Corporations: Securities: Private v. Public Offering

George A. Richards Jr.
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 de-
fendant 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 accommo-
dation. 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 inter-
pretation 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 func-
tion 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 appli-
cable 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 de-
cision would have perhaps been more meaningful had it been addressed
directly to that policy issue.

MICHAEL M. BERZOWSKI

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-

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 contempt4 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.
6 *Id.* at 125.
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 him-
self.

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 sophisti-
cation 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 con-
sidered 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 de-
sirable 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,

\(^10\) 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. 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. 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 and, because the United States Supreme Court denied certiorari in the Custer action, 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 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).
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).
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\(^2\) 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.

**George A. Richards, Jr.**

---

\(^1\) Section 12(1),\(^1\) 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.

\(^2\) Holding issuer liable to purchasers when transaction was found to be unregistered.

---