

⁷³ "Crawford was an officer and director of the corporation, and even if he had not participated in negotiating the particular sale to Smith, his official relation to the corporation and his signing the stock certificate rendered him liable if the stock was sold in violation of any provision of the law." *Smith v. Crawford*, 228 Ky. 420, 15 S.W.2d 249, 250 (Civ. App. 1929).

⁷⁴ 90 Utah 212, 58 P.2d 18 (1936).

⁷⁵ 78 Utah 39, 300 P. 1040 (1931).

⁷⁶ Utah Spec. Sess. Laws 1919, ch. 17, § 24.

⁷⁷ *Buttery v. Guaranteed Sec. Co.*, 78 Utah 39, 300 P. 1040, 1044 (1931).

directly, in the unlawful sale, no injustice or unmerited hardship can result, for the honest and pure in heart can always avoid liability by the simple expedient of not taking part in a sale. . . .⁷⁸

The matters stated by the Utah Supreme Court in the *Buttery* case were only dicta insofar as the officers and directors were concerned since the plaintiff did not allege that anyone had participated in the sale other than the selling agent. Certainly, however, the *Harper* case clearly shows the extent to which that court will apply the participation doctrine.

There would seem to be some validity in the argument that even those states which purport to hold officers and directors liable solely by virtue of their official capacity nevertheless still require some affirmative act on the part of the officer or director. However, in regard to a particular sale, such affirmative act may be nothing more than the formalistic signing of the stock certificate⁷⁹ or voting on matters relating to such illegal sale.⁸⁰

The Illinois court has probably gone further than any other in holding directors "absolutely" liable on the sale of an unregistered security. The Illinois statute states that the "seller of the securities so sold, the officers and directors of seller, and each and every solicitor, agent or broker of or for such seller, who knowingly performed any act or in any way furthered such sale, shall be jointly and severally liable . . ."⁸¹ The court in construing this statute noted:

"After carefully reconsidering the matter we are now convinced that the legislature contemplated that liability should attach to all who were directors of a corporation when its stock was sold in violation of the said law, and had knowledge or were chargeable with knowledge of such sale."⁸²

The court found that the liability of an officer or director was just as absolute as that of the seller of the unregistered security regardless of the officer's or director's connection with such sale. As to the requirement of knowledge presented by the statute, the court stated, "[W]e know of no principle of law that affords a basis for construing the statute otherwise than that the director is liable whether he participated in or knowingly aided or furthered the individual sale or not."⁸³

⁷⁸ *Ibid.*

⁷⁹ *McWhirter v. Holmes*, 49 Ga. App. 536, 176 S.E. 153 (Ga. Civ. App. 1934); *Smith v. Crawford*, 228 Ky. 420, 15 S.W.2d 249 (Civ. App. 1929).

⁸⁰ *Westerhaver v. Dunnivant*, 225 Ala. 400, 143 So. 823 (1932).

⁸¹ SMITH-HURD ILL. STAT. ANN. art. 121-1/2, § 132(1) (1935).

⁸² *Goelitz v. Lathrop*, 286 Ill. App. 248, 3 N.E.2d 305 (1936).

⁸³ *Id.* at 315.

III. RELATED CIVIL LIABILITY UNDER FEDERAL SECURITIES ACTS⁸⁴

A. Securities Act Of 1933

The principal purpose of this inquiry is to discover the various forms of *vicarious* liability, so to speak, of parties only tangentially involved in the sale of securities under state blue sky laws. However, no such discussion can be complete without at least cursory mention of the liability which an issuer, or the officers or directors thereof may incur under the federal securities acts. This discussion is intended only to illustrate the fact that where liability is found to exist under one or more state blue sky provisions, liability probably has been incurred by the selling parties and/or their officers, directors or agents under the federal laws as well.

In the case of *Stadia Oil & Uranium Co. v. Wheelis*,⁸⁵ stock registered in Utah was sold to one Nevada resident destroying the intra-state exemption.⁸⁶ The vice president of the company and a director presided over and participated in the board of directors meeting where the sale of stock and disposition of the proceeds was discussed and authorized. The vice president, who owned one-third of the total stock of the selling company, signed the stock certificate. The court held that there was sufficient evidence to sustain the jury finding that the vice president was a "controlling person"⁸⁷ and therefore was liable to the same extent as would be the seller under section 12 of the 1933 Act.⁸⁸

B. Securities Exchange Act Of 1934

Section 10(b) of the Securities Exchange Act of 1934⁸⁹ and rule 10(b) (5)⁹⁰ issued thereunder have been used increasingly to reach the corporate insider who through various practices promotes sales in violation of the federal securities acts. Illustrative of these holdings as they relate to officer-director liability is the statement of the court in *Freed v. Szabo Food Serv., Inc.*:

Action under Section 10(b) and Rule 10(b) (5) will lie against third parties in the absence of privity. *New Park Mining Co. v. Cranmer*,

⁸⁴ For related articles in this Symposium, see the table of contents.

⁸⁵ 251 F.2d 269 (10th Cir. 1957).

⁸⁶ 48 Stat. 74, § 3(a) (11); 15 U.S.C. 77c (1963).

⁸⁷ 48 Stat. 74, § 15; 15 U.S.C. 77o (1963).

⁸⁸ See also the following cases finding officers and directors liable under § 12 through the use of the "control" provisions of § 15 of the act: *Lennerth v. Mendenhall*, 234 F. Supp. 59 (N.D. Ohio 1964); *Bailey v. Huntington Sec. Co.*, 35 F.R.D. 169 (S.D.N.Y. 1963); *Schamber v. Aaberg*, 186 F. Supp. 52 (D. Colo. 1960); *Miller v. Hano*, 8 F.R.D. 67 (E.D. Pa. 1947).

⁸⁹ 48 Stat. 881, 15 U.S.C. § 78(b) (1963).

⁹⁰ 17 C.F.R. § 240.10(b)-5 (1964).

CCH Fed.Sec.L.R., Sec. 91, 280 at p. 94, 245 (1963) . . . Were this not the rule, corporate officers and directors would possess an immunity from the consequences of their fraud under Section 10(b) or Rule 10(b)(5) which outsiders who may have collaborated with them in defrauding the corporation would not possess.⁹¹

A full discussion of the problems inherent in the use of section 10(b) of the Securities Exchange Act of 1934 and rule 10(b)(5) is, of course, beyond the scope of this discussion; however, the above quotation will illustrate the tone of the court decisions in this area.⁹²

In view of the enlarging and expanding concepts imposing liability on officers, directors and any one remotely connected with the sale of an illegal security, it is somewhat refreshing to find the federal district court in *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Boccock*,⁹³ quoting with approval the language in *Royal Air Properties, Inc. v. Smith*: "The purposes of the Securities Exchange Act are to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act."⁹⁴

IV. CONCLUSIONS

Implicit but unexpressed in both "agent" cases and those involving officers and directors is the concept of "private enforcement" of the blue sky laws. No state, nor the federal government for that matter, is willing to expend sufficient funds to finance a truly rigorous enforcement of the security acts. By expanding the concept of civil liability and persons liable for "illegal" security sales, legislatures and the courts seek to provide incentive for "private enforcement" of the law rather than to provide the funds required for public enforcement. Possible civil liability is doubtlessly a meaningful deterrent provided those who may become liable know of its existence.

One is tempted to draw broad conclusions and sweeping generalizations from the relatively few reported cases involving liability of parties peripherally involved in illegal security transaction. Yet caution is advised in view of the amazingly few cases reported in this area. Seemingly expansive civil liability should provide a most lucra-

⁹¹ CCH FED. SEC. L. REP. ¶ 91,317; 91,363 (N.D. Ill. 1964).

⁹² See also *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Miller v. Bargain City, U.S.A., Inc.*, 229 F. Supp. 33 (E.D. Pa. 1964); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963); *New Park Mining Co. v. Cramer*, CCH FED. SEC. L. REP. ¶ 91,280 (S.D.N.Y. 1963).

⁹³ 247 F. Supp. 373, 377 (S.D. Tex. 1965).

⁹⁴ 312 F.2d 210 (9th Cir. 1962). (Emphasis added.) For a similar court expression see *Fuller v. Dilbert* quoted at note 97 in *Meer, The Private Offering Exemption*, 20 Sw. L.J. 503, 526 (1966).

tive and profitable field of litigation for the more "knowing" investor, though certainly the blue sky laws were not enacted for his benefit. The reasons for the paucity of cases becomes an interesting exercise in speculation and conjecture. Settlement is the first and most obvious conclusion; non-availability of a sufficiently wealthy defendant is another. One would probably like to conclude that corporate officials and attorneys are so well versed in modern security practices that such illegal security sales no longer arise. Another possible answer is that the general gambling aura which early pervaded stock investments has so taken the public mind that the general investing public seldom thinks of attempting to "recoup" an investment loss. Rather, the public feels they have made their bet, the wheel has spun, and the ball has stopped on the wrong number. "Welshing on a bet" still is not considered very honorable. Lack of knowledge of the available remedies on the part of the small investor well may play some part. Contributing also may be the relative smallness of most investments as compared to the high costs of recoupment—attorneys fees, trial and appellate court costs. Though most blue sky laws permit interest, attorneys fees and costs in addition to original investment (and in some instances punitive type damages), these spoils are only for the victor; and the battle must be financed before it can be won. In reality all these factors, and probably more, contribute to the scarcity of decisions in this area. The relatively few decisions, taking into consideration their respective "ages", remain the only proven guideposts.

A. Agents

Aside from situations involving actual fraud, deceit or "conspiracy by silence," one is prone to question the wisdom of the extension of liability announced in the *Brown* case.⁹⁵ However, it is very likely that this new pronouncement expanding the number of parties civilly liable will be followed by other courts. Anybody forming a link in the chain by which a sale is negotiated, made, or concluded may be liable to the purchaser of a security sold in violation of blue sky provisions. Questions of profit, knowledge, authority, equal opportunity and good faith will not benefit the defense. The seller (to his amazement) may find that he had many "agents" working for him though without his knowledge—much less his authorization.

Although the Texas court rejects the joint-venture theory of defense where the negotiations for the sale of the securities were carried out as part of the creation of the business entity, one must hope,

⁹⁵ *Brown v. Cole*, 155 Tex. 624, 291 S.W.2d 704 (1956).

for the sake of the business community, that a better rule will develop which will not impose liability as between those who stand on equal footing at the inception of the business venture. Such a rule should still permit recovery by our typical duped and innocent widow and children yet deny recovery where the investor has, or should have, a reasonable amount of business acumen and a chance to investigate (if not in fact participate in) the formative venture. Hope springs anew with the Fifth Circuit's recitation from the *Royal Air Properties* case⁹⁶ that the purpose of the securities acts is to protect the innocent, not to provide a "heads I win; tails you lose" cinch bet for the wily. Hopefully then in this area of "agent" liability, while the courts expand the concept of who is an agent, they will at the same time limit the parties who may take advantage of the extended liability.

B. Officers And Directors

It is difficult to discern a development or trend in officer-director cases. Most of the cases are of relatively ancient vintage, particularly the more stringent holdings which, like the Illinois decision in *Goelitz v. Lathrop*,⁹⁷ border on the verge of absolute liability based solely upon official capacity. The dates of these cases may be significant, coming in the early to middle 1930's. Conceivably, the general disenchantment of that day with corporate securities and affairs in general may in part account for the harsh treatment of corporate officers and directors at the hands of the courts.

Encouraging are the later cases which deny recovery where the officer and/or director has participated in an official capacity not directly connected with the transaction and then only *after* the sale has been negotiated and, for all practical purposes, completed.⁹⁸ It offends one's inherent sense of justice to hold a president liable for an "illegal" sale where his only connection with the transaction was signing one stock certificate (among many) as is his duty under most corporate by-laws and state corporation acts. If one agrees with the Kansas court in the *Daniels* case⁹⁹ that the plaintiff, after payment of the

⁹⁶ 312 F.2d 210 (9th Cir. 1962).

⁹⁷ 286 Ill. App. 248, 3 N.E.2d 305 (1936). See note 82 *supra* and accompanying text.

⁹⁸ *Scott v. Novick*, 172 So.2d 516 (Fla. Ct. App. 1965). See note 68 *supra* and accompanying text. *Holland v. American Founders Life Ins. Co.*, 151 Colo. 69, 376 P.2d 162 (1962). See note 67 *supra* and accompanying text. *Willis v. Spring Canyon Copper Co.*, 4 Utah 2d 211, 291 P.2d 878 (1956). See notes 56 and 57 *supra* and accompanying text. *But cf. Spears v. Lawrence Sec., Inc.*, 399 P.2d 348 (1965). See note 64 *supra* and accompanying text. *Miller v. Griffith*, 28 Ohio App. 2d 278, 196 N.E. 154 (C.P. 1961). See note 62 *supra* and accompanying text. *Ferar v. Hall*, 330 Mich. 214, 47 N.W.2d 79 (1951). See note 53 *supra* and accompanying text.

⁹⁹ *Daniels v. Craiglow*, 131 Kan. 500, 292 P. 771 (1930). See note 58 *supra* and accompanying text.

purchase price, could not fully enjoy her new status as a shareholder without a certificate, then certainly the corporate president could be forced (through appropriate court action) to sign and issue a certificate for such shares. It should not follow that by performing such an act after a sale made by a third party, the president of the corporation should become liable to the purchaser of the security.

The conflicting interests of society in protecting the innocent from the unscrupulous on the one hand and in preserving a fundamental advantage of what has become an essential business format on the other, should have produced a more impressive sound than the whimper heard to date. The concept of no personal liability for corporate officers acting in their official capacity is an ingrained part of American business thinking today. The clash of this concept with society's inherent desire to protect the unwary should have produced far more decisions than the records reveal. In both the officer-director area and the agency area the intensity and complexity of the battle may nevertheless be seen even in the few decisions revealed by the cases to date. It is hoped that neither institution should be made the victim of the other. Neither the blue sky laws nor the security acts should be allowed to become an investor's "hedge"; yet these laws must still be construed broadly enough to permit the innocent to recover. Mr. Plunger has paid his money and with open eyes taken his chance; he should be required to abide it. Mrs. Widow has taken hers with eyes closed and should be allowed to rescind it. Certainly the law should be wise enough and flexible enough to accommodate both concepts.