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A SURVEY OF THE SECURITIES ACT OF NEW MEXICO[†]

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INTRODUCTION

One school of jurisprudence maintains that "law" in its truest sense is the way in which people behave, and not necessarily the duly-enacted statutes of a legislature. Any practicing lawyer who comes within the broad scope of the Securities Act of New Mexico¹ (the New Mexico Act) may find himself abandoning the arena of written or "positive" law and embracing this proposition to justify his failure to comply with the "law." To isolate one of the many troublesome features of the Act, consider the problem confronting any practitioner who has formed a New Mexico corporation since a somewhat unique² 1969 amendment. Since 1969, the New Mexico Act has required formal notification to the New Mexico Securities Commissioner in the event that any person intends to avail himself of *any* transactional exemption from the registration requirements of

[†]The authors of this article are greatly indebted to both Mr. Andrew Swarthout, the present Commissioner of Securities, State of New Mexico, and Mr. Robert Granger, a former Commissioner of Securities, State of New Mexico, whose gracious assistance in interpreting the Act was invaluable.

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1. N.M. Stat. Ann. § § 48-18-16 through 48-18-35 (Repl. 1966, Supp. 1971). This article will not deal with the New Mexico Insurance Securities Law [N.M. Stat. Ann. § § 58-22-1 *et seq.* (Repl. 1966)] nor the statutes pertaining to Installment Savings & Investment Certificates [N.M. Stat. Ann. § § 48-16-14 *et seq.* (Repl. 1966)].

2. The general proposition of requiring notification to the local securities administration in the event that a person intends to avail himself of an exemption is not unique to New Mexico. The securities laws of Arkansas [Ark. Stat. Ann. § 67-1248(f) (Repl. 1966)], Texas [Tex. Rev. Civ. Stat. art. 581, § 5(1) (Repl. 1964)], Georgia [Ga. Code Ann. § 97-107(j) (1957)], Louisiana [La. Rev. Stat. § 51.704(12) (1971)], Oregon [Ore. Rev. Stat. § 59.035 (12) (Repl. 1967)] and Idaho [Idaho Code Ann. § 30-1434 (Supp. 1967)] also contain uncommon notification requirements with respect to *some*, but *not* all exemptions. One more common example of an exempt security that must be "cleared" with the local Commissioner prior to issuance is the investment contract issued in connection with employees' stock purchase, pension or similar plans. *See, e.g.*, Wash. Rev. Code § 21.20.310 (11) (Repl. 1967); however, New Mexico is the only jurisdiction providing for mandatory notification for *all* exempt transactions. Further, very few states, *e.g.*, New Mexico [N.M. Stat. Ann. § 48-18-31 (Repl. 1966)], Georgia [Ga. Code Ann. § 97-114 (1957)], and Oregon [Ore. Rev. Stat. § 59.115 (O) (Repl. 1967)], appear to allow the rescission remedy for failure to comply with the notification requirement; other jurisdictions merely disable the violator from bringing an action for the price of the securities issued without such notification.

the Act. Thus, the "private placement" exemption³ which, traditionally, is the exemption which permits the formation of a close corporation without regard to the securities laws of a jurisdiction, is not an "automatic" exemption in New Mexico, but must be requested or at least formally announced in accordance with § 48-18-22(O):

[A]ny person, corporation, or issuer shall give notice, in a form prescribed by the commissioner, of the intentions to avail themselves of the exemptions afforded by this section thirty days after the effective date of this act prior to the first offer or sale to be made thereunder. The commissioner may by order deny or revoke the exemption specified in any subsection with respect to a specific security.⁴

Notification forms have been prescribed by the Commissioner for several categories of exempt transactions.⁵ The notification provision may mean, according to a technical interpretation of the statute, that every share of stock issued or sold without such notification has been issued in violation of the Act thereby entitling the purchaser to rescind the transaction. As witnessed by the dearth of such notifications filed with the Commissioner, it is only the most careful practitioner who is complying with the notice requirement.⁶

An example of the way § 48-18-22(O) could be troublesome is the following situation: Mr. Risk, the attorney for Goodtime Research and Development Corporation, causes the corporation to issue 1,000 shares at \$10 per share to each of Dreamer, Schemer and Duns (all officers and directors of Goodtime) and to Welsher, a "passive investor." One year later, after Goodtime has failed, Welsher, represented by Mr. Rigid, seeks rescission⁷ of the transaction, proceeding against Dreamer, Schemer, and Duns, personally because of Risk's failure to file notice under § 48-18-22(O).

Although it is unlikely that official action would ever be taken in the above situation—in all probability it would be dismissed by the Commissioner as an inadvertent "technical violation"⁸—it is unwise to rely on this reasoning as a defense in a private civil action. The

3. N.M. Stat. Ann. §§ 48-18-22(I) and (J) (Repl. 1966, Supp. 1971); see text at 31-35 *infra*.

4. N.M. Stat. Ann. § 48-18-22 (O) (Repl. 1966, Supp. 1971).

5. The New Mexico Securities Commission has "prescribed" a form for the exempt transactions set forth in N.M. Stat. Ann. § 48-18-22(A), (I) and (J) (Repl. 1966, Supp. 1971). No forms have yet been prescribed for the remaining exempt transactions.

6. Interview with Andrew M. Swarthout, Commissioner of Securities, June 29, 1971 [hereinafter cited as Swarthout Interview].

7. The rescission remedy is set forth in N.M. Stat. Ann. § 48-18-31 (Repl. 1966). See note 232 *infra* and accompanying text.

8. See generally L. Loss and E. Cowett, Blue Sky Law 87-89 (1958) [hereinafter cited as Blue Sky Law] for discussion of the attitudes of securities commissioners with respect to similar violations.

most trenchant weapon of the Act, the rescission remedy, is available as a self-enforcement device. Welsher in the above example, or the angry uncle or brother-in-law, having invested his money and his faith in an energetic promoter of the idea that "can't lose," may seize upon the most technical of violations in an attempt to assuage his injured pride for having been "taken in." And despite the "technical" nature of the requirement, which might perhaps be viewed by some as a reasonable excuse for having failed to give the requisite notice,⁹ the careful lawyer should be unwilling to depend upon litigation for determination of the validity of security issuances involving large sums.

New Mexico has had some form of "blue sky"¹⁰ law since 1921, twelve years before Congress' mid-depression adoption of the Securities Act of 1933.¹¹ The present New Mexico Act, which purports to regulate a wide range of transactions in securities, is broad enough to affect almost every legal practitioner in the state.

It is the purpose of this article to describe some of the most significant features of securities' regulation under the New Mexico Securities Act. In the course of this description, an analysis of some of the major problem areas will be in order.

The regulatory philosophies behind the New Mexico Securities Act and the federal acts differ. The Securities Act of 1933, the so-called "truth in securities" law, does not empower the Securities and Exchange Commission (the SEC) to make judgments concerning the merits of the ventures coming within its jurisdiction. The registration requirements of the Securities Act of 1933, as well as the reporting requirements of the Securities Exchange Act of 1934,¹² seek instead to elicit full disclosure of the affairs and of the personages involved in the registrant. The New Mexico Act, in contrast, requires that the Commissioner pass upon the *merits* of ventures coming under his jurisdiction.¹³ He must determine in accordance with broad

9. The Idaho Securities Commission, interpreting a similar notification provision, has indicated that the "form prescribed" is nothing more than an informal letter setting forth the nature and intended use of the exemption. In this sense, the burden of improvising a form is placed on the person using the exemption.

10. See Mulvey, *Blue Sky Law*, 36 Can. L.T. 37 (1916), quoted in *Blue Sky Law supra* note 8, at 7 n. 22:

The State of Kansas . . . has a large proportion of agriculturalists not versed in ordinary business methods. The State was the hunting ground of promoters of fraudulent enterprises; in fact, their frauds became so barefaced that it was stated that they would sell building lots in the blue sky—in fee simple. Metonymically they became known as blue sky merchandise and the legislation intended to prevent their frauds was called Blue Sky Law.

11. Act of May 27, 1933, 48 Stat. 74, as amended 15 U.S.C. §§ 77a-77aa (1971) [hereinafter cited as Securities Act of 1933].

12. Act of June 6, 1934, 48 Stat. 881, as amended 15 U.S.C. §§ 78a-78jj (1971) [hereinafter cited as 1934 Exchange Act].

13. See text at 13-15 *infra*.

statutory standards whether the transaction is "fair, just and equitable," and is required to reject any transactions not meeting such standards. Because of the unfortunate lack of meaningful statutory and administrative guidelines, what is "fair, just and equitable," may frequently depend on the personality of the Commissioner.

The New Mexico Act follows the general pattern of the Uniform Securities Act.¹⁴ It provides for the registration of both securities and broker-dealers, as well as containing provisions aimed at the curbing of fraudulent practices in the sale of securities. The New Mexico Act is more up-to-date in many respects than the Blue Sky Laws of other jurisdictions: It provides for expedited registration by coordination in those cases of offerings registered under the Securities Act of 1933;¹⁵ it contains the necessary exemption for offers made after filing but before the effectiveness of a registration statement filed under the federal act;¹⁶ it exempts securities and transactions that are regulated by other agencies.¹⁷ Moreover, it has been administered by conscientious commissioners who do their best to comply with their legislative mandates.

However, the present Act carries with it duplications,¹⁸ ambiguities,¹⁹ and inconsistencies²⁰ which have caused confusion in an

14. Uniform Securities Act, 9C U.L.A. 86 (1956) [hereinafter cited as Uniform Act].

15. N.M. Stat. Ann. § 48-18-19.4 (Repl. 1966); see text at 6 *infra*.

16. N.M. Stat. Ann. § 48-18-22 (L) (Repl. 1966).

17. N.M. Stat. Ann. § 48-18-21 (Repl. 1966, Supp. 1971); N.M. Stat. Ann. § 48-18-22 (Repl. 1966, Supp. 1971).

18. *E.g.*, N.M. Stat. Ann. §§ 48-18-19.2 (A)-(K) (Repl. 1966) are substantially similar to N.M. Stat. Ann. §§ 48-18-19.1 (B)(1)-(11) (Repl. 1966); N.M. Stat. Ann. § 48-18-19.7 (Repl. 1966) duplicates in substance the requirements of N.M. Stat. Ann. § 48-18-19.5(C) (Repl. 1966); N.M. Stat. Ann. § 48-18-19.10 (Repl. 1966) duplicates N.M. Stat. Ann. § 48-18-19 (D) (Repl. 1966); N.M. Stat. Ann. § 48-18-19.11 (Repl. 1966) duplicates N.M. Stat. Ann. § 48-18-19 (E) (Repl. 1966).

19. See, *e.g.*, note 160 *infra* and accompanying text.

20. *E.g.*, N.M. Stat. Ann. § 48-18-20.4 (Repl. 1966): "If an applicant [for registration as dealer], *other than an issuer*, has not had at least two years experience . . . the commissioner shall deny the registration of such applicant . . ." [emphasis added]. The italicized phrase is misleading in that it suggests an issuer must register as a dealer when in fact N.M. Stat. Ann. § 48-18-17(B)(1) (Repl. 1966) expressly exempts issuers from the definition of dealers; N.M. Stat. Ann. § 48-18-19 (A) (Repl. 1966) provides: "It is a felony for any person to offer or sell any security in this state, except securities exempted or securities sold in transactions exempted, unless the security is registered by notification, by co-ordination, or by qualification under the Securities Act of New Mexico." This ignores the special registration provisions for investment fund shares [N.M. Stat. Ann. § 48-18-25 (Repl. 1966, Supp. 1971)] and mining and oil securities [N.M. Stat. Ann. § 48-18-24 (Repl. 1966)]; N.M. Stat. Ann. § 48-18-19.8 (Repl. 1966) appears to conflict with N.M. Stat. Ann. § 48-18-24 (Repl. 1966). See text at 8-10 *infra*. N.M. Stat. Ann. § 48-18-19.8 (Repl. 1966) and N.M. Stat. Ann. § 48-18-24.3 (Repl. 1966) provide that the Commissioner determine if the issuances or sales are "fair, just and equitable," while N.M. Stat. Ann. § 48-18-25(1) (Repl. 1966, Supp. 1971), dealing with the standard for Investment Fund shares, requires the Commissioner to find that the offering will not "work or tend to work a fraud"—is the difference in language intended?

otherwise adequate statute, thereby creating dangerous pitfalls for all but the most wary. The problems with the New Mexico Securities Act are many: Does § 48-18-22(O) *really* mean what it purports to say? Must *every* isolated sale, *every* broker's transaction in a non-exempt security, and *every* formation of a privately-held New Mexico corporation involve the notification of an intent to use an exemption? Are §§ 48-18-24 through 48-18-24.7 to be dismissed as meaningless as the opinion of a former New Mexico Attorney General would indicate?²¹ What is the meaning of a "fair, just and equitable" offering? Does the Commissioner have the power to issue a "cease and desist" order preventing any violation of the Act?

In addition to these problems which face any practitioner who seeks to organize even a small business association in strict accordance with statutory norms, a basic knowledge of securities law is becoming increasingly indispensable to the practicing bar. There is evidence that more and more companies are seeking out the New Mexico investor: The dollar amount of securities registered for sale in New Mexico increased from \$11,245,939 in 1964 to \$750,117,000 in 1969.²² The number of both intrastate offerings and Regulation A offerings, together with interstate issues registered under the Securities Act of 1933, have caused this great increase. More and more lawyers are (albeit sometimes unwillingly) taking "lettered stock" for their fee. In addition, although there are few New Mexico reported cases in the area at present,²³ as activity in both the "private" and "public" areas of securities transactions increases, it is to be expected that the number of controversies (regardless of whether they eventually reach the litigation arena) respecting such transactions will also increase.

I. ADMINISTRATION

A. *Registration of Securities and Securities Dealers*

Before a security may be offered for sale or sold within New Mexico, it must be registered under the New Mexico Act unless specifically exempted or sold in a transaction that is specifically exempted from the provisions of the Act.²⁴ New Mexico has

21. 67 Op. N.M. Att'y Gen. 130 (1967); see note 41 *infra* and accompanying text.

22. N.M. Dep't of Banking, 55th Ann. Rep. 98 (1969) [hereinafter cited as 1969 Banking Report].

23. *Bills v. All-Western Bowling Corp.*, 74 N.M. 430, 394 P.2d 274 (1964); *Farrar v. Hood*, 56 N.M. 724, 249 P.2d 759 (1952); *Marney v. Home Royalty Ass'n of Okla.*, 34 N.M. 632, 286 P.2d 976 (1930); *N.M. Potash & Chemical Co. v. Independent Potash & Chemical Co.*, 115 F.2d 544 (10th Cir. 1940).

24. N.M. Stat. Ann. § 48-18-19 (Repl. 1966).

adopted substantial portions of the Uniform Act²⁵ including the techniques of registration of securities by coordination,²⁶ notification,²⁷ and qualification²⁸ and the basic pattern of registration of broker-dealers, agents and investment advisers.²⁹

1. *Registration by Coordination.*

Registration by coordination is available as an expedited procedure in cases in which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering.³⁰ The prospectus filed with the SEC is the basis for the registration application filed in New Mexico.

The Commissioner may require the issuer to file additional documents and information. Refusal or inability to supply information requested by the Commissioner will probably lead to voluntary withdrawal of the offering from registration in the State. Although the New Mexico Act provides an opportunity for formal hearing whenever the Commissioner issues an order forbidding sale of the securities,³¹ in practice few issuers avail themselves of its provisions.³²

25. N.M. Stat. Ann. § 48-18-29 (Repl. 1966).

26. N.M. Stat. Ann. § 48-18-19.4 (Repl. 1966).

27. N.M. Stat. Ann. § 48-18-19.1 (Repl. 1966).

28. N.M. Stat. Ann. § 48-18-19 (C) (Repl. 1966).

29. N.M. Stat. Ann. § 48-18-20.9 (Repl. 1966) pertains to investment advisers. The Commissioner may also require a minimum capital for dealers by rule [N.M. Stat. Ann. § 48-18-20.2 (Repl. 1966)]. He may also suspend or revoke the registration of dealers, salesmen and investment advisers [N.M. Stat. Ann. § 48-18-23 (Repl. 1966)].

30. The contents of the federal prospectus are prescribed by the Securities and Exchange Commission; although the contents may vary depending on the type of issue being registered, there is a good deal of similarity among prospectuses. Issuers are required to disclose all material information about themselves, their plan of business and actual or contemplated business operation to satisfy the Securities and Exchange Commission that a prospective investor will, after reading the prospectus, be able to make an informed decision before purchasing the security.

31. N.M. Stat. Ann. § 48-18-26 (Repl. 1966).

32. Blue Sky Law, *supra* note 8, at 80-81. As reasons for this situation, Loss and Cowett have suggested:

Normally the administrator wants to avoid the necessity for a formal administrative proceeding. He does not ordinarily consider it essential to record his disapproval of the application. He may not be too anxious to test the soundness of his objections. And the time consumed in a hearing may seriously curtail the ability of his office to handle its normal duties. The applicant, for his part, is usually amenable for any of a variety of reasons. It may not be essential to qualify the securities for sale in the particular state. An administrative proceeding probably will not be concluded until after the proposed offering has been completed in other states. The expense involved in pursuing an administrative remedy is substantial. And, most important, a denial order would induce other administrators to reconsider the appropriateness of the security for registration in their states. When an offering is being registered in several states, a denial order can be fatal to the success of the entire offering.

2. *Registration by Qualification.*

Registration by qualification is designed for use by promotional and relatively new companies; it is also available for use by issuers selling pursuant to Regulation A promulgated under the Securities Act of 1933. However, the greatest use of this method of registration in New Mexico is made by issuers making intrastate offerings. Since issuers using this method of registration generally have not filed a registration statement with the SEC, the Commissioner requires the filing of detailed information, similar to that required by Schedule A of the Securities Act of 1933. The registration statement becomes effective when the Commissioner so orders, and delays of several months between filing and effective date are not uncommon.³³ The New Mexico Act requires that a prospectus be used in connection with any offer or sale of securities registered by qualification.³⁴

3. *Registration by Notification.*

Registration by notification is available for issuers who have been in existence for at least five years and satisfy certain earnings tests.³⁵ The term "notification" is somewhat of an anomaly when applied to this form of registration. The draftsmen of the Uniform Act, from which this section was taken, note that the statement filed pursuant to it requires more information than is specified in the average statute with notification procedure in order to supply the Commissioner with enough information to enable him to apply stop-order standards.³⁶ Primarily applicable to high quality intrastate offerings, this section has little relevance to securities regulation in New Mexico.³⁷ It might, moreover, present a problem for the Commissioner in at least one situation. The sections relating to notification specify the contents of a prospectus if one is used in connection with the offering, but they do not require its use. Since the New Mexico Act specifically requires the use of a prospectus when an issue is registered by qualification, it is at least arguable that the legislature did not intend to require a prospectus to be used with the notification section. This position receives support in the Draftsmen's Commentary to the Uniform Act which suggests that it was not intended to be primarily a disclosure act.³⁸ The statutory power of

33. Interview with Robert M. Granger, then New Mexico Securities Commissioner, in Santa Fe, Nov. 24, 1970 [hereinafter cited as Granger Interview].

34. N.M. Stat. Ann. § 48-18-19.7 (Repl. 1966).

35. N.M. Stat. Ann. § 48-18-19.1 (Repl. 1966).

36. Blue Sky Law, *supra* note 8, at 288.

37. As a practical matter the section is not used. In 1969, one year for which figures are available, no issues were registered with the Commissioner by notification [Granger Interview, *supra* note 33].

38. Blue Sky Law, *supra* note 8, at 305, quoting Uniform Act, *supra* note 14, at § 304 (d) (draftsmen's commentary).

the New Mexico Commissioner extends to rule making, but the fact that he has adopted a rule requiring the use of a prospectus in connection with the offer or sale of *all* securities registered under the Act may be meaningless in this case.³⁹ A situation could arise where an intrastate issue is taken out under the notification section without use of a prospectus thereby denying the public the protection afforded by disclosure of information in a prospectus that would otherwise be available.

4. Mining, Oil and Investment Fund Securities.

Mining and oil securities and investment fund shares are the subjects of special consideration under the New Mexico Act. The sections governing these types of securities require more specialized information of the issuer than do the normal registration methods,⁴⁰ and differ from the Uniform Act, which does not attempt to deal with particular types of securities but directs attention to the financial and economic condition of the issuer. Under the Uniform Act, information peculiar to a particular industry could be obtained by an administrator by the exercise of his rule-making power. The Uniform Act's approach thus does not seek to isolate specific industries but attempts to provide for a greater flexibility by requiring that the administrator exercise continuous supervision of all issuers.

Further, the specialized provisions of the New Mexico Act relating to mining and oil securities may be void. An opinion by an Attorney General of New Mexico has held the provision relating to registration of mining and oil securities to be void insofar as it purports to provide the exclusive method of registering such securities and insofar as it limits the exemptions available to issuers of such securities to less than the number of exemptions available for issuers of securities registered by coordination, notification and qualification.⁴¹ The sections adopting the general registration methods of coordination, notification and qualification were enacted subsequent to the enactment of the section pertaining to registration of mining and oil securities. Since the general sections refer to registration of any security under the Act without mention of the specialized section for mining and oil securities, the Attorney General found a conflict existing between the two types of registration and held the mining and oil sections were repealed to the extent of the conflict

39. Reg. N.M. Sec. Comm'r, Rule IV, 2 Blue Sky L. Rep. ¶ 34, 604 (1967).

40. N.M. Stat. Ann. § 48-18-24 (Repl. 1966) (mining and oil securities); N.M. Stat. Ann. § 48-18-25 (Repl. 1966, Supp. 1971) (investment fund shares).

41. 67 Op. N.M. Att'y Gen. 130 (1967).

with the later sections. The opinion has resulted in the almost total disuse of the mining and oil sections.⁴² Similarly, the legislature's decision to restrict the scope of exemptions available to issuers of mining and oil securities was reversed in the same opinion of the Attorney General on the basis of a technical oversight by the draftsmen of the 1965 amendments.⁴³ No action has been taken by the legislature to correct the Act since the Attorney General rendered his opinion.

The Attorney General was not asked to rule on the validity of the section specifying the exclusive method of registering investment fund shares.⁴⁴ Since this section was amended in 1969, it does not suffer the same defect ascribed to the mining and oil section. However, the legislature amended § 48-18-25 in 1969, and added a new provision, the apparent purpose of which is to deny registration to so-called no-load funds and other funds sold primarily by mail without having a sales office in New Mexico.⁴⁵ To accomplish this purpose, the new provision denies registration of investment fund shares under the special sections unless such shares are offered for sale or sold through an office of "supervisory jurisdiction" located within New Mexico. Although clearly aimed at halting the sale of fund shares solely by mail, the section has not achieved its purpose.

After the amendment was adopted, a former Commissioner took the position that § 48-18-25(O), did not purport to be the exclusive method for registration of investment fund shares and allowed registration under the general sections providing the issuer met the requirements of those sections. As a result, such issuers registered under the Act by either coordination, qualification or notification, and the amendment was effectively avoided leaving a slight increase in registration fees for some issuers as its only consequence.⁴⁶

Once again, it is difficult to know whether the legislature intended specific and exclusive methods of registration for securities issued by

42. During 1969 only one issuer chose to use the mining and oil section for registration. His decision was made after the Commissioner instructed him that the issue was eligible for registration by qualification. Granger Interview, *supra* note 33.

43. 67 Op. N.M. Att'y Gen. 130 (1967).

44. N.M. Stat. Ann. § 48-18-25 (Repl. 1966, Supp. 1971).

45. N.M. Stat. Ann. § 48-18-25 (O) (Repl. 1966, Supp. 1971): "A registration under this section shall be denied unless such investment fund shares shall be offered for sale or sold through an office of supervisory jurisdiction within the state."

46. N.M. Stat. Ann. § 48-18-25 (I) (Repl. 1966, Supp. 1971) provides for a registration fee of \$50.00 for a registration of investment fund shares pertaining to a single class of shares plus \$10.00 for each additional class. Renewals are allowed at a flat rate of \$30.00 for the first class and \$10.00 for each additional class. Issuers who cannot use the investment fund sections are subject to the standard registration fees set forth in N.M. Stat. Ann. § 48-18-19 (D) (Repl. 1966), i.e., 1/20% of aggregate offering price up to \$400.00.

this particular branch of the securities industry. This result can only be attributed to a failure to integrate the various sections of the Act with a measure of technical precision.

5. Registration of Broker-Dealers, Salesmen and Investment Advisers.

The New Mexico Act provides for the registration of broker-dealers,⁴⁷ their salesmen⁴⁸ and investment advisers⁴⁹ and gives the Commissioner jurisdiction over such persons.⁵⁰ The Commissioner has promulgated rules providing for specified minimum capital requirements for broker-dealers.⁵¹ Since most New Mexico broker-dealers are members of the National Association of Securities Dealers⁵² and also subject to SEC jurisdiction⁵³ the New Mexico Act has little effect upon them. Registration is largely a formality and compliance with the Act's requirements is the rule.

B. The Commissioner

The administration of the New Mexico Act rests with the Commissioner of Securities who is appointed by the Commissioner of Banking and serves, subject to possible reappointment, for a term of two years.⁵⁴ The Securities Division is not an independent agency but is a division of the Department of Banking under the control and regulation of the Commissioner of Banking.⁵⁵

Whether or not the Securities Division is performing adequately the tasks entrusted to it by the legislature is a question that should be answered only after considering the place of securities regulation in state government and the nature of the task of securities regulation. Clearly, the Act goes farther than its federal counterpart, for in addition to requiring disclosure, the New Mexico Act gives the Commissioner the duty of making decisions concerning registration on the basis of merit. The standard imposed is that the business of the issuer and the proposed issuance of securities be "fair, just and equitable."⁵⁶ The standard ordered by the legislature clearly implies

47. N.M. Stat. Ann. § 48-18-20 (Repl. 1966).

48. N.M. Stat. Ann. § 48-18-20.6 (Repl. 1966).

49. N.M. Stat. Ann. § 48-18-20.10 (Repl. 1966, Supp. 1971).

50. N.M. Stat. Ann. § 48-18-35 (Repl. 1966, Supp. 1971).

51. 2 Blue Sky L. Rep. ¶ 34, 613 (Nov. 30, 1961).

52. The National Association of Securities Dealers (NASD) is a "self-regulating" national securities association registered with the Securities and Exchange Commission, 1934 Exchange Act, *supra* note 12, at § 15 (A).

53. 1934 Exchange Act, *supra* note 12, provides for regulation of broker-dealers.

54. N.M. Stat. Ann. § 48-18-18 (Repl. 1966, Supp. 1971).

55. *Id.*

56. N.M. Stat. Ann. § 48-18-19.8 (Repl. 1966).

the existence of a regulatory agency, not a mere licensing agency, and the formal powers granted the Commissioner complement this regulatory function. Moreover, the Commissioner has broad investigatory power including the power to hold hearings,⁵⁷ subpoena witnesses and documents and compel attendance.⁵⁸ The Commissioner issues permits authorizing the sale of securities and may issue orders revoking such permits.⁵⁹ Informally, the Commissioner may bring substantial pressure to bear upon those issuers or dealers he believes to be in violation of the Act or to be engaged in deceptive practices.⁶⁰

The place of the Securities Division within the hierarchy of state government is confused by tangled lines of authority. The Securities Commissioner, until 1971, was appointed by the Commissioner of Banking with the approval of the Governor.⁶¹ The 1971 amendment removed the requirement of gubernatorial approval of the Commissioner's appointment. Although the Commissioner's office is ostensibly under the control of the Commissioner of Banking, the latter official's role is apparently limited to approving the Securities Commissioner's selection of employees and establishing policy for the division via control of its budget.⁶² All orders and regulations affecting registrants under the Act are issued by the Securities Commissioner and administrative appeal from them is made directly to the State Corporation Commission.⁶³ Further appeal may be had in the District Court for Santa Fe County.⁶⁴

Historically, the Commissioner of Securities has maintained an office that is underfinanced and understaffed. Loss and Cowett report that during the 1950's the Commissioner had no staff, but during that same period, New Mexico, thirty-ninth among the states in terms of population, ranked eighteenth in terms of the number of securities registered.⁶⁵ In terms of volume, the ranking translates

57. N.M. Stat. Ann. § 48-18-26 (Repl. 1966).

58. N.M. Stat. Ann. § 48-18-26.1 (Repl. 1966, Supp. 1971). Until 1971, the Commissioner had the power to compel testimony and grant witnesses immunity from prosecution, N.M. Laws 1965, ch. 312, § 11.

59. N.M. Stat. Ann. § 48-18-18 (Repl. 1966, Supp. 1971) and N.M. Stat. Ann. § 48-18-26.1 (Repl. 1966, Supp. 1971). It is unclear whether or not the Commissioner has the power to issue a cease and desist order to persons he finds engaging in fraudulent practices in violation of the Act. *See* text at 42-43 *infra*.

60. Granger Interview, *supra* note 33.

61. N.M. Stat. Ann. § 48-18-18 (A) (Repl. 1966, Supp. 1971).

62. Apparently the Securities Commissioner may appeal any decision of the Banking Commissioner to the State Corporation Commission, N.M. Stat. Ann. § 48-18-18 (C) (Repl. 1966, Supp. 1971).

63. N.M. Stat. Ann. § 48-18-27 (Repl. 1966).

64. *Id.*

65. Blue Sky Law, *supra* note 8, at 60.

into over 150 applications for registration annually. The volume is substantially larger today with 422 registrations permitted during 1969, and 38 issues determined as exempt from registration during the same year.⁶⁶ Other writers have noted a tendency on the part of state administrators to decrease their antifraud and inspection activities as the volume of registration activity in a state increases.⁶⁷ Such decreases are probably attributable to a lack of staff and to a small budget, both of which are readily apparent in the New Mexico operation.⁶⁸

During 1970, the Commissioner was authorized to employ a full-time assistant and two secretaries. The secretaries (one of whom resigned without replacement in 1971) were assigned the tasks of reviewing applications for registration of securities and dealers including salesmen and investment advisers. The assistant performs a number of functions including reviewing applications for registration and investigation of issuers. In addition to his supervisory duties the Commissioner participates actively in investigations and hearings.⁶⁹ Few comments can be made on the effectiveness of this allocation of effort because even the rudimentary staffing available has not been in existence for any appreciable time. The most that can be said for the present staffing is that it is an improvement over the situation during the 1950's, better enabling the Commissioner to fulfill his legislative mandate as a regulator and not simply existing as the head of a licensing agency.

In practice, the operation of the Securities Division, with the exception of approval of applications for registration of dealers, salesmen and investment advisers, is governed by the volume of applications for registration of securities. As the volume increases the amount of investigation decreases and the Commissioner must decide whether to approve an application substantially on the basis of its proffered contents. Even in this situation, applications for registration of securities by coordination present little problem.⁷⁰ These applications provide by far the bulk of the dollar value of all securities registered in New Mexico. They also represent the largest segment in absolute terms; in 1969, 318 of the 422 permits issued were for coordination applications.

66. 1969 Banking Report, *supra* note 22, at 98-99.

67. Blue Sky Law, *supra* note 8, at 57.

68. The Commissioner does not submit an independent budget request to the legislature but includes his requests in the budget of the Department of Banking.

69. Granger Interview, *supra* note 33; Swarthout Interview, *supra* note 6.

70. These applications provide by far the bulk of the dollar value of all securities registered in New Mexico. They also represent the largest segment in absolute terms; in 1969, 318 of the 354 permits issued (other than Investment Fund Shares) were for co-ordination applications, 1969 Banking Report, *supra* note 22, at 99.

The powers and duties of the Commissioner seem to imply the need for an independent agency to administer the Act if it is to be implemented to its fullest extent,⁷¹ since administration of the Act requires a knowledge of the securities industry as well as an ability to investigate alleged violations of the law.

C. Merit Requirements

Ambiguity and uncertainty are introduced into the administration of the New Mexico Act by the presence of merit standards governing registration of securities. The use of a standard as broad as "fair, just and equitable" does, to a significant degree, give the Commissioner the power to determine the right of any enterprise to tap the capital market.⁷² High quality issues rarely will be bothered by merit requirements; the most active area in which the Commissioner is given the opportunity to exercise his power is that of promotional and speculative issues. The question then becomes whether or not speculative offerings should have a right of access to the capital market. Evidence of new issue experience gathered by the SEC, while it suggests that a disclosure statute alone is not enough, raises a question about the helpfulness of merit standards in Blue Sky Laws.

A survey taken by the SEC concerning new issue behavior between 1952 and 1962 of 2,880 corporations going public during that period showed that some 37 percent either could not be located, were known to be liquidated, inactive or in receivership.⁷³ Only 34 percent showed a net profit in their last balance sheet. Of the 1,050 companies classified as promotional by the survey, 55 percent were out of business. They had failed after raising more than \$100 million from the public. Only 14 percent of the promotional companies showed a profit on their last balance sheet. These statistics question the efficacy of the merit standards in Blue Sky Laws because most of the promotional companies that failed had qualified in one or more states having such standards. A sad story indeed.

A problem arises whenever an attempt is made to analyze and define merit requirements. The use of the term "merit" should warn that standards are imprecise. The most common requirements include regulations designed to (1) limit the amount of stock taken by

71. The draftsmen of the Uniform Act, *supra* note 14, took no position on the question of who should administer it. See Blue Sky Law, *supra* note 8, at 383. Various states have placed the Act's administration in officials ranging from the Attorney General and Commissioner of Insurance to the creation of an independent Securities Division. *Id.* at 47.

72. Cf. Bloomenthal, *Blue Sky Regulation and the Theory of Overkill*, 15 Wayne L. Rev. 1447 (1969).

73. Hueni, *Application of Merit Requirements in State Securities Regulation*, 15 Wayne L. Rev. 1417 (1969).

promoters (promotional and "cheap" stock); (2) limit the amount of dilution of the public investors' interests; (3) require a minimum capital contribution by the promoters in cash or its equivalent depending on the price charged to outside investors; (4) require escrow of promotional shares for a period of time or until an earnings or dividend test has been met; (5) restrict the number of options and warrants granted; (6) restrict the amount paid as expenses in connection with the public offering; and (7) regulate the kinds of securities sold publicly (restrictions on non-voting and senior securities).⁷⁴

New Mexico requires that the value placed on property or services sold to the corporation be fully substantiated and that the risk of enterprise be borne in substantial measure by the promoters.⁷⁵ The sale of securities to underwriters or promoters at prices less than the public offering price at a time in close proximity to the public offering is a ground for refusal to permit the sale, as is the sale of promotional stock to promoters in such amounts as to take control away from the public where the public contributes sums that warrant control being vested in it.⁷⁶ The granting of warrants or options to purchase stock to persons other than public purchasers is "looked upon with great disfavor and will be considered as a basis for denial of the application. . . ."⁷⁷ This warning is attached to the sale of securities by any officer or director of the issuer if a commission is to be paid for their sale.⁷⁸ Commissions paid to underwriters or salesmen for sale of the securities may not exceed twenty percent of the purchase price.⁷⁹

Although these rules have been in existence for some time, it is clear that they have suffered from non-enforcement.⁸⁰ In addition, the standards as written have little meaning. Requiring promoters to bear in substantial measure the risk of enterprise does nothing by way of establishing what maximum dilution, of both assets and stock, will be tolerated. When the problem of dilution is combined with that of requiring a minimum equity investment on the part of the promoters, some workable standard may be found; the regulation

74. See generally Mofsky, *Reform of the Blue Sky Laws*, 23 Vand. L. Rev. 599 (1970) and Hueni, *supra* note 73.

75. 2 Blue Sky L. Rep. ¶34, 601, Rule I (C) (1967).

76. *Id.* at Rule I (D).

77. *Id.* at Rule I (E).

78. *Id.* at ¶34, 605, Rule V (A).

79. *Id.* at Rule V (C).

80. Cases have arisen involving offerings approved in the past in which it was found that the promoters had no equity in the company at the time of registration, Swarthout Interview, *supra* note 6.

as drafted, however, does not offer a standard against which an issue may be measured.

The regulations also provide for escrow of securities issued in payment for intangibles or for property⁸¹ and for escrow of treasury stock.⁸² Funds received from the sale of speculative securities, those issued by a corporation whose business or earnings are based upon future developments and potentials rather than on current tangible assets, are subject to impoundment as a condition of registration.⁸³ Unfortunately, the regulations do not provide standards for imposition of these requirements. Not surprisingly, valid reasons do exist and could easily be codified. With respect to the escrow condition, one commentator has suggested three principal reasons for imposing it: (1) the weak economic condition of the corporation; (2) a legal weakness in the corporation's stock structure; and (3) a lack of confidence by the Commissioner in the reputation or integrity of the persons whose stock is required to be escrowed.⁸⁴

The economic reasons generally stem from the absence of an earnings record for a measurable period of time (such as three years). Problems in the stock structure may arise from the existence of non-voting or inequitable classes of shares. The final category concerning a lack of confidence by the Commissioner in the reputation or integrity of the persons whose stock is to be escrowed is apt to arise when a promoter's stock is under scrutiny. Instances of promotional ventures failing because the promoter sold out before the venture became self-sustaining are not uncommon. The problem can usually be met by restricting the transfer of promotional stock, although stronger measures may be needed. Promoters' stock is also suspect because of the possibility that intangible assets may have only doubtful value. At any rate, identifiable criteria are available for consideration before deciding to impose the escrow requirement. The Commissioner should make these criteria known in the form of regulations not only for the escrow provision but also for the other merit requirements.

For the issuer seeking to register a new or promotional issue in New Mexico, the absence of ascertainable standards must often lead him to the conclusion that the successful registration of the issue depends solely on the personal attitude of the Commissioner.

The Act gives the Commissioner power to promulgate rules, reg-

81. 2 Blue Sky L. Rep. ¶ 34, 606, Rule VI (1967).

82. *Id.* at ¶ 34, 607, Rule VII.

83. *Id.* at ¶ 34, 608, Rule VIII.

84. Pearce, *Escrows—Burden or Boon?*, 14 Hastings L. J. 124 (1962).

ulations and orders necessary or appropriate to the public interest or for the protection of investors and consistent with the purposes of the Act.⁸⁵ Only a few rules have been published pursuant to the statute; they are neither sufficiently precise nor comprehensive to furnish adequate guidelines to a prospective issuer. Although the present Commissioner and his immediate predecessor place emphasis on consistency in reaching decisions, the absence of regulations to act as a standard against which one might measure the Commissioner's actions and anticipate them makes it difficult to measure his success at achieving consistency.⁸⁶

II. EXEMPTIONS

The most comfortable position in which to find oneself or one's client with respect to the New Mexico Act, as with most regulatory laws, is outside its area of applicability. Compliance with the Act, as indicated earlier, is not a simple matter and, in addition to its cost,⁸⁷ may involve the disclosure of information that an issuer would prefer to keep confidential. Accordingly, an examination of the most significant exemptions to the registration provisions of the Act may be especially helpful.

A. No Exemptions from "Anti-Fraud" Provisions

An important principle to keep in mind throughout this Section is that, with the exception of an exemption by definition, the exemptions set forth below do not exempt any person offering, selling or purchasing securities from the "anti-fraud" provision of the New Mexico Act. For example, a person making an "isolated sale" might find himself exempt from the securities and broker-dealer registration provisions by reason of § 48-18-22(A). Yet, if that person engaged in a fraudulent practice, the anti-fraud provisions of the Act would apply with as much force as to a non-exempt transaction. The New Mexico Act thus follows the principle of the Uniform Securities

85. N.M. Stat. Ann. § 48-18-18 (F) (Repl. 1966).

86. In at least one case, an attempt was made to determine whether or not New Mexico followed its own regulation concerning the issuance of options and warrants to other than public purchasers. The survey found New Mexico had disregarded its own policy by registering an issue of a corporation that did not meet one or more requirements of the regulation. Calvin, *A History of State Securities Regulation of Options and Warrants to Underwriters*, 17 Bus. Law 610, 633 (1962).

87. The cost of an *intrastate* registration rarely exceeds \$8,000, excluding brokers' commissions; a full-scale *interstate* registration involves an average cost, again excluding commissions, of \$50,000-\$100,000.

Act⁸⁸ and the Securities Act of 1933⁸⁹ respecting the inapplicability of exemptions to the anti-fraud provisions.

B. Exemption by Definition

Two factors, the inapplicability of specified exemptions to the anti-fraud provisions and the 1969 addition of subsection "O" to § 48-18-22, (requiring the giving of notice of an intention to avail oneself of a transactional exemption)⁹⁰ make it preferable to be exempt from the New Mexico Act by reason of an exception by definition rather than by a specific exemption.

As mentioned above, § 48-18-22(O) is potentially very troublesome. Subsection "O" should not be confused with § 48-18-18(D). The latter provides that any person may apply, by paying a \$25.00 filing fee, to the Commissioner for a determination that a particular transaction or security is exempt. Subsection "O" is mandatory, requiring notification of the intent to make use of any transactional exemption.

Despite the fact that the Commissioner has prescribed the notification forms only for those exempt transactions provided for by subsections 48-18-22 (A), (I) and (J), strict compliance with this provision would seem to require some notification to the Securities Division if one is seeking to preclude possible future attacks on any of the remaining exempt transactions.⁹¹ Thus, as indicated by the example in the introduction to this article, any lawyer setting up a close corporation would be well advised to notify the Commissioner, on forms available from him, of the corporation's intent to avail itself of the "private placement" exemption.

An even more burdensome feature of the provision, and one that sets New Mexico apart from other jurisdictions having more selective notification provisions,⁹² is that *any* person selling a non-exempt security in an exempt transaction, (for example, a person availing himself of the isolated transaction exemption,⁹³ or the unsolicited broker-dealer exemption⁹⁴) must notify the Commissioner of his intention to avail himself of the exemption. Obviously, this is requiring too much, not of the lawyer in the "private placement" situation, but certainly of the person making the isolated sale or selling through

88. Uniform Act, *supra* note 14, at § 101.

89. Securities Act of 1933, *supra* note 11, at § 17(a).

90. See note 4 *supra* and accompanying text.

91. See notes 5 and 9 *supra*.

92. See note 2 *supra*.

93. N.M. Stat. Ann. § 48-18-22(A) (Repl. 1966).

94. N.M. Stat. Ann. § 48-18-22 (C) (Repl. 1966).

a broker pursuant to an unsolicited offer. And, in practice, this subsection is frequently ignored.

Indeed, insofar as the provision purports to affect exempt transactions other than "private placements," it may be a mistake in draftsmanship. It appears that § 48-18-22(O) may have been intended to be modeled after a provision such as that added in 1963 to the Texas Securities Act.⁹⁵ The Texas provision requires notification of an intention by a corporation to sell its securities to not more than fifteen persons during any twelve-month period—such sales being exempt under the Texas Securities Act. That provision, which was inserted as a companion to the liberalized private placement exemption in 1963, was probably intended to curb any potential abuses of the broadened exemption by affording the Securities Division the opportunity to scrutinize its use. Under the New Mexico Act, however, the provision applies to *all* transactional exemptions and is not limited to the private placement exemption—a fact which would cause the New Mexico Commissioner's officer to be inundated with notices if it were ever implemented to the full extent required by the statute.⁹⁶ Moreover, implementing the notice requirement in the case of unsolicited broker transactions would probably eliminate such transactions altogether because of the delay in consummating the sale.

It seems unlikely that a court would, in accordance with the remedy provided in the Act, permit the harsh remedy of rescission for all transactions accomplished without notification to the Commissioner. For example, assume a layman failed to give the requisite notice of an isolated sale of non-exempt securities and his transferee sued to rescind the sale six months later because of a decrease in the value of the securities. A court might justify holding against the transferee by reference to the "technicality" of the violation.⁹⁷ However, an issuer represented by a lawyer in a private placement of its securities might not, and probably should not in view of the legislative purpose behind the subsection, be accorded the same judicial generosity. The provision is the only check against many

95. Tex. Rev. Civ. Stat. art. 581, § 5(I) (Rev. 1964). The New Mexico Commissioner in office at the time that subsection (O) was adopted has acknowledged that its application should have been similarly limited. The then Commissioner has also indicated that the actual language of the provision was substantially modeled after a similar notice provision in the Idaho Securities Act dealing with certain exempt securities, Granger Interview, *supra* note 33; see also note 2 *supra*.

96. One Albuquerque broker-dealer estimated that ten to twenty notices per day would be required.

97. See note 8 *supra*.

types of questionable promotional schemes that are otherwise outside the coverage of the Act.

The above discussion of the necessity of filing a notice of intention to avail oneself of a transactional exemption is intended to point out the desirability of being exempted from the registration requirements of the Act by reason of an exception to a definition. For example:

- (i) Goodtime Research and Development Corporation, a New Mexico corporation with three shareholders, issues ten shares of its common stock to Dreamer, Schemer and Duns. Although the transaction is exempt under § 48-18-22(J), technical compliance with the Act requires notification to the Commissioner under § 48-18-22(O) prior to the issuance to Dreamer, Schemer, and Duns.
- (ii) Goodtime Research and Development Corporation sells ten acres of land to Dreamer, Schemer, and Duns. Assuming no investment contract is present, land is not within the definition of "security," and neither the New Mexico Act generally nor § 48-18-22(O) specifically applies to the transaction.

1. The Meaning of "Security."

If the item being offered, sold or purchased is not a "security," none of the provisions of the New Mexico Act, including the anti-fraud provisions, apply. The Act defines "security" as:

[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation, certificate of interest in oil, gas or other mineral rights, collateral trust certificate, preorganization certificate or subscription, transferable shares, investment contract, voting-trust certificate or beneficial interest in title to property, profits or earnings, or any other instrument commonly known as a security, including any guarantee of, temporary or interim certificate of interest or participation in, or warrant or right to subscribe to, convert into or purchase any of these. "Certificate of interest in oil, gas or other mineral rights" does not mean oil royalties. . . .⁹⁸

The New Mexico definition is thus substantially similar to that contained in the Securities Act of 1933.⁹⁹ In the great majority of cases, there is no problem in deciding whether one is issuing a "security"

98. N.M. Stat. Ann. § 48-18-17 (H) (Repl. 1966, Supp. 1971).

99. Securities Act of 1933, *supra* note 11, at § 2 (1).

and hence within the purview of the Act: If X Corporation is issuing shares of its capital stock, warrants or debentures, it is issuing securities and the Act applies; if Y Corporation is selling land, the Act does not apply because, as a general rule, land is not a security. But what of the area within the limits of these two extremes? What of referral sale contracts, franchises, land coupled with a management arrangement? If these items can be classified as securities, the Act applies.

Aside from the statutory definition, New Mexico has no test for the "securitiness" of any particular item. Therefore, for those gray areas (usually dealing with items thrown into the category of "investment contracts") where it is not absolutely clear whether a security is being offered, it is appropriate to look to federal and state cases interpreting statutes containing similar definitions.

Before looking to the cases, however, a crude formula for the practitioner who may be unsure whether he should even begin worrying about compliance with the New Mexico Act or federal securities statutes might be set forth as follows: A person *may* be in the securities area if (1) he is soliciting risk capital (in the form of money or anything else of value) and (2) he is exchanging for that capital something other than or in addition to tangible property. More sophisticated tests have been suggested and analyzed in much greater detail elsewhere;¹⁰⁰ this simpler version is intended only to serve as a preliminary warning device to the practitioner.

In the two leading federal cases which define a "security" under the Securities Act of 1933, *S.E.C. v. C.M. Joiner Leasing Corporation*¹⁰¹ and *S.E.C. v. Howey Company*¹⁰² the Supreme Court held

100. The court in *State of Hawaii v. Hawaii Market Center, Inc.*, 485 P.2d 105 (Hawaii 1971), adopted the following test for the definition of an investment contract as involving a situation where:

1. an offeree furnishes initial value to an offeror; and
2. a portion of this initial value is subjected to the risks of the enterprise; and
3. the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the enterprise; and
4. the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

[This case in its trial court stage was cited in *D.M.C. of Colorado, Inc. v. Hays*, No. C-20289 (Denver Dist. Ct., Feb. 26, 1971) (appeal filed).] For an excellent discussion of the problem and an emphasis on the urgent need to regulate what might be termed "securities" in the gray area, see Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 Okla. L. Rev. 135 (1971); see also, e.g., L. Loss, *Securities Regulation* 483-96 (2d ed. 1961) and 2500-09 (Supp. 1969); Coffey, *Economic Realities of a "Security": Is There a More Meaningful Formula?* 18 Western Res. L. Rev. 367 (1967).

101. 320 U.S. 344 (1943).

102. 328 U.S. 293 (1946).

in both cases that real estate interests, if coupled with management contracts in which it is intended that the investor will be a passive participant, are within the definition of "security." Thus, in *Joiner*, persons were offering leasehold subdivisions ranging from 2½ to 20 acres at a price of from \$5.00 to \$15.00 per acre (N.B.: sellers were *not* offering "fractional undivided interests" in oil and gas rights, which are expressly within the definition of a security under both the Federal and the New Mexico Act, but were offering instead the leasehold interests themselves). The sellers also assured the purchasers that the Joiner Company would drill a test well so located as to test the oil-producing possibilities of the lease-holder. The Supreme Court stressed the fact that the advertising literature "emphasized the character of the purchase as an investment and as a participation in an enterprise."¹⁰³

The Court, when presented with the argument that the leases sold were interests in real estate under Texas law, said that real estate, coupled with other inducements, could in some circumstances be considered to be a security:

Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms of courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.'" The proof here seems clear that these defendants' offers brought their instruments within these terms.

It is urged that because the definition mentions "fractional undivided interest in oil, gas or other mineral rights," it excludes sales of leasehold subdivisions by parcels. Oil and gas rights posed a difficult problem to the legislative draftsman. Such rights were notorious subjects of speculation and fraud, but leases and assignments were also indispensable instruments of legitimate oil exploration and production. To include leases and assignments by name might easily burden the oil industry by controls that were designed only for the traffic in securities. This was avoided by including specifically only that form of splitting up of mineral interests which had been most utilized for speculative purposes. We do not think the draftsmen thereby immunized other forms of contracts and offerings which are proved as matter of fact to answer to such descriptive terms as "investment contracts" and "securities."

Nor can we agree with the court below that defendants' offerings were beyond the scope of the Act because they offered leases and assignments which under Texas law conveyed interests in real estate. In applying acts of this general purpose, the courts have not been

103. *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 346 (1943).

guided by the nature of the assets back of a particular document or offering. The test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be.¹⁰⁴

In *Howey*, the Supreme Court held, once again, that an interest in real property (a small parcel of a citrus grove) if coupled to a "service contract" whereby a corporation affiliated with the seller would manage the groves, constituted a security within the meaning of the Securities Act of 1933:

We reject the suggestion of the Circuit Court of Appeals, 151 F.2d at 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. 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. See *S.E.C. v. Joiner Corp.*, *supra*, 352. The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae.¹⁰⁵

The cases arising in state courts and state agencies interpret statutory definitions of the word "security" even more broadly than do the federal cases. In California, the test of whether an item is a security appears to be the use to which the consideration for the item is put: *i.e.*, if the purchaser is furnishing risk capital to the seller in exchange for an item which cannot be supplied without first obtaining such capital then the item is likely to be held to be a security.¹⁰⁶ A hope of gain through the efforts of others is not a necessary element of "securitiness" in California as it appears to be under federal law. The furnishing of risk capital in exchange for memberships in a proposed country club caused the California Supreme Court to rule that such a membership is a security,¹⁰⁷ despite the absence of any "hope of gain" on the part of those furnishing the capital. Thus California's Attorney General, setting forth the California policy on franchises prior to the adoption of specific legisla-

104. *Id.* at 351-53.

105. 328 U.S. 293, 301 (1946).

106. *Silver Hills Country Club v. Sobreski*, 55 Cal.2d 811, 361 P.2d 35, 13 Cal. Rptr. 186 (1961).

107. *Id.*

tion¹⁰⁸ was of the opinion that if either (i) the franchisor intends, by selling franchises, to secure a substantial portion of the initial capital that is needed to provide the franchisee with such goods and services as constitute the substance of the franchise (N.B.: no hope of gain through the efforts of others need be present) or (ii) if the franchisee participates only nominally in the franchised business for a share of the profits, then the franchise is within the definition of "security" and all transactions pertaining thereto are subject to the California Blue Sky Law.¹⁰⁹ The rationale of holding the situation in (i) to involve a security appears to be as follows: the investor-franchisee, by purchasing a franchise that does not consist of immediately available tangible goods and services is investing in the talents and fortunes of the franchisor at one level (level "A") before such investor-franchisee will have the opportunity to actively participate in his own business enterprise at level "B." If the franchisor furnishes the substance (goods, advertising, etc.) without using the franchisee's capital to initially develop and produce such items, then the franchise is not a security.

A recent Colorado case, *D.M.C. of Colorado, Inc. v. Hays*,¹¹⁰ is an example of what appears to be a growing trend¹¹¹ to use state Blue Sky Laws to protect the public from multilevel (pyramid) distributorship plans. By including participation contracts in such plans within the definition of "security," the promoters of the plan become subject to the requirements of the state Blue Sky Laws. *D.M.C. of Colorado, Inc.* (*D.M.C.*) was offering "founder-member contracts" to citizens of Colorado. Such contracts entitled the purchaser to participate in a percentage of the gross profits from sales of merchandise in the proposed store if and when such store was opened. There were two categories of "founder-member contracts": one, a

108. Cal. Corp. Code §§ 31001 *et seq.* (West Supp. 1971).

109. 49 Op. Cal. Att'y Gen. 124 (1967).

110. *D.M.C. of Colorado, Inc. v. Hays*, No. C-20289 (Denver Dist. Ct., Feb. 26, 1971) (appeal filed). An affiliate of *D.M.C.*, Western Market Centers, Inc. (*W.M.C.*), is at present a defendant in a suit by the New Mexico Commissioner of Securities seeking an injunction forbidding *W.M.C.* from selling similar contracts without complying with the New Mexico Act. See *Albuquerque Journal*, Aug. 4, 1971, at A1, col. 1.

111. Cases in addition to *D.M.C. of Colorado, Inc. v. Hays*, No. C-20289 (Denver Dist. Ct., Feb. 26, 1971) (appeal filed), holding similar propositions as involving a security are: e.g., *Florida Discount Centers, Inc. v. Antinori*, 226 So.2d 693 (Fla. 1969), *aff'd*, 232 So.2d 17 (Fla. 1970); *State of Hawaii v. Hawaii Market Center, Inc.*, 485 P.2d 105 (Hawaii 1971); *Alberta v. Great Way Merchandising, Ltd.*, App. 7901 (Ontario S. Ct. Feb. 24, 1971). The Securities Commissioners of both New Mexico and Oregon are seeking judicial construction of similar plans as a "security": see note 110 *supra* and *State of Oregon v. Development Corp. of America*, No. 73460 (Marion Cty. Jul. 2, 1971). *Contra*, *Gallion v. Alabama Market Centers, Inc.*, 213 So.2d 620 (Ala. 1968); *Georgia Market Center, Inc. v. Fortson*, 171 S.E.2d 620 (Ga. 1969). (The Georgia Legislature has since reversed the effect of this case.) Cf. *Koscot Interplanetary, Inc. v. King*, 452 S.W.2d 531 (Tex. 1970).

"distributor" contract entitled the distributor to a specified number of "purchase-authorization cards"—each time a holder of such a card made a purchase, the distributor was to receive a commission on the sale; the other, a "supervisor" contract, entitled the supervisor to commissions on purchase authorization cards just as in the case of the distributor. The supervisor was to receive, in addition to such commissions, "override commissions" from those persons brought into D.M.C. as distributors by him as well as a large one-time commission when such persons joined D.M.C. as distributors.

D.M.C. had no store, as it was intending to build it and purchase inventory with the money obtained from persons buying the "founder-member" contracts. Thus, risk capital was being furnished by the purchasers of the contracts. Further, the purchasers of the contracts had no right to participate in the management or operation of D.M.C. and had no control of the funds that they furnished to the venture. They were in effect investing in D.M.C.'s business of building the store, developing inventory, etc. (level "A") in order to have the opportunity to use their own efforts to stimulate sales (level "B").

According to the California view, it would appear that the mere furnishing of the risk capital alone in this situation to the level "A" venture would be sufficient to cause the courts to look upon the founder-member contract as a "security." Judge Finesilver reached a similar result, relying upon the somewhat narrower federal rule and found that the federal element of anticipating profits by reason of the efforts of others, in addition to the element of the furnishing of risk capital, was present:

[T]his Court holds that even if the Supreme Court in *Howey* meant the phrase "solely from the efforts of others" to be taken literally [as opposed to the judgment of the Hawaii Supreme Court in substituting the word "substantially" for "solely,"] that test of "solely" applies to efforts in management of the common enterprise. Under the D.M.C. scheme, although the individual investors may contribute some minimal personal effort, such effort is not involved in the control and management aspect of the proposed discount stores from which future profits are expected to flow back to the investor.¹¹²

The trend appears to be established. As a means of protecting the unwary consumer, it is to be welcomed along with the more glamorous consumer-protection struggles of current times. Courts are showing an increased willingness to regard the solicitation of risk

112. *D.M.C. of Colorado, Inc. v. Hays*, No. C-20289, at 8 (Denver Dist. Ct., Feb. 26, 1971).

capital in exchange for something other than, or in addition to tangible property, as inherently involving a security. The exemption by reason of the definition of "security" would therefore appear to be available in a lessening number of cases.

2. The Meaning of "Broker-Dealer," "Salesman" and "Agent."

The New Mexico Act requires not only the registration of securities but the registration of those persons who deal in securities.¹¹³ It is unlawful for any person to act either as a "dealer," "broker-dealer," "salesman" or "agent" without having first registered with and furnished a surety bond to the Commission.¹¹⁴

The New Mexico Act's definition of the term "broker-dealer" or "dealer," substantially identical to that of the Uniform Act,¹¹⁵ means "any person engaged in the business of effecting transactions in securities for the account of others or for his own account."¹¹⁶ The New Mexico definition specifically excludes, however, "agents" and "issuers."¹¹⁷ Thus, an agent or salesman employed by a broker-dealer need not himself register as a *broker-dealer* as he will be registered instead as a *salesman*. The specific exclusion of any *issuer* from the definition means that an issuer selling its securities in New Mexico without using the services of a registered broker-dealer need not itself register as a broker-dealer.

The New Mexico Act's definition of a "salesman" or "agent,"¹¹⁸ differing in some respects from the Uniform Act,¹¹⁹ includes any person who represents either a broker-dealer or an issuer in effecting or attempting to effect sales of securities. The final sentence of the definition, a potential source of considerable confusion, provides that "a partner, officer or director of a broker-dealer or issuer is an agent only if he otherwise comes within this definition."¹²⁰ This obviates the need for *all* partners, officers or directors of broker-dealers or issuers to register separately as "agents," or "salesmen," the thought being that registration of the corporation or partnership, involving specific information about officers or partners, etc., affords sufficient control of such persons. If the partner, officer or director does indeed actively represent the broker-dealer in effecting sales of

113. See text at 10 *supra*.

114. *Id.*

115. Uniform Act, *supra* note 14, at § 401 (C).

116. N.M. Stat. Ann. § 48-18-17 (B) (Repl. 1966).

117. N.M. Stat. Ann. § 48-18-17 (B)(1) (Repl. 1966); the Uniform Act, *supra* note 14, at § 401 (b), similarly excludes such persons in a somewhat different way.

118. N.M. Stat. Ann. § 48-18-17 (G) (Repl. 1966).

119. Uniform Act, *supra* note 14, at § 401 (b).

120. N.M. Stat. Ann. § 48-18-17 (G) (Repl. 1966).

securities, he then "otherwise come[s] within this definition" and must register as a salesman.¹²¹ As for partners, officers or directors of *issuers*, it had formerly been the practice in New Mexico for such persons to be considered as excluded from the definition of salesmen and agents by virtue of the final sentence.¹²² This appears to be a misconception of the exclusion. Any partner, officer or director of an issuer whose only relationship with the issuer's securities lies in his position as such partner, officer or director is not to be considered ipso facto a salesman or agent. However, if a partner, officer or director of an agent actively represents the issuer (*i.e.*, *sells* or offers for sale the securities of the issuer) he then "otherwise come[s] within this definition" and must register as a salesman.¹²³

Three further exclusions from the definition of "salesmen" should be noted: (1) Any person representing an issuer in transactions involving *any* exempt security (the Uniform Securities Act limits this to only five categories of exempt securities)¹²⁴ is not a salesman or agent and hence need not register; (2) Any person representing an issuer in any exempt *transaction* is not a salesman or agent;¹²⁵ and (3) Any person representing an issuer in effecting a transaction with existing employees, partners or directors of the issuer "if no commission or other remuneration is paid or given, directly or indirectly, for soliciting any person" in New Mexico is not a salesman or agent.¹²⁶

Examples:

(A) Givup Corporation, a New Mexico registered broker-dealer, has five directors and ten officers. Only two directors and three officers are actually involved in the effecting of sales of securities for Givup. The remaining seven officers and three directors manage and operate other aspects of the business. Only the three officers and two directors come within the definition of "salesman" or "agent" and must register.

(B) Goodtime Corporation proposes to issue its securities in New Mexico and offer and sell such securities without the intervention of any broker-dealer. Five of Goodtime's eleven officers will be involved, in addition to their managerial duties, in the selling of such securities; the remaining six officers and all of the directors will not be involved in such sales. In addition to the necessary regulation of the securities themselves, the five officers must be registered as sales-

121. See Blue Sky Law, *supra* note 8, at 334.

122. Swarthout Interview, *supra* note 6.

123. See Blue Sky Law, *supra* note 8, at 334.

124. N.M. Stat. Ann. § 48-18-17 (G) (Repl. 1966).

125. *Id.*

126. *Id.* The quoted conditional phrase should be limited to the third category of persons in keeping with the pattern of the Uniform Act, *supra* note 14. It is grammatically possible, however, to read the conditional phrase as applicable to all three categories.

men or agents. Goodtime, as issuer, is excluded from the definition of "broker-dealer" and need not register.

(C) The officers and directors of Thinksmall Manufacturing, Inc., a New Mexico corporation having five shareholders, propose to offer and sell its securities to not more than ten New Mexico residents. As such officers and directors are representing an issuer in effecting an exempt transaction they are not salesmen or agents under the Act and need not register.

3. *The Meaning of "Offer" and "Sale."*

The New Mexico Act makes it a felony¹²⁷ for any person, without complying with the registration requirements of the Act, "to offer or sell" any non-exempt security in New Mexico in a non-exempt transaction. If one cannot be said to be "offering" or "selling," one is therefore outside the scope of the Act and need not look for a specific statutory exemption.

Under the Securities Act of 1933, it is unlawful to "offer" either to buy or sell a security prior to *filing* a registration statement with the Securities and Exchange Commission.¹²⁸ However, the definition sections of that Act, in the definition of the terms "offer to sell," "offer to buy" and "offer for sale" specifically excludes preliminary negotiations or agreements between an issuer, (or a person controlling or controlled by the issuer) and any underwriter.¹²⁹ Because of this exception to the definition, offers may be made by issuers to underwriters without fear of violating the Securities Act of 1933. An issuer can approach 500 underwriters without having first filed a registration statement as it is not making an "offer" by reason of the aforesaid definition.¹³⁰

All other offers under the Securities Act of 1933, whether they be solicited under the name of "indication of interest," "expression of intent" or any other euphemism, are within the scope of the Act and cannot be made prior to the filing of the registration statement unless an exemption is available.¹³¹ Thus, in the absence of an exemption, if X writes letters to the public asking whether they "might be interested in" subscribing for shares in his corporation—even if he makes it clear that their response in no way binds them to go through with the purchase, he is violating the Securities Act of 1933.

Under the Securities Act of 1933, again provided no exemption is available, it is unlawful to sell or deliver for sale any security without

127. N.M. Stat. Ann. § 48-18-19 (A) (Repl. 1966).

128. Securities Act of 1933, *supra* note 11, at § 5 (c).

129. *Id.* at § 2 (3).

130. Loss, *supra* note 100, at 184.

131. See, e.g., Van Alstyne, Noel & Co., 22 SEC 176 (1946); Otis & Co., 35 SEC 650 (1954); See also Loss, *supra* note 100, at 196-97.

a registration statement in effect as to such security.¹³² A definitional exemption is available, however, in certain cases. Thus, as under ordinary circumstances a gift is not a sale under the Securities Act of 1933, bona fide gifts of securities may be made without registration.¹³³ In addition, Rule 133,¹³⁴ promulgated under the Securities Act of 1933, provides that certain exchanges of stock are not "sales," if accomplished pursuant to a statutory merger, consolidation, sale of assets, etc., in each of which case a vote of the majority of the stockholders is required by state law to approve the transaction:

Example:

Conglom Corporation, with 300 shareholders, decides to purchase substantially all of the assets of Standstill Corporation, having 200 shareholders in exchange for 20,000 shares of the common stock of Conglom. Assuming both Conglom and Standstill are New Mexico corporations, a majority vote of two-thirds of the shareholders entitled to vote is required to authorize the transaction. The issuance in this transaction of Conglom shares need not be registered as this is not within the definition of "sale" because of Rule 133.

The New Mexico Act provides *no* exemptions resulting from the definition of either the term "offer" or "sale." If an issuer approaches an underwriter, seeking a public offering of the stock, the approach *is* an offer, unlike the case under federal law, and the issuer must therefore have a specific statutory exemption. A specific exemption for such transactions is included in the "Exempted Transactions" section of the New Mexico Act.¹³⁵ However, because an "offer" of securities is being made, § 48-18-22(O) raises its head again, and every time an issuer approaches an underwriter, it must, technically, notify the Commissioner in the manner set forth above. Moreover, the anti-fraud provisions of the New Mexico Act apply to such cases.

The "no-sale" theory of Rule 133 in the area of merger, consolidation and sales of assets is treated by the New Mexico Act in a similar manner. Instead of being "defined away" as in the case under the Securities Act of 1933, the New Mexico Act affords a specific transactional exemption for "[a]ny transaction incident to . . . a merger,

132. Securities Act of 1933, *supra* note 11, at § 5(a).

133. Loss, *supra* note 100, at 516. Note, however, the caveat: "But it must be remembered that even a *gift* of a *warrant* involves an 'offer' of the security it calls for, so that the registration and prospectus provisions must be satisfied for the latter security before the gift is made of the warrant."

134. 17 C.F.R. § 230.133 (1971).

135. N.M. Stat. Ann. § 48-18-22 (D) (Repl. 1966).

consolidation or sale of assets.”¹³⁶ Again, this means that the “anti-fraud” provision of the New Mexico Act is applicable to such transactions and the Commissioner must receive prior notification of any person’s intent to avail himself of this exemption.

4. *Investment Advisers—The “Performance Fund” Problem.*

Another example of what this article has referred to as a definitional exemption concerns companies registered under the Investment Company Act of 1940, as amended (the Investment Company Act).¹³⁷ Mutual Funds, defined as “open-end management companies” under the Investment Company Act,¹³⁸ are generally managed by a separate corporation, an adviser, which makes decisions as to the fund’s portfolio with the adviser receiving a fee for its services. This fee has traditionally been one-half of one percent of the total net asset value of the fund annually, subject to reduction as the assets exceed a given figure.

With the emergence of the performance funds, a new fee arrangement was established in the industry.¹³⁹ One example might be that an adviser is to receive, in addition to the traditional fee, an “incentive fee” equal to one-tenth of one percent of the net asset value of the fund for every whole percentage point that the annual performance of the fund exceeds the change in Standard and Poor’s Composite Stock Price Index. Thus, if a fund with an assumed average net asset value of \$1,000,000 is managed by its adviser so as to out-perform the Standard & Poor’s Index by three percentage points, the adviser will receive a basic fee of \$5,000 (one-half of one percent of \$1,000,000) plus an incentive fee of \$3,000 (one-tenth of one percent of \$1,000,000 times three).

The anti-fraud provision of the New Mexico Act indicates that the above fee schedule, if practiced by an investment adviser, is both an unlawful and fraudulent practice.¹⁴⁰ However, the definitional section of the Act excludes from the definition of “investment adviser” any person who “has no place of business in [New Mexico] if: (a) his only clients in [New Mexico] are . . . investment companies as defined in the Investment Company Act of 1940”¹⁴¹ Thus, because of the definitional exemption, an out-of-state adviser to a per-

136. N.M. Stat. Ann. § 48-18-22 (N) (Repl. 1966).

137. Act of Aug. 22, 1940, 54 Stat. 789, as amended 15 U.S.C. §§ 80a-1 through 80a-52 (1971).

138. *Id.* at § 5(a)(1).

139. See generally U. Pa. L. School and ALI-ABA Comm. for Continuing Legal Educ., *Conference on Mutual Funds*, 115 U. Pa. L. Rev. 669, 689-99 (1967).

140. N.M. Stat. Ann. § 48-18-29 (C) (Repl. 1966).

141. N.M. Stat. Ann. § 48-18-17 (I) (Repl. 1966).

formance fund is not *prima facie* engaged in unlawful conduct so as to entitle New Mexico residents to rescind their purchase of such fund's shares.

C. *Exempt Transactions*

The New Mexico Act provides that certain transactions in securities, although not coming within any definitional exemption, are exempt from its registration requirements. Although denominated "exempt transactions" in the Act, all of the transactions discussed in this section are subject to the notification provision of § 48-18-20(O)¹⁴² and to the anti-fraud provisions of § 48-18-29.¹⁴³

1. *The Private Placement.*

(a) *1933 Act Considerations: A Diversion*

The Securities Act of 1933 exempts from federal registration requirements (but *not* from federal anti-fraud provisions)¹⁴⁴ all "transactions by an issuer not involving any public offering."¹⁴⁵ The frequently-used federal transactional exemption has been the source of much litigation: What is a public offering? An offering to 25 informed, related persons? An offering to 100 insurance companies? An offering to 10 uninformed, unrelated persons? This subject has been dealt with competently and extensively in other books and articles.¹⁴⁶ Suffice it to restate here simply that a transaction coming within the federal "private offering" exemption must meet the following test: the offering (N.B.: it is the number of *offerees* as opposed to the number of ultimate purchasers that is controlling) must be made to persons who are in such a relationship to the issuer as to not need the protection afforded by the federal registration procedure. The ubiquitous rule of thumb, dangerous to rely on with any great confidence, is that an offering to 25 persons of a relatively high degree of investment sophistication will come within the exemption.¹⁴⁷

The other especially significant exemption from the registration requirements of the Securities Act of 1933 is that available for secur-

142. See note 90 *supra* and accompanying text.

143. See text at 16 *supra*.

144. Securities Act of 1933, *supra* note 11, at § § 4 and 17; See also Loss, *supra* note 100, at 710.

145. Securities Act of 1933, *supra* note 11, at § 4(2).

146. See, e.g., Loss, *supra* note 100, at 653, 697 and 2629-66; C. Israels & G. Duff, *When Corporations Go Public* 13-23 (1962); R. Jennings & H. Marsh, *Securities Regulation* 364-404 (2d ed. 1968).

147. *Id.*

ities sold intrastate. Coming in the "exempt securities" (as opposed to "exempt transactions") section of the Act for no good reason,¹⁴⁸ the exemption covers all offers and sales of securities to the residents of a single state or territory by issuers resident and doing business in (and if corporations, incorporated by) such state or territory.¹⁴⁹ The offers and sales can be made by mail or any other interstate means of communication. The great danger of the exemption, however, and the reason for its infrequent use by the financial community,¹⁵⁰ is that a *single offer* or *sale* to a non-resident invalidates the entire transaction and affords the rescission remedy to all purchasers. This is especially significant in a state, like New Mexico, which has a high percentage of servicemen.

Another less-noted¹⁵¹ reason for not using the intrastate exemption is that, assuming the intrastate offering is successful, the issuer may be compelled to register with the Securities and Exchange Commission under § 12(g) of the Securities Exchange Act of 1934¹⁵² relatively soon after the intrastate offering. Registration under § 12(g) requires the furnishing of similar material as registration under the Securities Act of 1933 and is therefore costly and exhaustive. Thus, an issuer who believes that its *intrastate* offering will be successful enough to boost its assets to \$1,000,000 and its number of shareholders to greater than 500 would do well to consider whether the dangers of attempting to comply with the requirements for the intrastate exemption in addition to the complexities of the filing requirements under the New Mexico Act's "qualification" procedure do not warrant full-scale registration under the Securities Act of 1933.

(b) *Private Placements in New Mexico*

In the New Mexico Act, the substance of the federal private offering exemption appears as three separate transactional exemptions: (1) offers and sales to "institutional investors";¹⁵³ (2) offers and sales of preorganization certificates or subscriptions to the public (*i.e.*, anybody) when *ultimate subscribers* to an as yet unformed

148. Securities Act of 1933, *supra* note 11, at § 3 (a)(11); Prof. Loss suggests that the exemption was placed under "exempt securities" rather than "exempt transactions" because of a "legislative accident." See Loss, *supra* note 100, at 709.

149. Securities Act of 1933, *supra* note 11, at § 3 (a)(11).

150. For a discussion of the exemption, see, *e.g.*, Loss, *supra* note 100, at 591-604 and 2601-05; Israels & Duff, *supra* note 146, at 32-34.

151. See, *e.g.*, Newton, *The Intrastate Exemption in the Light of the Securities Exchange Act Amendments of 1964*, 27 Mont. L. Rev. 19 (1965).

152. 1934 Exchange Act, *supra* note 12.

153. N.M. Stat. Ann. § 48-18-22 (H) (Repl. 1966).

issuer do not exceed fifteen;¹⁵⁴ and (3) the "issuance and sale" of securities of any New Mexico corporation if the number of the security holders does not, and will not in consequence of the sale, exceed twenty-five.¹⁵⁵

The first two exemptions are straight-forward and offer no conceptual problems; the third, probably the most frequently used, is troublesome because it is subject to a variety of interpretations. Before discussion of the "25-or-less" exemption, some examples may clarify the thrust of the first two private offering exemptions:

- (i) Richman Corporation offers and then sells its shares to 100 banks, which banks are located both in New Mexico and other western states. The offering is probably exempt from the Securities Act of 1933 because it does not involve a public offering.¹⁵⁶ It is definitely exempt from the registration requirements of the New Mexico Act under § 48-18-22(H).
- (ii) The promoters of the as yet unformed Nokash Corporation, a New Mexico corporation which will do business principally in New Mexico, send letters to 5,000 New Mexico residents offering 10,000 shares at \$100 apiece to the first 15 subscribers. Both the offer and sale of the preorganization certificates or subscriptions themselves are exempt under the New Mexico Act if no commissions are paid and the proceeds are placed in escrow. The offer and sale are exempt under the federal Securities Act of 1933 because of the above-mentioned *intrastate* exemption. It must be noted, however, that before the *shares* subscribed for can be lawfully issued or sold, a specific exemption must be found as § 48-18-22(I) merely *postpones* the registration requirements until after the preorganization period has passed. In the usual case, § 48-18-22(J) will serve as the necessary supplemental exemption.
- (iii) If the offer of Nokash Corporation's shares set forth in example (ii) had been made to even *one* non-resident of New Mexico, the federal *intrastate* exemption would have been unavailable. Accordingly, although the transaction would remain exempt under the New Mexico Act, it would be subject to the registration requirements of the Securities Act of 1933.¹⁵⁷ The federal "private placement" exemption would be unavailable because of the large number of offerees.

Although the wisdom of permitting promoters to offer preorgani-

154. N.M. Stat. Ann. § 48-18-22 (I) (Repl. 1966, Supp. 1971).

155. N.M. Stat. Ann. § 48-18-22 (J) (Repl. 1966). If the "isolated sale" exemption is construed as applicable to non-issuers, a fourth type of private placement exemption may be added to the above: see note 168 *infra*.

156. See notes 145 and 146 *supra* and accompanying text.

157. See notes 149 and 150 *supra* and accompanying text.

zation subscriptions to an unlimited number of persons may be questionable,¹⁵⁸ there is no difficulty in determining what the statute provides in this area. Because the statute expressly exempts *both* "offers" and "sales" as long as the ultimate number of subscribers does not exceed fifteen, the exemption is clear.

The third private placement exemption, § 48-18-22(J), provides for an exemption for the "issuance and sale" of securities that will not have the effect of increasing the number of security holders of a New Mexico corporation to more than 25. Unlike similar exemptions in many other jurisdictions,¹⁵⁹ this exemption is not available to business forms other than the corporation. If a promoter prefers, for tax or other reasons, to use the limited partnership form, the exemption is inapplicable and the limited partnership interests must be registered. A further difficulty with this exemption lies in the interpretation of the words "issuance and sale." May offers be made to an *unlimited* number of persons as long as the ultimate *purchasers* do not exceed, together with existing security holders, twenty-five? Or, must the number of *offerees* also be limited, as under the federal rule, to the twenty-five person maximum?

According to a former New Mexico Securities Commissioner, the official interpretation of § 48-18-22(J) had been to treat the phrase "issuance and sale" as if it read "offer and sale."¹⁶⁰ This interpre-

158. For a discussion, see Blue Sky Law, *supra* note 8, at 368-374.

159. *E.g.*, Mo. Rev. Stat. § 409.402 (b)(9) (Repl. 1967); Okla. Stat. tit. 71, § 401 (b)(9) (Repl. 1969); Fla. Stat. Ann. § 517.06 (11) (Repl. 1963); Wis. Stat. Ann. § 551.23 (11) (1970). See note 168 *infra* and accompanying text for the suggestion that the "isolated sale" exemption may be yet another private placement exemption available to *all* issuers.

160. Granger Interview, *supra* note 33. The New Mexico case of *Bills v. All-Western Bowling Corp.*, 74 N.M. 430, 394 P.2d 274 (1964), warrants some discussion at this point, in that it may be viewed as supportive of this view of the exemption. In *Bills*, plaintiff on January 27, 1961, subscribed for 1500 shares in All-Western Bowling Corp. (AWB) paying \$150.00 "down" and the remaining \$1,350 on March 8, 1961. In August, 1961, AWB attempted to register its securities with the New Mexico Securities Commission; it failed to accomplish this and the Commissioner forbade further sale of its securities. Plaintiff sought rescission and AWB defended on the grounds that it had made a private placement under an earlier version of N.M. Stat. Ann. § 48-18-22 (J) (Repl. 1966). The court held that AWB had sustained its burden of proving the exemption by oral testimony (including testimony by the then Securities Commissioner) rather than by "hard" evidence such as stock transfer ledgers, etc. The court rejected plaintiff's argument that "the exemption was intended to apply to the small close corporation where additional capital was to be raised by sales to friends and relatives familiar with the business." The Court said:

This section provides in substance that if the number of stockholders in the corporation do not exceed twenty-five, and will not exceed this number as a result of the sale, or if the aggregate amount raised by the sale of stock does not, and will not, as a result of the sale, exceed \$50,000. [the \$50,000 limitation was eliminated in 1965] then the sale is exempt. . . .

Although the court did take the position that it will strictly construe the New Mexico Act, it apparently did not consider the possibility that if AWB had made what was in fact a

tation likened § 48-18-22(J) to the preorganization situation covered by § 48-18-22(I): *i.e.*, assuming an exemption from the Securities Act of 1933, offers of a New Mexico corporation's securities could be made to an unlimited number of persons without coming within the registration requirements of the New Mexico Act if the total number of security holders after such offering and sale did not exceed twenty-five, and such persons, in the reasonable belief of the issuer, are purchasing for investment purposes.

Example:

Nokash Corporation, a New Mexico corporation having ten security holders, offers 10,000 shares of the common stock at \$100 per share to the first fifteen New Mexico residents who respond to the offer. The offer is made by letter to 2,500 New Mexico residents. Welsher, one of the 2,500, purchases 1,000 shares and fourteen other persons do likewise. The corporation fails one year after the sale and Welsher sues the original directors for rescission of his purchase.

Under the interpretation of the former Commissioner, Welsher would be denied recovery. It should be noted, however, that (in the absence of an official rule, regulation or order)¹⁶¹ an interpretation of the Commissioner may not be a good defense in a private civil action.¹⁶²

The present New Mexico Securities Commissioner does not interpret § 48-18-22(J) as permitting an unlimited number of offers.¹⁶³ He would limit the interpretation of "issuance" and "sale" to their common meanings and restrict "offers" to the public by reference to the federal standard. Thus the numerical test applied to ultimate security-holders is supplemented by a non-numerical test of the type of offering made.¹⁶⁴ If the offering is "public," the transaction will not be exempt even though the number of security-holders does not exceed the twenty-five person limitation of § 48-18-22(J).

public offering, by soliciting capital from a broad sector of population, subsection (J) should not protect it. Moreover, the opinion contains no discussion of the specific language of subsection (J). For these reasons, it is questionable that the court intended to set any broad guidelines for future treatment of the exemption and its holding should be accordingly limited. Although the exemption is available for situations other than that suggested by the plaintiff, the other limits of its availability remain to be defined.

161. N.M. Stat. Ann. § 48-18-18 (G) (Repl. 1966).

162. Assuming New Mexico follows the federal example: *see, e.g.*, Loss, *supra* note 100, at 1844-45, 1895; Blue Sky Law, *supra* note 8, at 83.

163. Swarthout Interview, *supra* note 6.

164. For a discussion of the treatment of the non-numerical test in Texas, *see* Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities*, 18 Sw. L. J. 537 (1964). Bromberg continues:

The Texas numerical limits [35 and 15] apply only to purchasers, but the prohibition on public solicitation imposes non-numerical limits on the offerees, with a result similar to the federal non-numerical limits. *Id.* at 552.

Under this interpretation, action would lie against Nokash Corporation in the above example. This appears to be a reasonable and desirable limitation to place on the exemption. For in most jurisdictions that do not expressly exempt both "offers" and "sales," there is some restraint imposed upon either the number of offers or the means of communicating the offer.¹⁶⁵ Florida, for example, provides for an exemption for *sales* to not more than twenty persons but *offers* leading to those twenty sales cannot be made by "public solicitation or advertisement."¹⁶⁶ The language of the Texas Securities Act is similar.¹⁶⁷

Without express statutory language to the contrary—as is the case with § 48-18-22(I) which exempts *both* "offers" and "sales" of pre-organization subscriptions—in view of the long-standing federal rule of putting the limitation on *offerees* rather than on ultimate purchasers, and in view of the existence of similar provisions in the majority of other jurisdictions, a preferred construction of the exemption should limit the number of offerees. Indeed, as the exemption runs only to the "issuance" and "sale" of securities, and makes no express provision for the exemption of "offers" (N.B.: If the "offer" has been made under the exemption provided by § 48-18-22(I), a sale of shares to the fifteen or fewer *subscribers* is exempt under § 48-18-22(J), it may be argued that the New Mexico Act does not exempt any offers at all other than those directly leading to the issuance or sale. That is, if twenty-five persons purchase shares, only offers to those persons are exempt; if an offer is made to a twenty-sixth person, the exemption is not available. An interpretation that does not in some way limit the number of offerees might afford the energetic promoter the opportunity to poll every resident of New Mexico until he finally collects twenty-five unsophisticated investors willing to invest an unlimited amount of money in securities pursuant offering literature that has not passed under the scrutiny of the New Mexico Securities Commission (N.B.: The Commissioner must, however, be notified of the transaction pursuant to § 48-18-22(O)).

2. Non-Issuer Transactions.¹⁶⁸

The previous section of this article dealt with transactions in

165. *E.g.*, Va. Code Ann. § 13.1-514(b)(8) (Repl. 1966); Wis. Stat. Ann. § 551.23 (10) (1970).

166. Fla. Stat. Ann. § 517.06 (11) (Repl. 1963).

167. Tex. Rev. Civ. Stat. art. 581, § 5 (I) (Repl. 1964).

168. The authors have engaged in what might be termed "poetic license" in placing the "isolated sale" exemption [N.M. Stat. Ann. § 48-18-22 (A) (Repl. 1966)] under the non-issuer heading. For a discussion as to the validity of this action, see note 181 *infra* and accompanying text.

which an *issuer* could offer and sell securities in New Mexico without going through the state registration process. At this point the question arises: When may a *non-issuer*, i.e., someone to whom securities have been issued by an issuer or a third person, offer and sell securities free from the registration requirements of the Act?

The treatment of non-issuer transactions or secondary distributions under the Securities Act of 1933 and rules promulgated thereunder involves difficult questions revolving around the terms "statutory underwriter," "control," Rules 133 and 154, etc. This article will limit any discussion of the aforesaid terms to the general statement that, under the Securities Act of 1933, because of the exemption afforded by § 4(1) to "transactions by any person other than an issuer, underwriter, or dealer," securities sold by non-issuers are not subject to the registration requirements of such Act unless the non-issuer is in a control relationship with the issuer and the distribution involves an underwriter.¹⁶⁹ Unlike the Securities Act of 1933, the New Mexico Act, absent specific exemptions, applies to non-issuer transactions with as much force as primary distributions.

Under the New Mexico Act, three categories of non-issuer transactions, in addition to the exemptions available to issuers, are exempt from security and broker-dealer registration requirements. The Act requires registration in the relatively few cases that are outside the scope of these exemptions.

(a) The "Prior Registration" Exemption¹⁷⁰

Any non-issuer may offer and sell, without registration as a broker-dealer and without registration of the security, "any security" that has been previously registered under the New Mexico Act if the "registration was terminated with the consent of the commissioner."¹⁷¹ The broad nature of this exemption, available with respect to securities of a company that may have registered five or ten years ago, should be limited by restricting the definition of "any security" to include only those securities actually registered—not extending it to the entire class of security registered. However, § 48-18-19(E), providing that "[a]ll outstanding securities of the same class of registered security are considered to be registered for the purpose of any non-issuer transaction" would appear to allow the registration of a few shares for a primary distribution by an issuer, thereby entitling a shareholder to engage in a large secondary distribution. Aside from the potential loss of revenue to the state, this

169. See, e.g., Loss, *supra* note 100, at 641; Blue Sky Law, *supra* note 8, at 317.

170. N.M. Stat. Ann. R 48-18-22 (B)(3) (Repl. 1966).

171. *Id.*

provision may nullify the effectiveness of any action by the Commissioner against the issuer once the registration has been accomplished.¹⁷²

(b) The "Manual" Exemption¹⁷³

A non-issuer may sell any amount of securities without coming within the registration requirements of the New Mexico Act if, with certain limitations, the security is listed in a recognized securities manual.

In addition, the New Mexico Act provides that the New Mexico Securities Commissioner may approve an "issue" of securities that are *not* so listed if he finds that the "issue" is "in the public interest."¹⁷⁴ This section appears to contain an error in draftsmanship as a non-issuer does not "issue" securities. What the section must mean is simply that the Commissioner may exempt a non-issuer distribution of securities that are not listed in any manual.

(c) The "Uninterrupted Dividends" Exemption¹⁷⁵

If the security being offered or sold by the non-issuer has a fixed maturity or fixed interest or dividend provision and there has been no default in the payment of principal, interest or dividends on the security (1) during the current fiscal year *or* (2) within the three preceding fiscal years, or during the existence of the issuer and any predecessors (if the issuer has not been in existence for three years) it may be sold without registration.

(d) The "Isolated Sale" Exemption¹⁷⁶

A non-issuer may sell unregistered securities in "isolated transactions." As the Act does not define the term "isolated," the exemption is somewhat vague. The present New Mexico Commissioner has construed the term as inapplicable to a planned sale to two persons,¹⁷⁷ and other states have similarly limited the exemption to from anywhere from two to five contemporaneous transactions.¹⁷⁸

The New Mexico Act, unlike the Uniform Act¹⁷⁹ and unlike the majority of state securities statutes containing an "isolated sale" pro-

172. For a discussion of the way this exemption is treated by the Uniform Act, *supra* note 14, see Blue Sky Law, *supra* note 8, at 314-23.

173. N.M. Stat. Ann. § 48-18-22 (B)(1) (Repl. 1966).

174. N.M. Stat. Ann. § 48-18-22 (B)(2) (Repl. 1966).

175. N.M. Stat. Ann. § 48-18-22 (B)(4) (Repl. 1966).

176. N.M. Stat. Ann. § 48-18-22 (A) (Repl. 1966).

177. Swarthout Interview, *supra* note 6.

178. Blue Sky Law, *supra* note 8, at 317-18.

179. Uniform Act, *supra* note 14, at § 402 (b)(1).

vision,¹⁸⁰ does not specifically limit the exemption to non-issuers. In those jurisdictions which do not so limit the exemption there has been no judicial decision as to whether the term "non-issuer" should be read into the section. The New Mexico Securities Commissioner considers the exemption available to issuers.¹⁸¹ This has the effect of creating a non-numerical private placement exemption for *all* users of securities (*i.e.*, corporations, limited partnerships, etc., whether or not residents of New Mexico). The legislative purpose of narrowly limiting the private placement exemption by § 48-18-22(H) (I) and (J) thus appears partially defeated.

(e) *Unsolicited Sales Through Broker-Dealers*¹⁸²

A non-issuer may sell any security through a registered broker-dealer provided that there was no solicitation of either the order or the offer to purchase.

3. *Miscellaneous Exemptions.*

All of the exemptions discussed herein under the general heading "exempt transactions" are available to non-issuers as well as issuers.

In addition, the New Mexico Act provides for the more or less "standard" transactional exemptions, with certain conditions, for executors,¹⁸³ administrators,¹⁸⁴ sheriffs,¹⁸⁵ pledgees,¹⁸⁶ etc.; and transactions involving the existing security holders of an issuer.¹⁸⁷

It was the practice of a former New Mexico Securities Commissioner to grant, pursuant to § 48-18-18(D), "special" exemptions for certain transactions not coming within the express exemption under the New Mexico Act. Thus certain limited partnerships, where public policy did not dictate otherwise, could seek a special exemption despite the unavailability of § 48-18-22(J), which applies only to corporations. The present Commissioner, however, takes the position that § 48-18-18(D) is limited to only those exemptions made available by the language of the Act. Although the former interpretation

180. *E.g.*, Fla. Stat. Ann. § 517.06 (3) (Repl. 1963); Colo. Rev. Stat. Ann. § 125-1-13(2) (b) (Repl. 1963); Mo. Rev. Stat. Ann. § 409.402 (b)(1) (Repl. 1967); Ariz. Rev. Stat. Ann. § 44-1844 (3) (1956, Repl. 1970).

181. Swarthout Interview, *supra* note 6. Prof. Loss now appears to concede that in absence of explicit language to the contrary, the exemption is available to issuers. *See* Loss, *supra* note 100, at 2639. Washington merges its isolated sale exemption and its private offering exemption: "Any isolated transaction, or sales not involving a public offering, whether effected through a broker-dealer or not" are exempt. Wash. Rev. Code Ann. § 21.20.320 (1) (1961).

182. N.M. Stat. Ann. § 48-18-22 (E) (Repl. 1966).

183. N.M. Stat. Ann. § 48-18-22 (F) (Repl. 1966).

184. *Id.*

185. *Id.*

186. N.M. Stat. Ann. § 48-18-22 (G) (Repl. 1966).

187. N.M. Stat. Ann. § 48-18-22 (K) (Repl. 1966).

provided a flexibility somewhat in the manner of the "no-action" letter of the SEC, the latter interpretation appears to be more in keeping with the intent of the legislature and may also serve to protect the issuer from incurring civil liabilities that are possible despite granting of a "special" exemption by the Commissioner.¹⁸⁸

D. Exempt Securities

The New Mexico Act provides that certain categories of securities are exempt from registration.¹⁸⁹ As is the case with exempt transactions, exempt securities are within the coverage of the "anti-fraud" provisions of the Act. Unlike exempted transactions, however, persons dealing in exempt securities need not notify the Commissioner of an intention to use the exemption under § 48-18-22(O).

Also unlike the case with exempt transactions, the New Mexico Act, like the Uniform Act, provides that exempt securities are exempt only from the *securities* registration provisions of the Act and not specifically from *broker-dealer* registration requirements.¹⁹⁰ Thus, if a broker-dealer were to conduct a business by dealing only in exempt *securities*, such broker-dealer would nevertheless be required to register, while if such broker-dealer were to deal only by exempt *transactions*, no registration would be required. However, because any person *selling* exempt securities as a salesman representing an *issuer* (and not as, or representing a broker-dealer or dealer) comes within an exception to the definition of "salesman," such person need not be registered under the Act.¹⁹¹ The securities exempt under the New Mexico Act include, generally, securities issued by governments,¹⁹² banks,¹⁹³ savings and loan associations,¹⁹⁴ insurance companies¹⁹⁵ (but not variable annuities),¹⁹⁶ credit unions,¹⁹⁷ regulated common carriers,¹⁹⁸ non-profit organizations,¹⁹⁹ securities listed or approved for listing on a securities exchange,²⁰⁰ certain commercial paper²⁰¹ and investment contracts

188. Blue Sky Law, *supra* note 8, at 83; *see also* notes 161 and 162 *supra* and accompanying text.

189. N.M. Stat. Ann. § 48-18-21 (A) through (J) (Repl. 1966, Supp. 1971).

190. N.M. Stat. Ann. § 48-18-21 (Repl. 1966, Supp. 1971).

191. *See* notes 120 and 124 *supra* and accompanying text.

192. N.M. Stat. Ann. § 48-18-21 (A) (Repl. 1966).

193. N.M. Stat. Ann. § 48-18-21 (C)(1) (Repl. 1966).

194. N.M. Stat. Ann. § 48-18-21 (C)(2) (Repl. 1966).

195. N.M. Stat. Ann. § 48-18-21 (C)(3) (Repl. 1966).

196. 60 Op. N.M. Att'y Gen. 60-137 (1960).

197. N.M. Stat. Ann. § 48-18-21 (D) (Repl. 1966).

198. N.M. Stat. Ann. § 48-18-21 (E) (Repl. 1966).

199. N.M. Stat. Ann. § 48-18-21 (G) (Repl. 1966).

200. N.M. Stat. Ann. § 48-18-21 (F) (Repl. 1966).

201. N.M. Stat. Ann. § 48-18-21 (H) (Repl. 1966).

issued in connection with employees' stock purchase or similar plans.²⁰²

The New Mexico Act contains an exemption for a security not expressly provided for in the Uniform Act.²⁰³ The exemption is for securities issued by an investment club of not more than twenty-five persons.²⁰⁴ This exemption contains several stringent limitations, one of which is specific notification by the Commissioner that such securities are exempt.²⁰⁵

III. ENFORCEMENT

The dual questions of exposure to civil liability for violation of the New Mexico Act and official enforcement of its provisions deserve extensive discussion. The classic situation involving the trusting investor who is fraudulently induced to purchase shares in a non-existent corporation almost always engenders sympathetic overtures from lawyers and laymen alike. These cases still arise with unfortunate regularity, but in many jurisdictions extensive remedies are available through "blue sky" legislation.²⁰⁶ The legislatures in such jurisdictions have gone beyond the older rules that required the investor to look to the common law of fraud and deceit for a remedy.²⁰⁷ That many attorneys are unaware of the change is unfortunate. The Blue Sky Laws are largely self-enforcing and provide such generous remedies that one writer was prompted to title his article "*Hidden Gold*" in the Blue Sky Laws.²⁰⁸ To ensure their effectiveness, these laws and the remedies offered by them must be pursued in private civil litigation. As the preceding discussion has shown, the New Mexico Act is extensive in its registration requirements;²⁰⁹ if the legislature chose to fund the securities division in such a manner as to allow it to be both an investigatory and a licensing agency rigorous enforcement of its provisions would be possible and might result in substantial elimination of attempts to

202. N.M. Stat. Ann. § 48-18-21 (I) (Repl. 1966).

203. The Uniform Act, *supra* note 14, at § 402 (b)(9), apparently would treat the small investment fund as another small issuer.

204. N.M. Stat. Ann. § 48-18-21 (J)(1) (Repl. 1966, Supp. 1971).

205. N.M. Stat. Ann. § 48-18-21 (J)(12) (Repl. 1966, Supp. 1971).

206. The blue sky laws of a few states allow the purchaser to rescind if the seller failed to comply with even a technical requirement of the law: e.g., N.M. Stat. Ann. § 48-18-31 (Repl. 1966); Iowa Code Ann. § 502.23 (Repl. 1949); Tenn. Code Ann. § 48-1645 (Repl. 1964); Utah Code Ann. tit. 9, § 4225 (Repl. 1970).

207. See, e.g., *Derry v. Peek*, 14 A.C. 337 (1889); *Kountze v. Kennedy*, 147 N.Y. 124, 41 N.E. 414 (1895); *McIntyre v. Lyon*, 325 Mich. 167, 37 N.W.2d 903 (1949). See also, Note, *The Liability of Directors and Officers for Misrepresentation in the Sale of Securities*, 34 Colum. L. Rev. 1090 (1934).

208. Wolens, "*Hidden Gold*" in the Blue Sky Laws, 20 Sw. L. J. 578 (1966).

209. See text at 5-10 *supra*.

sell our big blue sky. As it is, the New Mexico Act provides for three types of remedies—criminal, administrative and civil—for violations of its provisions.

A. Criminal Sanctions

The New Mexico Act provides for penalties of fine or imprisonment for willful violation of any of its provisions, of any rule or order of the Commissioner and for willfully making or causing to be made in any document filed with the Commissioner a "statement which, is at the time and in the light of the circumstances under which it is made, false or misleading in any material respect"²¹⁰ Criminal liability for violation of a rule or order and for making misstatements of fact is contingent on both willfulness and knowledge of the rule or order and the falsity of the statement.²¹¹

Criminal proceedings are a relatively unimportant aspect of the Act. The SEC has concurrent jurisdiction if the violation involves fraud or an interstate transaction²¹² and the penalties provided under the Federal Securities Acts are more severe than those provided by the New Mexico Act.²¹³ It is probable that the majority of the violations of the New Mexico Act involve what a court might term unwitting technical violations.²¹⁴ There is no evidence that the State has prosecuted when such violations have occurred.

B. Administrative Sanctions

1. Formal Powers.

The legislature has authorized the Commissioner to conduct investigations to aid in enforcement of the Act and, specifically, to determine whether registration should be granted, denied or revoked and to determine whether any person has violated or is about to violate any provision of the Act.²¹⁵ Coupled with his subpoena power²¹⁶ and the power to compel attendance,²¹⁷ it would seem the Commissioner's powers are great enough to discourage violations

210. N.M. Stat. Ann. § 48-18-32 (Repl. 1966).

211. *Id.*

212. Securities Act of 1933, *supra* note 11, at § 17.

213. The penalty under Securities Act of 1933, *supra* note 11, at § 24, is a fine of not more than \$5,000 or imprisonment for not more than five years, or both. *See also* 1934 Exchange Act, *supra* note 12, at § 32. Under the New Mexico Act, the fine is also \$5,000, but imprisonment may only be imposed for three years. N.M. Stat. Ann. § 48-18-32 (Repl. 1966).

214. Blue Sky Law, *supra* note 8, at 129.

215. N.M. Stat. Ann. § 48-18-26.1 (Repl. 1966, Supp. 1971).

216. *Id.*

217. *Id.*

of the terms of the Act without resort to criminal proceedings. The same factors that make time of the essence in the registration of securities tend to make administrative actions of the Commissioner as effective and as damaging to the wrongdoer as criminal sanctions. If an investigation and public hearing are insufficient to obtain compliance the Commissioner may bring an action in district court to enforce compliance and obtain injunctive relief.²¹⁸ Although it is sometimes suggested that the power to conduct formal disciplinary proceedings is largely unused by state securities commissioners, the observation is inapplicable to New Mexico.²¹⁹ In recent years the New Mexico Securities Commissioner has engaged in a program of active enforcement of the Act.²²⁰

2. *Summary Powers.*

There is some question about the necessity for the Commissioner to use these rather formal administrative procedures in any given case. It has not been common for the Commissioner to use these rather formal administrative procedures. In practice it has not been uncommon for the Commissioner to simply issue a cease and desist order upon discovery of a violation of the Act and leave the decision to demand a hearing up to the person against whom the order was issued.²²¹ This practice has arisen of necessity; its legal justification is less clear. Some illumination can be cast upon the issue by distinguishing between issuing cease and desist orders against persons who have made no attempt to comply with the registration provisions of the Act and revocation and suspension orders entered against issuers, brokers and others who have registered under the Act.

(a) *Cease and Desist Orders*

Although the New Mexico Act does not give the Commissioner the power to issue cease and desist orders per se, he has the implied power from the general grant of authority contained in § 48-18-18(F):

The Commissioner may promulgate rules, regulations and orders necessary to carry out the provisions of the Securities Act of New Mexico. No rule, regulation or order shall be promulgated unless the

218. N.M. Stat. Ann. § 48-18-30 (Repl. 1966).

219. Granger Interview, *supra* note 33; Swarthout Interview, *supra* note 6.

220. *Id.*

221. Granger Interview, *supra* note 33; Swarthout Interview, *supra* note 6. See also Albuquerque Journal, *supra* note 110.

commissioner finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes of the Securities Act of New Mexico.²²²

Other states have statutes worded in similar fashion, and some of them construe such provisions to imply the power to issue these orders from the statute,²²³ but some condition the power by requiring the Commissioner to hold a hearing before issuing the order or in some other way comply with the procedures generally found in an administrative procedures act.²²⁴ The New Mexico Commissioner is not subject to the New Mexico Administrative Procedure Act²²⁵ and has not felt compelled to hold hearings prior to issuing the order.

The inference drawn by the Commissioner from § 48-18-18(F) is not the only one that might be drawn from the words of the Act. It could be argued that in the absence of an express grant of the claimed authority, the Commissioner has no right to issue a cease and desist order. However, in support of the Commissioner's position, it should be noted that even in this situation arguably adequate procedural safeguards are provided by the Act. Section 48-18-26 requires the Commissioner to send to the issuer a notice of opportunity for a hearing whenever an order forbidding the sale of securities has been issued. If the issuer chooses to avail himself of this opportunity, the statute clearly spells out the appellate process, both administrative and judicial, he may follow to reverse the Commissioner's decision once the hearing has been held.²²⁶

It may be trite to suggest at this point in the history of securities regulation that one should balance the need for swift action against the right of access to the public market for securities, but if such balancing is undertaken, it will be seen that the benefit to the investing public far outweighs any potential harm to an issuer in this situation. Here, the issuer is not faced with a strict deadline concerning the effective date of his offering; all he has to worry about is the beginning date of what may be a tortious enterprise. The issuer may also be benefited if the Commissioner's action illuminates a violation that might otherwise be the source of much financial grief in a later civil action for rescission.

222. N.M. Stat. Ann. § 48-18-18 (F) (Repl. 1966).

223. See, e.g., D.C. Code Ann. § 2-2415 (e) (1967); Okla. Stat. Ann. tit. 71, § 410 (Repl. 1967); Mo. Rev. Stat. § 409.408 (Supp. 1971); S.C. Code Ann. § 62-6 (1962). (Letters confirming such constructions are on file in the office of the New Mexico Law Review.)

224. Note the practice of the Department of State of South Carolina (letter on file in the office of the New Mexico Law Review).

225. N.M. Stat. Ann. § 4-32-23 *et seq.* (Supp. 1971) (Administrative Procedures Act).

226. N.M. Stat. Ann. § 48-18-27 (Repl. 1966).

(b) Suspension and Revocation Orders

When dealing with orders revoking or suspending permits authorizing the sale of securities or registration of dealers, salesmen or investment advisers, the Commissioner is on firmer ground because revocation and suspension procedures are referred to specifically in the Act.²²⁷

Suspension and revocation of a dealer's, salesman's or investment adviser's registration permit is governed by § 48-18-23 of the Act. Under that section the Commissioner is required to afford an opportunity for a hearing and hold one upon request of the registrant. To revoke or suspend a permit the Commissioner is required to find that the registrant has either willfully violated the Act, failed to meet the minimum capital requirements, been guilty of a fraudulent act or practice in connection with the sale of a security, engaged in unconscionable selling efforts, failed to file a financial statement with the Commissioner as required by the Act or that the registrant is no longer in existence.²²⁸

The power to revoke permits authorizing the sale of securities is mentioned in the Act,²²⁹ but there is no reference to the procedure to be followed in deciding whether or not to revoke. As a result the Commissioner has inferred the power to revoke such permits when he finds that "...the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes of the Securities Act of New Mexico."²³⁰

It is clear that the Commissioner may apply to the court for an injunction to halt the activities of persons who have made no attempt to comply with the Act; as noted above, the Commissioner has also inferred from the Act the power to issue an order to such persons demanding that they cease their activities until they have complied with the Act. Neither method is mutually exclusive, but as a matter of tactics one might be preferred over the other. The use of an administrative order is less expensive to all parties and has the effect of keeping the profile of the proceedings at a low publicity level while allowing the parties to negotiate their differences away from the formality of a judicial proceeding. Resolution of the issue at an administrative level may also serve to avoid possible damage to

227. N.M. Stat. Ann. § 48-18-23 (Repl. 1966).

228. *Id.*

229. "Every registration shall remain effective until revoked by the Commissioner or until terminated upon request of the registrant with the consent of the Commissioner. . . ." N.M. Stat. Ann. § 48-18-19(E) (Repl. 1966). "The Commissioner may recommend revocation of the permission for the sale of any mining or oil security. . . ." N.M. Stat. Ann. § 48-18-24.6 (Repl. 1966).

230. N.M. Stat. Ann. § 48-18-18 (F) (Repl. 1966).

the issuer whose actions are being questioned but who is able to satisfactorily explain or correct them.

C. Civil Sanctions

Despite the formal administrative and criminal proceedings, civil liability is essential to an effective securities act. As many writers have indicated, inadequate budgets and uneven enforcement at the state level make civil liability a *sine qua non* in the "blue sky" laws.²³¹ It is the exposure to economic injury from suits by disgruntled investors that makes blue sky laws effective. For convenience, the discussion of civil liabilities will be divided into two parts: express and implied remedies. The similarity of language among the major federal securities acts referred to in this paper, especially to Rule 10(b)(5) adopted under the 1934 Exchange Act, makes the division necessary.

1. Express Remedies.

The New Mexico Act makes sales or contracts for sale of securities voidable at the election of the purchaser if they were made in violation of any provision of the Act or any order issued by the Commissioner under any provision of the Act.²³²

Joint and several liability under this section is imposed upon "every director, officer, salesman or agent of or for such seller who shall have participated or aided in any way in making such sale . . . upon tender to the seller, in person or in open court, of the securities sold or of the contract made for the full amount paid by such purchaser. . . ."²³³ The remedy includes not only rescission but an allowance for all taxable court costs and reasonable attorney's fees.²³⁴

This express remedy is limited in scope. It applies only to purchasers who are in privity of contract with the seller and perhaps to those who can establish the existence of a third party beneficiary contract.²³⁵ Furthermore, recovery is limited by a two-year statute of limitations that runs from the date of the sale or contract of sale and by a requirement that the purchaser may not avail himself of the section's remedy if he refuses an offer of the seller to voluntarily rescind the sale or contract and repay the purchase price.²³⁶

231. E.g., Wolens, *supra* note 208; Blue Sky Law, *supra* note 8, at 130.

232. N.M. Stat. Ann. § 48-18-31 (Repl. 1966).

233. *Id.*

234. *Id.*

235. *Id.* Loss, *supra* note 100, at 1759.

236. N.M. Stat. Ann. § 48-18-31 (b) (Repl. 1966). The purchaser has thirty days in which to accept the offer. The offer must be in writing.

In addition to the express remedy for violations involving the sale of securities, the New Mexico Act provides an express remedy for anyone having a claim under § 48-18-31 against a broker-dealer. Section 48-18-20.3 requires each broker-dealer registered under the Act to post a surety bond in the amount of \$10,000 and to provide that suit may be maintained on the bond "by any person" who has cause of action under § 48-18-31.²³⁷

The significance of this provision should not be underestimated. Liability under § 48-18-31 clearly extends to broker-dealers participating in a sale; while the issuer may be devoid of assets at the time the stockholder asserts his claim under § 48-18-31, the participating broker-dealer will still be liable on his surety bond.

The express remedies under § 48-18-31 require that the purchaser tender the securities sold or the contract to the seller. A problem for the purchaser will arise when he has sold the securities subsequent to the purchase and later repurchased on the market and then tenders them in an action to rescind the original sale. The buyer may have a chance to recover although his success is unlikely. The intervening sale and repurchase may relieve the original seller from liability by destroying the required privity of contract between them.

The seller may also defend against the purchaser on the grounds of ratification, estoppel and laches. These equitable defenses should be available to him even in the exceptional circumstance in which a court would find the purchaser to have been *in pari delicto* with the seller.²³⁸ It has been suggested that mere knowledge of the violation of the Blue Sky Law will not place the purchaser in that status in the absence of exceptional circumstances.²³⁹ The problem for the purchaser will arise when he has actively participated in the affairs of the corporation he subsequently sues. It would seem reasonable to raise the issue if the purchaser was an active participant at or near the time of the violation and is defending against creditors of the now insolvent company by claiming the violation of the Blue Sky Law as an excuse for nonpayment of the subscription price of his stock. The cases in other jurisdictions have generally required the shareholder to pay in this situation²⁴⁰ and in the situation where the shareholder seeks rescission and a prior claim against the corporation's assets against other creditors.²⁴¹

237. N.M. Stat. Ann. § 48-18-20.3 (Repl. 1966) makes this action subject to the two year statute of limitations.

238. Loss, *supra* note 100, at 1676.

239. *Id.* and cases cited at n. 231.

240. *Id.* at 1680 n. 240.

241. *Id.* at 1680 n. 242.

2. *Implied Civil Liability.*

Section 48-18-31(C) of the New Mexico Act provides: "Nothing in this act shall limit any statutory or common-law right of any person in any court for any act involved in the sale of securities." The section differs from the Uniform Act only to the extent that the Uniform Act adds an additional phrase: "...but this act does not create any cause of action not specified in this section or § 202(e)."²⁴² The significance of this provision is suggested by Professor Loss:²⁴³

But, given a statute like the Uniform Securities Act in which careful attention was paid to the scope of civil liability in the interest of specificity and predictability, there is no room for implying liabilities which are not expressly created. And without a provision like the second half of § 410(h) (quoted in text above) there could be no assurance that the courts might not—perhaps quite properly—consider additional liabilities to be consistent with the statutory purpose.

In the absence of implied liabilities for violation of the New Mexico Act, the available remedies are restricted to use by defrauded purchasers and are subject to the further restrictions of a short statute of limitations and the requirement that the purchaser accept voluntary rescission. A more expansionist view of the New Mexico Act may be in order since § 48-18-31(C) goes beyond the limits of the Uniform Act.

Such a view is required if remedies are to be extended to *sellers* of securities and to purchasers against whom the statute of limitations has run. Without implied remedies the seller who has been deceived into selling his securities is left with only the protection available at common law. Clearly, he would benefit from a construction of the New Mexico Act which would afford him a remedy against persons violating its provisions rather than forcing him to rely on the common law remedies for fraud and deceit. The purchaser with a valid claim that has been barred by the § 48-18-31 two-year statute of limitations would benefit from a similar construction of the Act since the requirements of proving liability may be less than for proof of common law fraud which proof he would have to supply since an express remedy through an action for rescission would be barred.

Courts have implied civil liability for violation of legislative enactments without hesitation in the past. In so doing, they substitute the

242. Uniform Act, *supra* note 14, at § 410 (h).

243. Loss, *supra* note 100, at 1649 n. 100.

standard expressed in the enactment in place of the traditional due care standard. They generally require that the purpose of the statute be exclusively or in part: (1) to protect the class of persons which includes the injured party; (2) to protect the particular interest that has been invaded; (3) to protect that particular interest from the kind of harm that has resulted; and (4) to protect the interest from the particular hazard from which the harm results.²⁴⁴ New Mexico courts have adopted this standard in other contexts,²⁴⁵ but they have not yet had the opportunity to apply it to the New Mexico Act. Federal courts have consistently implied civil liability for violations of the provisions of the various federal securities acts under this standard.²⁴⁶

3. Federal Parallels.

(a) Implied Civil Remedies for Sellers

The problem presented by a defrauded seller now seeking a remedy against the person to whom he sold the security has arisen under federal law. The Securities Act of 1933²⁴⁷ was designed to provide remedies for *purchasers* of securities and did not extend its protection to *sellers*. However, the subsequently enacted 1934 Exchange Act²⁴⁸ made it possible to extend protection to the defrauded seller. Section 10(b) of the 1934 Exchange Act²⁴⁹ applies to both the *purchase* and *sale* of securities. Although civil remedies were not expressly granted to private parties under the 1934 Exchange Act, federal courts considering the question have held that a private civil remedy is available for the defrauded seller.²⁵⁰ In so doing, these courts have applied state law to determine the appropriate statute of limitations for fraud.

Section 48-18-29 of the New Mexico Act is similar to § 10 of the 1934 Exchange Act in that it declares certain practices in connection with the "offer, sale or purchase" of securities to be fraudulent. The purchaser who engages in such practices is subject to criminal liability under the Act; if New Mexico chooses to follow the lead of the

244. Restatement (Second) of Torts § 286 (1965).

245. *Sellman v. Haddock*, 66 N.M. 206, 345 P.2d 416 (1959); *Pettes v. Jones*, 41 N.M. 167, 176, 66 P.2d 967, 973 (1937); *Hittson v. Chicago, R.I.&P. Ry.*, 43 N.M. 122, 125, 86 P.2d 1037, 1038 (1939).

246. *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1947), *requests for additional findings granted*, 83 F. Supp. 613 (E.D. Pa. 1947); *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

247. Securities Act of 1933, *supra* note 11.

248. 1934 Exchange Act, *supra* note 12.

249. *Id.* at 78j.

250. *Jennings & Marsh*, *supra* note 146, at 847 n. 3.

Federal courts civil liability may be imposed on the purchaser as well.

(b) Implied Civil Remedy for Purchasers

When the situation arises where the purchaser has a valid claim against a seller but is apparently barred from bringing an action by the statute of limitations, the Federal courts have not been consistent in implying a civil remedy in addition to the express remedies provided for purchasers under the Securities Act of 1933. These courts have faced a dilemma: if a remedy may be implied for a defrauded seller under § 10 of the 1934 Exchange Act, a similar remedy should be available to the purchaser under the same construction of § 10. However, the remedies offered a purchaser under the express provisions of the Securities Act of 1933 are subject to venue and other restrictions not applicable to the implied right under the 1934 Exchange Act.²⁵¹ Without further definition of the implied right it is arguable that were such a right intended by Congress, it must also have intended to revoke, or at least eliminate, the necessity of using the remedies provided by the Securities Act of 1933.²⁵²

Normal rules of statutory construction have been used to resolve the problem posed in the situation where the purchaser, barred by the statute of limitations from bringing an action based on a specific violation of the Securities Act of 1933, sought to avoid application of the statute of limitations by bringing the same action under a theory of an implied remedy based on the 1934 Exchange Act.²⁵³ Although § 10 of the 1934 Exchange Act and Rule 10(b)(5) promulgated thereunder were broad enough to encompass the alleged violation, one court dismissed the contention noting that the express remedy provided by the Securities Act of 1933 for the specific violation had to be used.²⁵⁴ The more general right implied under the 1934 Exchange Act was held to be available only where the violation was not within the more narrow and specific statute.²⁵⁵ Other cases are *contra*, allowing the defrauded purchaser to use Rule 10(b)(5) thereby lessening the significance of the express remedies of the Securities Act of 1933.²⁵⁶

251. Compare Securities Act of 1933, *supra* note 11, at § 22(a) with 1934 Exchange Act, *supra* note 12, at § 27; see also Jennings & Marsh, *supra* note 146, at 867.

252. *Id.*

253. *Montague v. Electronic Corp. of America*, 76 F. Supp. 933 (S.D.N.Y. 1948).

254. *Id.* at 936.

255. *Id.*

256. *E.g.*, *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951); *Ellis v. Carter*, 291 F.2d 270 (9th Cir. 1961).

Applying the former line of reasoning to the New Mexico Act may result in a severe limitation on the availability of implied remedies for the purchaser of securities. Section 48-18-31 purports to provide a remedy for *every* sale or contract for sale made in violation of *any* of the provisions of the Act. However, as indicated above, the remedy is not exclusive since the section also provides that "[n]othing in this act shall limit any statutory or common-law right of any person in any court for any act involved in the sale of securities." The practical problem facing the purchaser is in identifying the area not covered specifically by the Act. If a seller's act is not made the subject of regulation by specific provisions of the Act, an implied remedy would be particularly appropriate.

As indicated above, cases arising under the Federal Acts have posed the issue by alleging a violation of § 10 of the 1934 Exchange Act and Rule 10(b)(5). Section 48-18-29(A) of the New Mexico Act is substantially identical to both § 10(b) of the Exchange Act and to Rule 10(b)(5). The New Mexico Act provides:

Section 48-18-29. A. It is a fraudulent practice and unlawful for any person, in connection with an offer, sale or purchase of any security, directly or indirectly, to:

- (1) employ any device, scheme or artifice to defraud;
- (2) make any false statement of material fact or to omit to state a material fact necessary in order to make the statements made true in the light of circumstances under which they are made; or
- (3) engage in any act, practice or course of business which operates, or would operate, as a fraud or deceit upon any person.

Thus, whereas a remedy may be implied for violations under the federal law, in New Mexico a violation of this section would activate the express remedy provided by the statute. Since the practices described in § 48-18-29(A) of the New Mexico Act are made fraudulent by that section, it would seem that if they result in a sale or contract to sell securities the remedy would have to be found in § 48-18-31.

(c) Civil Liability for Engaging in Fraudulent Practices

Section 48-18-29(A), quoted above, founds civil liability on a showing of some form of fraud or material misstatement or omission of fact. Like Rule 10(b)(5) the section makes no mention of the other elements of common law deceit—reliance, causation and *scienter*.²⁵⁷

As Professor Loss has stated, the courts applying Rule 10(b)(5)

257. Loss, *supra* note 100, at 1765.

have generally required that the plaintiff show at least reliance in part on the defendant's misstatements or omissions.²⁵⁸ Some form of causation is also generally required.²⁵⁹ *Scienter* is generally required although a growing number of courts have indicated that proof of *scienter* is not necessary when the claim is based upon a material misstatement or omission of fact.²⁶⁰ Since none of these questions have been decided in New Mexico, it is debatable whether the New Mexico courts would require proof of all the elements of common law deceit or adopt a less exacting standard.

CONCLUSION

Several principles emerge from the authors' analysis of the present state of securities regulation in New Mexico. As New Mexico companies seek funds for expansion, the public market will be tapped with increasing frequency. To provide adequate professional service for their clients, lawyers should be at least as aware of the New Mexico Act and related federal legislation as they are with other areas of law. This is essential in order to protect their corporate clients from voidable issuances of securities and to be familiar with the generous remedies provided by the Act.

Regulation of the securities industry is a task that requires the fine brush of an artist. As pointed out in this article, the New Mexico Act contains many ambiguities, inconsistencies and duplications. Remedial legislation is sorely needed, and without it, the Commissioner will remain at a serious disadvantage in administering the Act. Legislation is not the only answer, but clarification by the judiciary is slow, erratic and costly. Further needed are administrative standards that will effectively implement the concept of merit regulations. If the phrase "fair, just and equitable" is to be meaningful, regulations establishing guidelines are necessary to ensure consistent application of the statutory standard, giving particular attention to new issues and promotional companies seeking to register under the Act. These regulations should have the effect of easing the path to public capital without increasing the risk imposed upon the investing public. Administrative standards can be set forth in such a manner as to give issuers fair warning of the requirements for registration without imposing the burden of finding one's way through a labyrinth of regulatory procedure.

258. *Id.* at 3876, 3878-80.

259. *Globus, Inc. v. Jaroff*, 266 F. Supp. 524, 530 (1967), *motion for summary judgment denied*, 271 F. Supp. 378, 381 (1967).

260. *Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961); *see also* cases cited at CCH Fed. Sec. L. Rep. ¶92,290 and *Loss, supra* note 100, at 3886.

Properly considered, the Act and regulations promulgated by the Commission would complement the consumer-protection function of the New Mexico Attorney General. At present, fraudulent securities schemes are usually detected only after some irremediable harm has been done. Vigorous enforcement of the regulatory and supervisory roles prescribed to the Commissioner could reduce the success of fraudulent schemes devised by those who would sell, given the opportunity, even the insubstantial clouds in New Mexico's big blue sky.