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Corporations: Securities: Private v. Public Offering

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courage them not to do so, for fear that any recognition of the action may jeopardize valid, though technical, attacks on jurisdiction.

Another potential effect of the decision is that the prospective defendant unwittingly deprives himself of his option of joining in the answer his objection to jurisdiction, as authorized by section 262.16(2). The import assigned to the layman's letter has the practical effect of defeating a procedure designed, not only to encourage the speedy and final determination of actions on their merits, but, at the same time, to preserve the defendant's legitimate attacks on jurisdictional defects. There is no question that a defendant may waive his right to be served as required by statute, as he may waive any other procedure or accommodation. Statutes, by conferring jurisdiction upon the basis of general appearance, so provide. But there are both legal and policy reasons why the principle of "harmless error" should not be too freely applied to clearly-prescribed jurisdictional formalities. The court's liberal interpretation of statutes requiring that its jurisdiction be acquired in a prescribed way is something of a "bootstrap operation," and introduces the unfortunate aspects of unpredictability into rules whose whole function is, like traffic signs, to designate the path which a litigant shall follow.

In the final analysis, this case represents only a small incursion on the rules of jurisdictional procedure, and on that account should perhaps evoke no strong objection. It is abundantly clear, however, that the substantive impact of the decision is to enlarge the period of the applicable statute of limitations, for otherwise the case could not sensibly have provoked an appeal, in lieu of the easy process of reservice. The "liberal construction" which the court invokes, therefore, is effectively a construction which weakens the force of statutes of repose. The decision would have perhaps been more meaningful had it been addressed directly to that policy issue.

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Corporations: Securities: Private v. Public Offering: Section 4(1) of the Securities Act of 1933 exempts "transactions by an issuer not involving any public offering"[1] from the registration requirements of section 5.[2] Because the term "public offering" is not defined in the Securities Act and the commission has not attempted by rule or regula-

[1] 15 U.S.C. §77d (1964).

[2] §5. "(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or
(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale . . ."
15 U.S.C. §77e (1964).

tion to state the meaning of these words, there is much confusion in this area as to what is public and what is exempt.

This was the issue in *United States v. Custer Channel Wing Corp.*[3] In this case, Custer Channel Wing Corporation and its president were convicted of criminal contempt[4] for violating an injunction issued by the district court, permanently enjoining them from using the mails to sell stock of Channel Wing as part of a public offering. Defendants admitted selling unregistered shares of stock but maintained that the sales constituted a private offering within the section 4(1) exemption.

In 1953 the Supreme Court ruled in the leading case in this field, *Securities & Exchange Commission v. Ralston Purina Co.*,[5] that a transaction "not involving any public offering" is an offer made to those who are able to "fend for themselves."[6] In addition, the Court stated that if the offer had been made to those who because of their position had access to the same kind of information that registration would disclose,[7] the offer would be considered private and exempt from registration. Thus, the Court in *Ralston* attempted to further the purpose of the Securities Act, which is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[8]

After *Ralston,* the courts could have interpreted the "fend for oneself" test strictly to mean that there can be no substitute for the information that registration would disclose; and, if the purchaser does not have such information—the offering will be deemed public. In other words, being in "position to fend" for oneself means that the prospective purchaser must have actual access to the knowledge that would be imparted by a registration statement.

However, prior to *United States v. Custer Channel Wing Corp.,* the courts had not accepted the registration statement rule as solely definitive of public and private offerings. In fact they based their findings on criteria such as the following: (a) smallness of the offering; (b) number of offerees; (c) fewness of the units offered; (d) close relationship and past dealings of the parties; (e) former business and social

[3] United States v. Custer Channel Wing Corp., 376 F.2d 675 (4th Cir. 1967).

[4] The court held that they intentionally acted with full knowledge of all relevant circumstances, and proof of evil purpose or bad motive; that is, proof of specific intention to violate the injunction was not necessary. The District Court fined the corporate defendant $5000 plus one-half of the costs, and sentenced the individual to serve 183 days in prison and pay one-half of the costs. *Id.* at 677.

[5] Securities and Exchange Comm'n. v. Ralston Purina Co., 346 U.S. 119 (1953).

[6] *Id.* at 125.

[7] Thirty-two requirements of registration are found in Securities Act of 1933, 15 U.S.C. §77 aa, Schedule A, (1964).

[8] A. C. Frost & Co. v. Cover D'Alene Mines Corp., 312 U.S. 38, 40 (1941). The words of the preamble to the Securities Act of 1933 are helpful: "An act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes."

contacts of the parties; (f) the fact that the investor initiated the transaction; (g) the investor's varied business experience including the stockmarket and prior ownership of stocks similar to the one upon which the suit was founded;[9] indicating the courts' feeling that these criteria are also relevant to a decision as to whether one could "fend" for himself.

Nonetheless, in *United States v. Custer Channel Wing Corp.*, the court in answer to appellant's argument that the individual purchasers were able to "fend for themselves" because they were "sophisticated investors" and "businessmen of mature experience," stated that sophistication is not a substitute for access to the kind of information which registration would disclose.[10] Hence, even though the court went on to state that "a purchaser of unregistered stock must be shown to have been in a position to acquire similar information about the issuer"[11] as a registration statement would disclose before the transaction will be considered exempt, the court has in effect said that the position of the parties to each other is not relevant—rather the sole test is whether the purchaser *actually* has access to the necessary information.

Channel Wing and its president required each prospective purchaser to sign an investment letter acknowledging that he knew the stock was not registered, that the purchaser initiated the sale by application, and that, "the corporation has allowed me unlimited access to all its books, records, files, plant and personnel to obtain all information about its affairs which I desire. I have made such inquiry as I believe to be desirable for my decision to purchase. . . ."[12] This was held not sufficient to constitute the Channel Wing offering a private one in the absence of proof that the purchasers actually had access to the kind of information that a registration statement would have disclosed.[13]

Thus, the *Custer* case may be distinguished from previous cases to the extent that it created a new test concerning when the purchaser is in a position to fend for himself. Decisions of other districts hold that a person is able to fend for himself when there is a relationship with the issuer that indicates the purchaser, based on his own position, *should* be able to get the required information. *Custer* holds that a person is

[9] Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963); Shimer v. Webster, 225 A.2d 880, 883 (1967); Woodward v. Wright, 266 F.2d 108 (10th Cir. 1959), where the court found the offering to be private because the purchasers had made other oil investments, they had inspected the properties, the parties were friends; and the sale was conducted on a personal basis; Collier v. Mikel, 183 F.Supp. 104 (D.C. Minn. 1958), where the court found an exempt offering because it was to "long time" friends and business associates experienced in this type of investment. See also, Campbell v. Degenther, 97 F.Supp. 975 (D.C. Penn. 1951); Private Placements and Intrastate Offerings of Securities, 13 Bus. Law 301 (1957-58).

[10] United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir. 1967).

[11] *Id.* at 678.

[12] United States v. Custer Channel Wing Corp., 247 F.Supp. 481, 485 (D.C. Maryland 1965).

[13] United States v. Custer Channel Wing Corp., 376 F.2d 675, 679 (4th Cir. 1967).

not able to fend for himself unless he actually *has access* to the necessary information. This is not to say that the information must be used or even sought; rather, it means the investor must know where he can get this information, and, the information must actually be available at this place.

The *Ralston* case adds strong support for the strict interpretation of *Custer*. In *Ralston,* the Court found no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation.[14] The Court evidently felt the fact that purchasers are few in number and probably should be able to get information because of their limited numbers can be no substitute for actual access to the information required by a registration statement. Thus, *Ralston* itself appears to discard at least one of the criteria that courts have used to find a private offering.

Although the courts probably will not emphasize the position of the parties in deciding whether a person can fend for himself—because of the *Custer* decision and the attitude of the Supreme Court in *Ralston* —rather than ignore the position and circumstances of the parties, they may use such criteria as a basis for determining the burden of proof. The burden of establishing the exempt character of the transaction rests on the one who claims it.[15] But if such person shows that the purchaser, because of his position, is likely to have the required information, the burden of proof may shift to the Securities Exchange Commission to show lack of access to the information that a registration statement would disclose.

CONCLUSION

The *Custer* decision by itself could add a much needed definiteness to the difficult and confusing area of private stock offerings. However, *Custer* is a decision of the United States Fourth Circuit Court of Appeals that is in conflict with decisions of the Tenth Circuit[16] and, because the United States Supreme Court denied certiorari in the *Custer* action,[17] the law in this area still suffers from indefiniteness. But in light of the pro-investor orientation of *Ralston,* it seems logical to assume that the Supreme Court will adopt *Custer's* strict interpretation—that there is no substitute for access to the information that a registration statement would make available—when it rules on this issue.

The risk to companies and attorneys, in light of possible civil and criminal liability[18] seems too great to ignore the real possibility that the Supreme Court will endorse the strict interpretation. Civilly, violation of the registration requirements of section 5 creates liability under

[14] 346 U.S. 119, 125 (1953).
[15] United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir. 1967). See also, SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953).
[16] *Supra* note 9.
[17] United States v. Custer Channel Wing Corp., 88 S. Ct. 38 (1967). Mr. Justice Black is of the opinion that certiorari should be granted.
[18] *Supra* note 4; See also, Securities Act of 1933 §5, 17, 24, 15 U.S.C. §77 (1964).

section 12(1),[19] which provides that unless a registration statement is in effect or an exemption is applicable, the vendor "shall be liable to the person purchasing such security from him," thus, the financial implication of an offering being ruled public is serious indeed.

To avoid trouble, counsel would be wise to advise his client to give the investor access to the information that a registration statement would contain; better yet perhaps, would be to include a memorandum containing this information in any solicitation. Another obvious precaution is to obtain a "no action" letter[20] from the commissioner. This can ordinarily be obtained if (1) reputable counsel will give their unqualified opinion that the proposed transaction does not involve a public offering, and (2) the staff of the commission agrees with that conclusion. A detailed written presentation of the facts is required and usually such a presentation should include certain contemplated undertakings. The "no action" letter itself will state that "on the basis of the facts presented, this Division (the Corporate Finance Division of the Commission) will not be disposed to take any action if the proposed transaction is carried out," or words to that effect.

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[19] 15 U.S.C. §77(1) (1964). See also, Shimer v. Webster, 225 A.2d 880 (1967), holding issuer liable to purchasers when transaction was found to be unregistered.

[20] Victor & Bedrick, *Public Offering: Hazards for the Unwary,* 45 VIRGINIA L. REV. 869, 872, 873 (1959).