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Texas Exemptions for Small Offerings of Corporate Securities - The Prohibition on Advertisements

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TEXAS EXEMPTIONS FOR SMALL OFFERINGS OF CORPORATE SECURITIES — THE PROHIBITION ON ADVERTISEMENTS

by

Alan R. Bromberg*

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1. PROLOGUE

This article is about the implications of an ambiguous statement

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on a side issue in an intermediate court's already discounted opinion. Why bother? Because it threatens the most widely used exemptions in the Texas Securities Act, just when they had become workable and reasonably free from pitfalls.

The exemptions are those for small offerings: sales up to thirty-five securityholders, employee options, and fifteen sales a year. They have been analyzed in some detail by an earlier article, which noted that each of them is conditioned on the absence of "public solicitation or advertisements," but found little to say about the quoted phrase except that it obviously precludes mass media advertising and large-

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1 Texas Securities Act (hereinafter cited simply "Section" or "§").

1. Provided such sale is made without any public solicitation or advertisements, (a) the sale of any security by the issuer thereof so long as the total number of security holders of the issuer thereof does not exceed thirty-five persons after taking such sale into account; (b) the sale of shares of stock pursuant to the grant of an employee restricted stock option as defined in the Internal Revenue Laws of the United States; or (c) the sale by an issuer of its securities during the period of twelve (12) months ending with the date of the sale in question to not more than fifteen persons (excluding, in determining such fifteen persons, purchasers of securities in transactions exempt under other provisions of this Section 5, purchasers of securities exempt under Section 6 hereof and purchasers of securities which are part of an offering registered under Section 7 hereof), provided such persons purchased such securities for their own account and not for distribution.

The issuer shall file a notice not less than five days prior to the date of consummation of any sale claimed to be exempt under the provisions of clause (c), of this Subsection I, setting forth the name and address of the issuer, the total amount of the securities to be sold under this clause, the price at which the securities are to be sold, the date on which the securities are to be sold, the names and addresses of the proposed purchasers, and such other information as the Commissioner may reasonably require, including a certificate of a principal officer of the issuer that reasonable information concerning the plan of business and the financial condition of the issuer has been furnished to the proposed purchasers. The Commissioner may by order revoke or suspend the exemption under this clause (c) with respect to any security if he has reasonable cause to believe that the plan of business of the issuer of such security, the security, or the sale thereof would tend to work a fraud or deceit upon the purchaser or purchasers thereof, such order to be subject to review in the manner provided by Section 24 of this Act. The revocation or suspension of this exemption shall be applicable to the issuer until such issuer shall have received actual notice from the Commissioner of such revocation or suspension.

Prior Version. At the time of the Tumblewood transaction, it read:

1. The sale by any corporation of its securities or by any unincorporated association or partnership of interests, where the total membership or stockholders will not thereafter exceed thirty-five persons, and where the sale is made without the use of advertisements or any form of public solicitation.

Employee Options. This article concentrates on the problems under the 35-man and 15-a-year exemptions. No particular attention is given to the employee option exemption, although it generally presents the same difficulties in respect of advertisements.

Oil and Gas Interests. A parallel exemption for sales of oil and gas interests to thirty-five or fewer purchasers similarly requires that "no use is made of advertisement or public solicitation," § 5.Q. This provision is not separately treated in the present article, but most of the argument and analysis is applicable to it.

1 Bromberg, Texas Exemptions for Small Offerings of Corporate Securities, 18 Sw. L. J. 537 (1964).
scale mail or telephone solicitation. This language, particularly the “advertisements” part is ripe for further discussion because of the Tumblewood decision. The case is the first to pass on the quoted phrase in Texas and one of the few anywhere to construe advertisements under the securities law.

The threat, in brief, is that compliance with the federal securities laws and other parts of the Texas act, may violate the small offering exemptions and subject the seller to civil liability, and perhaps worse.

2. The Tumblewood Case

Matise (the Plaintiff) was one of several persons instrumental in forming the Tumblewood Bowling Corp. He performed a number of services for it, including some in connection with the preliminary planning and construction of its bowling alley, and others in selling its stock. He was promised payment approximating ten per cent of the total capitalization of the corporation and was voted $15,000 (close to the ten per cent) in cash and stock by the board of directors. When he was not paid, he sued, and was met with the defense that he had no securities license and therefore could not recover any commission for the sale of stock. Claiming that the sale was exempt under section 5.1 [now, with changes, 5.1(a)] because the number of stockholders did not exceed thirty-five, and therefore that no license was necessary, he had the burden of proving the exemption in all its elements, including the absence of “public solicitation or advertisements.” He prevailed on special issues and on defendants’ motion for judgment n.o.v. This was no small achievement since he conceded that he talked to some 250 people about buying the stock. The number was too big (especially considering that some of them

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3 Id. at 552.
5 For the consequences of violating an exemption see Bromberg, op. cit. supra note 2, at 556-57. Another consequence, of course, is what happened to Matise: loss of commission for failure to have a dealer’s license.
6 Section 12.
7 Section 34.
8 There were only twenty-seven or twenty-nine. Apparently no question arose whether husband and wife owning as community property were to be counted as one or two; see Bromberg, op. cit. supra note 2, at 542, 550.
9 Matise had the 35-man limit firmly in mind but was pathetically—or blatantly—ignorant of the prohibition of public solicitation and advertisements; see his testimony at 388 S.W.2d at 482.
10 388 S.W.2d at 482-83.
were strangers)\(^{11}\), and the Beaumont Court of Civil Appeals predictably and correctly reversed and rendered on the ground there had been public solicitation. It invoked, quite reasonably, federal and other states' precedents on "public offering," effectively equating the phrase with "public solicitation," and concluded: "One who talked to some 250 people about purchasing stock in a corporation, some of whom he did not know beforehand, and testified that he was going to talk to as many people as necessary to sell $150,000 worth of stock cannot be heard to say that he did not engage in public solicitation in the sale of securities."

If the court had stopped here, this article need not have been written.

3. The Statement on Advertising

The decision also deals with brochures used by Matise to aid in the stock sales. Unfortunately, it is not clear from the opinion what the brochures said, how many different versions there were, or who saw them. The court wrote:

In 1960 [Matise] . . . prepared brochures to sell the stock . . . stating that his compensation was to be a commission of 10 per cent of total stock sold. The brochures contained the usual data as to proposed capital stock, nature of project, estimated [future] income and amounted to a detailed prospectus. In soliciting the sale of stock to some 250 persons, appellee exhibited said brochures to such prospective purchasers of stock.\(^{14}\)

Actually, it appears that there were three different brochures: two prepared by pinsetter manufacturers (AMF & Brunswick) and one prepared by Matise by reproducing parts of the other two as well as additional material. I have not been able to lay hands on any of these but can reconstruct them this far from briefs and partial transcripts:

Matise brochure (Exhibit D-1): cover sheet stating "Pete Matise,

\(^{11}\) See Bromberg, *op. cit.* supra note 2, at 332. The court emphasized the lack of prior contact both in the quotation at note 12 *infra* and in italics at 388 S.W.2d at 482. See also *Birchfield v. State*, 401 S.W.2d 821 (Tex. Crim. App. 1966) (letters to certain companies listed in the Houston telephone book).

\(^{13}\) 388 S.W.2d at 483.

\(^{13}\) This is not to say that the case was an easy one. There were perplexing issues, not treated here, of pari delicto, acquiescence, estoppel and joint venture. There were also questions about whether the sales or offers were made by means of the disputed advertisements or solicitation, the number of people who saw the advertisements, and whether Matise was to be compensated for selling securities or for general services to the corporation. Of these, the only one dealt with at all directly by the civil appeals court is whether the sales were made by use of the brochure; the court quoted the sweeping definition of sale in § 4. E, which includes "an attempt to dispose of a security for value," and implied (correctly) that the brochure was used in the sales, in this sense. 388 S.W.2d at 481.

\(^{14}\) 388 S.W.2d at 482.
Investments" and "Blanton-Matise Investment Company," with addresses and phone numbers; second sheet with various information pertaining to profitability and building plans for a bowling alley; third-fourth sheets: picture of proposed bowling lane, and plot plan; proposed set of bylaws copied from another bowling alley; AMF estimate of a bowling alley's receipts, disbursements and net; finally, a statement concerning Matise's ten per cent compensation for selling stock.15 There may have been three copies of this Brochure, although this is not clear. At some stage in the selling, the Tumblewood attorney saw the Matise brochure and directed Matise to stop using it.16 It is not clear how many people saw it.

Brunswick brochure or book: described only as complete and explaining more than the Matise brochure. It had nothing on Tumblewood specifically. There were either two or three of these,17 but Matise's testimony may have confused them with his own brochures. They were apparently used in addition to the Matise brochures in some instances.18

AMF brochure: a financial estimate from this was included in the Matise brochure, but there is no indication what else it contained, or whether it was used in any other way.

The brochure described by the court was obviously Matise's, although the court should not be understood as saying that it was "a detailed prospectus" in the sense required for a registered offering by either Texas or federal law. It omitted much required information and contained estimates of future income which are almost invariably prohibited.19 For an exempt offering, no specific form of

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15 Testimony of P. T. Matise, Cause No. A-76, 750—In re Tumblewood Bowling Corp., 81-83. For the format, see text accompanying note 65 infra.
16 Id. at 105.
17 Id. at 80, 87.
18 Id. at 101, 102, perhaps 87.
19 Texas. Section 9. C: "... by prospectus which fairly discloses the material facts about the plan of finance and business." The prospectus is subject to approval by the Commissioner who has promulgated a detailed "Suggested Outline to Assist in Preparing Prospectus for Local Texas Offerings Only" (undated). It appears that the following major items, which are practically all the applicable ones called for by the Current Outline, were omitted from Matise's brochure, or incompletely stated: use of proceeds, capital structure, plan of distribution, cost of equity shares held by organizers, organization and affiliates, background and history of business, capital stock being registered, directors and executive officers, remuneration of officers and directors, principal holders of equity securities, options to purchase securities, interest of management and others in certain transactions, and legal opinions. The current Outline, as well as the one probably in effect at the time of these transactions (1960), would in all likelihood have precluded any earnings projection or prediction. This has been the consistent administrative practice, so far as I am aware, and is suggested by the portion of the "Outline" which prohibits "any subject matter which goes further than a fair and factual presentation necessary to disclose the material facts" (page 3 of the current version).

Federal. For the contents of the typical prospectus, see SEC Form S-1, Items 1-21, 17 CFR § 239.11 (Supp. 1965), CCH Fed. Sec. L. Rep. §§7121, 7123. On the prohibition of
information or prospectus is required or prohibited, unless it constitutes an advertisement, or is untrue or misleading. No issue was made that the Tumblewood brochures were untrue or misleading in any way, although the seller naturally would not need or want to go into this area.

Of the Matise brochure, the court wrote what we dub the statement on advertising:

Clearly, the provisions of Section 22(A.) indicate that a pamphlet or brochure used to aid in the sale of securities would be advertising within the meaning of that term as used in The Securities Act. One who is engaged in selling securities is not entitled to an exemption under Section 5(I.) of The Securities Act if he uses such a brochure to aid in the sale of such securities as appellee used and admitted that he used to aid him in selling stock.

This disturbing language, which suggests that any brochure or pamphlet (and thus perhaps any written material) would destroy the small offering exemptions, is almost verbatim from the amicus brief of the Attorney General. The first sentence is identical, but the second varies from the Attorney General's: "One who is engaged in selling securities is not entitled to an exemption under Section 5(I) of the Securities Act if he uses a brochure to aid in the sale of such securities. [Matise] used a brochure as an aid in selling stock. . . ." This latter interpretation is even more disturbing, coming as it does from the state's chief legal officer, filing as amicus at the instance of the Securities Commissioner, because of the "state-wide importance" of the case in interpreting advertising and public solicitation.

The court's statement on advertising is clearly not a principal holding. The public solicitation issue is treated first, occupies all but a paragraph or two of the four-page opinion, and is the subject of the main holding. It is tempting to dismiss the statement on advertis-
ing as dictum, since it seems tossed in for good measure, with little analysis or citation to support it. But there is specific reversal on the point, which was an integral one, though secondary. So we classify the statement as an alternative holding: a little more than dictum, but not much.

4. Possible Impact of the Statement

Assume that the statement means that any written material constitutes an advertisement and is therefore prohibited in a small offering exemption. How, then, can a seller comply with his obligation to make full disclosure to the buyer? He can, of course, present his information orally, although this (if at all complex) is not as likely to be absorbed and understood. Not only would oral presentation tend to defeat the investor-informing purpose, but it would almost certainly be less carefully and systematically presented. In addition, there would be much greater room for later dispute about what really was said. It would probably do more to encourage fraud than to deter it. Admittedly, most securities are sold on oral representations, though (in the case of issues registered under federal or state law) backed up by a comprehensive prospectus. It is hardly thinkable that the legislature intended to prevent a seller from putting his representations in writing, particularly in a new or small venture where the risks of failure (and hence of unhappy investors) are likely to be unusually high. A more welcome possibility is that there can be written material which is not a brochure; see the discussion below.

The problem has become even more acute since the 1963 amendment to section 5.1, which added the 15-a-year exemption. The latter

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54 Section 33.A(2) creates civil liability (for rescission or damages) against any person who "offers or sells a security (whether or not exempt . . .) by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading . . ." This language was enacted in 1963 and was in force when the Tumblewood sales were made. Its predecessor impliedly created civil liability for misrepresentation. *Texas Gen. & Spec. Laws* 1917, ch. 269, § 33. Quite apart from the Securities Act, sellers of securities have since 1919 been subject to triple damages (though on a different, loss of the bargain, measure) for false representations or promises in the sale of securities. *Tex. Rev. Civ. Stat. Ann.* art. 4004 (1941). Federal law often operates to require full disclosure in local securities transactions. Even though they are exempt from federal registration, they are subject to the civil liability provisions [similar to Texas § 33.A(2) above] whenever the mails or interstate commerce are used. Securities Act of 1933, § 12(2), 15 U.S.C. § 77q(2).

55 The untrustworthiness of oral salesmanship of securities is one reason for the customary disclaimer in prospectuses:

No dealer, salesman, or any other person, is authorized to give any information or to make any representation not contained in this Prospectus. Any information or representation not contained herein must not be relied on as having been authorized by the company [issuer].

For many years, this has been part of the Texas Commissioner's suggested prospectus, *op. cit. supra* n.19, at 2.

56 See Bromberg, *op. cit. supra* note 2, at 564, n.125.

57 Parts 9-10 infra.
effectively requires that buyers receive "reasonable information con-
erning the plan of business and the financial condition of the
issuer."28

Facing these unhappy possibilities, we turn back to Tumblewood
to dig deeper for its meaning.

5. Meaning of the Statement: This Brochure
or Any Written Material?

The court’s statement on advertising29 is ambiguous. The “such”
before “a brochure” may refer back to “a pamphlet or brochure used
to aid in the sale of securities” in the preceding sentence, or forward
to “as appellee used . . . to aid him in selling stock” in the same
sentence.

(A) The first construction would prohibit any brochure in the
sale of a security under section 5.1. Since the word “brochure” is left
undefined and unlimited (except perhaps by the facts of the case),
serious doubt is cast on the use of any written matter in a small
offering exemption.

(B) The second construction would be a less restrictive prohibi-
tion, covering brochures like Matise’s in method of use or perhaps in
content.30

The second interpretation seems more desirable and less rigid, but
we can’t be confident that it is the right one.

6. Statutory Evolution of Small Offering Exemptions:
Progressive Relaxation

Any statute is a product of its evolution, particularly the Texas
Securities Act which has been changed by virtually every session of
the legislature since 1935. The small offering exemption, first intro-
duced in that year, has been repeatedly amended to enlarge the
types of issuers who may use it, the kinds of securities which may
be sold, and the number of persons who may buy.31 At the same
time, the conditions restricting methods of offering have progres-
sively relaxed:

1935-55: “without the use of advertisements, circulars, agents,
salesmen, solicitors, or any form of public solicitation.”33

1955-57: “without the use of advertisements, circulars, or any
form of public solicitation.”33

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28 Bromberg, op. cit. supra note 2, at 549-50.
29 See note 20 supra.
30 Part 9 infra.
31 The details are traced in Bromberg, op. cit. supra note 2, at 539, n.6.
33 Tex. Gen. & Spec. Laws 1955, ch. 67, § 3 (j) and ch. 384, § 3 (j).
1957-63: "without the use of advertisements or any form of pub-
lit solicitation."  
1963-date: "without any public solicitation or advertisements."

Thus, the prohibitory language has dropped agents, salesmen, solici-
tors and circulars, all of which are impliedly permitted—unless,
of course, their use amounts to public solicitation or advertisement.
When the legislature stopped its absolute ban on circulars in 1957,
it authorized a reasonable inference that circulars are not identical
with advertisements. Since brochures and circulars have so much in
common, it seems likely that brochures are not absolutely banned
(i.e., as being equivalent to advertisements) either. At the very
least, the statutory history makes it imperative that all the circum-
stances be considered in deciding whether a particular piece is an ad-
vertisement.

When the legislature added the specific information provision to
one of the small offering exemptions in 1963, it neither required nor
prohibited written information. For good reasons, it must have con-
templated that some of the information would be in writing. Yet it
retained the prohibition on advertisements in all the small offering
exemptions. This strongly confirms the view that written material
is not an advertisement per se.

7. Advertisement Prohibition In Small Offering Exemptions

There are two basic ways to write a small offering exemption: (A)
limit the number of offerees, numerically or otherwise, or (B)

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26 For the dictionary definitions of "brochure," see note 59 infra.
27 See Part 9 infra.
28 Note 28 supra.
29 See Part 4 supra.
30 E.g., Uniform Securities Act § 402(b)(9) (10 offerees in the state); 22 jurisdic-
tions referred to in note 41 infra.
offering") construed, e.g., in SEC Securities Act Release No. 4552, Nov. 6, 1962, 1 CCH
32 See Part 9 infra.
33 Note 28 supra.
34 See Part 4 supra.
limit the number of buyers or security holders. For the former group, advertising is impliedly prohibited since it constitutes an offer and normally exceeds the limits. For the latter group, whose exemptions are more generous than an equal limit on offerees, express restriction on advertising or public solicitation is a logical corollary. It serves as a sort of non-numerical limit on offerees and helps to keep the offering from getting out of hand. It may reduce the temptation to exceed the limits on buyers or holders by creating beneficial interests which do not appear of record, in hopes of escaping detection. More basically, it helps shield the general public against unregistered offerings and keeps the offerings more or less confined to people who know each other or can take care of themselves. Without some limit on offerees, a seller would be free to solicit the world for the most helpless buyer, or the one who would pay the highest price.

Only four states appear to be following this pattern of a numerical limit on buyers or holders, and a non-numerical limit on offerees, although others may reach a similar result by different means.

8. Advertising Regulation

8.1 General

Quite apart from the advertisement prohibition in the small offering exemptions, some states exercise more sweeping control over advertising, typically in non-exempt transactions, by requiring either its filing or its approval. Texas takes the former approach. The amended by Laws 1966 S.B. No. 102, § 2; Blue Sky L. Rep. (Va.) § 49.214.


13. Thirteen jurisdictions referred to in note 41 supra. Texas §§ 5.1(a) and 5.1(c) illustrate both variations, limiting security holders and buyers, respectively.

42 On advertising as an offer, see note 52 infra. See also Robertson v. Business Boosters' Country Club, 212 Ala. 621, 103 So. 576 (1921); People v. Clark, 215 Cal. App.2d 734, 30 Cal. Rptr. 487 (1963), cert. denied, 371 U.S. 943 (1963) (newspaper advertisement for an "associate" destroyed claimed exemption, under Calif. Corp. Code § 25100(m), for joint venture not offered to the public). See also note 45 infra.

43 For a more comprehensive discussion of the rationale for the small offering exemptions, see Bromberg, op. cit. supra note 2, at 558-67.

44 For a more comprehensive discussion of the rationale for the small offering exemptions, see Bromberg, op. cit. supra note 2, at 558-67.

45 Cf. 1 Loss, Securities Regulation 503-06 (2d ed. 1961), discussing a Wall Street Journal ad for one or two partners in an oil drilling venture, administratively treated as a public offering under federal law. See also note 43 supra.

46 Florida, Pennsylvania, Texas, and Virginia, note 41 supra.

47 See note 41 supra, last par.

48 E.g., Uniform Securities Act § 403; Calif. Corp. Code § 25602. Semble, under the limited federal exemptions (Regulations A) for offerings under $300,000, SEC Rule 230, 17 C.F.R. 230, 218.


50 Section 22.B(3). This has been interpreted to require filing five days before use, except in the case of final prospectuses and "tombstone ads." State Securities Board, Interpretation of the Quoted Portion of Subsection (3) of § 22.B, Texas Securities Act (Oct. 29, 1962).
primary purpose is to let the administrator police the advertising, e.g., by prohibiting its use if fraudulent or misleading. A second purpose is deterrent, to discourage advertisers from preparing misleading material.

This kind of advertising control is part of the larger thrust of the securities laws to prevent offers of unregistered securities and misleading offers of all securities. Advertising is embraced by the customary broad definition of "offer" and is therefore typically illegal unless the security is registered, or the security or transaction is exempt.

In Texas, at least, history demonstrates that the trend in advertising regulation (as in small offering exemptions) has been relaxation. The last major revision (1955) reversed an administrative practice which prohibited the circulation of "red herring" (preliminary) prospectuses filed with the SEC in registrations which had not yet become effective at federal or state levels. It carried forward in other respects the old rule preventing advertising of unregistered securities, and necessarily preserved the broad concept and implied definition of advertising for this purpose which dates from 1935 and is almost the same today: "any circular, advertisement, pamphlet, prospectus, program or other matter . . . concerning any security." Even this need not include all written material, since the verbs operating on the quoted objects are "issue, distribute, or publish," which denote some fairly broad dissemination.

8.2 Application To Tumblewood

This general provision on advertising regulation was the basis of the Tumblewood court's statement on advertising in the small offer-
ing context—indeed it seems tacitly to equate the two notions of advertising—as well as of the Attorney General’s brief on the issue. It is a logical starting point, but it doesn’t take us very far. For one thing, it is not an explicit definition, even within its own section. For another, it talks of “advertising” rather than “advertisements” (the latter used in section 5.I). It probably requires broad dissemination before it is invoked. Its history indicates that its purpose was to prevent offers in general, not to restrict particular offers expressly permitted. This brings us to the last and most important reason why the general advertising regulation is irrelevant: it has, by its own terms, never applied to exempt transactions and securities. All these factors were regrettably overlooked, or ignored, by the Attorney General and perhaps by the court. There is an intimation that the court grasped them when it toned down the Attorney General’s unqualified language by adding the “such” verbiage whose ambiguity we have noted. There is a hope that the Texas Supreme Court grasped them when it refused the writ, “n.r.e.,” although it gave us no guidance.

9. Elements of an Advertisement

“Advertisement” and “advertising” are words of many nuances. They don’t mean necessarily the same thing on Madison Avenue and on Main Street. I think they mean different things in sections 5.I and 22. Although dictionary and treatise definitions abound, it is tolerably clear that the words take coloration from their surroundings and need interpretation in context. The following effort at analysis is aimed at the section 5.I problem.

9.1 Format and Quantity

This discussion is concerned primarily with written material, since it is hard to regard spoken words as an advertisement unless they
are broadcast. A written advertisement is not readily definable by physical form, although most would agree that a salesman's personal notes of what he is going to say are not advertising, and that a billboard, or newspaper spread is. In between lie individual letters, mimeographed circulars, printed booklets and many other varieties. Perhaps a useful line can be drawn between sales aids (used by the seller himself in dealing with prospects) and advertisements (used to locate or pre-condition prospects). This line is not rigid; since a sales aid can become an advertisement if used on a large enough scale.

Logically, and I think, legally, the method of production is irrelevant, although the slicker and more "professional" the art work, layout, packaging, and processing, the more it seems like an advertisement. Similarly, the more copies that are made, the more it suggests an ad.

Matise’s piece, which the court consistently calls a brochure,64 was made by him on the equipment of his blueprint shop. Thus it was not press-printed, although it apparently reproduced some things which were. We are not told how it was put together, although there is reference to one copy in an elaborate arrangement, with acetate dividers and an elaborate back.65 There may have been only two or three copies in all.

9.2 Content And Tone

Again, it is hard to draw sharp lines. But it appears that (at least from the legal viewpoint) the more factual, comprehensive, balanced, and low-keyed the presentation, the less it resembles advertising. Without disparaging the advertising business, we must recognize that it tends to deal in the promotional, the selective, the emphatic. An SEC prospectus would not be advertising in this sense. But it would be with the addition of “Special this week while they last!”, “Make a Million in Tumblewood!”, “Here’s the bargain you’ve been waiting for!” or “Want to Double Your Money?”66 A related factor is who prepared the material. The use of a professional advertising or public relations man points toward advertising, though it is hardly decisive. Nor is it conclusive the other way that an amateur did the work.

64 A brochure is "a printed or stitched book containing only a few leaves," WEBSTER'S NEW INTERNATIONAL DICTIONARY (2d ed. 1954), a "pamphlet, booklet," id. (3d ed. 1961). In the trial, Matise and others referred variously to brochures, booklets, brochure booklets. Testimony, op. cit. supra note 15, at 86-88, 104-05.
65 Testimony, op. cit. supra note 15, at 104-05.
66 Moreover, when publicly distributed, even the most sober SEC prospectus is probably an advertisement. It is for § 22 purposes, e.g., § 22.D. Even a bare-bones “tombstone” announcement, identifying the security and the place where a prospectus may be obtained, is probably an advertisement if it appears in a newspaper.
We have insufficient facts to rate Matise’s brochure on these scores.

9.3 Dissemination And Medium

The most important ingredient, and the only one on which there is any legal authority, is the way the material is used. No one could seriously argue that a piece of paper is an advertisement before anybody sees it, and it is reasonable to say that a fair number of persons have to see it before it achieves that status. How many must see it is a troubling question. Despite the variety of contexts in which it arises, cases outside the securities area have said with surprising uniformity that advertising involves the public. What little Texas authority exists is in accord, as are the one or two securities decisions from other states. All this dovetails neatly with the idea that the Texas small offering exemptions are for private rather than public use.

Critical readers will wonder how I distinguish “advertisements” from “public solicitation,” which are side by side in the prohibition. In all honesty, I think they are partially redundant, with the latter

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Edwards v. Lubbock County, 33 S.W.2d 482, 484 (Tex. Civ. App. 1930) (advertising requirement for sale of land by county commissioners): advertising is "a means or method of attracting public attention." The Tumblewood trial court followed this when it instructed the jury in connection with Special Issue No. 4 on advertisements: "By the term 'advertisement' is meant printed material, pictures, drawings, or other means or method of attracting public attention, issued, distributed or published to aid and assist in selling stock. The term 'advertising' is synonymous with 'notice.'" The three verbs in the first sentence are from the advertising regulation provision, § 22, discussed at text accompanying note 57 supra and correctly carry the public connotation. The second sentence of the instruction, also taken from the Edwards case, seems irrelevant and incorrect unless it means public notice. The jury answered: "The sale of stock was accomplished without the use of advertisements."

See also State v. Guardian Foundation of Texas, Inc., 128 S.W.2d 880, 882 (Tex. Civ. App. 1939) (advertising requirement for sale of land by corporation organized to do a general advertising business): "Advertising ... means more than merely announcing, making known, or turning the attention of the public toward a certain product. Its ultimate purpose is to sell or to help sell," [quoting STARCH, PRINCIPLES OF ADVERTISING (1923)]. Sale to the public seems implied.

People v. Montague, 280 Mich. 610, 274 N.W. 347, 351 (1937) (exemption for pre-incorporation subscriptions if not "solicited by advertising"): advertising means "making public intimation or announcement of anything" (quoting from 2 C.J.S. 891); other definitions are mentioned.

Conversely, where there is an exemption (or exclusion) of non-public offerings (e.g., see note 41 supra), the courts have cited the absence of advertising as a factor sustaining the exemption. Gillespie v. Long, 212 Ala. 34, 101 So. 671 (1924); Robertson v. Business Boosters’ Country Club, 210 Ala. 460, 98 So. 272 (1923); People v. Ruthven, 160 Misc. 112, 288 N.Y.S. 631 (Rochester City Ct. 1936). Gillespie v. Long, supra, held that a private transaction was not within the statute prohibiting sales and offers "by means of any advertisements, circulars or prospectus, or by any other form of public offering." The court recognized that advertising was necessarily public in this context.
completely overlapping the former. But this is “bad” statutory construction, since it fails to give effect to all words.70 The technical distinction, then, perhaps is that solicitation involves a more personal element; while advertisement is an impersonal document or broadcast. For example, a man peddling stock on a busy street corner might not be advertising if he only talked; he would be if he handed out leaflets or wore a sandwich board. But he would be soliciting in any case.71

All this reduces to the familiar proposition that advertising is a use of media such as newspapers, handbills, radio, or television. Direct mail is another advertising medium72 but involves more than a few recipients. Robot typewriters and copying machines have eliminated any legal difference between what appears to be a personal letter and what is identifiably mass-produced. This is not to say that a few letters or memoranda would constitute advertising; normally they would not. But in a mailing of a thousand, the technique of production is unimportant.

9.4 Relative Weight Of Elements

In identifying an advertisement, I think public distribution is the dominant criterion and perhaps the only one. Yet it is certainly reasonable to recognize an interdependence of elements. It may be that a hand-written communication to one person could be so strident and alluring, such a come-on, that it would be classed as advertisement and defeat the exemption. I doubt it, particularly since the securities law has other ways of dealing with this kind of thing,73 but I do not deny the possibility. Tone and content seem more important factors than format and quantity (except so far as the latter is a link to public distribution). The relevant number is those who see the material, not those who keep it. A single billboard or TV broadcast is as much an advertisement as a quantity of circulars placed in cars in a shopping center. And a single brochure shown briefly to a hundred people but retained by the exhibitor, seems to

70 If you think the legislature can’t be redundant, look at the preamble of § 5.

71 It makes a kind of formal sense to say that advertisement is distinct from solicitation in that the former is prohibited even in private use, and the latter only in public. But I cannot accept this argument in view of the much stronger ones for public dissemination as an essential ingredient of an advertisement.

72 If legal confirmation is needed, it can be found in § 4.E, discussed supra note 52. See also Birchfield v. State, 401 S.W.2d 825 (Tex. Crim. App. 1966) (letters were public solicitation).

73 The Commissioner may prevent its use if he finds it false, misleading or likely to deceive, § 23.B. The catch, of course, is that he’s not likely to know about it. But the buyer is given a potent remedy—recovery of his purchase price from the seller—if it is misleading, § 33.A(2). Somewhat comparable remedies are available under federal laws, depending largely on whether the mails or interstate commerce have been used.
be no more or less an advertisement than a hundred mailed to or left with the same persons, one each.

10. Final Critique Of Tumblewood

Now we can make a fuller appraisal of Tumblewood. Its main holding (on public solicitation) is not disputed. Its alternate holding (on advertisements) is ambiguous at best and catastrophic at worst. If it means that Matise's brochure was an advertisement because it was shown to several hundred people and perhaps because of its promotional character (e.g., earnings projections) or material omissions, our only complaint would be that the court didn't spell out the reasons. This is the better, more logical interpretation, but who can be sure that it is what the court had in mind?

If the statement means that any written material shown to a prospective buyer is an advertisement which destroys the small offering exemption, it is disastrously wrong for many reasons:

1. It is inconsistent with the disclosure purposes of the Texas and U. S. acts.

2. It takes its concept of advertising from a quite distinct statutory context, which is expressly inapplicable.

3. It ignores the essential ingredient in advertising: its public distribution.

4. It disregards the history and purpose of § 5.I, particularly its successive relaxations.

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[Notes and references omitted for brevity.]
5. It threatens small business with unwitting civil (and conceivably even criminal) liability in perfectly honest securities sales which turn out not to be exempt because information given the buyer is treated as an "advertisement." The seriousness is magnified because these are the most commonly used exemptions.

If by chance Tumblewood (construed to prohibit any written material in a small offering exemption) was right on the law in 1960, it is wrong on the law since 1963.1

And if Tumblewood means that some written material is advertising, but other is not, it has left us woefully without guidance in conducting everyday business under the Securities Act.

Whatever damage has been done by the ambiguous statement on advertising in Tumblewood has been compounded by its unambiguous, unqualified injection into the bloodstream of legal literature, through the West headnote: "Pamphlet or brochure used to aid in sale of securities would be 'advertising' within provision of securities act exempting sales of securities when total number of stockholders will not exceed 35 and sale is made without use of advertising."2

So it will emerge into Words and Phrases, the Digests and encyclopedias, and thence very likely into the writings of other lawyers and the holdings of other judges.

The Tumblewood problem emerges a classic of inadvertence and waste: the minor issue in a hard-fought case, the sweeping generalization of a state official more concerned with other things, the loose language of one court, the failure to perceive and correct the trouble in another, the literal-mindedness of a digester, and now the long-winded apprehensions of a law professor.

11. Need for Clarification

Far from an academic problem, the meaning of advertisement is critical to thousands of corporations, many thousands of investors, and millions of dollars of transactions in Texas every year.3 Unless sooner clarified by binding precedent, the next legislature should be asked to do the job. It might proceed in various ways, stated in descending order of efficiency, as I see them.

1. Delete "advertisements" from the section, so that the only remaining prohibition would be on public solicitation. This would enlarge the intended scope of the provision not at all, or only mini-

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1 Sections 29.A, 29.B.
2 See Bromberg, op. cit. supra note 2, at 560-61 nn.117-18.
3 See notes 24, 71 and 77 supra and text at notes 28 and 38.
4 388 S.W.2d 479, headnote 6.
5 See estimating data in Bromberg, op. cit. supra note 2, at 560-61, esp. n.118.
mally." The change would be a natural one historically." Moreover, it would recognize that the small offering exemption is not dependent on the general advertising control of section 22 and avoid any compromise of the broader definition appropriate to the latter.

2. Clarify that "advertisement" in section 5.I has a public aspect, either by inserting "public" before it, or by substituting "without any public solicitation (by advertisements or otherwise)." The former, though awkward in phraseology, is clearer in meaning, since the latter leaves something to implication."

3. Define advertising, either positively (by saying what it is) or negatively (by saying what it is not). Both present difficulties, one of rigidity, the other of incompleteness. A middle ground, perhaps no better, would be a specification that an advertisement is determined by its use, not by its physical form or content.

12. WHAT TO DO UNTIL THEN

Meanwhile, back in the office, we have to live with Tumblewood. This article is full of reasons why the court's ambiguous statement on advertising should mean only a rather promotional brochure (with earnings predictions and without other relevant information) shown to a group large enough to be called public. It is also full of reasons why the statement, if it means more, should be limited to its facts. While waiting for the doubts to be put at rest by the legislature or a more precise and authoritative decision, we must continue to use the small offering exemptions, since registration would be entirely impractical in most instances and since business cannot stop financing. How we use them will depend on our appraisal of the risk of Tumblewood and, of course, on how much control we can exert over our clients.

Written disclosure to buyers in small offering exemptions is still vital, in my estimation, to comply with the spirit of the Texas and (if applicable) federal securities laws, and to escape civil liability under them. This, in my judgment, takes precedence over any contrary implications of Tumblewood. To minimize the dangers created by Tumblewood, my suggestions are:

1. Stick to the facts, as complete and unadorned as possible. Disclose the negative as well as the positive aspects of the offering. Earn-

\[\text{\textsuperscript{84}}\text{ See Part 9.3, 2d par., supra.}\]
\[\text{\textsuperscript{85}}\text{ See Part 6 supra.}\]
\[\text{\textsuperscript{86}}\text{ This would strengthen the inference given by the 1963 amendment, which put "public solicitation" before "advertisements" and arguably made "public" modify "advertisements" too; see note 77 supra.}\]
\[\text{\textsuperscript{87}}\text{ An appealing variant is the 1966 Virginia amendment, \textit{op. cit. supra} note 41: "if . . . not . . . offered to the general public by advertisement or solicitation."}\]
ings projections should be avoided or, if absolutely essential, conservatively presented with a clear explanation of the underlying assumptions and inevitable uncertainties.

2. Avoid art work, fancy layouts, professional advertising men, printing and binding. Stay with typed material, preferably stapled as a letter or memorandum.

3. Minimize the number of copies and, above all, do not expose them (or any oral offer) to more than a small number of carefully selected prospects. Keep track of all copies, in case a question arises later.

Even with these precautions, a lawyer will hope that he isn’t asked for an unqualified opinion that a transaction is exempt. Of course, all this may not be feasible for some situations. More sadly, most businessmen and many lawyers will not even know there’s a need for caution.