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A Look at the Montana Securities Act and Its Relation to the Federal Securities Act

James E. Newton*

INTRODUCTION

The Montana Securities Act of 1961 recently came of age through the adoption of rules and regulations.¹ This article is a review of its provisions and its rules and regulations. It is also a comparison of the Montana Securities Act with the Federal Securities Act.

Although the objectives of both state and federal securities regulations are the same, there is considerable variance in practice, theory and impact between the state and federal acts as well as among the regulations of certain of the states. The two principal types of securities regulations are "disclosure" and "qualification." The first is exemplified by the federal securities law² and the second by the securities laws most commonly found among the states, including Montana.³

Disclosure Type

The Federal Securities Act of 1933, a "disclosure" type securities law, is administered by the Securities and Exchange Commission. It vests in the Commission no authority to pass on the qualifications or merits of a proposed offering of securities; but instead, limits the Commission's authority to assuring the disclosure of all material information necessary for a prospective investor to make an informed judgment. It has been referred to as the "Truth in Securities Law," and is sometimes said to change, with respect to securities transactions, the old saying *caveat emptor* or "let the buyer beware," to "let the seller beware."

Qualification Type

The "qualification" type securities law is designed to vest in the state official charged with its administration⁴ the duty and responsibility

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¹For complete text of the rules and regulations see, *Montana Securities Law—Its Rules and Regulations*, 25 MONT. L. REV. 205 (1964).

²48 STAT. 74 (1933), as amended, 15 UNITED STATES CODE §§ 77a-77aa (1958). Hereinafter UNITED STATES CODE will be cited as U.S.C.

³SEE REVISED CODES OF MONTANA, 1947, §§ 15-2001 to -2025. Hereinafter REVISED CODES OF MONTANA will be cited as R.C.M.

⁴In Montana the State Auditor is named as ex-officio investment commissioner in charge of administration of the Act. R.C.M. 1947, §§ 15-2001, -2024.

of determining whether a proposed issue of securities qualifies for the right to be offered to the public. In so doing, the merits of the offering are considered and passed upon.

"OLD" MONTANA SECURITIES LAW

The Montana securities law as originally adopted in 1913 was no better and probably no worse than most other state laws regulating the sale of securities in effect at that time. It was a qualification type statute of the so-called "fair, just, and equitable" stripe in vogue at the time of its enactment. These laws were so described and classified because they vested in the Investment Commissioner the duty and responsibility of determining whether a proposed offering of securities was "fair, just, and equitable."⁵ These words of art vested such broad and undefined discretion in the Investment Commissioner that they were sometimes said to give more discretion than a good administrator should want, and more discretion than a bad administrator should have. Because of infrequent application of the "old" Montana securities law its shortcomings were not burdensome to members of the Bar or to persons interested in financing activities.

The keynote to effective securities regulation is the extent of its coverage. This is usually measured by the scope of the term "security." The definition of "security" in the Montana law when expanded by amendment in 1931, partially kept up with the times.⁶ However, prior to 1957 the definition remained peculiarly deficient since it did not include oil and gas interests.

Amendments of 1957 and Their Effect

The definition of a security was expanded in 1957 to include "oil, gas, or other mineral lease, right, royalty, or any interest therein."⁷ Such interests had previously been classified in Montana as "real estate"

⁵Laws of Montana 1933, ch. 47, § 4, at 76.

If he finds that such investment company is solvent, that its articles [sic] incorporation or association, its constitution and by-laws, its proposed plan of business, and proposed contracts contain and provide for a *fair, just and equitable* plan for the transaction of business . . . the investment commissioner shall issue to such investment company a statement, entitling it to sell such securities in the State of Montana . . . (Emphasis added.)

⁶Laws of Montana 1931, ch. 194, § 2, at 548.

The term "securities" as used in this act shall be taken to mean shares, bonds, debentures, evidence of indebtedness, certificates of interest or participation, certificates of interest in profit sharing agreement, collateral trust, certificates contracts, diversified trustee shares, fixed investment trusts, selected shares corporations, investment contracts, or contracts for the performance of personal services or the furnishing of materials in connection with the burial or cremation of dead human bodies which contracts are to be performed at a future time determinable only by the death of the person in connection with whose decease said services are to be performed or materials furnished, contracts or agreements or any other instrument commonly known as a security.

⁷Laws of Montana 1957, ch. 178, § 1, at 373.

for the purpose of the regulation of their sale.⁸ That the inclusion of oil interests in the definition of a security was overdue is evidenced by the fact that by 1957 the securities laws of more than twenty states had been expanded to include oil and gas interests within the definition of "security."⁹

The critical deficiency of the old Montana law, however, was not the limitation on the scope of its definition of a security, but rather the provision which excepted from regulation of the law the offerings "of a corporation where the persons holding the same shall not exceed fifty in number."¹⁰ As a result of this exception counsel for legitimate financing could and did ordinarily ignore the act.

The Legislature in 1957 completely eliminated the exemption of "fifty," and substituted in its place exemptions for offers limited to ten persons during any period of twelve months¹¹ and original subscriptions by bona fide incorporators, if they were no more than fifteen in number, and no part of the subscription was taken for public distribution.¹²

With these changes, members of the Montana Bar could no longer, with safety, forget or ignore the securities law. The attorney then had to take cognizance of the act or risk hurting his client's interests.

Although the amendments of 1957 increased the applicability of the law and effected certain other improvements,¹³ it remained so antiquated and garbled that it defied all attempts to work out, by amendment, a law which would be wholly fair to and usable by financing

⁸See *Willard v. Federal Surety Co.*, 91 Mont. 465, 8 P.2d 683 (1932), and *Johanne v. Dwire*, 94 Mont. 590, 23 P.2d 971 (1933), holding generally that oil and gas interests are interests in real estate. R.C.M. 1947, § 66-1904, provides: "Agreements of every kind respecting prospecting, drilling or operating land for oil, or disposing of the oil or oil mining rights therein, whether upon a royalty basis or otherwise, shall be deemed dealing in real estate."

⁹States which by 1957 included in their definition of "security" oil and gas interests included Arizona, California, Indiana, Iowa, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Virginia, Washington, and West Virginia.

¹⁰Laws of Montana 1937, ch. 120, § 1, at 361.

¹¹Securities to Which Provisions of Act Not Applicable. The provisions of this act shall not apply to the following securities:

10. Any transaction pursuant to an offer directed by the offerer to not more than ten (10) persons during any period of twelve (12) consecutive months, if the seller reasonably believes that all the buyers are purchasing for investment. Laws of Montana 1957, ch. 178, § 2, at 373.

¹²Securities to Which Provisions of Act Not Applicable. The provisions of this act shall not apply to the following securities:

11. Original subscriptions to stock by those who have signed articles of incorporation as bona fide incorporators, providing said articles of incorporation are not signed by more than fifteen (15) persons and no part of such original issue of capital stock is taken for the purpose of public distribution. Laws of Montana 1957, ch. 178, § 2, at 373.

¹³The 1957 changes gave the Investment Commissioner power to "establish such rules and regulations as may be reasonable or necessary to carry out the purpose and provisions of this act . . ." Laws of Montana 1957, ch. 178, § 4, at 376. The amendments also expanded to a meaningful extent the anti-fraud provision and criminal penalties for violations of the act. Laws of Montana 1957, ch. 178, §§ 5, 6, at 377-378.

interests, the investing public, and the Bar. Consideration was necessarily given to the adoption of a new law.

NEW MONTANA SECURITIES LAW

Proposed changes in the Montana securities law did not contemplate as radical a changeover as that from a qualification to a disclosure type act. However, a qualification type statute did not necessarily have to be of the "fair, just, and equitable" stripe. At the time Montana was contemplating new securities legislation the Uniform Securities Act,¹⁴ with certain variations, already had been adopted by a number of states. Of particular importance was the fact that Washington, whose problems were in many respects similar to those of Montana, had adopted the Uniform Act in 1959.¹⁵

The Montana Legislature failed to act favorably on a proposed new law in 1959, but in 1961 it adopted the Uniform Securities Act with a few changes designed to accommodate situations peculiar to Montana. This new securities law became effective July 1, 1961.

The Uniform Securities Act discards the vague and all-inclusive "fair, just, and equitable" test, and provides in its place limited and definite criteria to be applied by the Investment Commissioner in passing on the merits of a proposed offering.¹⁶

Rules and Regulations—A Good Beginning

The Montana securities law did not "come of age" until March 30, 1964, when the State Auditor and Ex-Officio Investment Commissioner, acting pursuant to authority vested in him,¹⁷ adopted rules and regulations.¹⁸

These rules, as adopted, did not seek any authority for the Investment Commissioner not contemplated by the act. Evidence that the Legislature intended the act to be implemented by rules is found in the authority vested in the Investment Commissioner by the 1957 amendments to the old law.¹⁹ The Commissioner did not adopt rules to cover every conceivable pattern which might be used in the financing world. However, the Montana Bar should expect that the limited rules and regulations adopted in March, 1964, are only the beginning. Only

¹⁴Through the efforts of Professor Louis Loss of the Harvard Law School and Edward Cowett, a "Uniform Securities Act" for use by the states had been drafted and in 1956 had been approved by the American Bar Association and the National Conference of Commissioners on Uniform State Laws.

¹⁵WASH. REV. CODE §§ 21.20.005-940 (1959), as amended, WASH. REV. CODE §§ 21.20.005-340 (Supp. 1963).

¹⁶For a comprehensive discussion of the Uniform Securities Act as compared with the California Securities Law, a "fair, just and equitable" act, see *The Uniform Securities Act*, 12 STAN. L. REV. 103 (1959).

¹⁷R.C.M. 1947, § 15-2024.

¹⁸*Supra* note 1.

¹⁹Laws of Montana, 1957, ch. 178, § 4, at 376.

when implemented by adequate rules and regulations, can the Montana Securities Act of 1961 fulfil its role of protecting the investing public without unnecessary expense to persons engaged in legitimate financing activities and without burdening their legal counsel with unpredictable situations.

SCOPE

The Montana Securities Act of 1961 adopted the definition of a "security" from the old law as expanded by the 1957 amendment to include oil and gas interests.²⁰ Although the current definition has, for the most part, been in the Montana law since 1931 no Montana decisions defining its scope are available. This is largely due to the gaping exemption of "fifty" in the pre-1957 law. However, since it is identical with the definition of a "security" in the Federal Securities Act²¹ as well as that in many other state acts, judicial guidelines are otherwise available.

The true scope of this definition is probably best described by the United States Supreme Court in *SEC v. Joiner Leasing Corp.*, where the Court stated: "[T]he reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached. . . ." ²² Since there can be little doubt about the Court giving a broad interpretation to the scope of the act, this can and should be taken as a warning that ascertaining whether a security is involved in a particular transaction can be the most difficult problem an attorney faces.

The definition expressly includes many of the more orthodox types of securities, and, though patent, even these are sometimes inadvertently "missed" (for example, preorganization subscriptions). The definition contains several categories, however, which can be extremely troublesome, and understandably "missed." Categories such as evidence of indebtedness, certificates of interest or participation in any profit-sharing agreement, and investment contracts cover the "novel, uncommon, or irregular devices" which, without careful diagnosis, often do not appear to involve a security.²³

²⁰R.C.M. 1947, § 15-2004(11).

"Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable shares; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such title or lease; or, in general, any interest or instrument commonly known as a "security," or any certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay a sum of money, either in a lump sum, or periodically for life, or some other specified period.

²¹48 STAT. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1958).

²²320 U.S. 344, 351 (1943).

²³The case of *U.S. v. Pandolfo*, Criminal No. 6589, D. Mont., May 10, 1940, is a good illustration of an unorthodox type of "security" transaction. The case involved a scheme under which oil, allegedly collected from service stations and refined, was sold to the public much as fuel oil would be sold, except that as an

"Certificate of interest or participation in a profit-sharing agreement" can cover many joint non-corporate arrangements and agreements as well as more devious patterns, but should not present particular difficulty if reasonable care is exercised. The difficulty here is usually caused by failure to think through all the facets of involved patterns.²⁴

"Evidence of indebtedness" is often more troublesome than is warranted. The difficulty usually results from overlooking, in essence, the presence of an evidence of indebtedness, rather than from overlooking its effect.

It can, however, be said categorically that "investment contracts" present the principal and the most difficult problems. There are two Supreme Court cases, *SEC v. C. M. Joiner Leasing Corp.*,²⁵ and *SEC v. Howey*,²⁶ which "must guide us in solving this problem."²⁷ The *Joiner* case was concerned with the sale of assignments of oil leases on small parcels of land, the value of which was to be enhanced by drilling activities of the seller. The Court held an investment contract to be involved. In so doing it established as a criterion for classifying a security of this type that *returns to the purchaser were to be dependent upon the efforts of one other than the purchaser*. The *Howey* case dealt with the sale of citrus grove acreage in small units to be managed and operated by the seller. The annual return to the purchaser was to be a percentage of the profits based on the sale of all the produce of the entire citrus grove. The Court, in holding an investment contract to be involved, established the further criterion or test that there be a "*common enterprise*," and provided the oft quoted formula: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."²⁸

The scope of this formula is further illustrated by the Ninth Circuit decision of *Los Angeles Trust Deed & Mortgage Exchange v. SEC*.²⁹ In that case individual trust deeds or mortgages were selected for and sold to individual purchasers under an arrangement whereby the seller would collect and service the notes for the purchasers. The purchasers

integral part of the transaction the purchaser (or victim) would authorize the seller (or promoter) to make the oil so purchased part of a pool composed of similar oil purchased by others, on the assurance that all of the oil so pooled would be sold periodically for the respective pro rata benefit of all concerned. The promoter not only failed to comply with the requirements of the securities act, but also failed to have any oil to cover the purchases. He was convicted of violation of the securities act. The indictment described the security involved in the following language: "contracts for the purchase of re-refined oil together with the right to participate in a pooling arrangement and profit-sharing agreement in connection therewith."

²⁴An example of this type of "security" would be joint enterprise and syndicate interests.

²⁵*Supra* note 22.

²⁶328 U.S. 293 (1946).

²⁷*Los Angeles Trust Deed and Mortgage Exchange v. SEC*, 285 F.2d 162, 166 (9th Cir. 1960).

²⁸*Supra* note 26, at 301.

²⁹*Supra* note 27.

were assured that it was the seller's policy to repurchase any delinquent trust deed, so that the purchaser would suffer no loss in case of default. A reserve was set up to protect the Los Angeles Trust Deed & Mortgage Exchange from any loss by reason of such repurchase.

The Trust Deed & Mortgage Exchange urged that an investment contract was not involved since the *Howey* case requirement of a "common enterprise," was lacking. In answering this argument the court posed this question: "Is the investor led to expect profits solely from the efforts of one or more defendants arising from a common enterprise?"³⁰ After an extended discussion of the facts, it answered:

We find "a common enterprise" in which the appellants and the purchasers of second trust deed notes have an *economic interest*. We find that the economic welfare of the purchasers is inextricably woven with the ability of LATD to locate by the exercise of its independent judgment a sufficient number of discounted trust deeds, and the ability of LATD to subsequently meet its commitments, to check, evaluate, supervise, and supersede

The terms of the offer, the plan of distribution, the economic inducements held out to the prospects, the results dependent on one other than the purchaser, the common enterprise, all combine herein to make the second trust deed notes "securities," as that term has been defined by the Supreme Court.³¹ (Emphasis added.)

It cannot definitely be said that the *Howey* formula is extended or expanded by the Ninth Circuit decision. However, the perimeter of the formula appears less definite and its application is rendered sufficiently malleable to at least open an additional area for consideration in determining whether a common enterprise exists.

The scope of the *Joiner* and *Howey* decisions is further illustrated by the case of *Roe v. United States*,³² where "small patch mineral leases" were being sold for as little as \$10.00 an acre. In holding that a "security" in the form of an "investment contract" was being sold, the court said:

The promoters were selling a chance to make a great deal of money from activities which were then, or would shortly be, carried on by persons other than the purchasers. In that setting it mattered not whether the test wells were to be drilled by the seller, or by third persons either under, or independent of, their control. What the purchasers were told was that after they acquired these pieces of property (leases), the activity and energies and expenditures of others — the backers of the test

³⁰*Supra* note 27, at 168.

³¹*Supra* note 27, at 172.

³²287 F.2d 435 (5th Cir. 1961).

wells — would produce earnings on the investment. That is enough.³³

COMPLIANCE

The provisions of the Federal Act which require filing of information with the Securities and Exchange Commission and the furnishing of information to prospective investors, are commonly referred to as the "registration requirements,"³⁴ and are to a considerable extent emulated by the provisions of the new Montana Act.

The mechanics of the Federal Act entail the filing of information in the form of a registration statement. This information is secured through the completion of a selection of forms geared to the particular issue or issuer involved.³⁵ The registration statement includes information which will be furnished to investors in the form of a prospectus. This material is filed and processed at the Commission's office in Washington, D. C. The material is first reviewed by attorneys, accountants, and appropriate technicians, and their suggestions are then forwarded to the registrant in a "letter of comments." Upon completion of any amendments, additions, or subtractions which may be necessary to cure deficiencies, the registration is declared to be "effective," and the registrant is so advised. Commencement of the offering must await such advice.³⁶

Under the old Montana Act a permit or license authorizing an offering was issued pursuant to an application. The new Montana Act, following the pattern of the Federal Act, provides for a registration procedure; and where formerly the steps to comply reached fruition in the issuance of a permit, now the filed registration statement becomes "effective."

There are, under the new Montana Act, three separate methods or

³³*Id.* at 439.

³⁴48 STAT. 78 (1933), 15 U.S.C. § 77f (1958); 48 STAT. 78 (1933), 15 U.S.C. § 77g (1958); 48 STAT. 79 (1933), as amended, 15 U.S.C. § 77h (1958); 48 STAT. 81 (1933), as amended, 15 U.S.C. § 77j (1958).

³⁵The following forms are the most commonly used:

- Form S-1. General Form for Commercial and Industrial Companies
- Form S-2. For Shares of Certain Corporations in the Development Stage
- Form S-3. For Shares of Mining Corporations in the Development Stage
- Form S-4. For Closed-End Management Investment Companies Registered on Form N-8B-1
- Form S-5. For Open-End Management Investment Companies Registered on Form N-8B-1
- Form S-6. For Unit Investment Trusts Registered on Form N-8B-2
- Form S-10. For Oil or Gas Interests or Rights
- Form C-2. For Certain Types of Certificates of Interest in Securities
- Form C-3. For American Certificates Against Foreign Issues and for the Underlying Securities
- Form D-1. For Certificate of Deposit
- Form D-1A. For Certificates of Deposit Issued by Issuer of Securities Called for Deposit
- Form F-1. For Voting Trust Certificates.

³⁶These registrations filed in Washington, D. C., under the Federal Act are to be distinguished from the filings in the Regional Offices of the Commissioner under exemptive Regulation A.

forms of compliance, each represented by a separate form of registration statement. Each method is designed to accommodate certain offerings by certain issuers with the least burdensome impact possible, and still retain the basic purpose of the act—protection of the investing public. The three methods of compliance are: Notification, Coordination, and Qualification.

Notification

A simplified procedure known as “registration by notification”³⁷ is provided for securities of issuers which meet certain standards:

1. Issuer has been in *operation at least five years*.
2. *No default, current or past three fiscal years*, in securities of issuer with fixed maturity, interest or dividend.
3. Average net earnings for past three fiscal years of at least 5%—measured by offering, market, or book.

The information which must be filed pertains primarily to the eligibility of the issuer registrant. This procedure is consistent with the rationale that offerings of issuers of such defined stature are not required to otherwise “qualify.”

Registration by notification becomes effective automatically either the second full business day after filing, or earlier if the Commissioner so orders.

The inclusion of this form of registration is one of the more worthwhile changes in the new act. It saves time, effort, and expense for seasoned issuers.

Coordination

A procedure known as “registration by coordination”³⁸ is provided for in the Montana Act for those offerings for which a filing is also being made or has been made under the Federal Act. Under this procedure the information filed with the Montana Investment Commissioner involves little more than that which is filed with the Securities and Exchange Commission in Washington, D. C. This includes, in the case of registration, copies of the prospectus, and in the case of filings under exemptive Regulation A, copies of the offering circular and letter of notification. Under either procedure all amendments suggested by the Securities and Exchange Commission must be included.

Registration by coordination becomes effective automatically if and when a filing with the Securities and Exchange Commission becomes effective, provided that the registration statement and pros-

³⁷R.C.M. 1947, § 15-2008.

³⁸R.C.M. 1947, § 15-2009.

pectus, or offering circular and letter of notification, have been on file with the Montana Investment Commissioner at least ten days. Registration by coordination remains effective only as long as the filing or exemption with the Securities and Exchange Commission remains effective.³⁹

Registration by coordination is subject to denial or revocation by the Investment Commissioner for the same reasons as other registration procedures. Information and material filed with the Securities and Exchange Commission are merely furnished in lieu of information otherwise prescribed by the Montana Securities Act. Retention of this denial and revocation power in the Commissioner is wholly consistent with the difference between the two types of law. An offering might well meet all the requirements of the Federal Act and still not be qualified under the Montana law. It is also consistent with the differences in the two types of acts that where a registration is effective under the Montana Act in reliance upon a filing with the Securities and Exchange Commission pursuant to registration or under the Regulation A exemption, the Montana registration should remain effective only so long as the filing with the Securities and Exchange Commission remains effective.

Registration by coordination under the new Montana Act represents an expansion of what is referred to as the "coordination privilege." This procedure avoids the time, effort, and expense incident to furnishing substantially the same information, in compliance with both the state and federal requirements. Under the old act this means of compliance was normally provided for only in connection with large offerings which had been registered in Washington, D. C.⁴⁰ Although fine as far as it went, it was not adequate because no aid was given to small companies which usually made offerings exempt under Regulation A. For this reason the new Montana Act expanded the "coordination privilege." It is now available for offerings of less than \$300,000 for which filings have been made with the Securities and Exchange Commission under Regulation A, as well as for offerings registered in Washington, D. C. This is an important change, and a step forward in aid of small companies in Montana.

Qualification

Whereas registration by notification or coordination is selective and available to only certain issues and issuers, any security may be registered by the procedure known as "Qualification."⁴¹ All non-exempt offerings not eligible for registration by some other procedure must be registered by this procedure.

The registration statement filed with the Investment Commissioner

³⁹R.C.M. 1947, § 15-2011(3).

⁴⁰Laws of Montana 1947, ch. 175, § 1, at 234.

⁴¹R.C.M. 1947, § 15-2010.

under this form of compliance must set forth certain specified information.⁴² Even though the scope of the Investment Commissioner's authority to deny effectiveness to a registration statement is now limited, as compared to the "fair, just, and equitable" days, under "Qualification" he still has considerable responsibility. This includes not only passing on the reasonableness of "amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options,"⁴³ but also whether "the offering has worked or tended to work a fraud upon purchasers or would so operate."⁴⁴ To assist him in the performance of this duty, the information requirements include data concerning:

1. The issuer — when, where
2. Personnel — names, addresses, interests in issuer
3. Promoters and their "take"
4. Securities to be offered — kind, amount, and price
5. Proceeds — amount, use, and order of priority.⁴⁵

Exhibits required to be furnished are limited and not burdensome. The preparation of financial statements should not be burdensome, since no certification is necessary.⁴⁶

The use of a prospectus is not an absolute requirement; however, the Investment Commissioner may specify as a condition of registration that a prospectus be used.⁴⁷

In the case of Qualification the registration statement does not become effective until the Commissioner "so orders."⁴⁸ This is different from the case of Notification and Coordination, where the registration statement becomes effective automatically.

In complying with the Qualification procedure, particular consideration must be given to those rules and regulations reflecting the attitude of the Commissioner. Although his discretion is more circumscribed than before, he still retains sufficient power to disqualify a particular offering. It would appear ill advised to attempt registration by qualification of

⁴²This procedure differs from the other forms of registration in that under Notification the accomplishments of the issuer in a sense speak for themselves, and with Coordination the Securities and Exchange Commission has reviewed the proposed offering.

⁴³R.C.M. 1947, § 15-2012(1)(i).

⁴⁴R.C.M. 1947, § 15-2012(1)(e).

⁴⁵R.C.M. 1947, § 15-2010(1)(a), (b), (d), (f), (g).

⁴⁶R.C.M. 1947, § 15-2010(1)(n).

⁴⁷R.C.M. 1947, § 15-2010(3) provides: "The commissioner may require as a condition of registration under this section that a prospectus containing any designated part of the information specified in section 10 [15-2010] be sent or given to each person to whom an offer is made"

⁴⁸R.C.M. 1947, § 15-2010(3).

an offering upon which the Commissioner could be expected to look with "disfavor."⁴⁹

APPLICABILITY

The registration requirements of the Montana Act apply to "any person" offering to sell "any security"⁵⁰ in the state unless an exemption is available. In short, if *any* security is to be offered for sale the act must be considered. When compliance is required will be discussed *infra*, but unless and until an exemption from compliance has been established the Montana Securities Act must be regarded as applicable.⁵¹

The requirements of the Federal Act are more selective and apply only to "issuers, underwriters, and dealers."⁵² The term "issuer" is substantially free from ambiguity. The "issuer" is the company, organization, or person whose securities are being distributed. However, the term "underwriter" is less clear and, by definition, contains certain alternate ingredients.⁵³ Resort to judicial interpretation is necessary in its application.

The breadth of the definition is evidenced by the opinion of Judge Augustus Hand in the case of *SEC v. Chinese Consolidated Benevolent*

⁴⁹Rules 5 and 10 of the Securities Act of Montana Rules and Regulations indicate courses of conduct which would not meet with the approval of the Commissioner. Rule 5 provides: "Financing of a new venture by the sale of shares, or securities, which are non-participating, or which have a fixed return, or are redeemable (unless convertible on an equitable basis) shall be considered with disfavor even though sold in units together with common shares." Rule 10, with a few limited exceptions in the cases of management, employees, and underwriters dealing with public offerings, states that warrants or stock purchase options to others than purchasers of securities shall be looked upon with disfavor. Moreover, in connection with all forms of compliance, *i.e.*, Notification, Coordination, and Qualification, the rules relating to "filing" should be noted. *First*, Rule 1. provides, in effect, that the Commissioner may require advance approval of all sales material to be used in connection with the sale of securities in Montana. *Second*, Rule 2. provides that before registration statements by notification, coordination, or qualification shall be deemed to have been filed they must contain all information required by the Act or requested by the Commissioner. *Third*, Rule 8. requires applications by brokers, dealers, and salesmen to contain all information requested by the Commissioner before such applications shall be deemed to have been filed.

⁵⁰R.C.M. 1947, § 15-2007. Registration of securities. "It is unlawful for any person to offer to sell any security in this state, except securities exempt under section 13 [15-2013] or when sold in transactions exempt under section 14 [15-2014], unless such security is registered by notification, coordination, or qualification under this act."

⁵¹The burden of establishing an exemption is on the person claiming benefit thereof. See *SEC v. Sunbeam Gold Mines Company*, 95 F.2d 699 (9th Cir. 1938), and *SEC v. Ralston Purina Company*, 346 U.S. 119 (1953).

⁵²48 STAT. 77 (1933), as amended, 15 U.S.C. § 77d (1958). "The provisions of section 5 [77e] shall not apply to any of the following transactions: (1) Transactions by any person other than an issuer, underwriter, or dealer . . ."

⁵³48 STAT. 75 (1933), as amended, 15 U.S.C. § 776(11) (1958).

The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission.

Association.⁵⁴ In that case an association of Chinese residents in New York, New Jersey, and Connecticut, having no official contractual relation with the Chinese government, set up a committee to urge members of Chinese communities to purchase Chinese government bonds. Acting as agents for purchasers, they would deposit funds in the New York Agency of the Bank of China. No fee or commission was charged or received by the committee. The court held that the committee was "selling" the bonds by its solicitation of offers to purchase, and that such activities, either with or without compensation, brought it within the prohibition.

Whether the Chinese Government as issuer authorized the solicitation, or merely availed itself of gratuitous and even unknown acts . . . does not affect meaning [T]he solicitation was equally for the benefit of the Chinese Government and broadly speaking was for the issuer in connection with the distribution of the bonds.⁵⁵

An additional far-reaching reason was given by the court in holding that an underwriter was involved:

Even if the defendant is not itself "an issuer, underwriter, or dealer" it was participating in a transaction with an issuer . . . the . . . Government The exemption is limited to "transaction" by persons other than "issuers, underwriters or dealers." *It does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of security issues.*⁵⁶ (Emphasis added.)

The fact that conventional or contractual privity with the issuer is not required to qualify as an "underwriter" was again pointed out in the case of *SEC v. Culpepper*.⁵⁷ In this connection, it must be remembered that the term "underwriter," as opposed to "dealer," is not defined with reference to a person's general business, but instead, on the basis of his relationship to the particular offering. No distinction is made between professional investment bankers and rank amateurs.⁵⁸

Redistributions or Secondary Offerings

The Federal Act does not apply to redistributions or secondary offerings by "any person," as does the Montana Act, but does apply to redistributions or secondary offerings of securities held by persons in a

⁵⁴120 F.2d 738 (2d Cir. 1941).

⁵⁵*Id.* at 740.

⁵⁶*Id.* at 741.

⁵⁷270 F.2d 241 (2d Cir. 1959).

⁵⁸The term "underwriter" is important not only for determining whether the registration requirements are applicable, but also for determining whether the individual involved is subject to civil liability. The term also has importance in determining the information that must be furnished under registration and Regulation A (small offering exemption).

control relationship to the issuer.⁵⁹ It was the feeling of Congress that where control of a company might be exercised by one individual or a select group of individuals, a public offering of their securities could possess all the dangers of a new offering. Whether a person is in a control relationship is a question of fact. An important criterion in making this determination is whether the person is in a position to obtain necessary signatures of the issuer, its officers and directors, on a registration statement.⁶⁰ The Commission has seen fit to discern with a "practical eye" whether control exists. For control to exist it is not necessary that the individual single-handedly be able to obtain the issuer's compliance with the registration requirements. He may, with other members of family, business associates, or any grouping, be able to achieve such control. When outside influences are present, even though stockholdings may be very small, control can nevertheless exist. An example of this might be where the holder of a relatively few shares was chairman of the financial institution with which the issuing company did its financing.

The rules of the Commission provide a means whereby a person in a control relationship to the issuer can dispose of at least some of his shares.⁶¹ He may sell some of his stock through a *broker* who does not solicit purchasers if the sales do not exceed, during any six-month period:

In the case of over-the-counter stock, not more than 1% of outstanding shares.

In the case of listed stock, not more than 1% of outstanding shares or 1% of largest one week trading during any of four weeks prior to sales, whichever is lesser.

This rule does not contemplate, and will not be available for, a program designed to sell such an amount each six-month period. It is important to note that this rule is not available for sales on a principal basis, but only for sales handled through a broker who does not solicit purchasers.

By virtue of the broad definition of the term "issuer" in the Federal Act, together with the exemptions provided by the Montana Act, the result of "any person" versus "issuer, underwriter, and dealer" becomes relatively negligible. The difference, in effect, is that secondary offerings of the securities of little known and unseasoned issuers by a person not in a control relationship are covered by the Montana Act but not by the Federal Act.

The term "dealer," contrary to the term "underwriter," is limited

⁵⁹48 STAT. 75 (1933), as amended, 15 U.S.C. § 77b(11) (1958). "As used in this paragraph the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer."

⁶⁰17 C.F.R. § 230.405(f) (1964).

⁶¹17 C.F.R. § 230.154 (1964).

in its applicability and depends on a person's general activities rather than his conduct in connection with a particular offering.⁶²

EXEMPTIONS

Exemptions from compliance with the registration requirements of both the Federal and Montana Acts are available for various types of securities and sale transactions, where investor protection is deemed unnecessary or is otherwise provided.⁶³ Both acts in some instances intermingle the bases for the exemptions.

Exempted Securities

Even though the Federal and Montana Acts differ in form and method of regulation, the exemptions provided for various types of securities are in most cases common to both acts. These exemptions, with a few exceptions, break down into the following categories:

1. Where issuance of the securities is otherwise regulated, supervised, or approved by a Banking Commissioner, Insurance Commissioner, or the Interstate Commerce Commission.⁶⁴
2. Where the nature or character of the issuer allows the exemption. Some examples of this type are: securities of or guaranteed by a state, the federal government, or a political subdivision thereof, commonly referred to as "Municipals" and "Governments,"⁶⁵ securities issued by religious, educational, fraternal, and eleemosynary institutions organized and operated not for profit,⁶⁶ securities issued by savings and loan associations;⁶⁷ and certain types of securities issued under employee "benefit plans."⁶⁸ Securities issued by a trustee in bankruptcy are exempt, as such, under the Federal

⁶²48 STAT. 75 (1933), 15 U.S.C. § 77b(12) (1958). "The term 'dealer' means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling or otherwise dealing or trading in securities issued by another person."

⁶³The exemptions do not apply to the anti-fraud provisions of either the Federal Act or the Montana Act.

⁶⁴See 48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(a)(2) (1958), and R.C.M. 1947, § 15-2013(3), relating to securities issued under regulation, supervision, or approval of a Banking Commissioner; 48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(a)(8) (1958), and R.C.M. 1947, § 15-2013(5), relating to securities under supervision of an Insurance Commissioner; and 48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(a)(6) (1958), and R.C.M. 1947, § 15-2013(7), relating to those securities controlled by the Interstate Commerce Commission.

⁶⁵48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(a)(2) (1958); R.C.M. 1947, § 15-2013(1)-(2). Subdivision (2) of § 15-2013, unlike the Federal Act, also exempts similar Canadian and other foreign government securities.

⁶⁶48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(a)(4) (1958); R.C.M. 1947, § 15-2013(9).

⁶⁷48 STAT. 76 (1933), 15 U.S.C. § 77c(a)(5) (1958); R.C.M. 1947, § 15-2013(4). Subdivision (2) of § 15-2013 also allows exemption of credit union securities.

⁶⁸R.C.M. 1947, § 15-2013(11).

Act if issued with the approval of the court.⁶⁹ Under the Montana Act such securities are exempted as part of any transaction by an executor, administrator, sheriff, marshal, receiver, or trustee in bankruptcy.⁷⁰

3. "Commercial paper" arising out of a current transaction and having a maturity not exceeding nine months is exempt under the Federal Act, and exempt under the Montana Act if sold to banks or insurance companies.⁷¹
4. An exemption for securities listed on certain named stock exchanges (New York, American, Midwest), as well as other stock exchanges registered with the Securities and Exchange Commission and approved by the Commissioner, is applicable only to the Montana Act.⁷² Such securities are not exempt from the Federal Act.

Exempted Transactions

Unlike the case of exempt securities, exemptions under the Montana and Federal Acts for various types of sale transactions do not, for the most part, coincide.

The Federal Act exempts those sales transactions involving offerees who have sufficient information to protect themselves. The number of offerees is relatively unimportant.⁷³ However, for very sound and practical reasons the Montana Act provides that irrespective of the knowledge of the offerees, "any transaction pursuant to an offer directed by the offeror to not more than ten persons" in the state of Montana during any period of twelve consecutive months is exempt.⁷⁴ Under this exemption an issuer may only make *offers* to ten persons during the span of twelve months. It does *not* mean that an issuer may consummate ten sale transactions during that period irrespective of the number of offers necessary to find those ten purchasers.

The true meaning of this section with its magic number of "ten" is well illustrated by a comparison of it and the exemption relating to the sale of preorganization certificate or subscriptions. With preorganization subscriptions "any offer" is exempt if "the number of subscribers

⁶⁹48 STAT. 76 (1933), 15 U.S.C. 77c(a)(7) (1958).

⁷⁰R.C.M. 1947, § 15-2014(5).

⁷¹48 STAT. 76 (1933), 15 U.S.C. 77c(a)(3) (1958); R.C.M. 1947, § 15-2013(10). This exemption involves a combination of the "security" and "transaction" exemptions.

⁷²R.C.M. 1947, § 15-2013(8).

⁷³48 STAT. 77 (1933), as amended, 15 U.S.C. § 77d (1958) provides: "The provisions of section 5 [77e] shall not apply to any of the following transactions; (1) transactions by an issuer not involving any public offering . . ." For a discussion of troublesome situations where this exemption is commonly misunderstood and misapplied, see Newton, *Problems in General Practice Under the Federal Securities Act*. 18 MONT. L. REV. 33, 36 (1956).

⁷⁴R.C.M. 1947, § 15-2014(8).

does not exceed ten”⁷⁵ In one the restriction is on the number of offers; in the other the number of offers is not limited, only the number of subscribers.

The provision of the Montana Act which exempts transactions with “security holders of the issuer” is considerably broader than a similar exemption in the Federal Act.⁷⁶ Montana exempts “any transaction,” which includes offers of preemptive rights; whereas the exemption in the Federal Act covers only exchanges.⁷⁷ An early case under the Federal Act held that an offer restricted to existing security holders of an issuer was not exempt as a non-public offering merely by virtue of such restriction.⁷⁸

The Montana Act exempts any transaction by a bona fide pledgee, where no evasion is intended.⁷⁹ The Federal Act contains no such provision, and the Court of Appeals for the Second Circuit has held that a sales transaction by a pledgee may be subject to the registration requirements of the Federal Act, regardless of good faith involved.⁸⁰

The Montana Act also exempts transactions incident to corporate reorganizations.⁸¹ The Federal Act does not contain a comparable provision, except where there has been court approval,⁸² or where the security is issued as part of a statutory reorganization. This is because a reorganization issue is not deemed to involve a sale of the security.⁸³

Since the registration requirements of the Montana Act are applicable to “any person,”⁸⁴ in order to avoid undue burden to the individual investor, it provides, in addition to an exemption for “any isolated trans-

⁷⁵R.C.M. 1947, § 15-2014(9).

⁷⁶R.C.M. 1947, § 15-2014(10).

⁷⁷48 STAT. 906 (1934), 15 U.S.C. 77c(a)(9) (1958). See also 17 C.F.R. § 230.149 (1964), under which this exemption is held to be available where cash is paid to effect equitable adjustment in respect to dividends or interest.

⁷⁸*SEC v. Sunbeam Gold Mines Company, supra* note 51.

⁷⁹R.C.M. 1947, § 15-2014(6).

⁸⁰*SEC v. Guild Films Company, Inc.*, 279 F.2d 485, 490 (2d Cir. 1960), *cert. denied*, 364 U.S. 819 (1960).

The banks have contended that they were “bona fide pledges” and therefore “entitled upon default to sell the stock free of restrictions.” They assume that “good faith” in accepting the stock is a sufficient defense But the statute does not impose such a “good faith” criterion. The exemption in § 4(1) was intended to permit private sales of unregistered securities to investors who are likely to have, or who are likely to obtain, such information as is ordinarily disclosed in registration statements The “good faith” of the banks is irrelevant to this purpose. It would be of little solace to purchasers of worthless stock to learn that the sellers had acted in “good faith.” Regardless of good faith, the banks engaged in steps necessary to this public sale, and cannot be exempted.

⁸¹R.C.M. 1947, § 15-2014(13).

⁸²48 STAT. 906 (1934), 15 U.S.C. 77c(a)(10) (1958). See also Bankruptcy Act of July 1, 1898, added by Chandler Act, 52 STAT. 902 (1938), 11 U.S.C. 664 (1958); 52 STAT. 914 (1938), as amended, 76 STAT. 574 (1962), 11 U.S.C. 793 (1958), as amended, 11 U.S.C.A. 793 (Supp. 1963); 52 STAT. 928 (1938), 11 U.S.C. 918 (1958).

⁸³17 C.F.R. 230.133 (1964). For background and Commission theory, see *National Supply Co. v. Leland Stanford Jr. University*, 134 F.2d 689 (9th Cir. 1943), *cert. denied*, 320 U.S. 773 (1943), and 1 LOSS SECURITIES REGULATION 518 (2d ed. 1961).

⁸⁴R.C.M. 1947, § 15-2007

action,"⁸⁵ an exemption for any "non-issuer transaction" effected by or through a broker-dealer "pursuant to an unsolicited order."⁸⁶ This latter exemption is comparable to the provision in the Federal Act which exempts brokers' transactions executed upon customers' orders "but not the solicitation of such orders."⁸⁷

The Montana Act, applying as it does to "any person," necessarily provides certain other exemptions. One of these is for non-issuer offering by registered broker-dealers, if information on the particular security is available through "a recognized securities manual."⁸⁸ An exemption is also available if the security has a financial history comparable to that required for an issuer to qualify for registration by notification.⁸⁹

The Federal Act contains two further exemptions which are entirely peculiar to it: the so-called "intrastate" or local exemption,⁹⁰ and the small offering exemption provided by Regulation A.⁹¹

Since the writer's earlier comments on the intrastate exemption⁹² there have been two court decisions dealing with the subject that are of particular interest. In *Hillsborough Investment Corporation v. SEC*, the court, in upholding an injunction against an issuer who had violated the intrastate exemption stated:

Under the statutory scheme as construed, an entire issue must be sold only to residents or the exemption is lost . . . the use of interstate facilities in any sale, to resident or non-resident without registering the security is a violation of the Act. . . .

An issuer that has lost the exemption as to one issue of securities by a non-resident sale, does not have the opportunity to regain the legal use of interstate facilities or the mails by halting the non-resident sales and confining itself to sales to residents.⁹³

In the other case, *SEC v. Capital Funds, Inc.*⁹⁴ a decree resulted in a permanent injunction being entered against sales made to members of the U. S. Armed Forces stationed in Alaska under military orders.⁹⁵ Based

⁸⁵R.C.M. 1947, § 15-2014(1).

⁸⁶R.C.M. 1947, § 15-2014(3).

⁸⁷48 STAT. 77 (1933), 15 U.S.C. § 77d(2) (1958). 17 C.F.R. 230.154 (1964) sets out the guidelines for use of this exemption for sales by persons who, because of a control relationship to an issuer, are subject to the registration requirements.

⁸⁸R.C.M. 1947, § 15-2014(2).

⁸⁹R.C.M. 1947, § 15-2014(2).

⁹⁰48 STAT. 906 (1934), 15 U.S.C. § 77c(a)(11) (1958). For a discussion of the "intrastate" exemption, see Newton, *supra* note 73, at 39.

⁹¹This exemption was adopted by the Securities and Exchange Commission pursuant to Section 3(b) of the Federal Securities Act. 48 STAT. 76 (1933), as amended, 15 U.S.C. § 77c(b) (1958).

⁹²Newton, *supra* note 73, at 39.

⁹³276 F.2d 665, 668 (1st Cir. 1960).

⁹⁴Civil No. A-46-60, D. Alaska, Sept. 29, 1960.

⁹⁵The decision was based on the unavailability of the so-called "intrastate" exemption under 48 STAT. 906 (1934), as amended, 15 U.S.C. § 77c(a)(11) (1958).

on this case, "persons resident," for the purpose of this exemption, means "persons domiciled."

Because of the provision for Regulation A registration under the expanded coordination privilege in the new Montana Act, the value of the intrastate exemption has been largely emasculated. To risk the uncontrollable features of the intrastate exemption, which can result in contingent civil liabilities of dangerous proportions, seems foolhardy since the relatively limited additional effort necessary to file under Regulation A is offset by the lack of effort necessary to register by coordination. Furthermore, the use of the intrastate exemption, together with use of the qualification procedure, largely restricts potential investors to the state of Montana.

*Regulation A (Small Offering Exemption)*⁹⁶

The so-called "small offering" exemption, Regulation A, permits an offering of securities not in excess of \$300,000 in any twelve-month period without compliance with the registration requirements of the Federal Act, provided specific conditions are met. The other exemptions previously described are automatically available if certain facts or circumstances exist. However, for the exemption provided by Regulation A to be available it is necessary to file with the Securities and Exchange Commission prescribed information and also to furnish purchasers an offering circular or prospectus.⁹⁷

Filings under Regulation A are made in the Regional Office of the Securities and Exchange Commission for the region in which the issuer's principal business operations are conducted.⁹⁸ This is different from the case of registration, where filings are made only in Washington, D. C. The filings are processed by the Regional Office, except for review of technical material (including mining) by members of the Commission's technical staff in Washington, D. C. This facilitates pre-filing conferences by the registrant, its counsel and accountants, with the Commission personnel who will process the filing.⁹⁹

The filing consists of two parts. The first part, a Letter of Notification (Form 1-A), provides information for the use of the Commission, including: the existence of any factors which might preclude use of the exemption, such as injunctions or convictions against insiders, promoters,

⁹⁶17 C.F.R. §§ 230.251-263 (1964). For an excellent discussion of this Regulation and the manner of compliance, see Weiss, *Regulation A Under the Securities Act of 1933—Highways and Byways*, 8 N.Y.L.F. 2 (1962).

⁹⁷17 C.F.R. § 230.256 (1964). Under 17 C.F.R. § 230.257 (1964) the offering circular specified in § 230.256 need not be filed if total offering of securities does not exceed fifty thousand dollars.

⁹⁸Issuers in the states of Alaska, Idaho, Montana, Oregon and Washington would file with the Seattle Regional Office in Seattle, Washington.

⁹⁹Such pre-filing conferences in the Regional Offices can be, and often are, very worthwhile. They are welcomed by the Commission's staff, provided the material submitted for consideration is well prepared and not hastily put together for a dry run.

or underwriters; jurisdictions in which the securities are to be offered (the Securities and Exchange Commission notifies the various states in which the issuer proposes to offer the securities); exhibits, including underwriting contracts, instruments defining rights of holders of the securities, written consents of accountants, engineers, geologists, or other experts whose names are used in connection with the offering, and an instrument in which each underwriter consents to being named as such.

The second part, Schedule I to Form 1-A, specifies the information which must be set out in the offering circular. The items of information required to be furnished include the offering price, underwriting discounts or commissions, the purposes (and order of priority) for which the proceeds are to be used, a brief description of the securities being offered and of the business and properties of the issuing company, and pertinent facts concerning officers and directors and their remuneration.

Financial statements must also be furnished. However, since they need not be certified by an independent public accountant, a large item of the expense incident to registration is avoided. Financial statements by even the bookkeeper of the issuer, if properly prepared, are acceptable.

CIVIL LIABILITIES

Express Liabilities

Serious consequences can result under the civil liabilities provisions of both the Montana and Federal Acts from a failure to appreciate their scope, recognize their applicability or understand their exemptions. Non-compliance can be costly, regardless of whether the resulting violation was inadvertent—good faith affords no solace.

The liabilities provisions of the Montana and Federal Acts are quite comparable.¹⁰⁰ However, the Montana Act spells out in more detail the manner of computing damages and the manner of making tender, as well as designating those persons, other than the issuer, who are liable for violative transactions. In essence, both acts provide that "any person" who fails to comply with the registration requirements in offering or selling a security is liable to "any person" purchasing the security and that recoverable damages shall be the consideration paid for the security with interest thereon,¹⁰¹ less the amount of any income received, upon tender of the security, or for "damages" if the security is no longer owned. The Montana Act describes "damages" as the "amount recoverable upon tender, less value of security when disposed of, and 6% from date of disposition."¹⁰²

Liability of persons in a control relation to the seller is also provided

¹⁰⁰48 STAT. 84 (1933), as amended, 15 U.S.C. § 77i (1958); R.C.M. 1947, § 15-2022.

¹⁰¹The Montana Act specifies the interest rate as six per cent (6%) per annum from the date of payment. R.C.M. 1947, § 15-2022(1).

¹⁰²R.C.M. 1947, § 15-2022(1).

for in both acts. The effect of both acts in this regard is substantially the same, although they differ somewhat in language.¹⁰³

Both acts provide for a very short statute of limitations. In fact, this period is so short as to negate much of the benefit designed to accrue to investors. The Montana Act provides a two-year period from date of sale.¹⁰⁴ The Federal Act provides for only one year from date of sale for violations of the registration requirements.¹⁰⁵ In the case of fraud the Federal Act extends this period to one year from discovery, with a maximum of three years.¹⁰⁶ The Montana Act makes no such distinction.

This short statute of limitations provided by the acts unquestionably precludes effective use of the civil liabilities provisions by purchasers. However, other serious consequences of inadvertent violations are not emasculated by this restriction on actions by purchasers. Prior to the expiration of the statutory period, any contingent civil liability accruing as a result of violative transactions, if reflected in the financial statements of the issuer seeking credit, can result in substantial detriment to such issuer. A feeling of assurance on the part of an issuer or its counsel that all purchasers are well satisfied with their investments and that no danger of any purchaser actions exists, sincere though this feeling may be, will seldom cause a financial institution, as a prospective lender, to disregard the item *until the period of the statute has run*. And it is equally seldom that needed financing can be so deferred without disadvantage.

Implied Liabilities.

It does not suffice to restrict consideration of private rights of action to the civil liabilities provisions expressly included in the Federal Act. As stated by Mr. Justice Clark in a recent case involving alleged violations of the proxy requirements of the Securities Exchange Act of 1934:¹⁰⁷ "It is for the Federal courts 'to adjust their remedies so as to grant the necessary relief' where Federally secured rights are invaded."¹⁰⁸ In this case a stockholder had sought to void a merger effected through alleged misleading statements in the proxy solicitation material, as well as damages for himself and all other stockholders similarly situated. The court of appeals in reversing the lower court held that the court below had

¹⁰³48 STAT. 84 (1933), as amended, 15 U.S.C. § 77o (1958); R.C.M. 1947, § 15-2022(2).

¹⁰⁴R.C.M. 1947, § 15-2022(3).

¹⁰⁵48 STAT. 84 (1933), as amended, 15 U.S.C. § 77m (1958).

¹⁰⁶48 STAT. 84 (1933), as amended, 15 U.S.C. § 77m (1958).

¹⁰⁷48 STAT. 895 (1934), 15 U.S.C. § 78n(a) (1958).

It shall be unlawful for any person, by the use of mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commissioner may prescribe as necessary or appropriate in the public interest or for the protection of investors.

¹⁰⁸J. I. Case Company v. Borak, 84 Sup. Ct. 1555, 1560 (1964).

jurisdiction "to award damages or such other retrospective relief to the plaintiff as the merits of the controversy may require."¹⁰⁹

The Supreme Court, in affirming and in answer to defendant's contention that Congress made no specific reference to a private right of action in Section 14(a) [78n(a)], held:

The purpose of Section 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitations. . . . [I]ts chief purpose is "the protection of investors," which certainly *implies the availability of judicial relief when necessary to achieve that result.*¹¹⁰ (Emphasis added.)

The Court also quoted the following "significant language" from its opinion in the case of *Deckert v. Independent Shares Corp.*:

The power to *enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.¹¹¹

The decision in the recent *Borak* case is an important addition to those cases which have held implied private remedies available where no express private remedies are provided under the federal securities laws.¹¹²

Federal cases which have held implied private remedies available have sometimes had the important effect of extending the statute of limitations.¹¹³

Although private rights of action are expressly provided by the Montana Act for any violation for which an express right of action is not so provided, it should be noted that the state courts in other states have also held implied rights of action to be available.¹¹⁴

CONCLUSION

The Montana Securities Act of 1961 provides the means for adequate investor protection without undue burden on legitimate financing, and

¹⁰⁹J. I. Case Company v. Borak, 317 F.2d 838, 849 (7th Cir. 1963).

¹¹⁰J. I. Case v. Borak, note 108, *supra* at 1599-1560.

¹¹¹311 U.S. 282, 288 (1940). Quoted in *J. I. Case v. Borak*, note 108, *supra* at 1560.

¹¹²See North, *Implied Liability Cases Under the Federal Securities Laws*, 4 CORP. PRAC. COMM. 1 (1962), and Joseph, *Civil Liability Under Rule 10-5—A Reply*, 59 N.W. U.L. REV. 171 (1964).

¹¹³See Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953).

¹¹⁴See, e.g., Intermountain Title Guaranty Co. v. Egbert, 52 Ida. 402, 16 P.2d 390, (1932); Kneeland v. Emerton, 280 Mass. 371, 183 N.E. 155 (1932); Edward v. Ioor, 205 Mich. 617, 172 N.W. 620 (1920); Drees v. Minnesota Petroleum Co., 189 Minn. 608, 250 N.W. 563 (1933); Karamanou v. H. V. Greene Co., 80 N.H. 420, 124 Atl. 373 (1922); Pennicard v. Coe, 124 Ore. 423, 263 Pac. 920 (1928).

should permit members of the bar to effectively counsel clients as to its application. As administration of the act develops, it can be anticipated that clarifying interpretations by the Montana courts will be available; however, in the meantime, decisions of the federal courts and the courts of other states will aid in interpretation of the act.

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