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Florida Securities Regulation, 1966

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FLORIDA SECURITIES REGULATION, 1966

HUGH L. SOWARDS*

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I. NEW LEGISLATION

The year 1965 marked the enactment of significant amendments to Florida's Uniform Sale of Securities Law.¹

A. *Private Offering Exemption*

Until 1965, with one exception hardly worth noting, there was no private offering exemption available to a Florida corporation desirous of raising funds through the issuance of securities to individuals who were residents of Florida, unless those individuals were also owners of that corporation's securities. By way of illustration, suppose that XYZ, Inc., a Florida corporation, had as its incorporators and only stockholders, A, B and C. Suppose further that XYZ, Inc. had an authorized capitalization of twenty thousand shares of one dollar par value common stock, ten thousand shares of which had been issued to A, B and C at par and ten thousand of which were authorized but unissued. XYZ, Inc. was in need of additional capital for expansion, and Mr. A, the president, learned that the following Florida residents were willing to purchase XYZ, Inc. shares from the company: (1) R, a blood brother of Mr. A; (2) E, a long-time employee of XYZ, Inc.; (3) O, one of XYZ, Inc.'s customers; (4) B, one of the incorporators. In this situation, no exemption was available for sales from the corporate treasury of XYZ, Inc. stock to any of the above persons except B, one of the incorporators.² The one exception was contained in the former section 517.06(11), providing an exemption for sales out of the corporate treasury, if the total number of shareholders did not exceed twenty after such sales and the total face amount or total sales price of such shares did not, and would not after such sales, exceed ten thousand dollars. But the point was that the total sales price of *all stock issued* could not exceed ten thousand dollars.³

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1. FLA. STAT. § 517 (1965).

2. See Robinton & Sowards, *The Florida Securities Act: A Re-examination*, 12 U. MIAMI L. REV. 1, 3-5 (1957).

3. See FLA. ATT'Y GEN. OP. 041-402 (July 25, 1941).

Thus in the above example, since ten thousand dollars in stock had already been issued to the incorporators of XYZ, Inc., the post-incorporation exemption was unavailable.⁴

This state of affairs often placed an onerous burden on corporations with limited financial resources seeking funds from outsiders, since, absent an exemption, registration was required, with all its attendant time and expense. Now for the first time, under section 517.06(11) as amended in 1965, there is a realistic private offering exemption available to Florida corporations:

The sale of its shares by a corporation organized and existing under the laws of this state during any period of twelve consecutive months to not more than fifteen persons (other than those designated in subsection (5)), and provided that each purchaser prior to the consummation of the sale has been furnished adequate information concerning the true financial condition of the issuer, its business operations and the use of the proceeds from the sale. Provided further that sales made pursuant to this subsection shall be made without any public solicitation or advertisement, and no commission or other remuneration is paid or given, directly or indirectly, in connection with the sale and that sales are made only to persons who purchase for investment purposes only.

A careful examination of the above statutory language is in order.

First of all, the exemption is available only to a *Florida* corporation. Second, there is no ceiling on the amount of funds which may be obtained under this exemption. Next, the statute limits the number of "sales" to a maximum of fifteen persons during any period of twelve consecutive months. Presumably, then, the exemption may be used year after year. But is the exemption available for sales to fifteen *ultimate purchasers* or only to fifteen *offerees* in the twelve month period? Another section of the statute defines "sale" to include every "attempt to dispose, of a security . . . for value . . . an attempt to sell, . . . a solicitation of a sale, a subscription or an offer to sell. . . ." ⁵ It is arguable, then, that the numbers factor in determining the availability of the exemption is dependent upon the total number of offerees rather than the number of actual purchasers.⁶ On the other hand, the new section 517.06(11) also

4. Section 517.06(4) (1963), in effect, provided an exemption for sales to persons who were already security holders of the issues. Section 517.06(5) provided an exemption for sales to "a bank, savings institution, trust company, or other trust, insurance company, corporation, pension plan, or to a broker or dealer."

5. FLA. STAT. § 517.02(3) (1965).

6. Such is the situation with respect to the private offering exemption provided by § 4(2) of the Securities Act of 1933. See OP. GEN. COUNSEL, SEC Securities Act Release No. 285 (1935); SEC Securities Act Release No. 4552 (1962). The Uniform Securities Act, adopted at this writing in 21 states, specifically limits the exemption to "any transaction pursuant to an offer . . . to not more than ten persons." UNIFORM SECURITIES ACT § 402(b)(9) (1956).

refers to "consummation of the sale." This language, read together with the word "sale" in the first sentence of the section, could be interpreted to mean that "sale" in this context means a *completed* sale so as not to limit the maximum number to fifteen offerees. However, it must be borne in mind that the intent of the section is to provide a *private offering* exemption, rather than to afford a means of general solicitation of an unrestricted and unrelated group of prospective purchasers conducted for the purpose of ascertaining who would be willing to accept an offer to sell securities. This is evident from an examination of the remainder of the section and the restrictions and conditions surrounding the exemption, discussed below.

Prior to the consummation of the sale, each purchaser must have been "furnished" with information on the financial condition of the issuer, its business operations and the use of the proceeds from the sale. It is submitted that the word "furnished" in this connection means that financial statements, reports, or other written material should be actually transmitted to the purchasers (and offerees) rather than being made "available" to them.

The restriction contained in the section with respect to "public solicitation or advertisement" obviously precludes solicitation by means of newspaper, radio, television and similar advertising. In short, only direct private negotiation is in order.

The restriction with respect to "commission or other remuneration," of course, would preclude any brokerage commissions or finders' fees in connection with the sales. It seems equally obvious, however, that necessary expenses, such as legal fees and accounting fees in connection with the sales, would not spell loss of the exemption. Moreover, the apparent intent of the section permits officials of the issuer to solicit if the solicitation is only an incidental function of their duties and they receive no additional compensation.

Perhaps the most troublesome aspect of the section is its restriction that sales must be "made only to persons who purchase for investment purposes only." Of course, the purpose of this restriction is to keep the private offering private. Put another way, a public offering requires registration by the issuer with the Florida Securities Commission and clearance by that regulatory body before public sale. But if the fifteen yearly purchasers could buy their securities and immediately resell them to other persons, an indirect public offering would result, thus frustrating the purpose of the statute by depriving public investors of protection that would

Although § 517.06(11) does not limit the exempt sales to *Florida residents*, cautious counsel will advise his corporate client that offers or sales to nonresidents, under certain circumstances, may bring into play the federal registration requirements of the Securities Act of 1933, as well as the civil liability and fraud sections of that act.

be afforded by the registration process. Accordingly, purchasers in a private placement must take for investment rather than for resale. Furthermore, even though a purchaser represents to the issuer that he is taking for investment, if he immediately resells his securities, liability for violation of the statute may attach to the *issuer*.⁷ In this connection, counsel should advise that the issuer take three precautionary steps. First, each purchaser should sign an investment letter representing that he is taking for investment and not with a view to resell. The letter is only evidentiary, of course, but it will serve to put the purchaser on notice of his contractual obligations in connection with his purchase. Such a restriction upon the transferability of specific securities is enforceable against one taking with actual knowledge of it, if the restriction is noted on the security both under the Uniform Commercial Code, effective in Florida on January 1, 1967,⁸ and under the Uniform Stock Transfer Law.⁹ Accordingly, the second precautionary measure should be a restrictive legend on each stock certificate along the following lines:

These securities may not be sold, transferred, pledged or hypothecated unless they have first been registered under the Securities Act of 1933 and the Uniform Sale of Securities Act (of Florida) or unless Company counsel has given an opinion that registration under said Acts is not required.¹⁰

The third precautionary step to be taken is the placing of a stop-transfer order against the shares with the company's transfer agent, so that the alarm will be sounded if the purchaser attempts to transfer his securities.

Aside from these precautionary measures, however, a practical problem is raised with respect to how long the purchaser must hold his securities before disposing of them without violating the restriction. Certainly he is not locked in forever, but, on the other hand, the section does not specify any holding period. In this connection, a precedent appears when one examines the private offering exemption under the Securities Act of 1933, where there is also no definite holding period. It was once assumed by many securities attorneys that holding for one year with no predetermined intention to resell, was sufficient. But in 1957 the Securities and Exchange Commission threw cold water on this assumption:

Holding for the six months' capital gains period of the tax statutes, holding for an "investment account" rather than a "trading account," holding for a deferred sale, holding for a market rise, holding for sale if the market does not rise, or holding for a year, does not afford a statutory basis for an exemption and therefore,

7. FLA. STAT. § 517.21 (1965).

8. FLA. STAT. § 678.8-204 (1965).

9. FLA. STAT. ch. 614 (1965).

10. FLA. STAT. § 614.17 (1965).

does not provide an adequate basis on which counsel may give opinions or businessmen may rely in selling securities without registration.¹¹

Of course, the longer the period of retention, the more persuasive the argument that the resale is not at variance with an original investment intent.¹² In recent years the Securities and Exchange Commission has followed the practice of granting "no-action" letters, in the absence of unusual circumstances, if the purchaser has held for two years. This informal approval of a two-year holding period is believed to stem in part from *United States v. Sherwood*,¹³ a criminal contempt action. In the course of his opinion, Judge Sugarman stated:

The passage of two years before the commencement of distribution of any of these shares is an insuperable obstacle to my finding that Sherwood took these shares with a view to distribution [public resale] thereof, in the absence of any relevant evidence from which I could conclude that he did not take the shares for investment.¹⁴

Whatever the implications of the *Sherwood* case, securities attorneys commonly advise clients that they may sell investment shares after the passage of two years.¹⁵

From the standpoint of the purchaser, being locked in for two years, or more, may not be desirable. Accordingly, it would be wise practice for his counsel to request an agreement on the part of the company to register the shares within a given period of time.

In the final analysis, no matter how the Florida Securities Commission and the courts construe this exemption, it constitutes a long overdue and welcome innovation to attorneys and their corporate clients.

B. Pre-Organization Exemption

Prior to 1965, Florida business organizations had available to them an exemption from registration permitting the raising of an unlimited amount of funds, before organization, by means of a maximum of twenty-

11. Crowell-Collier Publishing Co., SEC Securities Act. Release No. 3825 (1957) (10 months of holding), *aff'd sub nom.* Gilligan, Will & Co. v. SEC, 267 F.2d 461 (2d Cir. 1959).

12. See SEC Securities Act Release No. 4552 (1962).

13. 175 F. Supp. 480 (S.D.N.Y. 1959).

14. *Id.* at 483. Of course, it is necessary in a *criminal* action that the finding be proved *beyond a reasonable doubt*.

15. It has been suggested that an *unforeseen* change of circumstances since the date of purchase may make the exemption available. "An unforeseen change of circumstances since the date of purchase may be a basis for an opinion that the proposed resale is not inconsistent with an investment representation. However, such claim must be considered in the light of all the relevant facts. Thus, an advance or decline in market price or a change in the issuer's operating results are normal investment risks and do not usually provide an acceptable basis for such claim of changed circumstances." SEC Securities Act Release No. 4552 (1962).

five pre-organization subscriptions. Prior to solicitation of these subscriptions, advance notice and filing of certain documents with the Florida Securities Commission was required. Additionally, the Commission had the option of requiring that the solicited funds be placed in escrow pending incorporation. Under section 517.06(10) as amended in 1965, this exemption is continued, but it is no longer necessary to file with the Commission. However, the amended section makes the escrow requirement mandatory when subscriptions are to be received from more than five subscribers. In that instance a copy of the escrow agreement must be furnished to the subscriber before funds are accepted.¹⁶ Finally, the amended section sets a maximum fund-raising period of six months and provides that if the total funds set forth in the escrow agreement are not deposited with the escrowee within the time provided in the escrow agreement, then the escrowee must return all funds held to the respective subscribers.

C. The "Shingle Doctrine"

At the 1965 session of the Florida Legislature, a new section 517.06 (16) was added. The new section represents an attempt to regulate excessive mark-ups by brokers and dealers who sell securities by incorporating what is substantially the federal case law, known as the "shingle doctrine." That doctrine evolved from an interpretation of section 17(a), the fraud section of the Securities Act of 1933, which, in effect, makes it unlawful for any person engaged in the sale of securities (1) to obtain money by means of any untrue statement of a material fact, (2) to omit to state a material fact necessary to make statements made not misleading, or (3) to engage in a course of business which operates as a fraud or deceit upon the purchaser. As Judge Clark observed in *Kahn v. SEC*,

[I]n certain circumstances one who sells securities to the public—who hangs out his shingle—implicitly warrants the soundness of statements of stock value, estimates of a firm's earnings potential, and the like. When such a person conceals known information inconsistent with this "implicit warranty of soundness" he has omitted a material fact without which the statement made would be misleading.¹⁷

Moreover, with respect to *dealers*—persons who buy for their own account and sell to customers from their own inventory—the courts and the Commission have consistently held, in interpreting section 17(a), that such dealers cannot charge prices unreasonably related to the current market price without disclosing that fact.¹⁸ The key words are "reasonably re-

16. The escrow agreement must set forth "the price per share, the total amount of stock to be issued and the total funds to be obtained from the sale, and the date the sale is to be concluded." FLA. STAT. § 517.06(10) (1965).

17. 297 F.2d 112, 115 (2d Cir. 1961).

18. See, e.g., *Charles Hughes & Co. Inc. v. SEC.*, 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1943); *MacRobbins & Co. Inc.*, Sec. Exch. Act Rel. 6846 (1962).

lated," and these words have been included in the new section 517.06(16). More particularly, the new section exempts the sale of securities, "as agent or principal, by a dealer registered pursuant to § 517.12, when such securities are sold at a price reasonably related to the current market price of such securities" In ascertaining whether the exemption is available, the above statutory language leaves two questions unanswered. First, what is the "current market price"? The answer is easy if the security in question is traded on an organized exchange, but in the over-the-counter market there is no ticker tape. In the event that the security is actively traded, reliance may be placed on the National Daily Quotation Sheets ("pink sheets"). But suppose that the security is inactively traded; in that instance the sheets carry no price quotations. Speaking of this situation, one eminent writer has stated: "As long as the dealer is sure that there were *bona fide* independent offers at a price reasonably near the dealer's sale price, the dealer is in the clear"¹⁹

The second question remaining unanswered is what mark-up qualifies as being "reasonably related" to the current market price? Following the celebrated *Charles Hughes* case,²⁰ the National Association of Securities Dealers, Inc. (NASD), conducted a survey and found that nearly one-half of its members' over-the-counter transactions involved mark-ups of three percent or less, and that in seventy-one percent of such transactions not more than a five percent mark-up resulted. Accordingly, NASD sent to all of its members a letter stating the above findings and adopting an "interpretation" of its Rules of Fair Practice which many of the members alleged constituted an adoption of a *rule* limiting spreads or mark-ups to five percent (adoption of a "rule" requires submission to the membership for a vote and filing with the Commission). But the Commission found that the NASD letter was advisory only.²¹ Nevertheless, the NASD position, known as the "five percent philosophy," has had a definite influence on restricting mark-ups.²²

Thus far, the responsibilities of persons who sell securities have been limited to those of dealers. But it will be noted that section 517.06(16) also includes *brokers* by using the phrase "as *agent* or *principal*." [Italics added.] It has been held repeatedly that one who is acting as a principal-dealer must do no more than refrain from taking excessive mark-ups. But, the agent is in a fiduciary capacity and must make full disclosure of any adverse interest in a transaction in which he sells his own securities to his principal-customer.²³

19. Loss, *The SEC And the Broker-Dealer*, 1 VAND. L. REV. 516, 520 (1948).

20. Note 18 *supra*.

21. National Ass'n of Securities Dealers, Inc., 17 S.E.C. 459 (1944).

22. See *Samuel B. Franklin Co. v. SEC*, 290 F.2d 719 (9th Cir. 1961), *cert. denied*, 368 U.S. 889 (1961); *Associated Securities Corp. v. SEC*, 293 F.2d 738 (10th Cir. 1961); *Herrick, Waddell & Co., Inc.*, 25 S.E.C. 437 (1937); *Noflatin & Co., Inc.*, SEC. Exchange Act Release No. 7220 (1964).

23. See *Arleen Hughes*, SEC. Exchange Act Release No. 4048 (1948), *aff'd*, 174 F.2d

Section 517.06(16) also provides that the exemption for dealers' and brokers' sales is unavailable unless the following information concerning the securities being sold is published in a "recognized manual of securities:"²⁴

- (a) A balance sheet as of a date not more than eighteen months prior to the date of sale and,
- (b) Profit and loss statements for a period of not less than two years next prior to the date of the balance sheet or for the period as of the date of the balance sheet if the period of existence be less than two years.

Finally, the new section provides that the exemption is not available if the sale is made for the "direct or indirect benefit of an issuer or controlling persons of such issuer or if such securities constitute the whole or a part of an unsold allotment to or subscription or participation by a dealer as an underwriter of such securities." The point of this significant wording is that it precludes a public offering, without the protection of registration, disguised as a "dealer's" transaction. In short, if the offering is for the benefit of an "issuer" (a company),²⁵ it is a public offering; the "dealer" who sells the securities is really acting as an underwriter, rather than as a dealer. The same result obtains when the "dealer" disposes of an issuer's unsold allotment of securities. Absent some exemption, registration is mandatory. Perhaps the least understood aspect of this problem, however, is when the sale is made on behalf of a "controlling person" of the issuer. The point is that a person in a control relationship with an issuer *is* an issuer for the purpose of making the one who effects a public offering for him an underwriter rather than a dealer. Suppose, for example, that X is in a control relationship with XYZ, Inc. When S, a securities dealer, makes a public offering of X's securities, X is considered as an issuer and S as an underwriter. It is important, then, to determine who is a "controlling person." Rule 330-1.25, adopted by the Florida Securities Commission on August 31, 1965, defines a controlling person as:

Any person, corporation, trust, partnership, officer or director owning directly or indirectly, equitably or beneficially, individually or cumulatively with members of his immediate family who owns or votes 10% or more of any class of the issued and outstanding securities of any issuer, shall be deemed a con-

969 (D.C. Cir. 1949); Loss, *supra* note 19, at 526.

Section 517.06(14) exempts ordinary dealer's transactions, but the section was amended in 1965 so as to limit the exemption to "unsolicited" purchases or sales.

24. Rule 330-1.24 was adopted on Aug. 31, 1965 by the Florida Securities Commission to implement this section. It provides that "Securities manuals published by Moody's Investors Service, Inc. and Standard and Poor's Corporation" are approved as "recognized securities manuals."

25. For statutory definition of "issuer," see FLA. STAT. § 517.02(5) (1965).

trolling person within the purview of Section 517.06(16), Florida Statutes.

D. *Cooperatives*

A gray area that existed for several years in the minds of securities attorneys concerned the problem of whether the sale of cooperative apartments (stock certificates being issued to the purchasers) constituted a sale of "securities" within the purview of the Florida Securities Act.²⁶ In 1965, a new section was added, providing an exemption from registration for "shares of a corporation which represent ownership, or entitle the holders thereof to possession and occupancy, or specific apartment units in property owned by such corporation and organized and operated on a cooperative basis, solely for residential purposes."²⁷

It should be noted that the exemption is limited to situations where the cooperative is organized and operated "solely for residential purposes." It is thus apparent that a business cooperative, such as a consumers cooperative, does not qualify for the exemption.²⁸ Similarly, if the cooperative apartment corporation should sell or lease one of its units to a person engaged in a business or profession, in all likelihood the exemption would not be available.

E. *Secured Bonds and Notes*

Prior to 1965, section 517.06(8) exempted sales by an issuer of bonds or notes secured by mortgage upon Florida real estate where the bonds or notes were sold to a maximum of twenty purchasers and the total face amount of the bonds or notes secured by a single mortgage did not exceed ten thousand dollars. Successive filings, however, could not be made by any one issuer. The section, as amended, continues the exemption but provides that an issuer may avail itself of the exemption "one time within any twelve month period."

F. *Dealers: Written Notice Requirements*

Prior to 1963, when registered dealers publicly offered securities through registration by notification (section 517.08), registration by qualification (section 517.09), or registration by announcement (section 517.091), such dealers were required to give written notice to the Florida Securities Commission before the public offering. Additionally, section

26. See Anderson, *Cooperative Apartments in Florida: A Legal Analysis*, 12 U. MIAMI L. REV. 13 (1957).

27. FLA. STAT. § 517.06(15) (1965).

28. Section 517.05(10) provides that "All agricultural cooperatives organized under chapter 618, and operating wholly within the state and all its stockholders are bona fide legal residents of the state, and no nonresident promoter is interested therein, shall be exempt from compliance with any of the provisions of the Florida Securities Law, same being chapter 517."

517.12 required such dealers who intended to offer "any security" to give this written notice. Dealers protested that such requirements were unduly onerous, and at the 1963 session of the Florida Legislature sections 517.08, 517.09, 517.091 and 517.12 were amended to delete this requirement. The Florida Securities Commission supported these amendments on the dual ground that the notice requirement did not provide investors with any measurable protection and that registered dealers could be civilly liable to investors when they inadvertently failed to notify the Commission of the sale of securities but had otherwise fully complied with the Florida Securities Act. Amendments in 1965 to sections 517.08 (2)(e) and 517.11 (by deleting the notice requirement) were in furtherance of the 1963 amendments.²⁹

G. Criminal Provisions

The 1965 session of the Legislature added a new criminal penalty provision.³⁰ Formerly, convictions for violation of the Florida Securities Act were punishable by fine *or* imprisonment. The new penalty provision provides for fine or imprisonment, "or both."

H. New Fraud Provisions

Along with the new private offering exemption, discussed previously, perhaps the most significant legislative change in recent years affecting Florida securities regulation was the enactment in 1965 of a new fraud section.³¹ It is predicted that the new section may produce far-reaching changes, both from the standpoint of administrative proceedings, by the Florida Securities Commission, and from the standpoint of private litigation by individual sellers and buyers.

That prediction is based upon the substantial amount of litigation in the federal courts as a result of adoption by the Securities and Exchange Commission of the controversial Rule 10b-5. The point is that the first part of the new fraud section is modeled on Rule 10b-5. It is worthwhile, then, to examine that important rule and its interpretation, in order to obtain a forecast of the shape of things to come in Florida securities fraud litigation.

Rule 10b-5 is perhaps the most important federal control over insider trading. Prior to the adoption of that rule, federal securities legislation did not afford adequate protection to defrauded sellers. More

29. An additional 1965 amendment, to § 517.13, extended the liability under *surety bonds* to "investment advisors, investment counsels or investment counsellors who knowingly and fraudulently give fraudulent investment advice or knowingly and fraudulently make or publish false statements directly or indirectly as to the value of securities."

30. Section 517.30 was repealed and a new section, 517.302 added.

31. Section 517.31, the former fraud section was repealed and a new section, 517.301, was added.

particularly, section 17(a) of the Securities Act of 1933 was limited to protection against fraud in the *sale* of securities, and section 15(c)(1) of the Securities Exchange Act of 1934, while including fraud in the *purchase or sale* of securities, was limited to over-the-counter transactions by *brokers and dealers*. In short, until the adoption of Rule 10b-5, investor protection under the federal securities acts was lacking with respect to fraud in the *purchase* of securities by persons *other than brokers and dealers*. Accordingly, the Securities and Exchange Commission closed this loophole by adopting Rule 10b-5 pursuant to authority granted by section 10(b) of the 1934 Act authorizing the promulgation of rules to outlaw manipulative or deceptive devices in connection with the purchase or sale of securities. Section 517.301 adopts the same approach by providing that it is unlawful for "any person . . . in the *sale or purchase* of any security in this state . . ."³²

The Florida Securities Commission may bring several types of proceedings under section 517.301: (1) *Injunction*. The Florida Securities Commission may apply to an appropriate court for an order enjoining any person from violating the section.³³ (2) *Administrative proceedings to discipline broker-dealers* (suspension and revocation of registration).³⁴ (3) *Criminal Prosecution*. Willful violation of the section may merit criminal prosecution.³⁵

In recent years, the question that has excited most comment with respect to Rule 10b-5 is whether the Rule provides for *implied* civil liability as the result of actions by private litigants. Undoubtedly this question will arise in the Florida courts in connection with section 517.301. The point is that both the federal securities acts and the Florida Securities Act contain *express* civil liability sections.³⁶ It may be argued, then, that a plaintiff may bring his action to recover (under the federal and state acts) *only* under those sections and that he is governed by their

32. Subsection 1. [Emphasis added.] Chapter 517, Florida Statutes, is amended by adding § 517.301 which reads:

Fraudulent transactions; falsification or concealment of facts.—It is unlawful, and a violation of the provisions of this chapter, for any person:

(1) In the sale or purchase of any security in this state, including any security exempted under the provisions of § 517.05, Florida Statutes, and including any securities sold in any transaction exempted under the provisions of § 517.06, Florida Statutes, directly or indirectly:

(a) To employ any device, scheme, or artifice to defraud;

(b) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

(c) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

33. FLA. STAT. § 517.19 (1965).

34. FLA. STAT. § 517.16 (1965).

35. FLA. STAT. § 517.302 (1965) ("willfulness" has been written in by judicial fiat).

36. See FLA. STAT. § 517.21 (1965).

limitations and restrictions. Further, it is arguable that the words in Rule 10b-5 and section 517.301, "It shall be unlawful" mean simply that the appropriate securities commission or other governmental authority may institute proceedings for violations. The answer may be given, however, that the express civil liability sections of the federal and state acts do not contain *exclusive* remedies for private litigants; that Rule 10b-5 and section 517.301 granted *implied* private rights of action.

It is now practically free from doubt, although the precise question has not been decided by the United States Supreme Court, that Rule 10b-5 may be involved in private actions against buyers by defrauded sellers and against sellers by defrauded buyers. It is a fair prediction that the Florida courts will adopt this approach.³⁷

The practical importance of whether a private right of action may be implied under Rule 10b-5 and section 517.301 is underscored by the fact that if there is an implied right of action, the plaintiff may bring that action *free of the restrictions* contained in the express civil liability sections. By way of illustration, such restrictions in the express civil liability sections may take the form of a short statute of limitations or a privity requirement. If the plaintiff can make an "end run" around the express civil liability sections and bring his action under Rule 10b-5 or section 517.301, he is free of these restrictions. It is certainly arguable that it would be unreasonable to assume a congressional (or Florida legislative) intent to grant to a defrauded buyer or seller an implied right to recover free of the restrictions contained in the express civil liability sections. At least under Rule 10b-5, however, the weight of authority is decidedly to the effect that the plaintiff is afforded such relief.³⁸

The second part of section 517.302 is modeled on section 17(b) of the Securities Act of 1933. In effect, the new subsection makes it unlawful to publish or circulate advertisements, circulars, newspaper articles, broadcasts and other publicity media which "though not purporting to offer a security for sale," describe the security but fail to state that the publicity was paid for, directly or indirectly, by the issuer, or an underwriter or dealer.

The words quoted above make it clear that the new subsection is not applicable to advertisements and the like, which *do* purport to offer

37. FLA. STAT. § 517.22 (1965), provides: "Nothing in this chapter shall limit any statutory or common law right of any person to bring any action in any court for any act involved in the sale of securities, or the right of the state to punish any person for any violation of any law." See also FLA. STAT. § 517.23 (1965), which extends the same civil remedies provided by federal law to "purchasers" of securities under the Florida Securities Act.

38. On privity, see, e.g., *Miller v. Bargain City U.S.A., Inc.*, 229 F. Supp. 33 (E.D. Pa. 1964); *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261 (S.D.N.Y. 1963). On the statute of limitations, see, e.g., *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Azalea Meats, Inc. v. Muscat*, 246 F. Supp. 780 (S.D. Fla. 1965); *Trussel v. United Underwriters, Ltd.*, 228 F. Supp. 757 (D. Colo. 1964).

a security for sale; rather, it is specifically aimed at articles, notices and similar utterances which do not purport to offer a security for sale, but which describe the security and leave the reader with the impression that the published matter was unbiased, when, in reality, it was bought and paid for. In short, in order to avoid liability, any fee or other remuneration received in connection with the publication must be disclosed.³⁹

The third part of the new section 517.302 substantially re-enacts former section 517.31 and is modeled on the false statements section of the Federal Criminal Code.⁴⁰ The thrust of this provision is to label as fraudulent the knowing and willful falsification or concealment of material facts, or the use of false writings or documents in connection with the purchase or sale of securities. An interesting aspect of this subsection is its applicability to statements, oral or otherwise, made to investigators of the Florida Securities Commission. Presumably, the subsection does apply, for, unlike perjury statutes, it contains no provision that the statement be *under oath*.⁴¹

Section 517.302, by incorporating what are substantially the fraud provisions of tried and tested federal acts, will serve to strengthen investor protection in this important area of Florida securities regulation.

II. RECENT DECISIONS

Is scienter a necessary element of an offense charged under section 517.07 (the sale of unregistered securities)? Surprisingly enough, the 1963 Florida case of *State v. Smith* held that it is.⁴² In its opinion, the First District Court of Appeal, although noting that section 517.07 does not specify scienter as an element of an offense under that section, nevertheless held that it was an *implied* element. In so deciding, reliance was placed on a previous case decided by the Supreme Court of Florida holding that scienter was an implied element of the statute making the sale of obscene literature a felony, and thus that an information was fatally defective for failing to allege that the defendant sold the literature knowing it to be obscene.⁴³ In a later case, *State v. Houghtaling*,⁴⁴ the defendants were charged in separate counts with offenses of the sale of unregistered securities in violation of section 517.07, and selling securities without registering as dealers, as required by section 517.12. The third district reluctantly affirmed a quashal order with respect to the count which had charged the sale of unregistered securities—on the authority of the *Smith* case.⁴⁵

39. See *Professional Investors, Inc.*, 37 S.E.C. 173, 176 (1956).

40. 18 U.S.C. § 1001 (1948).

41. See *United States v. Meyer*, 140 F.2d 652, 655 (2d Cir. 1944) (false oral statement); *United States v. Zavala*, 139 F.2d 830, 831 (2d Cir. 1944) (false customs declaration).

42. *State v. Smith*, 151 So.2d 889 (Fla. 1st Dist. 1963).

43. *Cohen v. State*, 125 So.2d 560 (Fla. 1961).

44. 173 So.2d 748 (Fla. 3d Dist. 1965).

45. “. . . we would be inclined to accept the arguments of the state upon which it is

However, the court refused to affirm the quashal order with respect to the count charging the defendants with selling securities without having first registered as dealers or salesmen, principally on the ground that "whether or not a party selling securities has sought and obtained registration as a dealer or as a salesman is a matter peculiarly within his own knowledge."⁴⁶

The state petitioned for certiorari only as to that portion of the *Houghtaling* decision which dealt with section 517.12. The Supreme Court of Florida, in reversing with respect to the count involving section 517.07, observed that, as originally enacted, the penalty section of the Florida Securities Act relieved one from the penalty if he affirmatively showed that the violation "occurred in good faith and on reasonable grounds for believing it not to be a violation. . . ."⁴⁷ But the court then noted that a 1935 revision of the statute deleted the "good faith provision" from the penalty section, and accordingly found a legislative intent to eliminate the requirement of *scienter* "from both sections of the statute."⁴⁸ It is submitted that, in overruling the holding of the *Smith* case, the court has correctly construed legislative intent.⁴⁹

Of special interest to land development firms and other persons who sell land and interests in land to the public is a recent opinion of the Attorney General of Florida.⁵⁰ The corporation involved in the opinion made offers to investors to sell small parcels of land by warranty deed. The sales contract provided that the purchaser was bound to keep the land in cultivation for peaches for a period of twelve years. For the first two years, however, he was bound to a management agreement under which the corporation would cultivate, maintain and manage the land. After two years, the purchaser was offered an option to continue to allow the corporation to cultivate and manage his land, or to perform these services himself. The purchaser received a percentage of the profits on the total amount of peaches that the corporation harvested from the land of that purchaser and all other purchasers of land from the corporation. As part of the transaction, the purchaser was given a "performance guarantee" containing the above provisions. The Attorney General concluded that the land sales contract, the warranty deed and the performance guarantee together constituted an "investment contract" and thus a "security"

contended *scienter* is not a needed element in a charge of selling unregistered securities in violation of § 517.07, Fla. Stat., were it not for the square contrary holding in . . . *State v. Smith*" *Id.* at 749.

46. *Id.* at 750.

47. Fla. Laws 1931, ch. 14899, § 17.

48. *State v. Houghtaling*, 181 So.2d 636 (Fla. 1965). See FLA. STAT. §§ 517.07 and 517.12.

49. In overruling *State v. Smith*, the court observed: "But this was a misreading of *Cohen v. State* That case did not turn on any such distinction between acts *mala in se* and *mala prohibita*. Rather, it turned on the authority of the Supreme Court of the United States in *Smith v. People of State of California*, 1959, 361 U.S. 147, holding that without the element of *scienter* the statute there involved would be invalid as infringing the constitutionally protected freedom of speech." *Id.* at 638.

50. FLA. ATT'Y GEN. OP. 064-177 (1964).

within the meaning of the definitions section of the Florida Securities Act.⁵¹ The practical effect of this conclusion is that, absent some exemption, the registration and penalty sections of the Florida Securities Act come into play.

The landmark case in this area of securities regulation, *SEC v. W.J. Howey Co.*, originated in Florida,⁵² and also involved the sale of a citrus grove development coupled with a contract for cultivating, marketing, and remitting part of the proceeds to investors. In holding that the deeds, land sales contracts and service contracts involved were "investment contracts," the United States Supreme Court emphasized the following factors: (1) the expectation of a profit, to be derived solely from the efforts of a promoter of a third party; (2) the element of a common enterprise; (3) the lack of economic feasibility of individual land development; and (4) the seller's retention of possession. The point is that, in the final analysis, the court will look through form to substance, and may find that the sale of real estate in an irregular manner amounts to the sale of a security. The following language of the *Howey* case has been quoted by courts time and again as the test for determining whether a particular piece of paper or interest constitutes a "security:"

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. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.⁵³

Of course, not *every* sale of an interest in land coupled with a profit-sharing arrangement constitutes a "security," within the meaning of the federal and state securities laws. But the recent opinion of the Attorney General of Florida serves to underscore the necessity for careful advice and careful draftsmanship in this type of situation.

51. FLA. STAT. § 517.02(1) (1965).

52. 328 U.S. 293 (1946). See also *SEC v. Bailey*, 41 F. Supp. 647 (S.D. Fla. 1941) (tung groves).

53. 328 U.S. at 301.