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PITFALLS IN THE TEXAS SECURITIES ACT†

by

Alfred Hill*

The recent decision of the Supreme Court of Texas in Brown v. Cole1 has focused attention on the problem of unwitting civil liability under the Texas Securities Act,2 more commonly known as the Blue Sky Law. In this case two investors in an unsuccessful mining venture recovered their $10,000 investment in an action brought under what is now Section 34 of the Act—the first such action ever to reach the appellate courts.3 The Court conceded the result to be "harsh" and "inequitable," but declared that the Act left it no alternative. The decision, which is more fully discussed below, is of particular interest because of its bearing on some common types of transactions which are consummated each day in oblivion of the possibility that the provisions of the Blue Sky Law may be applicable.4 This oblivion was seemingly shared, in the case of his own transaction, by the defendant in Brown v. Cole, although, as a person engaged in the securities business, he was a member of the group which is presumably best informed on the scope of the Blue Sky Law.

In general, securities must be qualified under this law if they are sold by an "issuer"5 or "dealer."6 Sales by a private person are in most instances excluded from the Act by the exemption for

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2 Tex. Rev. Civ. Stat. (1925), art. 579. Prior to 1955, when the Securities Act was amended in respects not relevant hereto, the Act was set forth in Art. 600a of Tex. Rev. Civ. Stat. (1925); Brown v. Cole arose under Art. 600a. References to the statute hereinafter are to the sections as they are presently numbered in Art. 579.

3 In Smith v. Fishback, 123 S.W.2d 771 (Tex. Civ. App. 1938) error ref., the plaintiffs, alleging non-compliance with the Securities Act, employed a rescission action to recover certain oil royalties that had been assigned to a promoter for pooling in a corporation. At the time of this action the statute did not have a provision equivalent to the present Section 34 which expressly grants a right of rescission for sales in violation of the Act.


5 Sec. 2(g).

6 Sec. 2(e).
sales “in the ordinary course of bona fide personal investment of... personal holdings or change in such investment.” Many types of securities are also specifically exempted from the operation of the Act; the regulatory features of the Act are aimed largely at promotional securities and securities not sold on national securities exchanges. In general, such securities, particularly where new ventures are concerned, may not be sold unless a permit is obtained from the Secretary of State, who may grant such a permit only upon finding that the transaction will be “fair, just and equitable” to the buyers. Failure of the seller to obtain a permit gives the buyers a statutory right of rescission.

The same securities may also be subject to the registration provisions of the Federal Securities Act unless they are offered exclusively intrastate or are exempt from the Federal Act on some other ground. It is to be noted that in one fundamental respect the exemptive scheme of the Federal Act differs from that of the State Act. Under the Federal Act, securities need not be registered unless they are the subject of a “public offering.” While the scope of this concept is often not clear, the Securities and Exchange Commission has long taken the view that an offering of securities limited to twenty-five persons or less is a “private offering” and therefore exempt, and it has generally been assumed that persons are safe in relying on this consistent administrative construction of the Federal Act. The Texas Act does not have a similar exemption for “private offerings.” The Texas Act has certain exemptions based on number of sales rather than number of offers. It may be possible under present law to have exempt status for an indefinite number of offers, and in some circumstances for as many as twenty-five actual sales. However, in some circumstances the sale to one person of one share of stock may not be exempt.

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7 Sec. 3(c). Some recent cases seem to hold broadly that any person who engages in an isolated transaction is a “dealer” within the meaning of the Act, and subject to certain statutory consequences if he fails to register as such. See note 27 infra. And see Sec. 30. However, in none of these cases did the persons involved sell securities they were holding for personal investment, so the Sec. 3(c) exemption was unavailable to them. Sec. 3(c) is so clearly intended to exempt every aspect of the sales described therein that it is almost inconceivable that the Court would hold persons making such sales of their own securities to be “dealers” within the meaning of the Act.

8 Sec. 4.

9 Sec. 8.

10 One of the principal amendments added in 1955 was a provision for registration by notification for concerns which have been in continuous operation for not less than three years and which meet certain minimum requirements as to earnings; in general,
SALE OF SECURITIES

EXEMPTION PROBLEMS

Let us assume that a corporation organized under the laws of Texas, and having forty stockholders, sells some of its shares to one or two key employees who are not already stockholders, but who are thoroughly conversant with the business and need no protection from the Secretary of State. There is no exemption for this transaction, and apparently it may be rescinded at will by the buyers. The most nearly applicable exemptive provision exempts sales by "any domestic corporation" only "so long as the total number of stockholders and security holders of said corporation does not and will not after such sale exceed twenty-five..." In the above illustration, however, the corporation had more than twenty-five security holders when the sale was made.

Or let it be assumed that a man owning mineral properties in Texas or in some other state forms a Delaware corporation to which he transfers such properties, and thereafter induces a financially sophisticated and affluent Texan to participate in the venture with him by purchasing a number of shares in the Delaware corporation. A literal reading of the Act, or at least a literal first reading, might again suggest the absence of an exemption, with the result that the transaction could be consummated legally only if permission is obtained from the Secretary of State upon a showing that the proposition is inherently "fair" to the investing financier. In this instance there are less than twenty-five stockholders, but the corporation is a Delaware corporation rather than a "domestic" corporation. Even if the securities are sold by the pro-

the securities of such concerns may be sold within five days after certain information is filed with the Secretary of State. See Sec. 5(b).

11 Sec. 34. See note 27, infra.
12 See Loss, Securities Regulation 120 et seq. (1951, with 1955 Supp.).
13 Id. at 351 et seq.
14 Id. at 394-400.
15 McCormick, Understanding the Securities Act 101 (1948); Loss, Securities Regulation 186 n. 321d (1955 Supp.)
17 Under Section 3(e) there is an exemption, under certain conditions, for sales by a corporation to persons who are already stockholders.
18 Sec. 3(j).
19 It is arguable that the term "domestic corporation" means one organized under the laws of any of the United States, as distinct from a corporation organized under the laws of a foreign country. The point can be made that when the legislators meant to designate a corporation organized under the laws of Texas they specifically referred to it as a "Texas corporation," as in Sec. 3(1). Cf. Sec. 3(h) with Sec. 3(o).

On the other hand it is understood that the Secretary of State has taken the view
mooter out of his own holdings, instead of directly by the corporation, this fact would not of itself exempt the transaction, for it is being assumed that the money is raised as an incident of the plan to finance the development of the mineral properties, and the statute provides that a sale by a private vendor is not exempt when intended directly or indirectly for the benefit of an issuer. But even if a sale has taken place within the ordinary meaning of that word, and perhaps even within the meaning of the word as defined in the Act if such definition is read literally, there remains the possibility that there has not been a sale within the meaning of the Act read as a whole and in the light of the obvious legislative intent. This is a problem to which Brown v. Cole is particularly relevant, as will be seen below.

Again, there are serious questions concerning the legal status under the Blue Sky Law of many types of unincorporated oil and gas ventures. In a typical promotion, one person or a small syndicate will acquire an entire working interest and will thereafter sell fractional undivided portions to others while keeping a major or principal portion. Often these fractional undivided interests will be sold to personal friends and business acquaintances directly rather than through the intermediation of professional brokers. One of the persons who has been induced to buy — say, a Mr. Smith — may recommend the investment to several others, who in turn buy on the basis of his description of it; possibly he may agree to hold a 1/32 undivided interest for the benefit of the others in his group. Even in the case of a fairly small oil or gas lease, the number of persons who become co-owners of the working interest in this manner may be fairly substantial.

Have there been transactions in securities? Apparently so, for the Blue Sky Law defines securities as including, inter alia, "any interest in or under an oil, gas or mining lease, fee or title."
Insofar as the original promoters are concerned, their activities, if pursued on a sufficiently large scale, seem clearly within the intended scope of such legislation, for in effect they are soliciting others to invest their money in a common enterprise and to look for their profits to the efforts of the promoters in developing production.\textsuperscript{22} The most nearly relevant exemption excludes from the operation of the Act "the sale of an interest in any partnership, pool, or other company, not a corporation, the total membership of which does not and will not after such sale exceed ten..."\textsuperscript{23} But it is common knowledge that such persons often do exceed ten in number, and that such promotions are virtually never qualified under the Blue Sky Law.\textsuperscript{24} The original promoters, at least, would seem to be particularly vulnerable to a rescission action under the statute.

Is Mr. Smith of the foregoing illustration similarly vulnerable on the theory that he "sold" securities within the meaning of the Act? One of the most difficult questions under the Act is when in fact does a sale take place. Thus a syndicate of twelve men may be organized to invest in an oil venture, all of them sharing equally in profits and losses and in control. The statutory exemption for unincorporated enterprises is unavailable, for more than ten participants are involved. Their participations, however evidenced, may be securities; but have securities been sold within the meaning of the Act?\textsuperscript{25}

**Brown v. Cole**

This fundamental question—what is a sale—was the principal issue before the Supreme Court of Texas in *Brown v. Cole*. A Mexican mining enterprise being in need of additional working capital, one of its representatives proposed to some Dallasites a plan of financing which, as it ultimately took shape, involved a $30,000 loan to be repaid "as promptly as is advisable," apparently with interest of five per cent. The lenders were also to receive, without further cost, a one-fourth interest in the mining

\textsuperscript{22} Cf. SEC v. W. J. Howey Co., 328 U.S. 293 (1946).
\textsuperscript{23} Sec. 3(k).
\textsuperscript{24} See Meer, *op. cit. supra* note 19, at 897.
\textsuperscript{25} "The terms 'sale' or 'offer for sale' or 'sell' shall include every disposition, or attempt to dispose of a security for value.... The term 'sell' means any act by which a sale is made...." Sec. 2(e).
property. The one-fourth interest, consisting of stock in a Mexican corporation, was to be transferred to another Mexican corporation to be organized, and the lenders in turn were to receive the stock of the latter corporation.

This financing proposal, or an earlier form of it, had been submitted to Brown and his employer, and a small group was formed to participate in the financing. How this group was organized is not clear, except that it appears Brown was at least partially instrumental in its formation. In the case of the co-plaintiffs Gould and Cole, it is clear that Brown brought the matter to their attention, repeatedly procured additional information for them when they asked for it, and advanced money, without any arrangement for reimbursement, to finance a trip made by himself and Cole's auditor to inspect the mining premises in Mexico. Brown also collected money from the various members of the group for transmission to Mexico and gave them receipts in which he represented himself to be their agent for the transmission of the funds.

For doing these things Brown apparently received no special compensation either from the Mexican interests or from the Dallas group. Together with a partner he made a personal investment in the enterprise of $5,000. Gould and Cole invested $5,000 each. As stated in the Supreme Court's opinion, these two persons "did not rely on any statements made to them by Brown, but, on the contrary, conducted their own investigation, through their own auditor, and relied solely on the auditor's report." When the venture turned out to be a total loss, Gould and Cole brought a rescission action against Brown under what is now Section 34 of the Act for the recovery of their $5,000 investments. They were

26 Cole first learned of the proposition from Gould, who had learned of it from Brown. Thereafter Brown dealt directly with Cole's auditor, and under the circumstances the Court held it to be immaterial that Cole's initial contact had been with Gould.

27 Then and now this provision (formerly Sec. 33a) gave a right of rescission for every sale "made in violation of any provision" of the Securities Act. The plaintiffs contended that there had been a violation not only in the failure to obtain a permit for sale of the securities, but also in the failure of Brown to obtain a separate license to act as a "dealer" in securities.

The question whether Brown was a "dealer" within the meaning of that Act was not an issue in the case, and the result would have been the same had the point not been decided at all. Hence it would seem that the discussion of this subject in Brown v. Cole has little precedential value if any.

Apart from the rescission provisions of Sec. 34, the Act provides in Sec. 35 that a "dealer" may not maintain an action for commissions unless he has previously obtained a license. Most of the private litigation involving the Act has arisen under Sec. 35, see Cox, The Securities Act, in 2 Vernon's Annotated Civil Statutes xii, xxv,
sustained by each of the courts which considered the matter, although Justice Smith entered a lone dissent from the decision of the Supreme Court.

Brown's principal defense was that he had not made sales to the members of the Dallas group. His claim was that they were all co-purchasers together, and that he had simply acted as the agent for the others in compiling information and in collecting and transmitting the funds. The Mexican interests, he maintained, had "sold" the securities. This latter proposition was conceded by the Supreme Court to be correct, but the Court stated that other persons might also be sellers if they constituted "any link of the chain of the selling process." Noting that the Act defines "sale" as including, *inter alia*, "any act by which a sale is made,"28 the Court con-

xxvi, and here also harsh penalties have been invoked in some cases of seemingly unwitting violations. Section 2(c) of the Act defines a "dealer" as "every person or company, other than a salesman, who engages in this state, either for all or part of his or its time . . . in selling . . . securities." It is arguable that (with certain exceptions not relevant here) the legislature did not intend to require licenses except in the case of persons engaged in the business of selling securities, at least on a part-time basis, and apparently some of the lower courts have taken this view. Cf. Culver v. Cockburn, 127 S.W.2d 328, 330 (Tex. Civ. App. 1939) *error dismissed, judgm. corr.*; Anderson v. Breeding, 250 S.W. 2d 467 (Tex. Civ. App. 1952), *rev'd.*, 152 Tex. 92, 254 S.W.2d 377 (1953). However, in Cosner v. Hancock, 149 S.W.2d 239 (Tex. Civ. App. 1941) *error dismissed, judgm. corr.*, where the person seeking commissions was a tax auditor who had acted as selling agent in only a single transaction, the Court held he was a dealer within the meaning of the Act; the curious rationale of this decision was that to construe the statute as requiring a license on the part of one who sells securities as a business while not requiring it on the part of one who engages in a single transaction "would cause the law to apply unequally and unfairly."

Subsequently, in Gregory v. Roedenbeck, 141 Tex. 543, 174 S.W.2d 585 (1943), the Supreme Court held that isolated sales constituted one a dealer within the meaning of the Real Estate Dealers' License Act. This Act compelled such a result in language that expressly dealt with the problem and left no room for doubt, as the Court pointed out; but the Court also cited, with apparent approval, the Court of Civil Appeals' decision in *Cosner v. Hancock*. In 1953, in Breeding v. Anderson, 152 Tex. 92, 254 S.W.2d 377, 380, the Supreme Court, with virtually no discussion, held that a single transaction constituted the plaintiff a "dealer" within the meaning of the Texas Securities Act. The cases relied upon were *Gregory v. Roedenbeck, supra*, and *Cosner v. Hancock, supra*. The most recent development came in Mecom v. Hamblen, 289 S.W.2d 553 (Tex. Sup. Ct. 1956) where the Court emphasized that the unlicensed dealers to whom it was denying commissions had been regularly engaged in the lease brokerage business; earlier cases were not cited on this question.

28 See note 25 *supra*. If Brown acted, as he claimed, for the syndicate, then he was a purchaser rather than a seller. If he acted for the vendors, then presumably he was a selling agent, and there is no doubt that a selling agent may himself be deemed a seller who is liable in damages under the Blue Sky laws. Cf. Cady v. Murphy, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 315 U.S. 705 (1940); Loss, *op. cit. supra* note 12, at 1006. But even the question of the capacity in which Brown acted cannot be determined for purposes of the present case except in the light of the fundamental aims of the Act. Thus, a person who may be an agent for the buyer under familiar principles of agency law, and who in fact is not acting as agent for anyone else, may in certain circumstances be deemed to be selling to the buyer within the meaning of the statutory language. See Loss, *supra*, at 1006-07.
cluded that Brown's activities fell within this definition.

Although the Securities Act is silent respecting joint adventures, the Court declared broadly that "the Act does not apply to a joint adventurer and to transactions between joint adventurers." The Court concluded, however, that "the elements of joint adventure are not present in this case": first, because the participants were free to sell their stock at will with the result that each might "realize a profit in varying amounts;" and second, because "there was no joint control of the enterprise," control being vested entirely in the original Mexican group. It is difficult to see why the possibility of realizing profits in varying amounts at various times was thought to impair the status of the syndicate as a joint adventure. Thus the most salient characteristic of the so-called "mining partnership," which resembles the joint adventure more than it does the partnership, is that the members are free to assign their interests at will, and it would seem possible to provide by contract for free assignability in any type of partnership. As to the issue of joint control, it appears that there was joint control in the legal sense, if not with respect to the mining venture as a whole, then with respect to the lending syndicate. While Brown played an active part in the organization of the latter, the more passive members of the syndicate evidently had the same "power of ultimate control" that suffices in establishing the ordinary partnership relationship. The point seems to have been overlooked that a joint adventure may exist as part of a larger enterprise. Moreover, there may well have been joint control even with respect to the larger enterprise; for the members of the syndicate were to receive one-fourth of the stock of the mining corporation, and if this was voting stock the assumed requirement of joint control was apparently satisfied. Joint control means participation in control, which may of course fall short of domination.

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29 Cf. Lewis v. Davis, 145 Tex. 468, 199 S.W.2d 146 (1947).
31 See Crane, Handbook on the Law of Partnership 62-63 (2nd ed. 1952), quoting from the Notes of the Commissioners on Uniform State Laws to Section 7 of the Uniform Partnership Act.
33 It has been recognized that, from the point of view of the Blue Sky Laws, a business enterprise may be a joint adventure even though it has been incorporated.
THE JOINT ADVENTURE THEORY

The aspect of Brown v. Cole which is of special interest here is the fact that, in its general approach to the concepts of "sale" and "joint adventure," the Supreme Court seems to have taken a view which may yield unfortunate results if applied in future cases and which is not at all compelled by the Blue Sky Law. To begin with, not every transaction between joint adventurers should be deemed exempt under the Act. A joint adventure may be undertaken by a large number of small unsophisticated adventurers who have been brought together into a common enterprise by a promoter who is himself a co-adventurer and who would certainly be held to the fiduciary duties of a co-adventurer. This is, of course, the very type of situation the Blue Sky Law is intended to regulate, and there is no reason to believe that the Court would rule otherwise if such facts presented themselves.

On the other hand, even where one person actively induces others to participate with him in a joint adventure (it may be assumed that the "participations" are securities within the meaning of the Act), it does not follow that there has been a "sale" in the statutory sense. Thus, if A and B are engaged in the lumber business and seek additional capital from C, the latter agreeing to supply the cash in return for a one-third interest in the business in the form of stock in a corporation to be formed, it does not follow that A and B have "sold" stock or a stock subscription to C. This essentially was the holding in a recent California case, the Court stating that "there appears no more reason for defendants to reimburse the plaintiff for his contribution to the venture than for plaintiff to reimburse defendants for theirs." Similar decisions

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34 Cf. Smith v. Fishback, 123 S.W.2d 771, 778 (Tex. Civ. App. 1938) error ref. ("...we believe it can be safely said that no state in the Union has offered a richer field for stock promoters and the sale of worthless stock and securities than has Texas"). Also see Kadane v. Clark, 135 Tex. 156, 143 S.W.2d 197, 199 (1940); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); SEC v. W. J. Howey & Co., 328 U.S. 293 (1946).


have been rendered by other courts, some cases resting on the theory that the instruments involved were not really "securities" within the meaning of the local Blue Sky Laws.\textsuperscript{38} Even where such transactions may appear to involve "sales" of "securities" insofar as their form is concerned, in substance the transaction may represent the formation of a joint adventure of a kind that could not have been within the intended reach of the several state legislatures when they adopted their securities statutes. The courts of some states have so held, as the Texas Supreme Court is evidently prepared to so hold, even in the face of legislative silence on a possible joint adventure exemption.\textsuperscript{39} The pertinent provision of the California statute exempting "any bona fide joint adventure interest, except such interests when offered to the public"\textsuperscript{40} is one which may fairly be said to be implicit in the scheme of the Blue Sky Laws generally.

It is to be emphasized that the fundamental problem is one of determining and effectuating legislative intent, and that concepts of the joint adventure which are valid in other legal contexts are not necessarily relevant in the context of the Blue Sky Laws. Apparently a creature of the American courts, the joint adventure has evolved in large measure as a device for fastening upon persons the duties and liabilities of partners in situations where there is really no partnership in the traditional sense of co-ownership.

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\textsuperscript{38} Cf. Austin v. Hallmark Oil Co., 21 Cal.2d 718, 134 P.2d 777, 782-83 (1943); MacDonald v. Jackson, 117 Cal. App.2d 598, 556 P.2d 591, 595 (1953). Also see the opinion of the Attorney General of Louisiana of Jan. 7, 1947, summarized in CCH BLUE SKY LAW REPORTER ¶ 1631.041. And see Hammer v. Sanders, 61 Ill. App.2d 346, 127 N.E.2d 492, 499 (1955), aff'd in part and rev'd in part, Hammer v. Sanders, __________, 134 N.E.2d 509 (1956). (The Supreme Court did not discuss the possibility of a joint adventure exemption; in holding certain investment interests to be securities the Court was not necessarily repudiating the theory of such an exemption, since, for reasons stated at pp. 272, 273, supra, interests in a joint adventure should be deemed securities in appropriate circumstances).

\textsuperscript{39} The Illinois statute involved in Hammer v. Sanders, supra note 38, does not have such a statutory exemption. Cf. ILLINOIS SECURITIES LAW OF 1953, as amended, Sec. 4, CCH BLUE SKY LAW REPORTER ¶ 16204. The Michigan cases cited in note 37 supra were apparently decided before the present express exemption for joint adventures (where there are not more than 25 participants) was added to the Michigan statute. Cf. COMPILED LAWS OF MICHIGAN, 1948, as amended, Sec. 451.105(1), CCH BLUE SKY LAW REPORTER ¶ 25105. Similarly, the opinion by the Louisiana Attorney General referred to in note 38 supra was rendered without the benefit of an express statutory exemption. Cf. LOUISIANA REV. STAT. OF 1950, Sec. 51.705, CCH BLUE SKY LAW REPORTER ¶21.105.

\textsuperscript{40} See Sec. 25100(m) of CALIF. CORP. CODE, CCH BLUE SKY LAW REPORTER ¶ 8221.
of a business for profit.\textsuperscript{41} If there is uncertainty concerning the critical elements needed to constitute a partnership, the uncertainty is compounded in the case of the newer and more variegated joint adventure.

Justice Smith, in his dissenting opinion in \textit{Brown v. Cole}, indicated that the majority's emphasis on mutuality of control as an indispensable aspect of the joint adventure stemmed from reliance on the so-called joint enterprise cases in the field of torts. It has become familiar doctrine that if \(A\) and \(B\) and \(C\), having a common destination, take a car on a long trip pursuant to an agreement to share expenses, and injury is caused through the negligent driving of \(A\), occupants \(B\) and \(C\) will not be allowed to recover from \(A\), and indeed may themselves be liable to strangers injured in the accident.\textsuperscript{42} Usually the three occupants of the car are said to have been parties to a "joint enterprise,"\textsuperscript{43} although the term "joint adventure" is used by some courts;\textsuperscript{44} in any event joint control is of the essence in these cases, and profit-sharing is usually entirely absent. On the other hand, in the leading case of \textit{Meinhard v. Salmon},\textsuperscript{45} a person having exclusive control over a real estate venture was charged with fiduciary responsibility toward a person who shared in the profits of the venture, largely because control was in fact exclusively vested in the one and not in the other;\textsuperscript{46} in this instance the theory of the joint adventure was employed to justify the imposition of a fiduciary obligation. The theory of the joint adventure is often put to another use, although perhaps not in Texas,\textsuperscript{47} when it is invoked to validate a joint undertaking by two or more corporations. As thus employed it serves largely as a fiction giving legal sanction to a common type of business arrangement which would otherwise be under a legal cloud because of the traditional rule that a corporation may not be a member


\textsuperscript{42} Prosser, \textit{Torts} 363-67 (2nd ed. 1955).

\textsuperscript{43} \textit{Id.}

\textsuperscript{44} See, \textit{e.g.}, Washington & O.D. Ry. v. Zell's Adm'n, 118 Va. 755, 88 S.E. 309, 312 (1916); Johnson v. Fischer, 292 Mich. 78, 290 N.W. 334, 336 (1940).

\textsuperscript{45} 249 N.Y. 458, 164 N.E. 545 (1928).

\textsuperscript{46} Also see Nichols, \textit{op cit. supra} note 41, at 439. \textit{Cf.} Oakley v. Rosen, 76 Cal. App.2d 310, 173 P.2d 55 (1946) (one of several co-adventures given complete charge of production of play).

\textsuperscript{47} \textit{Cf.} Luling Oil & Gas Co. v. Humble Oil & Refining Co., 144 Tex. 475, 191 S.W.2d 716 (1946).
of a partnership. In each of these instances the so-called joint adventure serves a different purpose and displays different characteristics.

Special complications are presented by practices in the oil and gas business. The persons owning undivided fractional interests in a lease typically execute an operating agreement which vests control of development, although not necessarily exclusive control, in an "operator," usually one of their number, and which provides that the several parties are to contribute to expenses and are to share in the profits in proportion to their ownership in the lease. The vesting of operating responsibility in one of the co-owners is not inconsistent with the existence of a partnership; in fact it is a common characteristic of the so-called mining partnership. In an effort to save the non-operators from partnership liability, the attorneys who draft these operating agreements commonly insert provisions thought to be inconsistent with the relationship of partnership or joint adventure—provisions such as express disclaimers of intent to form a partnership and provisions designed to avoid the semblance of co-ownership.

Other provisions which may have similar tendencies, such as those governing the right of each co-owner to take his share of the production in kind or the right to market it or direct its sale, are dictated primarily, it seems, by tax considerations. Even if such provisions negate the existence of a mining partnership or joint adventure for some purposes—and their efficacy in this direction is far from certain—it does not follow that they are relevant to the purposes of the Texas Securities Act.

The crucial problem in Brown v. Cole was whether the defendant had "sold" securities to the plaintiffs within the meaning of the Act. The theory of the joint adventure was significant only as an analytical tool in seeking a solution to this problem. As an analyti-

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48 See annotation, 80 A.L.R. 1049 (1932).
49 See Shepherd, Problems Incident to Joint Ownership of the Oil and Gas Leasehold Estate, FIFTH ANNUAL INSTITUTE ON OIL AND GAS LAW AND TAXATION 215, 233-57 (Southwestern Legal Foundation 1954).
50 See annotation, 24 A.L.R.2d 1359 (1952).
51 See Shepherd, op. cit supra note 49; 3 STAYTON'S ANNOTATED TEXAS FORMS, Sec. 4173 (1954 pocket part).
cal tool it was useful only to the degree that the Court was prepared
to give paramount consideration to the rationally inferrable inten-
tion of the legislature as revealed in the statute being construed.
It was not useful insofar as it opened the door to consideration of
the supposed attributes of the joint adventure in irrelevant legal
contexts.

SELLING ACTIVITY

As previously noted, the Court construed the Securities Act’s
definition of “sale” — “any act by which a sale is made” — as
encompassing “any link of the chain of the selling process.”
Undoubtedly the Court did not intend to include the secretary who
types a soliciting letter for the seller. But what about the investor
who, enthusiastic over a recent purchase, recommends the same in-
vestment to his friends and puts them in touch with the salesman?
Is this hapless investor also to be liable in an action in rescission?
The Supreme Court construed certain Michigan cases as reaching
such a result, although analysis of these cases raises serious ques-
tions concerning the Court’s interpretation of them. Whether
or not the Court was influenced by what it conceived the Michigan
rule to be, the Court did state that Brown had “displayed consid-
erably more salesmanship activity than was shown in the Michigan
cases.” In this connection the Court pointed out that in addition
to initiating the matter with Gould and Cole, Brown had repeatedly
taken steps to obtain more information for them. Most significant,
perhaps, in the view of the Court was the fact that, without any
agreement for reimbursement, Brown had made an outlay of
$1,200 in taking Cole’s auditor on an inspection trip to Mexico —
an unusual expenditure when it is considered that Brown’s total
personal investment (with a partner) was only $5,000.

It is, of course, rare that a joint adventure is conceived sponta-
neously in the minds of the several participants; inevitably, some

54 In Chambers v. Beckwith, 247 Mich. 255, 225 N.W. 605 (1929), the selling agent,
far from being an innocent fellow investor, turned out to be the president of the issu-
ing company, and there was evidence that he had personally guaranteed the buyer
against loss. In Thompson v. Cain, 226 Mich. 609, 198 N.W. 249 (1924), the holding
was only that the trial court had erred in charging the jury that the selling agent was
to be exonerated unless it was shown (1) that he had profited by the transaction and
(2) that his interest in the transaction was similar to that of the seller. In Lewis v.
Bricker, 235 Mich. 656, 209 N.W. 832 (1926), the holding was that there was error
in charging the jury that the selling agent was to be exonerated unless it was shown
that the sale would not have been made but for his efforts.
are more active than others in the promotion and organization of such enterprises. Since the Court was ready to exonerate Brown upon finding that a true joint adventure existed, it would follow that what the Court called "salesmanship activity" need not in all circumstances be regarded as "selling" within the meaning of the Act.\(^5\)

In the syndicate which Brown was partly instrumental in forming, he was himself a participant on terms of equality with the others; it does not appear that he received special compensation or consideration of any kind from the operators of the mining business. If his zeal was such that, as the Court said, Gould and Cole would not have participated "but for Brown's activities and repeated efforts," the same zeal apparently would have been condoned by the Court had the syndicate been formed to operate a business rather than, as the Court viewed it, to lend money to others who were operating a business. The distinction, under the circumstances of this case, does not appear to the writer to be a significant one from the point of view of the purposes of the Securities Act.

**Conclusion**

The Blue Sky Laws of the several states were adopted to prevent unscrupulous promoters from selling unsuspecting investors

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\(^5\) Section 3(k), as previously observed, exempts the sale of an interest in an unincorporated venture "the total membership of which does not and will not after such sale exceed ten," provided that the organization expenses do not exceed two percent. This exemption was held unavailable to Brown because he had "sold" interests in a corporation, and because in any event he had not sustained the burden of proof of showing that the other conditions of the exemption were met. If all the conditions of Section 3(k) are satisfied there may, of course, be exempt selling activity by the terms of the section itself. But if there has been no "sale" within the meaning of the Act, there is no need to find a specific exemption in the Act. Hence promotional activity in the interest of the organization of a true joint adventure (whatever that may be) would seem to be exempt even though the number of participants exceeds ten and the organizational expenses exceed two per cent, and even if a corporation is involved.

In 1945 the Attorney General of Texas rendered an opinion which is seemingly inconsistent with this view. Op. No. 0-6457. Section 3(1) of the Act exempts the sale of stock subscriptions to a proposed Texas corporation where the number of subscribers does not exceed fifteen. This exemption was inapplicable to the case before the Attorney General, which involved pre-incorporation subscriptions by thirty persons. The incorporators contended, however, that there had not been any "sale" within the meaning of the Act, apparently on the theory that the participants had banded together as joint adventurers to organize a quasi-civic water supply company. This view was rejected by the Attorney General without regard to the circumstances which attended the organization of this particular venture; the opinion seems vulnerable today in the light of *Brown v. Cole*. 
so many feet of "blue sky." Regulation of the sale of what are popularly understood to be stocks and bonds is not enough, for there are an infinite variety of get-rich-quick schemes by which ordinary people can be induced to place their money in an investment pool in the hope of profit through the management efforts of a third person. The Blue Sky Laws of the several states, including the Texas Securities Act, are broadly framed, particularly in their definitions, to encompass all these diverse possibilities. These broad definitions should not be permitted to become traps for the unwary.

While the result in Brown v. Cole, labeled by the Court itself as "harsh" and "inequitable," seems to have been unnecessary, the declared readiness of the Court to find an implied exemption for activity incidental to the organization of a joint adventure marks a step in the right direction. It must be remembered, however, that the theory of the joint adventure is useful only as a tool in determining whether there has been a sale of securities within the meaning of the Act. A promotion in which relatively small participations are sold to scattered investors with meager resources of investigation and financial comprehension may be a joint adventure for many legal purposes, but it is the very sort of thing the Blue Sky Law was designed to regulate. The need for such regulation, it may be added, is particularly strong in the highly speculative oil and gas business.

On the other hand, a promotion in which the parties are essentially equals who can, if they wish, and as they often do, make an effective investigation, is one in which, by hypothesis, no one needs the protection of an overworked state official. Promotions of this character necessarily involve only a small number of investors. A private offering exemption, such as is embodied in the Federal Securities Act, would effectively exclude most if not all such promotions from the scope of the Texas Securities Act. In general the state Blue Sky Laws are similar to that of Texas in not having a general private offering exemption. This has resulted, in various states, in holdings that what might otherwise be securities and sales

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57 Cf. Loss, SECURITIES REGULATION 318-29 (1951, with 1955 Supp.).
59 Cf. Loss, SECURITIES REGULATION 43 (1951, with 1955 Supp.).
were not “securities” and “sales” within the meaning of the several laws.\textsuperscript{60} Even where, as sometimes happens, such an approach requires a strained construction of the law, it is preferable to one which yields “harsh” and “inequitable” results that could not possibly have been within the contemplation of the state legislatures. The opinion in \textit{Brown v. Cole} reveals a readiness to follow the path of legislative intent, and there is ample basis in the opinion for limitation of the actual holding to the peculiar facts presented by the case.

\textsuperscript{60} See notes 37, 38 \textit{supra}.