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SECURITIES ISSUANCE AND REGULATION: THE NEW INDIANA SECURITIES LAW

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Legislation governing the issuance of securities should provide investors with adequate information and protection, but at the same time should not stifle the business community by preventing the acquisition of new capital. Previous Indiana blue sky legislation left much to be desired: In some areas an excess amount of protection was provided the investor against insignificant dangers, while in other areas the “investment quality” type of protection envisioned by the statutes was in practice not being applied. These and many other factors, in conjunction with the mushrooming increase of corporate finance activity during the last twenty years, clearly resulted in a situation in need of reform.

The 1961 Indiana Securities Law¹ is a modern approach to governmental regulation of the issuance and sale of securities.² Involving a significant change in regulatory philosophy and procedure from the old Indiana Securities Law,³ the new law represents an adoption, with numerous modifications, of the Uniform Securities Act.⁴ This discussion analyzes the new law and its model, the Uniform Securities Act, with respect to their effect on securities regulation in Indiana.

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2. For detailed compilation and general treatment of the various state securities laws, see Loss & Cowett, BLUE SKY LAW (1958) (hereinafter cited as Loss & Cowett); Loss, SECURITIES REGULATION (3 vols. 1961); CCH BLUE SKY L. REP. (2 vols.).


4. The Uniform Securities Act, the first uniform law primarily of a regulatory nature, was approved by the National Conference of Commissioners on Uniform State Laws in 1956. A slightly amended version was again approved in 1958. See HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 257-60 (1958). As of 1961 the act had been adopted, often with material modifications, by eleven states, with considerable portions of the act having been adopted by three additional states. Various sections or provisions of the act are reflected in the securities laws of seven more states. The act, together with brief official comments by the Commissioners on Uniform State Laws and with lengthy comments by its draftsmen, is available in book form which includes textual material on blue sky law by Professor Louis Loss, who was largely responsible for the drafting of the act. See Loss & Cowett. See also 9C U.L.A. 86 (1957) for the text of the act.

Legislation concerning securities regulation was first passed in Indiana in 1916, and the new 1961 law replaced a law enacted in 1937. The 1937 Indiana Securities Law was a conventional type of blue sky law, founded upon the police power of the state. All three of the common types of statutory regulation of the sale and issuance of securities—fraud prevention, registration of broker-dealers and agents and registration of securities—were incorporated into the law. The administration of the law was vested, as it is in the new Indiana Securities Law, in a division of the office of the Secretary of State. This office, previously designated as the Indiana Securities Commission, is designated by the new law as the Securities Division of the State of Indiana. A chief securities deputy, entitled “Securities Commissioner,” is appointed by the Secretary of State and is charged with the actual administration of the law.

REGISTRATION OF SECURITIES

Section 201 of the new Indiana Securities Law states as a registration requirement that “it is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 102 [exemption section].” It is in this area, registration of securities, that the new law differs most from the procedural requirements and underlying philosophy of the old law. Whereas the old law prescribed only one type of security registration, the new law provides for three types: registration by (1) notification, (2) coordination and (3) qualification. In addition, and involving even more of a change, substantive statutory standards required of a security before it is qualified for issuance or sale have been


6. The fraud prevention type of regulation typically broadens the common law definition of the term “fraud” and at the same time charges a state enforcement agency with the responsibility of issuing public warnings, investigating fraudulent activities and taking injunctive or other steps to prevent the occurrence of fraud in the issuance or sale of securities. Civil penalties are prescribed and criminal punishment for violation of the provisions is provided as a last resort.

7. Registration, or so-called licensing, of the professional sellers of securities is intended to prevent dishonest or otherwise unqualified persons from entering the securities business, to provide for supervision of their activities within the state once registration has been granted, and to result in revocation or suspension of their registration if they fall below the statutory standards.

8. Registration of securities whereby they are qualified for issuance and sale to the public is intended to provide the investor, whether informed or uninformed, with at least a modicum of investment safety by excluding from the state those securities which do not measure up to prescribed statutory standards.

greatly altered by the new law. In order to facilitate an orderly analysis, the three types of security registration found in the new law are first discussed, followed by a presentation of the one type of registration found in the old law. Then follows a discussion of the effect on Indiana blue sky regulation of the new law's alteration of previously existing substantive "qualification" standards.

Registration by "notification" applies in substance to any security whose issuer has been in continuous operation for five years if (a) no senior security has defaulted in the payment of any principal, interest or dividends during the three prior fiscal years and (b) if the issuer during the past three fiscal years has had average earnings of five percent on its common stock. Registration by notification also applies to any non-exempted security (other than certain oil, gas or mining interests) which is to be registered as a non-issuer distribution if any security of the same class has ever been registered under Indiana law or if the security being registered was originally issued pursuant to an exemption under Indiana law.

A registration statement filed under the notification type of registration automatically becomes effective two days after the filing of the statement unless the Commissioner affirmatively makes an objection before such time. The basic minimum information about the security and its issuer that is required to be filed with the registration statement is much less detailed than that which was required under the old Indiana "qualification" procedure discussed below. The specific disclosure requirements are set forth in section 202(b) of the new law. The draftsmen of the Uniform Securities Act felt that registration by notification was important "primarily for those intrastate issues of high quality which are not registered under the federal statute or for some of the better private offerings and interstate issues of 300,000 dollars or less which are exempted under section 4(1) of the Federal Securities Act of 1933... or SEC Regulation A." The rationale behind this type of registration is that securities which qualify are necessarily "well seasoned" and have already proven themselves in the market, and thus there is no need to


11. Oil, gas and mineral interests are excluded because they have no "issuer" as that term is defined in the law and hence all distributions of such securities would be eligible for registration by notification (as non-issuer distributions) if they were not ruled out.


15. Loss & Cowett 286.
subject them to close administrative scrutiny.

The second type of security registration under the new law is registration by "coordination." This type of registration, applicable to any security for which a registration statement has been filed under the Federal Securities Act of 1933 in connection with the same offering, is the normal method of registration for nation-wide offerings of non-exempt securities. Where securities are registered by coordination the state registration is effective automatically upon effectiveness of the federal registration, providing the state registration statement has been on file for ten days, a statement of the maximum and minimum offering prices has been on file for two days, and the Commissioner has not theretofore invoked a stop order. A stop order proceeding may be instituted if a coordinated offering does not meet the standards described in the act for all non-exempt securities regardless of how they are registered.

The information required with the registration statement when registering by coordination is identical to that required by the Securities and Exchange Commission. Thus, through a subordination of Indiana registration requirements to the SEC's requirements, the contents of the registration statement and the procedure by which it becomes effective are greatly streamlined. The importance of simultaneous state-federal approval and the fact that an overwhelming majority of security issues are registered with the SEC led the draftsmen of the Uniform Securities Act to call the registration by coordination provision "perhaps the most important reform... in the entire [uniform] statute." Although the coordination type of registration is new to Indiana blue sky law, it is not an entirely new concept to Indiana blue sky procedure. Section 8 (cc) of the old Indiana Securities Law provided that the Securities Commissioner had the discretion to waive the normal "qualification" registration statement requirements and to accept an SEC registration statement in lieu thereof. In addition, it was the usual practice of the Commissioner to make the effective date of the Indiana registration the same as that of the federal registration, provided that all of the required

18. When a particular security is eligible for registration by notification and also by coordination it is discretionary with the person filing the registration statement as to which procedure to use.
19. The Commissioner has the power to waive minimum time requirements.
20. The SEC prospectus is thus the basic registration document required for registration by coordination. The Commission may by request or rule require additional documents to be filed.
information had been submitted in advance. Whether or not a combination of the above procedures resulted in a mere "rubber-stamping" by the Commissioner of federally registered issues is a moot question in view of the new law's provision for registration by coordination.

The third type of registration under the new law, registration by "qualification," is the type most similar to the single method of security registration which existed under the old law. Registration by qualification involves the filing of a great amount of information, exhibits and documents and also requires the preparation of an extensive prospectus. Since any security may be registered by qualification, this type is necessarily used to register those securities which do not qualify for registration by notification or coordination.

Under Indiana's previous method of registration, the Commissioner was required to take affirmative action before a registration statement became effective. Under the new law's registration by "qualification" requirements, a registration statement automatically becomes effective thirty days after filing if the Commissioner does not issue a stop order prior to that time. This automatic effectiveness feature is a departure from the standard pattern among the states and from the Uniform Act with regard to registration by qualification.

After the date of effectiveness, the Commissioner may revoke a registration under section 206, but, section 206(a)(II) limits the Commissioner to a period of thirty days within which he may institute revocation proceedings based on facts known to him when the registration statement became effective. Designed to promote fairness, this section does not seem to be sufficiently explicit. Whether the Commissioner may be deemed to have "known" of an existing fact concerning a security at the time the security became effectively registered depends on how the term "Commissioner" is interpreted. If interpreted to embrace the office of the Commissioner, including office personnel and office records, then the thirty day limitation obviously assumes a more restrictive nature in view of the automatic effectiveness feature of the law. An additional problem involved is whether the Commissioner may be deemed to have knowledge of facts concerning a security or issuer when such facts are a matter of public record, either within Indiana or possibly in the securities office of another state. If such is the case, and if the facts in a particular registration situation involve misleading information about a security or its issuer which does not come to light within the first thirty

23. IND. ANN. STAT. § 25-859(c) (Burns Supp. 1962).
days of registration, the limitation of section 206(a)(H) would seem capable of imposing a severe restriction on the ability of the Commissioner to furnish accurate information to the investing public of Indiana.

Fortunately, other protective sanctions are left open. Even after the thirty day grace period has elapsed the Commissioner may issue a cease and desist warning to a seller that he is wilfully selling by means of a misleading statement and that unless he stops doing so he will be subject to criminal charges under other provisions of the Securities Law. The Commissioner may also initiate injunction proceedings against any person who has engaged in or is about to engage in any act or practice constituting a violation of any provision of the law or any rule or order adopted thereunder. In addition, the registration of a registered broker-dealer is continually subject to suspension or revocation under the provisions of section 304 of the new law.

The new law's three forms of registration should result in the removal of a considerable burden from the Securities Division in that a much smaller number of new issues will require registration by qualification. In addition, those securities (speculative and intrastate issues) which do not qualify for the mechanical write-in procedures and which therefore require registration by qualification involving extensive disclosure will receive the bulk of the Division's attention. The new law thus provides the investing public with the most protection where such protection is needed.

Substantive Registration Requirements. The new law's extensive disclosure requirements for registration by qualification constitute a most important addition to Indiana securities regulation. The disclosure provisions of the Uniform Securities Act are included in toto, and these are supplemented with additional requirements thought necessary by the draftsmen of the Indiana law. These new provisions, in conjunction with the requirement of a prospectus (discussed below), cannot help but result in increased investor information and thus greater potential investor protection.

Another significant change that the new law makes, and one which in effect changes the basic philosophy of Indiana blue sky regulation, concerns the substantive standards on the basis of which the Commissioner may either issue a stop order denying the effectiveness of a regis-

27. IND. ANN. STAT. § 25-865 (Burns Supp. 1962). For a discussion of § 304, see text following note 133 infra.
28. The disclosure requirements which must accompany an application for registration by qualification are set forth in IND. ANN. STAT. § 25-859(b) (Burns Supp. 1962).
tration statement or suspend or revoke an already effective statement. Although in the new law the substantive standards applying to all three such actions by the Commissioner are identical, the old law provided separate substantive grounds for the denial of registration as compared to a suspension or revocation of an existing registration. For that reason, they are dealt with separately in the following discussion.

The old Indiana Securities Law provided as a basis for denying registrations the following substantive standards:

If upon examination of any application the Commissioner shall find that the proposed plan of business of the issuer and the terms of the securities to be issued by such issuer are not unfair, unjust, or inequitable, that the enterprise or business of the issuer is not based upon unsound business principles, that the issuer intends to fairly and honestly transact its business, and that the securities it proposes to issue and the methods to be used by it in issuing and disposing of them are not such as would be fraudulent or would work or tend to work a fraud upon the purchaser . . . [he shall then register the securities.]

The Commissioner was also empowered to limit the amount of commissions charged and to limit the amount of securities issued at any one time by any one issuer. The above statutory language clearly indicates the extensive discretion which the Commissioner had at his disposal under the old law. The terms “unjust,” “unfair” and “inequitable” provide extremely broad standards. The Commissioner was in effect charged with the duties of an investment advisor for the people of Indiana. By looking at the “honesty” of the issuer and the “soundness” of his business, the Commissioner had the burden of deciding upon the investment quality of the proposed security.

The substantive registration standards found in the new Indiana law not only constitute a major change from the old Indiana law, but they also differ from the Uniform Securities Act. The relevant substantive standards in the Uniform Act under which a Commissioner is empowered to deny the effectiveness of a security registration are as follows:

306(a) (A) the registration statement . . . is incomplete . . . or contains any statement which was . . . false or misleading . . .
306(a) (B) any provision of this act or any rule . . . has been wilfully violated, in connection with the offering . . .

29. Ind. Acts 1937, ch. 120, § 8. (Emphasis added.)
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306(a)(E) the offering has worked or tended to work a fraud upon purchasers or would so operate;
306(a)(F) the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options. . . .

These standards are provided by the Uniform Act in place of the vague "fair, just and equitable" standards found in many of the older state laws, including the old Indiana law. The most important of the above standards, section 306(a)(E), is explained by the draftsmen of the Uniform Act as follows:

This clause [306(a)(E)] . . . is the one which gives the Administrator the greatest amount of discretion. . . . Clause (E) is not meant to be as broad as the old "sound business principles" standard . . . or the "fair, just, and equitable" standard. . . . Somewhere between the narrow limitation of common-law deceit and the opposite extreme of permitting the Administrator to substitute his business judgment for the registrant's, a degree of flexibility seems to be essential. Substantially the Clause (E) standard is today universal or almost so. It could not be deleted . . . without going over to a purely disclosure philosophy—which is simply not the philosophy of the overwhelming majority of the blue sky laws. . . .

The basic philosophy or approach of the Uniform Act is thus made clear. The Commissioner is not meant to have the great amount of discretion that he has traditionally been given by the older state blue sky laws, but he is meant to have enough discretion to properly carry out the anti-fraud purpose of the act and to keep the act from constituting one of mere "disclosure" philosophy.

It is therefore highly significant that the new Indiana Securities Law, which is identical in all other respects to the Uniform Act in the substantive standards which it establishes for the denial of a registration statement, completely omits section 306(a)(E). Indiana blue sky

30. Loss & Cowett 328-29. (Emphasis added.)
32. It is interesting to note that the Indiana draftsmen found reason to include an identical clause elsewhere in the new law. Witness § 102(b)(3)(C), concerning transactions exempted from registration requirements:
The Commissioner may revoke the exemption afforded by this subsection with respect to any securities by issuing an order to that effect if he finds that the further sale of such securities in this state would work or tend to work a fraud
regulation has thus completed nearly a full circle in its approach to investor protection. It not only steps down from its old extensive-discretion "investment merit" philosophy to the specific standards and moderate discretion level of the Uniform Act, but it goes one step further and approaches the level of a mere full disclosure philosophy. Additional evidence of this transition is found in section 503(g) of the new law:

All provisions of this act . . . shall be liberally construed to the end that the practice or commission of fraud may be prevented, [and the] disclosure of sufficient and reliable information in order to afford reasonable opportunity for the exercise of independent judgment of the persons involved may be assured. . . .

The new law thus makes clear its policy: Judgments of economic value are to be made by informed investors in a market policed of fraud rather than by advance authoritative selection. The development of this policy in Indiana gains additional significance when it is considered that, in spite of the Uniform Act, the number of states with "some sort of 'fair, just and equitable' standard" is actually growing.

The new law's substantial narrowing of the Commissioner's discretionary authority has not left him entirely barren of power to prevent the sale of securities which he personally feels are especially questionable. The discretionary judgment available under section 206(a)(E) of the new law (section 306(a)(F) of the Uniform Act) with regard to the unreasonableness of underwriters' and sellers' discounts, commissions, options and promoters' profits or participation is more than just an effective means of preventing watered stock. Almost all speculative offerings represent promotional efforts on the part of someone who would not have undertaken to distribute the offering unless the prospect of reward for the promotional services was lucrative. Thus in most cases the inherent nature of promotional offerings automatically subjects such


A revocation of a § 102(b)(3) exemption under § 102(b)(3)(C) would only mean that the seller would have to file a registration statement for the securities concerned. Coercion of this kind is not nearly as odious as a complete denial of registration resulting from discretionary judgment on the part of the Commissioner.

33. IND. ANN. STAT. § 25-859(g) (Burns Supp. 1962).

34. Loss, Developments in Blue Sky Laws, 14 BUS. LAW. 1161, 1162 (1959).


36. A provision whereby the Commissioner may require that securities be placed in escrow or where the proceeds from sale of securities may be impounded is found in the old Indiana law, in many of the other state blue sky laws and in the Uniform Securities Act. True to its overall policy of limiting the Commissioner's discretion, the new Indiana law does not contain such a provision.
issues to the standards of section 206(a)(E). Discretion under section 206(a)(A) as to whether statements made in a registration statement, prospectus or report are misleading can also be a powerful tool in the Commissioner's hands. Finally, it should be noted that mere disclosure requirements can, as proven by the effectiveness of the Federal Securities Act of 1933, result in a considerable measure of investment merit "qualification."

The same considerations elicited above as to denial of registration also apply in the case of a suspension or revocation of a security already effectively registered. The old Indiana law provided that a revocation or suspension could take place on an affirmative finding by the Commissioner: that the issuer of the security was insolvent or of bad business repute; that its affairs were in an unsound condition or not based upon sound business principles; that it was about to engage in fraudulent conduct; or that it had violated any provisions of the law or had in any way acted dishonestly. Here again are terms that gave extensive discretionary power to the Commissioner. The more restrictive provisions in the new Indiana law concerning standards for denial of security registration (previously discussed) apply identically to suspension and revocation of registration.

Prospectus Requirements. As previously indicated, when securities are registered under the "qualification" method, an extensive amount of information is required in the registration statement. Most of this information is also required to be included in an SEC-type prospectus which must accompany the registration statement when it is filed. A prospectus containing the same information must then be sent or given to those who buy the particular security or to whom a written offer to sell is made or to whom a written solicitation of an offer to buy is made before or concurrently with the occurrence of any of these events, whichever occurs first. This requirement that a prospectus be used, dictated by the new law's "full disclosure" philosophy of regulation, is not mandatory in the Uniform Securities Act and previously existed in Indiana only by virtue of an administrative rule.

There is no prospectus requirement for securities registered by notification, due to the strict standards such securities must meet. Nor does the new Indiana law require a prospectus for those securities regis-

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38. Ind. Acts 1937, ch. 120, § 10.
40. The Uniform Securities Act requires the furnishing of a prospectus only if the Commissioner so orders. UNIFORM SECURITIES ACT § 304(d).
41. Indiana Securities Commission Rule No. 2 (effective December 19, 1945).
tered by coordination since they have, in order to be eligible for registration, already met a federal prospectus requirement. In addition, preliminary summary prospectuses are no longer of any concern in Indiana with regard to Indiana registration and Commissioner approval.42 Such prospectuses are keyed directly to the SEC prospectus requirements by section 102(b)(12) of the new law, which exempts from registration requirements "any offer (but not a sale) of a security for which registration statements have been filed under both this [Indiana] act and the [Federal] Securities Act of 1933. . . ."43

Rules and Regulations. The Commissioner has authority, as he did under the old law, to "adopt such rules and regulations as may be necessary to carry out the provisions . . . ." of the securities law.44 The rules and regulations currently in force are five in number. The most important is a regulation fixing a minimum offering price of three dollars per share. Another regulation involves securities issued or issuable by a real estate investment trust. The Securities Division has adopted a statement of policy formulated by the Midwest Securities Commissioners Association regarding such securities. The statement establishes numerous rules and standards for real estate investment trusts and encourages compliance with the requirements by stating that noncompliance will cause an application to register the securities of such a trust to be "looked upon with disfavor."45

The three rules existing under the old law are still enforced, but the date on which they will officially be republished under the authority of the new law is not clear at the time of this writing. Rule number one concerns procedure, hearings and pleadings, and basically provides that the same means of procedure and pleadings will be followed before the Division that is required in practice in the circuit and superior courts. It also provides that applications for registration of securities and dealers and all applications for rulings shall be submitted on forms furnished by the Securities Division. Rule number two requires the use of a prospectus and provides how and when it shall be used. This rule is in serious need of revision due to the prospectus requirements that already exist within the text of the new law. Rule number three requires that when the Securities Division finds any security submitted for registration to be a speculative security, the issue shall be required by order to state on the front page of the prospectus or other advertising matter the words

42. Ind. Acts 1937, ch. 120, § 8A.
44. IND. ANN. STAT. § 25-869(f) (Burns Supp. 1962).
45. Statement of Policy Regarding Real Estate Investment Trusts, Securities Division, Secretary of State, Indiana.
"THESE ARE SPECULATIVE SECURITIES." Rule number three also requires that all sellers of such speculative securities shall inform all the purchasers thereof that such securities are speculative securities.

**Definitions and Exemptions**

*Definitions: “Offer,” “Sale,” “Transaction” and “Security.”* The definitions in the new law closely follow the definitions in the Uniform Act and represent a substantial improvement over the old Indiana law. Only those definitions which effect a significant change from the old law are here discussed.

The new law involves a considerable change in the area of corporate reorganizations. Whereas the old law substantially followed the "sale" theory in regard to the issuance or exchange of securities in connection with a corporate reorganization, the new law incorporates the SEC's traditional "no sale" theory. Specifically, transactions in connection with corporate reorganizations qualified as exempt transactions only if the plan of reorganization had first been approved by a federal court of competent jurisdiction. All other corporate reorganization securities were required to be registered by qualification pursuant to section 7 of the old law. Special administrative procedures were provided for the qualification process, including the submission of corporate reorganization plans to the Commissioner for his approval. The new law makes no reference in its exemption section to reorganization transactions but effectively removes such transactions from Indiana blue sky regulation (including antifraud provisions) by specifically excluding them, with exceptions, from constituting an "offer," "sale" or "transaction" under the section defining those terms:

"Offer," "sale" or "transaction"] do not include . . . (C) any act incident to a class vote by stockholders, pursuant to the articles of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or a sale of corporate assets in consideration of the issuance of securities of another corporation; or (D) any act incident to a judicially

47. Ind. Acts 1937, ch. 120, § 5(i).
48. Ind. Acts 1937, ch. 120, § 7. One exception to this section was provided by § 5(k) of the old law, which established certain exchanges of stock pursuant to statutory reorganizations as exempt transactions. The substantive requirements of this clause were so strict that practically the only exchanges which could qualify thereunder were certain stock dividends.
approved reorganization. . . .

The effect of this clause is that most corporate reorganization events do not under the new law come within the jurisdiction of the Securities Division if such events are effected pursuant to a class vote of shareholders or a judicially approved plan of reorganization.

Other exclusions from the terms "offer," "sale" and "transaction" under the new law include pledges or loans and stock dividends. The exclusion of stock dividends per se serves to clear up an ambiguity in the old Indiana law. Stock dividends thereunder were exempted only if they were paid out of net earnings or earned surplus, while section 12 of the Indiana General Corporation Act apparently permits a stock dividend to be paid out of appreciated surplus.

In contrast to the above exclusions from the terms "offer," "sale" and "transaction," the definitions of these terms were broadened by the new law to include a gift of assessable stock. They were also made more explicit in order to avoid the ambiguities and difficulties present in most of the state blue sky laws as well as the federal statute with reference to convertible securities and warrants or rights. The law now provides that there is always an "offer" of a security issued through a right or warrant or through a conversion privilege connected with a security of the same or another issuer. Hence the security so offered must be registered—unless some exemption is available—before the convertible securities or the warrants or rights are offered or distributed.

Although the definition of the term "security" was not significantly changed by the new law and it presently exists in substantially the same broad form as in the old Indiana law and the Uniform Act, much drafting attention was given to the definition with regard to the subject of

50. Ibid.
51. See IND. ANN. STAT. § 25-211 (Burns 1960).
52. For a detailed discussion of convertible securities, warrants and rights in relation to blue sky regulation, see Loss & Cower'te 345.
54. A common exemption is supplied by § 102(b)(11) which exempts offers or sales of securities "exclusively to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, non-transferable warrants, or transferable warrants exercisable within not more than ninety days of their issuance if no commission or other remuneration . . . is paid . . . for soliciting any security holder in this state." IND. ANN. STAT. § 25-855(b)(11) (Burns Supp. 1962).
55. IND. ANN. STAT. § 25-854(k) (Burns Supp. 1962). See Holloway v. Thompson, 112 Ind. App. 229, 42 N.E.2d 421 (1942). The court stated that the term "security" includes any form of instrument used to finance and promote enterprises and designed for investment, and also that in determining whether an instrument is a security it must be examined in the light of the purposes to be accomplished by its issuance as well as all the surrounding circumstances.
insurance contracts. The Uniform Act as originally approved in 1956 included variable annuity insurance contracts in the definition of "security" and excluded them from the exemption for insurance company securities. Both such references were made optional by the 1958 amendments to the act, however, and the act now makes no recommendation either way. The definition of "security" which existed in the draft of the new Indiana law as it was introduced into the Indiana Senate specifically excluded "any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period." This clause, which excludes orthodox insurance or annuity contracts from the definition of "security" and thus from blue sky regulation, was identical to the unamended version of the Uniform Act and was specifically phrased by the draftsmen of that act so as to include variable annuities within the definition of "security." Evidently disagreeing with the blue sky position overwhelmingly accorded to variable annuities, the Indiana Senate amended the above phrase by exchanging the word "money" for the words "a fixed number of dollars." This amendment effectively excluded variable annuity insurance contracts from the coverage of the Indiana Securities Law. In this respect, the new law also differs from the Uniform Act with regard to insurance company securities. The Uniform Act specifically exempts such securities from registration requirements, while the new Indiana law completely omits any reference to insurance company securities in its exemption section. This omission results in a continuance of previous

57. Senate Bill No. 170, 1961 Indiana Legislature.
58. See Loss & Cowett 350.
59. The SEC, the Supreme Court of the United States and a majority of the state blue sky administrators have taken the position that the term "security," and hence the scope of blue sky regulation, should include variable annuities. See SEC v. variable Annuity Life Ins. Co., 359 U.S. 65 (1959); Loss & Cowett 351; Report of Committee on Variable Annuities, North America Securities Administrators, 39 Proc. North Am. Sec. Admin. 45-48 (1957); CCH Blue Sky L. Rep. ¶ 4711.
61. The policy of leaving the regulation of variable annuities to the Insurance Department of Indiana seemed also to exist in the old law, which excluded from the definition of "security" any annuity contract issued by an insurance company qualified by said insurance department. Ind. Acts 1937, ch. 120, § 3(a).
62. Uniform Securities Act § 402(a)(5). The Uniform Act exempts insurance company securities from registration because the majority of the state blue sky laws exempt them. The rationale behind this exemption is that insurance companies are usually strictly regulated by other state agencies and thus there is no need to bring their securities under blue sky regulation. It may be noted that the Uniform Act exemption does not exclude the issuance or sale of such securities from the fraud provisions of that act.
Indiana policy of not exempting insurance company securities from registration requirements, while at the same time it does not detract from Indiana’s previous policy of excluding variable annuity contracts from blue sky regulation.

The important distinction between exemptions and exceptions from definitions should be kept in mind since the latter are completely excluded from the scope of the new law including antifraud and civil penalty provisions. Exceptions are made from the definitions of “agent,”“broker-dealer,”“sale,”“offer” and “security.”

Exempt Securities. The new law prescribes that any offer or sale of a security by any person is unlawful unless there is registration or an exemption from registration.

The exemption from registration provided by the old law for American governmental obligations is broadened by the new law to include Canadian governmentals and national obligations of other countries. The old law’s exemption for securities of financial institutions is redefined along the lines of the Uniform Act so as to make it clear exactly which securities and institutions are meant to be included. The old law’s exemption for public utility securities has been rephrased to include “any security issued or guaranteed by any railroad, other common carrier, public utility or holding company.” Such an issuer or guarantor must be subject to regulation or supervision as to the issuance of its own securities by a public commission, board or officer of the federal government or of any state or of any municipality located therein. The exemption for securities listed on the New York, American and Midwest stock exchanges (or any other exchange approved by the Commissioner) is clarified to include “any other security of the same issuer which is of senior rank; any security called for by [listed] subscription rights or warrants . . . or any warrant or right to purchase or subscribe to any

66. Ibid.
70. Any security issued by and representing an interest in or a debt of any bank, savings institution or trust company, federal savings and loan association, building and loan association authorized to do business in Indiana, federal credit union or any credit union, industrial loan association or similar association organized and supervised under Indiana law, or any corporation or organization whose securities are required by any other law to be approved by the Indiana Department of Financial Institutions or by any federal agency is exempted. Ind. Ann. Stat. § 25-855(a)(3) (Burns Supp. 1962).
of the foregoing.”

The exemption for securities issued by non-profit persons who operate for religious, educational, charitable, fraternal, social, athletic or reformatory purposes now includes persons organized as a chamber of commerce or trade or professional association. The nine month maturity limitation on the old law’s commercial paper exemption is extended under the new law to twelve months. A new exemption from security registration applies to any investment contract issued in connection with an employee’s stock purchase, savings, pension, profit sharing or similar benefit plan. This provision settles the problem in Indiana of whether such plans involve an offer of a security in the nature of an “investment contract” which must be registered. The old law’s exemption for securities issued by an agricultural cooperative association remains intact under the new law.

Exempt Transactions. The statutory scheme with respect to exemption from registration of secondary or non-issuer trading or distributions is necessarily elaborate. As stated by the draftsmen of the Uniform Act:

Perhaps the most difficult aspect of the area of securities registration, and often the most ambiguous under the present statutes, is the application of the registration provisions to secondary distributions or other transactions not involving the issuer of the security.

Section 102(b)(1) of the new law exempts from registration “any isolated non-issuer transaction, whether effected through a broker-dealer or not.” This exemption “takes care of Jones’s sale of X Corp. to Smith, but obviously does not cover something like the offering of Ford stock by the Ford Foundation.” Whether this exemption covers the multitude of transactions in between necessarily depends on the construction to be given to the word “isolated.” This question often need not be broached, however, due to various other exemptions in the new law.

76. The SEC takes a position contra to that of the new Indiana law, at least if participation is voluntary as to each employee and if he must contribute under the plan in order to participate. See I Loss, Securities Regulation 506-11 (1961).
78. The term “non-issuer” is defined in § 101(g) of the new law as meaning “not directly or indirectly for the benefit of the issuer.” Ind. Ann. Stat. § 25-854(g) (Burns Supp. 1962).
79. Loss & Cottrell 316.
81. Loss & Cottrell 317.
which make resort to the above exemption unnecessary. Thus, a non-issuer transaction or distribution which is something more than an "isolated" transaction may be exempted from registration: Under section 102(a)(5) if the security, right or warrant involved is listed on certain stock exchanges or is a security of the same issuer and senior in rank to the listed security; under section 102(b)(2) if the transaction is effected through a registered broker-dealer pursuant to an unsolicited order or offer to buy; under section 102(b)(6) if the transaction is by an executor, administrator, personal representative, receiver, trustee in bankruptcy, or one of the other persons there enumerated or anyone acting in a trust of fiduciary capacity where such transaction is effected pursuant to judicial authority or subject to judicial approval; under section 102(b)(7) if it is a transaction by a bona fide pledge; under section 102(b)(8) if the offer or sale is made solely to institutional buyers or broker-dealers; under section 102(b)(9) if the offer, sale, or issuance of corporate securities is made to certain persons or corporations connected with the selling corporation in the absence of any direct or indirect selling commissions or other remuneration; or under section 102(b)(10) if during the previous twelve months the offeror or seller has not directed offers to sell securities of the same class to more than twenty persons in the state of Indiana, excluding those persons receiving offers otherwise exempted and certain other persons, and if the buyer represents in writing that he is buying for investment purposes and not for resale and if no commission or other remuneration is involved.

A few of the exemptions listed above deserve further comment. The provision in the old law exempting sales to broker-dealers, banks, insurance companies and corporations has been expanded by section 102(b)(8) of the new law to include other "institutional" buyers such as in-

82. IND. ANN. STAT. § 25-855(a)(5) (Burns Supp. 1962). The stock exchanges which qualify are the New York, the American, the Midwest and any other exchange approved and designated by the Commissioner.
83. IND. ANN. STAT. § 25-855(b)(2) (Burns Supp. 1962). While such transactions were also exempted under the old law, the new law excludes the burdensome requirement that broker-dealers keep records of all such transactions for two years.
88. For a forceful argument in favor of the establishment of a specific number of persons to whom offers may be made in private offering exemptions, see Loss & Cowsx 369-74.
90. Ind. Acts 1937, ch. 120, § 5(f).
vestment companies and pension or profit-sharing trusts. The rationale behind such exemptions is that buyers of this type are "sophisticated" buyers who do not need the protection of security registration. In contrast, sales to corporations are no longer specifically exempted. A sale to a corporation is now exempt only if the corporation can qualify as a "financial institution" or "institutional buyer." This procedure seems more logical than the result of the old Indiana law, which in effect classified the owners of the incorporated corner grocery store with banks and insurance companies as "sophisticated" buyers.

The exemption in section 102(b)(9) is a carryover from the old Indiana Securities Law and is not found in the Uniform Act. The persons to whom securities may be sold without losing the exemption are directors, executive officers, administrators, managers or persons who work on a "full-time professional basis" and who have directly participated in the formulation or execution of corporate policy and who have met such a description for the past twelve months. Also exempted by this clause are sales to corporations affiliated with the issuing corporation and sales to any shareholder owning at least ten percent of the total combined voting power of all classes of the outstanding voting stock of the selling corporation or an affiliated corporation. The philosophy of this section is clear: Corporate insiders are deemed to be enough "in the know" as buyers that they do not need the protection of security registration.

Section 102(b)(10) furnishes much improved standards for the definition of a "private offering." The maximum of twenty offerees is not as low as it might seem. This limit does not include offers or sales to institutional buyers and securities dealers which are already exempted by section 102(b)(8). Also, there is no limit on the number of out of state offers that may be made as long as the total number of offerees "in this state" does not exceed twenty in number. While the Uniform Act provides that the Commissioner may, as to any security or transaction, increase or decrease the number of offerees permitted, the new Indiana law again imposes a restriction on the Commissioner's discretion by excluding any such provision.

The transaction exemption provided by section 102(b)(3) merits separate consideration. This section establishes a very important secondary or non-issuer distribution exemption, which is designed specifically to exempt "the sale by a registered broker-dealer, acting either as princi-

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93. Uniform Securities Act § 402(b)(9).
pal or agent, of securities theretofore sold and distributed to the pub-
lic . . . ” providing that specific statutory requirements are met.94 The
restriction of sales of outstanding securities to only those sales handled
by broker-dealers represents a narrowing of the similar but broader sec-
tion 402(b)(2) of the Uniform Act which exempts “any non-issuer dis-
tribution of an outstanding security” which meets specified require-
ments.95 The new Indiana law also departs from the Uniform Act with
regard to the specified statutory requirements mentioned above which
must be met before an outstanding security exemption may be had under
either act. The Uniform Act’s section 402(b)(2) requires that enum-
erated financial information about the issuer be published in a recognized
securities manual, or that the security have a fixed maturity or a fixed
interest or dividend provision and there has been no default within the
three preceding fiscal years. Indiana’s section 102(b)(3) is more re-
strictive than the Uniform Act and requires that the selling price be rea-
sonably related to the current market, that commissions not be in excess
of what is customary for similar securities, that the securities do not
constitute an unsold allotment in the original distribution of such securi-
ties, and that enumerated financial information on the issuer is published
in a recognized securities manual or is on file with the Securities
Division.96

An Indiana registration statement is effective for a minimum of
one year from its effective date.97 With regard to non-issuer distribu-
tions of securities of the same class as a registered security, the Uniform
Act provides an exemption from registration as follows: “all outstand-
ing securities of the same class as a registered security are considered to
be registered for the purpose of any non-issuer transaction. . . .”98 The
effect of this class registration technique is “that as long as a registra-
tion statement is effective, no matter who has filed it or how many units
of the class have been registered, all securities of the same class can be
legally traded by anybody as if they were registered.”99 This is true even
if the original registration was for a non-issuer distribution. Because of
the above, it is “immaterial whether the registration statement specific-
ally covers 100 shares or 1,000 shares.”100 The draftsmen of the new
Indiana law evidently do not agree with the draftsmen of the Uniform

98. Uniform Securities Act § 305(i).
100. Id. at 315.
Act that "when the Administrator [Commissioner] has permitted a registration statement to become effective, it seems perfectly safe to permit secondary trading in the same class of security without further ado for a period of at least one year."101 The class registration exemption for non-issuer trading provided by the Uniform Act is completely omitted from the new Indiana law. Thus if a non-issuer distribution by X of 10,000 shares of ABC common stock has been registered, a party other than X who desires to make a much smaller transaction in ABC common does not have a class registration exemption open to him. Assuming that no other registration exemption is available, X is required under Indiana law to register his proposed non-issuer distribution with the Securities Division. The narrowing by the new Indiana law of the Uniform Act's outstanding securities exemption and the complete omission of the Uniform Act's class registration exemption constitutes a substantial restriction on the freedom of security holders to conduct secondary trading without registration.

If no exemption is available for a non-issuer distribution, a special non-issuer registration statement must be filed. As in the case of a distribution for the account of an issuer, registration of a non-issuer distribution may be effected by coordination, by notification (which specifically provides for non-issuer distribution registrations)102 or as a last resort by qualification.

The problem of exempting occasional transactions by an issuer, as opposed to non-issuer trading, was not specifically dealt with by the old law but is given comprehensive treatment by the new law. Sales by an issuer to institutional investors and securities dealers are exempted under section 102(b)(8);103 sales by an issuing corporation of its own securities to persons or corporations connected with said corporation are exempted under section 102(b)(9)104 and offerings by an issuer to a limited number of people are exempted under the "private offering" exemption of section 102(b)(10).105 Indiana's previous exemption for offerings by an issuer to its existing security holders (usually offers of additional stock) applied only to closely held corporations.106 The new law's exemption in this area is broadened to include:

[A]ny offer or sale of securities exclusively to existing security holders of the issuer, including persons who at the time

101. Id. at 320.
102. See text following note 10 supra.
106. Ind. Acts 1937, ch. 120, § 5(h).
of the transaction are holders of convertible securities . . . or . . . warrants . . . if no commission or other remuneration (other than a standby commission) is paid or given for soliciting any security holder in this state.107

An exemption of this type is essential in order to accommodate corporations whose stockholders have preemptive rights.

The Uniform Act exempts preorganization subscriptions by a limited number of persons108 but Indiana's new law follows previous Indiana policy and omits any such exemption. This omission is not of great import, however, since the obtainment of preorganization subscriptions is normally exempted under the "offers made to a limited number of people" exemption of section 102(b)(10) of the new law.

Various other exempted transactions are found in the new Indiana law. These include underwriting transactions,109 public offerings of whole mortgages,110 offers made during an SEC waiting period,111 sales of interest in oil, gas or other mineral leases to a limited number of persons or in a limited amount112 and the deposit of shares under any voting trust agreement and the issue of voting trust certificates therefor.113

The new Indiana law provides, as did the old, that the exemptions given to the enumerated classes of exempt securities and transactions114 relate only to the registration of securities requirement,115 and that the actual carrying out of an exempted transaction is fully covered by the antifraud116 and civil penalty117 provisions of the law.

Denial and Revocation of Exemptions. With regard to the denial and revocation of security and transaction exemptions, the Uniform Act provides that a Commissioner may, after proper procedural steps have been taken, "by order deny or revoke any exemption [for any of the exempted transactions and two types of exempted securities] . . . with respect to a specific security or transaction."118

Summary denials or revocations pending final determination of proceedings under the denial and

107. IND. ANN. STAT. § 25-855(b) (11) (Burns Supp. 1962). A "standby" commission is one paid to underwriters to take up an issue when an offering to the existing security holders of a corporation has not been entirely successful.
108. UNIFORM SECURITIES ACT § 402(b)(10).
111. IND. ANN. STAT. § 25-855(b) (12) (Burns Supp. 1962).
112. Fifteen persons or $25,000. IND. ANN. STAT. § 25-855(b) (13) (Burns Supp. 1962).
113. IND. ANN. STAT. § 25-855(b) (14) (Burns Supp. 1962).
118. UNIFORM SECURITIES ACT § 402(c).
revocation subsection are also provided for. No order may operate retroactively.

By comparison, Indiana's new law, in an apparent attempt to follow its policy of limiting the discretionary powers of the Securities Commissioner, takes away—with one exception— all power on the part of the Commissioner to revoke an exemption and merely provides in section 102(c) that "the Commissioner shall have authority to consider and determine whether any proposed sale, transaction, issue or security is entitled to an exemption. . . ." Any interested party may request such a ruling by submitting a verified statement of facts and paying a filing fee. Any exemption order entered under this section "shall be binding upon the Commissioner and upon all interested parties, provided that the proposed sale, transaction, issue or security when consummated or issued conforms . . . with the facts as . . . submitted."

Thus in Indiana the Commissioner of Securities cannot himself initiate the procedure under which he is empowered to determine whether a particular security or transaction is entitled to an exemption. If a party, even one whose right to an exemption is highly questionable, refuses to approach the Commissioner for a ruling and begins trading, the Commissioner is powerless to deny the exemption or even to initiate a summary revocation and investigation. He must instead resort to a cease and desist order or an injunctive proceeding as discussed below in order to forestall the trading of the questionable securities. If a party's right to an exemption is statutorily clear but his proposed or actual dealings are of a nature whereby the purpose of the securities statute will be or is being defeated—indeed a possible situation—the Commissioner is again powerless to deny or revoke the exemption.

When allegedly "exempted" trading is taking place but is for one reason or another threatening harm to the public, the Commissioner needs to be able to act quickly or else most of the harm will be done before he has had a chance to engage the criminal machinery of the securities law. Since the Commissioner has no power of summary revocation, he must resort in such cases to section 505 of the new law, which provides as follows:

119. "The Commission may revoke the exemption . . . afforded by [subsection 102(b) (3)] . . . with respect to any securities by issuing an order to that effect if he finds that the further sale of such securities in this state would work or tend to work a fraud on purchasers thereof." Ind. Ann. Stat. § 25-855(b) (3) (Burns Supp. 1962).


121. Ibid.
Whenever it appears to the Commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act . . . the Commissioner may investigate and may issue such orders and notices . . . as are commonly known as cease and desist orders and notices, and . . . bring action . . . to enjoin such person . . . from continuing or doing any act or acts furthering such violation of this act.\textsuperscript{122}

If the offending seller is a broker-dealer or agent, continued selling activity in the face of a cease and desist order subjects him to possible suspension or revocation of his registration under section 304(a)(2).\textsuperscript{123} If the offending seller is a party other than a registered broker-dealer or agent, a cease and desist order is merely the Commissioner's method of laying the groundwork for a criminal prosecution by informing a party that he feels the party's actions are in violation of the securities law and from that point on the party will be considered as having "intended" his actions should they later prove to be a violation. If the Commissioner clearly thinks that a party is not entitled to an exemption under which the party is selling unregistered securities, he may bring suit to enjoin the party from further sales activity. Upon the occurrence of such an event, section 102(c)\textsuperscript{124} of the law becomes completely irrelevant and the basic issue of whether the defendant is entitled to an exemption becomes a judicial rather than an administrative problem.

The Indiana Commissioner is thus, in the absence of a request for an exemption ruling, forced to employ the judicial processes of a circuit or superior court when he wishes to contest the apparent assertion of a security or transaction exemption.\textsuperscript{125} Regardless of the discretion thereby accruing to the Commissioner, the Uniform Act's provision for administrative revocation of a security or transaction exemption (with respect to a specific situation) seemingly should not have been excluded from the new Indiana law. The practical advantages resulting from such a provision would appear to far outweigh any potential abuse of discretion that its inclusion in the new law would permit.

\textsuperscript{123} Ind. Ann. Stat. § 25-865(a)(2) (Burns Supp. 1962). "The Commissioner may by order deny, suspend, or revoke registration of any broker-dealer or agent if he finds that the order is in the public interest and that the . . . registrant . . . (2) has wilfully violated or wilfully failed to comply with any . . . rule or order under this act. . . ."
\textsuperscript{125} With the one exception cited note 119 supra.
Section 102(c) also poses another problem. Although notice under section 102(c) need only be given to those interested parties whom the Commissioner deems proper, the resulting exemption order is purportedly binding on all interested parties. Such a position is not only inconsistent within itself but it also makes the problem of seller liability depend on the vague question of who is or is not an "interested person." This problem is deftly handled by the Uniform Act which provides that "no person may be considered to have violated" the section making it unlawful to offer or sell unregistered and unexempted securities "by reason of any offer or sale effected after the entry of an order [denying or revoking an exemption] . . . if he sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the order." 126

Registration of Broker-Dealers and Agents

Section 301 of the new law makes it unlawful for any person to transact business as a broker-dealer or agent unless he is registered. 127 The terms "broker-dealer" and "agent" are defined much more specifically than they were in the old law. 128 Whereas the old law required an issuer selling his own securities without the intervention of a middleman to register also as a broker-dealer, the new definition of broker-dealer does away with this unnecessary duplication. Supervision over such an issuer is already provided in that the issuer's securities must be registered and also in that any employee of the issuer who does any selling must register as an agent. Specifically excluded from the definition of "broker-dealer" are agents, banks and out of state persons dealing through such in-state issuers as broker-dealers, banks and other specified financial institutions. 129 Although not specifically stated, it is obvious that the broker-dealer definition does not include an ordinary investor who buys and sells with considerable frequency. 130

The term "agent" is made more specific by the new law and does not include persons who effect transactions involving some of the specifically exempted securities; nor does it include persons who effect specifically exempted transactions. 131 Since this exclusion does not in-

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126. Uniform Securities Act § 402(c).
129. Ind. Ann. Stat. § 25-854(c) (Burns Supp. 1962). The new law omits Uniform Act § 401(c) (4) (B) which provides in effect that a dealer may engage in a limited number of transactions in a state wherein he does not have a place of business without being obliged to register as a dealer in that state.
130. With respect to this distinction, see II Loss, Securities Regulation 1295-99 (1961).
clude all exempted securities, a person representing an issuer of governmental securities (securities exempted from registration requirements) is not required to register as an agent, while the same person if involved with a security listed on a national stock exchange (also an exempted security) must register as an agent. This delineation successfully requires certain persons to register as agents even though the securities in which they are dealing are exempted from registration requirements. The new law also makes it clear that the employees of an issuer, if they are only indirectly involved in transmitting offers, need not register as agents. Whether a particular individual who represents a broker-dealer or issuer is an "agent" or is himself a "broker-dealer" is presumed to depend much upon the same factors which create an agency relationship at common law.

The provisions in the new law which relate to denial, suspension or revocation of the registration of broker-dealers and agents somewhat curtail the ease with which the Commissioner was able, under the old law, to prevent registration of these persons or withdraw their already effective registration. The vague substantive standards which gave the Commissioner much discretion have been replaced with more concise and appropriate standards, with the exception of section 304(a)(7), which provides that a registration may be denied, suspended or revoked if the applicant or registrant "has engaged in dishonest or unethical practices in the securities business. . . ." The net effect of the new standards is a definite improvement in the manner of informing those who deal in securities of what standards they must meet in order to retain their registration "license" and thus their livelihood, with little or no resulting detriment to overall investor protection.

The old Indiana law required security dealers to file, as a prerequisite to registration, a surety bond in the sum of 25,000 dollars. All such bonds were to be conditioned upon the faithful accounting of all securities entrusted to the registrant, and were for "the use and benefit of all persons damaged by the wrongful conversion of any securities by the registrant." Stock exchange members or members of the National Association of Securities Dealers, who are also required to file a surety bond, were exempt from the above requirement. The new Indiana law requires a 25,000 dollar bond regardless of NASD membership except that "no such bond may be required of any broker-dealer whose net capital . . .

132. Ibid.
134. Ind. Acts 1937, ch. 120, § 12.
136. Ind. Acts 1937, ch. 120, § 11(2).
exceeds $25,000." An appropriate deposit of cash or securities is also acceptable in lieu of the bond requirement. The significant difference between the two bond requirements is that the bond under the new law is subject to suit thereon by any person who has a cause of action under section 507, the broad civil penalty section of the new law, rather than being confined as under the old law to litigation involving a conversion of securities entrusted to a dealer.138

Due to the new cash or securities deposit option and the new bond liability feature there has been an almost universal refusal of the major bonding companies to write surety bonds of the type required by the new law. The practical result of this situation is that a person whose net worth is such that he cannot afford to pledge 25,000 dollars in cash or securities is effectively precluded from obtaining registration as a broker. This situation does not seem to have surprised the Indiana securities community, and thus presumably was actually intended by the draftsmen of the new law to be the result of the provisions discussed above.

An additional aspect of blue sky regulation, now required by approximately twenty states, concerns the registration of investment advisors. The Uniform Securities Act subjects investment advisors to the same general type of regulation as is applicable to agents and broker-dealers.139 Although the new Indiana Securities Law did not follow the Uniform Act in this respect, investment advisors are federally regulated by the Investment Advisors Act of 1940.140 If the problem of fraudulent practices by investment advisors ever reaches a significant level in Indiana, their regulation could easily be incorporated by amendment into the new law.

**Fraudulent and Other Prohibited Practices**

Section 401, the concise antifraud provision of the new Indiana law,141 replaces the long and detailed list of unlawful fraudulent practices which existed in the old law.142 Substantially the same as the SEC's Rule X-10B-5,143 section 401 includes the application of fraud in the purchase as well as the sale of a security:

> It is unlawful for any person in connection with the offer, sale

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137. **IND. ANN. STAT.** § 25-863(b) (Burns Supp. 1962). The term "net capital" may be defined by the Commissioner.

138. The new bond requirement also specifies a two year statute of limitations for suit on a bond.

139. **UNIFORM SECURITIES ACT** § 201(c).


142. Ind. Acts 1937, ch. 120, § 18.

143. 17 C.F.R. § 240.10(b)-5 (1949).
or purchase of any security, either directly or indirectly, (1) to employ any device, scheme or artifice to defraud, or (2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of circumstances under which they are made, not misleading, or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.  

This improved section accomplishes the desired antifraud result and yet does not narrow the scope of unlawful fraudulent conduct. The sanctions for conduct made unlawful by this section, from which there is no exemption, include administrative proceedings of various types, judicial injunctions and criminal prosecution in the event of a wilful violation.

Criminal penalties are imposed by the new law for wilful “fraudulent practices” (as defined under the section 101(d) definition of fraud), engaging as a broker-dealer or agent without registering, selling unregistered and unexempted securities, knowingly making false representations of material facts to the Securities Division and wilfully, wantonly or knowingly violating or aiding and abetting any violation of any provision of the law. Any one of three possible sanctions may be imposed: (1) not less than one or more than five years in the state prison; (2) imprisonment in the county jail or state penal farm for any period not exceeding one year and fines not exceeding 500 dollars; or

145. The draftsmen of the Uniform Securities Act state: “Although most of the state fraud provisions are considerably more verbose, some hundreds of decided cases under the federal provisions demonstrate exclusively that the language of . . . [this section] is sufficiently comprehensive.” Loss & COWETT 251.
149. Ind. Ann. Stat. § 25-872 (Burns Supp. 1962). The § 101(d) definition of “fraud” in the new law requires an intentional misrepresentation of a material fact while the old law specified an intentional misrepresentation of merely a relevant fact. Although the new law’s definition remains broader as a whole than the common law definition of “fraud,” it nevertheless represents a contraction of the old law’s “relevant fact” language.
(3) fines of not more than 2,000 dollars.\textsuperscript{150}

Although there is no civil liability for a violation of section 401, provision is made in section 507 (discussed below) for civil liability in the case of sales made through fraud or misstatement.\textsuperscript{161} Sections 401 and 507 thus retain the anomalous policy of the old Indiana law with regard to the liability of a fraudulent purchaser, i.e., such persons are subject to statutory criminal liability but not to statutory civil liability. A fraudulent purchaser does, however, still face civil liability under the Indiana common law remedies of deceit, rescission and damages for fraud. In addition, SEC Rule X-10B-5 would become relevant if the mails or other interstate means of commerce were involved.\textsuperscript{162}

The new law does not change the long-existent Indiana common law civil liability rule that corporate insiders have no obligation to make affirmative disclosure of circumstances especially within their knowledge when purchasing from existing stockholders.\textsuperscript{163} Such "insiders" may now, however, if their non-disclosure results in a half truth, be subject to criminal liability under clause (2) of section 401 of the new law: "[I]t is unlawful . . . to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they are made, not misleading. . . ."\textsuperscript{164} This clause is designed not only to emphasize that the fraud aspects of the law are not limited to common law deceit, but also to remove any doubt as to whether a "half-truth" is a lie, a doubt which was well founded under the old law. Whether the new law's imposition of criminal liability on silent corporate insiders who purchase securities under a "half-truth" will encourage a judicial alteration of the Indiana common law rule regarding the civil liability of such purchasers remains to be seen.\textsuperscript{165}

Section 501 provides that it is unlawful to file any document with

\textsuperscript{150} Ind. Ann. Stat. § 25-872 (Burns Supp. 1962). An exception applies to the "any violation of any provision" clause, which provides as a sanction a fine of not more than $500, to which may be added imprisonment in the county jail or state penal farm for a period not exceeding six months.


\textsuperscript{152} 17 C.F.R. § 240.10(b)-5 (1949). Regarding federal civil liability of purchasers, "the lower federal courts have uniformly implied a civil cause of action against fraudulent buyers under the SEC rule. . . ." Loss & Cowett 252.

\textsuperscript{153} See Board of Comm'rs of Tippecanoe County v. Reynolds, 44 Ind. 509 (1873). See generally Ryan, Should Tippecanoe County Commissioners v. Reynolds be Overruled?, 16 Ind. L.J. 563 (1941). In regard to federal liability in this area, see note, Purchaser's Duty to Disclose Under Securities and Exchange Commission Rule X-10B-5, 40 Minn. L. Rev. 62 (1955).


\textsuperscript{155} The Tippecanoe decision, supra note 153, has never been overruled nor seriously questioned by the courts and is apparently still the rule in Indiana.
the Commissioner or in any proceeding under the law any statement which is at the time and in the light of the circumstances under which it was made, false or misleading in any material respect.\textsuperscript{156} Section 502 provides that it is unlawful to make to any prospective purchaser, customer or client any representation alleging that a document filed with the Commissioner is true, complete and not misleading because of the fact that a security or person is effectively registered and also that:

Neither any such fact, nor the fact that an exemption or exception is available for a security or a transaction, means that the Commissioner has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security or transaction.\textsuperscript{157}

Criminal liability applies to both section 501 and section 502, and the civil liability provisions of section 507 are made specially applicable to section 502.

\textbf{Civil Liability}

An important feature of any blue sky law is the implementation of civil liability. Section 507, the civil penalty section of the new Indiana law,\textsuperscript{158} is a copy of the Uniform Act and as such is a considerable improvement over the "Sales Voidable by Purchaser" section of the old law.\textsuperscript{159} Clause (a)(1) of section 507 provides that actionable fraud is not needed for a cause of action by the purchaser if it can be proven that the seller has by an offer or sale of a security violated any of the provisions of the act which deal with security and broker-dealer registration, prospectus requirements or misrepresentation involving registration or exemption. Civil liability is imposed under this clause when an offer violates one of the specified provisions even though the sale does not. Thus, if a non-exempted offer is made before the effective date of a security registration and the offer results in a sale, the buyer may recover even though no contract was made until after the effective date. This imposition of civil liability should serve as an effective sanction in enforcing the prohibition against pre-effective offers (or pre-filing offers in the case of securities registered under the federal statute, in which event section 102(b)(12) exempts offers while the registration statement is pending).

\textsuperscript{159} Ind. Acts 1937, ch. 120, § 19.
Clause (a)(2) of section 507 creates a civil sanction for misleading statements or omissions in security sales as follows:

Any person who offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him. . . .

Since the criminal provision against deceptive activities (section 401) is broader, the civil section's emphasis on statements or omissions indicates that its purpose is only to compel full disclosure by sellers.

The old Indiana law created private rights of action by providing that:

Every sale . . . made in violation of any of the provisions of this act shall be voidable at the election of the purchaser and the person making such sale . . . shall be . . . liable to such purchaser . . . upon tender to the seller of the securities sold . . . for the full amount paid by such purchaser. . . .

Since the old law furnished the remedy of rescission upon the violation of any provision of the act, and the new law provides for rescission only upon the violation of specific sections, the new law would seem to make the remedy of rescission somewhat less easily obtainable. Much can be said in favor of the restriction. Sellers of securities are now provided with a precise definition of their liabilities and the areas in which these liabilities may arise. In support of securities regulation which does not indiscriminately give a remedy of rescission for any and all minute "seller" violations, Professor Loss has said "there can be little justification for a series of provisions which make it impossible for a legitimate seller to order his business in such a way that the creation of a contingent liability will be a relatively rare event." Section 507(h) makes it very clear that a court is not to imply any civil remedies for an unlawful violation of any provision unless such a remedy is specifically pro-

162. Loss & Cowett 131.
vided: "[T]his act does not create any cause of action not specified in this section. . . ."

Relief under the old act was burdened with a requirement of tender and was thus nothing more than a statutory recision action—with no provision for damages save court costs and counsel fees. If the purchaser seeking relief had disposed of his securities and could not restore them to the seller, he was remediless because of the "tender-back" requirement. A purchaser thus had no statutory redress if he failed to comply or was unable to comply with the traditional elements of rescission. The new Indiana law explicitly provides not only for rescission but also for damages as an alternative ground for relief. The measure of damages is the consideration paid to the seller less the value (not the price) of the security when the purchaser disposed of it, a measure which accomplishes the substantial equivalent of rescission for a purchaser who is unable to tender back his securities. An additional facet of the "tender" problem concerns the question of whether the power of rescission "runs" with the security, i.e., whether a purchaser from the first buyer of unregistered securities may tender back the securities to the original seller. The language of section 507(a)(2) of the new law codifies the Indiana common law position that such causes of action are not transferable and are available against the original seller only in favor of the first person to whom the seller sold the securities in question.

Two important limitations imposed on the civil liability section of the new law provide that the seller has two statutory defenses that he may assert: (1) that he did not know, and in the exercise of reasonable care, could not have known, of an alleged untruth or omission and (2) that the buyer knew of the alleged untruth or omission. The first defense introduces an element of scienter into the rescission remedy provided by the new law. This introduction of a non-innocent misrepresentation requirement serves to make the statutory remedy narrower in one sense than that of common-law rescission—which is satisfied by an innocent misrepresentation as long as it is material and there is reliance. The second defense is not intended as a requirement that the buyer-plaintiff prove "reliance" on the untrue statement or the omission. He need only show that he did not "know of" the untruth or omission.

164. See Holloway v. Thompson, 112 Ind. App. 229, 42 N.E.2d 421 (1942) (tender back of the securities is needed for rescission).
168. See Loss & Cowert 392.
Since this is presumably a lesser burden than the common-law requirement of proved “reliance,” this second defense broadens the statutory remedy and thus affords the buyer an advantage over common-law recission.

The statutory joint and several liability of officers and directors of a firm which directly or indirectly controls a seller who is liable under the act or of any person who has substantially aided in a fraudulent sale has also been somewhat modified under the new law. Such non-selling persons are given by the new law a defense of “good faith” or lack of knowledge.

They will not incur civil liability under the joint and several provisions if they sustain a burden of proof that they did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. In addition, the new law provides for contribution among such persons, a benefit not obtainable under the old law.

Section 507 provides that suit may not be brought thereunder more than two years after the contract of sale. If the common law elements of fraud are present, this provision would seemingly not supercede the statutory right to initiate a common law deceit action any time within six years from the date of an illegal sale or contract to sell. Section 507 also provides a second type of limitation that enables a violator to extinguish his contingent liability or substantially reduce the period for suing by making a rescission offer—provided that it is a written offer, made before suit, “to refund the consideration paid together with interest at six per cent per year from the date of payment less the amount of any income received on the security. . . .” Such an offer prevents a buyer from bringing any action whatsoever under section 507 if at the time of the offer (1) the buyer owns the security and fails to accept the offer within thirty days or (2) the buyer no longer owns the security and fails to reject the offer in writing within thirty days.

Conclusion

Improved substantive standards, increased disclosure requirements, a much needed shift of qualificative emphasis, more precise exemptions and definitions, a closer tie-in with federal securities legislation and pro-


170. IND. ANN. STAT. § 25-873(b) (Burns Supp. 1962).
171. Ibid.
procedure and a decided shift in blue sky philosophy constitute the major changes promulgated by the new law.

Indiana's adoption of much of the Uniform Securities Act has enabled not only Indiana but also the securities industry to benefit in part from the scholarly study and excellent draftsmanship which went into the formulation of that act. Some of the provisions of Indiana's old law, especially those having to do with administrative matters, were retained in the new law; while several provisions in the new law were newly drafted by its draftsmen and do not exist in either the old law or the Uniform Act. Indiana's new law is thus specially tailored to the contemporary needs, as envisioned by its draftsmen, of Indiana securities regulation.
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