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A PROSPECTUS ON THE MARYLAND SECURITIES ACT

By Decatur H. Miller*

HISTORY AND BACKGROUND OF THE MARYLAND SECURITIES ACT

The history of Maryland blue sky legislation begins in 1920, when a law designed to give the Attorney General the power to investigate and deal with frauds in the offering and sale of securities was enacted. This law was expanded in 1937 to provide for limited licensing of persons engaged in the securities business. For twenty-five years this statute, substantially unchanged, provided the only form of securities regulation in this state. A summary of its provisions is sufficient to raise serious doubts about its adequacy.

First, although it required persons engaged in the business of selling securities to register with the Attorney General, no provision was made for the denial of applications for registration unless they were formally defective; there was no requirement that the information in registration files be kept up-to-date; and most importantly, no specific obligations were imposed upon registrants as to the conduct of their business. Secondly, the law gave the Attorney General the power to investigate possible frauds in the sale of securities, and, if he were satisfied that a fraudulent scheme was being practiced, he could issue an order directing the offender to cease and desist therefrom. However, the law nowhere made it a crime to defraud in-

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1 The term "blue sky" refers to the insubstantiality of some securities or speculative schemes which have no more basis than so many feet of 'blue sky.' Hall v. Greiger-Jones Co., 242 U.S. 539, 550 (1917).
2 Md. Laws 1920, ch. 552.
4 § 13. Expressly excluded from the registration requirement were banks, trust companies and member firms of national securities exchanges.
5 § 16.
6 § 17.
vestors, nor did it require any kind of registration of securities or any particular form of disclosure of material facts to prospective investors.

During the 1930's the federal government entered the field of securities regulation, and for a time its activity alleviated the need for a more comprehensive blue sky law in Maryland. Some understanding of its role is necessary to an appreciation of any state securities law. The Securities and Exchange Commission is the federal agency charged with the enforcement of the securities laws of the United States. It regulates through the registration requirements of the Securities Act of 1933 the distribution of securities in interstate commerce or through the mails. Under the Securities Exchange Act of 1934, it regulates and supervises the regulation of national securities exchanges and the national over-the-counter market and brokers and dealers doing an interstate business.

By virtue of sections 6 and 15A of the Exchange Act, a good deal of regulatory authority is granted to the national securities exchanges and the National Association of Securities Dealers, Inc.

In 1954 a really monumental study of state securities regulation was begun at the Harvard Law School by Professor Louis Loss and Edward M. Cowett. Out of this study came Loss & Cowett, *Blue Sky Law* (1958). This treatise, which also contains the text of the Uniform Securities Act, together with the Official Comments and the Draftsmen's Commentary on the Act, is an invaluable aid in interpretation of the Uniform Act, from which the Maryland Securities Act is derived.

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7. 15 U.S.C.A. §§ 77a-77aa (1933). Under the Securities Act of 1933, offerings of securities by an issuer, underwriter, or dealer, involving the use of the facilities of interstate commerce or the mail, must be registered and sold by means of a prospectus. 15 U.S.C.A. § 77e (1933). Among the exemptions from this requirement is one for offerings made solely to the residents of a single state. 15 U.S.C.A. § 77c(a) (11) (1933).

8. 15 U.S.C.A. §§ 78a-78jj (1934). Among other things, the Securities Exchange Act of 1934 requires the registration of brokers and dealers (other than those whose business is exclusively intrastate) and provides for standards of business conduct and financial responsibility to be met by such persons. The Act does not require the registration of salesmen employed by brokers and dealers.

9. Section 5 requires the registration of securities exchanges, and Section 6 requires registered exchanges to enforce compliance with the Act by their members. Registered exchanges are permitted to adopt rules not inconsistent with the Act and to enforce them against their members. 15 U.S.C.A. §§ 78e, 78f (1934). The principal exchanges require member firms to meet certain net capital standards and examine the salesmen employed by member firms.

10. The National Association of Securities Dealers, Inc. ("N.A.S.D.") is the only national securities association registered under Section 15A, 15 U.S.C.A. § 78o-3 (1934). Its membership consists of over 80% of the brokers and dealers registered with the S.E.C. Members are subject to its Rules of Fair Practice, violation of which can result in severe penalties. The N.A.S.D. conducts qualification examinations for salesmen employed by its members and inspections of the books and records of its members.

11. The report of this survey is contained in Loss & Cowett, *Blue Sky Law* (1958). This treatise, which also contains the text of the Uniform Securities Act, together with the Official Comments and the Draftsmen's Commentary on the Act, is an invaluable aid in interpretation of the Uniform Act, from which the Maryland Securities Act is derived.
study came the Uniform Securities Act, which in 1956 was approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association. By 1961 the Uniform Act, or major parts of it, had been enacted in fourteen states.

In 1961 a committee was appointed to study the Maryland situation and to report on the adequacy of the Maryland Blue Sky Law. This committee found that the Blue Sky Law was deficient and proposed the enactment of a version of the Uniform Securities Act. The draft bill was introduced in the 1962 Session of the General Assembly, was passed with only minor amendments and without substantial opposition, and took effect on June 1, 1962. The Act created a new administrative agency within the State Law Department known as the Division of Securities. The agency is headed by the Securities Commissioner, who is advised by a committee of lawyers and persons in the securities business called the Maryland Blue Sky Advisory Committee.

The Maryland Securities Act is an attempt to do four things. First, it imposes a standard of honesty and truthfulness upon every transaction involving an offer to buy or sell a security, regardless of the size of the transaction or the sophistication (or lack of it) of the parties. This standard is implicit in the anti-fraud provisions. Secondly, it provides for the regulation of those engaged in the business of buying and selling securities. Thirdly, it regulates certain offerings of securities with the principal purpose of assuring that full disclosure of the material facts

13 Alabama, Alaska, Arkansas, Colorado, Hawaii, Indiana, Kansas, Kentucky, Montana, New Jersey, Oklahoma, South Carolina, Virginia and Washington. Since 1961 the Act has been adopted in Utah, and a substantial part of it has been adopted in Nevada.
15 Report of Committee to Study the Administration of the Blue Sky Law of Maryland (1961). This report also contains helpful commentary on the bill which with some alteration became the Maryland Securities Act.
18 Supra, n. 17, § 30.
19 Supra, n. 17, § 39.
20 Supra, n. 17, §§ 13, 34(a)(2).
21 Supra, n. 17, §§ 15-18, as amended by Md. Laws 1963, ch. 68, §§ 16(b), 18(a).
will be made to every prospective investor. Finally, it provides administrative, civil, and criminal remedies in cases where the standards prescribed by the Act are not met. In sum, the Act roughly approximates locally the coverage of the two principal federal securities laws: the Securities Act of 1933 and the Securities Exchange Act of 1934.

DEFINITIONS

The whole structure of the Act is built upon three definitions: the definition of “security” and the definitions of “offer” and “sale”.

The Act defines a security in 146 words, the net effect of which is to leave the careful attorney with the lingering fear that any piece of paper which purports to evidence legal rights may be a security. The list, of course, includes stocks, bonds, debentures, notes and other evidences of indebtedness, as well as a host of less familiar instruments. In addition to the rather exhaustive catalogue of specific securities, great flexibility is provided by the inclusion of “certificates of interest or participation in any profit-sharing agreement” and “investment contracts.”

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23 Supra, n. 17, §§ 31-35.
26 Supra, n. 17, § 25(1) defining “security” as:
   "... any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a ‘security,’ or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. ‘Security’ does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period."


27 In fact, it is clear that under the federal definition, and presumably under the Maryland definition, no actual piece of paper is necessary for a security to be involved. See e.g., S.E.C. v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961).

28 The classic definition of an investment contract is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.” S.E.C. v. W. J. Howey Co., 328 U.S. 293, 298-299 (1946).
Equally important are the definitions of “offer” and “sale”, for it is with the act and business of offering securities for sale that the Act is primarily concerned. An offer to sell “includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.” A “sale” is defined as including “every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value.” Here again, the approach is all-inclusive, only gifts of securities being excluded in the first instance. Obviously, there is a good deal of intentional vagueness in such words as “attempt” and “solicitation.” Suffice it to say that an attempt to dispose of a security or solicitation of an offer to buy a security may (and usually does) begin well before the prospective purchaser is asked directly whether he will buy the security.

Broad as they are, the definitions of “offer” and “sale” do not include three important classes of transactions. They are: (1) pledges and loans of securities, (2) stock dividends, and (3) the offer, issuance, and exchange of securities in certain corporate reorganizations. The effect, of course, of providing that these transactions do not involve offers or sales, is to make the Act wholly inapplicable to them.

The Anti-Fraud Provisions

To the very limits of the framework provided by the definitions just discussed, the Act prohibits fraud in all transactions involving the offer or sale of a security. These prohibitions apply just as truly to an offer to sell one share of stock in the family business as they do to the largest corporate offering.

The cornerstone of the anti-fraud provisions is section 13, which makes it unlawful for any person in connection with the offer, sale or purchase of a security:

“(1) to employ any device, scheme or artifice to defraud,

“(2) to make any untrue statement 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, 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.”

The only light shed on the meaning of this section elsewhere in the statute is the definition of “fraud”, “deceit”, and “defraud” as “not limited to common-law deceit”.3

Although the language of section 13, particularly subsections (1) and (3), may appear to be somewhat vague, it is a substantially verbatim copy of rule 10b-5 under the Securities Exchange Act of 1934 and consequently inherits a long line of judicial and administrative precedent.34

It would be inappropriate to comment too fully on the duties imposed upon buyers and sellers by the prohibitions of subsection (2), but it should be noted that these duties do not quite add up to “full disclosure”. That is to say, that the duty to avoid lies and half-truths is not quite the same as the duty “to state every fact about stock offered that a prospective purchaser might like to know or that might, if known, tend to influence his decision”.35

The possible consequences of a violation of section 13 include administrative action against the violator and against the offering,36 injunctive relief,37 and criminal liability.38 In addition, the standards of section 13(2) are carried over into the civil liability provisions and in certain circumstances may provide the investor with a statutory civil remedy against the seller and others.39

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3 Supra, n. 29, § 25(d).
34 Rule 10b-5, 17 C.F.R. § 240.10b-5 (1949), is in turn derived from Section 17(a) of the Securities Act of 1933, 15 U.S.C.A. § 77q(a) (1933). For a comprehensive consideration of these provisions, see 3 Loss, SECURITIES REGULATION (2nd ed. 1961) 1421-1525.
35 Otis & Co. v. S.E.C., 106 F. 2d 579, 582 (6th Cir. 1939), holding, however, that a broker-dealer was obliged to disclose the existence of agreements restricting supply and purchasing activities stimulating demand when it offered to sell a security “at the market,” on the theory that such an offer implied a free and unrestricted market.
36 Suspension or revocation proceedings may be instituted against the registration of the broker-dealer or agent involved under Section 18(a)-(2) (B) and against the registration of the security involved under Section 24(a) (2)(E). If the offering were being made under an exemption, the exemption could be revoked under Section 26(c).
38 Supra, n. 37, § 33.
39 Supra, n. 37, § 34(a) (2) provides in part:

“(a) Any person who

* * * * * * *

“(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary
A "broker-dealer" is a "person engaged in the business of effecting transactions in securities for the account of others or for his own account". Specifically excluded from the definition of broker-dealer are issuers (with respect to securities of their own issue) and banking institutions. Also excluded are persons with no office in this State whose Maryland transactions are solely with issuers of securities, other broker-dealers, financial institutions or institutional buyers and who direct no more than fifteen offers to sell or buy to the general public in Maryland in any 12 month period. This last exclusion is a de minimus standard and permits a brokerage firm with one or two Maryland customers to continue to service those accounts without subjecting itself to Maryland regulation. It also is designed to permit out-of-state firms to deal with Maryland firms either in transactions on stock exchanges or in the over-the-counter market.

The individuals who represent a broker-dealer in securities transactions are called "agents". Individuals who represent an issuer of securities in attempting to sell an offering are also agents, notwithstanding the fact that they do not usually regard themselves as securities salesmen. It is not uncommon for a small company to offer its own securities directly to the public through its officers, directors and employees. Such persons are treated the same as salesmen employed by a broker-dealer.

In order to make the statements made, in the light of the circumstances under which they were 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...

See text infra beginning at note 127.

Although the general public usually refers to all persons in the securities business as "brokers", the term is correctly applied only to a person who acts as agent in connection with a securities transaction. "Dealers" are persons who act as principals in such transactions. The term "broker-dealer" is used throughout the Act to avoid the uncertainty which might arise from references to "brokers" or "dealers".

Supra, n. 37, § 25(b).

Supra, n. 37, § 25(b) (2).

Supra, n. 37, § 25(b) (3).

Supra, n. 37, § 25(b) (4).

Supra, n. 37, § 25(a). Unlike many other securities laws, the Act requires the registration as agents of partners, officers and directors of a broker-dealer or issuer if their activities bring them within the definition of "agent". See sections 25(a), 16(b).

Supra, n. 37, § 25(a). However, exclusions from the definition of "agent" are provided for persons representing an issuer in selling certain securities or in certain transactions, section 25(a) (1)-(3).

They are required to be registered under section 15(a) and meet the standards of competence and professional conduct implicit in section 18, including passing the written examination prescribed by rule B-2.
The Act requires every broker-dealer and every agent transacting business in Maryland to be registered and makes it unlawful for a broker-dealer or an issuer to employ an agent unless he is registered. Registration is effective for one year from its effective date and may be renewed for additional one-year periods.

Registration involves the filing of an application for registration with the Commissioner, together with the appropriate filing fee and a consent to service of process. The application form for a broker-dealer discloses the history of the firm, particularly any recent disciplinary proceedings against it, its financial condition, and full information on its principals and its method of doing business. Agents’ applications require much the same information about the individuals. Failure to provide complete and true information on the application is a ground for its denial or for revocation of any registration granted as a result of the application.

Applications become effective automatically 30 days after the date on which they are received unless they are denied or proceedings looking toward a denial have been instituted. During this 30-day period the Commissioner makes whatever investigation he thinks necessary of the matters disclosed on the application. Typically, this includes correspondence with the applicant’s former employers in the securities business and with any state securities administrator who has previously registered him.

No person can be registered as a broker-dealer unless he has a net capital of not less than $15,000, and his aggregate indebtedness does not exceed 200 percentum of his net capital. The terms “net capital” and “aggregate indebtedness” are very much terms of art and are defined by rule B-3. In essence, the requirement is that every broker-dealer must have liquid capital in the required amount and liquid assets amounting to at least 105% of his liabilities. Such assets as real estate, furniture and fixtures, unamortized costs and prepaid expenses, and un-

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48 Supra, n. 37, § 15(a). As to what constitutes “transacting business in Maryland”, see section 28(a)-(e) and text infra beginning at note 131.

49 Supra, n. 37, § 15(b).

50 Supra, n. 37, § 15(c).

51 Supra, n. 37, § 16(a). The annual filing fee is $75.00 for a broker-dealer, $15.00 for an agent, except that partners, officers and directors registering as agents pay $2.00. The maximum filing fee for any broker-dealer and his agents is $500.00. Section 16(b). A consent to service of process is required even though the applicant is a Maryland resident. Section 38(g).

52 Supra, n. 37, § 18(a) (2) (A).

53 Supra, n. 37, § 16(a).

54 Supra, n. 37, § 16(d).
secured receivables are not considered liquid. Securities owned by the broker-dealer are considered partially liquid.

In the case of agents, the statute requires that they demonstrate their knowledge of the securities business. For the purpose of testing this knowledge, they are required to pass a written examination. Applicants who have met the New York Stock Exchange or N.A.S.D. requirements for registration or have been engaged in the securities business on full time basis for the 5 years preceding their application are exempted from this requirement. Also excused are persons engaged in selling only exempt securities.

In addition to imposing requirements designed to assure that persons engaged in the securities business will measure up to minimal standards of financial responsibility and professional competence, the Act provides that registration also may be denied under certain circumstances to persons who have been the subject of an administrative or judicial determination of a derogatory nature involving activities in the securities business or who have been convicted of a felony.

Of more importance, the statute gives the Commissioner the power to exclude persons from the securities business who have willfully violated or failed to comply with any provision of the Act or any rule or order under it, or who have engaged in dishonest or unethical practices in the securities business. These two provisions are

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65 Rule B-3, paragraph 1(C)(1)(b).
66 Rule B-3, paragraph 1(C)(1)(c).
67 Supra, n. 37, §§ 18(a)(2)(I), 18(b).
68 Rule B-2. The examination currently being used is the one prepared by the New York Stock Exchange specifically for use by state securities administrators.
69 Supra, n. 37, §§ 18(a)(2)(I), 18(b).
70 Supra, n. 37, §§ 18(a)(2)(C). The felony conviction must have been within the past 10 years.
71 Supra, n. 37, §§ 18(a)(2)(B).
72 Supra, n. 37, §§ 18(a)(2)(G).
designed, of course, to put the Commissioner in a position where he can compel compliance with the regulatory system contemplated by the Act and at the same time to give him a good deal of power to prescribe standards of professional conduct for persons in the securities business. Quite properly, broker-dealers are made responsible for seeing that these legal and ethical standards are observed by their agents.  

Aside from requiring that broker-dealers conduct their businesses in accordance with the law and professional ethics, the Act, as implemented by certain rules, imposes specific recordkeeping requirements and requires broker-dealers to keep the Commissioner informed of important developments in their businesses. Once each year broker-dealers must submit to an audit by independent accountants and file a detailed financial statement with the Commissioner.

**Regulation of Offerings of Securities**

Thus far, we have seen the very broad application of the anti-fraud standards to nearly every securities transaction. We have also seen that the Act provides for the licensing and regulation of persons engaged in the business of buying and selling securities. Presumably, the comprehensive application of the statute in these two respects would shock no one. After all, the traffic laws apply to everyone who drives a car, regardless of how short the trip, and every driver must be licensed, no matter how infrequently he drives.

Some blue sky laws go no farther than this. A rather primitive example, of course, is the old Maryland Blue Sky Law; a more sophisticated example is the recently enacted New Jersey Securities Act. Generally, however, the typical blue sky law singles out for special regulation what may be very loosely called public distributions of securities. In a public distribution the transaction is thought to be sufficiently large and the danger of injury sufficiently widespread that it is both fair and appropriate to impose more intensive regulation. This system of regu-
lation of public distributions is embodied in the provisions of the Act requiring registration of securities.\textsuperscript{68}

In Maryland, registration of securities is primarily a procedure for acquainting the Commissioner with the material facts about the issuer and the offering, putting such facts in a prospectus the use of which the Commissioner will permit, and seeing to it that the prospectus is given to every offeree before he invests.

Obviously, such a system is burdensome to persons offering securities and is unnecessary or impractical in many cases. It is one thing to say that a man cannot defraud his neighbor when he sells him a share of stock, but it is quite another to say that he cannot offer the share of stock without giving the offeree a complete written picture of the business and financial affairs of the issuer. It is equally absurd to require the United States to fully disclose its operational and fiscal situation whenever it seeks to borrow money. To take care of these obvious cases, and some not so obvious, the Act contains a list of exemptions from the registration requirement. These exemptions are contained in section 26 and are divided into “exempt securities” and “exempt transactions”.

“Exempt securities” include: government securities,\textsuperscript{69} securities of banks\textsuperscript{70} and savings and loan associations,\textsuperscript{71} insurance company securities,\textsuperscript{72} credit union securities,\textsuperscript{73} securities of common carriers and public utilities,\textsuperscript{74} and securities listed on certain stock exchanges.\textsuperscript{75} Generally speaking, these securities are exempted because their issuance or their issuers, or both, are subject to some other

\textsuperscript{69} Md. Laws 1963, ch. 68, § 26(a) (1); supra, n. 68, § 26(a) (2).
\textsuperscript{70} Supra, n. 68, § 26(a) (3).
\textsuperscript{71} Supra, n. 68, § 26(a) (4). In so far as state chartered associations are concerned, the exemption applies only to associations authorized to do business in Maryland.
\textsuperscript{72} Supra, n. 68, § 26(a) (5). The exemption applies only to insurance companies authorized to do an insurance business in Maryland. The present insurance law contains stringent provisions relating to the sale of securities of insurance companies in the organizational stages. 5 Md. Code (1957) Art. 48A, § 48. These provisions remain in effect until December 31, 1963, but the new Insurance Code, Md. Laws 1963, ch. 553, which becomes effective on that date, contains no counterpart.
\textsuperscript{73} Supra, n. 68, § 26(a) (6). The exemption applies only to federal credit unions and credit unions, industrial loan associations and similar associations organized and supervised under the laws of Maryland.
\textsuperscript{74} Supra, n. 68, § 26(a) (7). Some form of government regulation is essential for this exemption to apply.
\textsuperscript{75} Supra, n. 68, § 26(a) (8). The exchanges specified in this exemption are the New York Stock Exchange, the American Stock Exchange, the Midwest Stock Exchange, and the Philadelphia-Baltimore (now the Philadelphia-Baltimore-Washington) Stock Exchange.
form of public regulation. Securities of certain non-profit organizations are also exempt, for the usual reasons of public policy favoring such organizations and for the additional reason that the disclosure of investment considerations would not be particularly relevant to the purchaser of such securities. Finally, two rather technical exemptions are provided for short term commercial paper and certain employee's benefit plans.

Section 26(b), which deals with "exempt transactions", is an accommodation of the registration requirement to the practicalities of the financial world. In essence, it determines in what circumstances unlisted securities of issuers subject to no other regulation may be sold without registration. It would serve no purpose to review in order the thirteen exemptions, for they cannot be fairly stated except in the language of the statute. Several patterns do emerge from a careful reading of the section which are worth pointing out.

Of primary importance is the way in which section 26(b) defines the application of the registration requirements to sales by security holders, as opposed to sales by the issuer. A distinction is made between what might be called the "typical stockholder", a person owning less than 10% of the voting securities of the issuer, and the "controlling stockholder", a person owning 10% or more of the voting securities of the issuer. There is a very broad exemption for sales by the typical stockholder, giving him an almost unrestricted right to dispose of his securities, but the cases in which a controlling stockholder is free to sell his securities without registration are more narrowly defined. If his sale is an isolated one, and no distribution

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76 Md. Laws 1963, ch. 68, § 26(a) (9).
77 Supra, n. 68, § 26(a) (10). The scope of this exemption has been the subject of considerable controversy. It is drawn from a similar exemption contained in section 3(a) (3) of the Securities Act of 1933, 15 U.S.C.A. § 77c(a) (3) (1933), and is designed for "short-term paper of the type available for discount at a Federal Reserve Bank and of a type which rarely is bought by private investors." H.R. Rep. No. 85, 73rd Cong., 1st Sess. (1933) 15. Such paper cannot be used for capital financing.
78 Supra, n. 68, § 26(a) (11). The exemption here is narrower than it may appear to be. The S.E.C. has taken the position that certain employee's benefit plans involving the purchase of securities are themselves investment contracts and thus securities. This exemption applies only to the plan itself. The securities offered under the plan are not exempted by this subsection and must be registered unless another exemption applies.
79 Md. Laws 1963, ch. 68, § 26(b) (13). The exemption applies to all offers and sales not for the benefit of the issuer, a controlling stockholder, or an underwriter, so long as they are made by or through registered brokers and no stop-order or injunction exists against the offering or sale of the security or securities of the same class.
is involved, the transaction is exempt. However, if the controlling stockholder wishes to make a distribution, he can do it without registration only if a recognized securities manual contains certain information about the issuer, if the securities are preferred stock or debt securities as to which there has been no default during the current year or during the last three years, if he effects the distribution through a registered broker-dealer who does not solicit purchasers, or if he places the securities privately with institutional buyers and not more than 25 other offerees.

Secondly, section 26(b) recognizes that there are certain primary distributions (that is, distributions for the benefit of the issuer) which should be freed from the burden or registration. These are offerings to institutional buyers, private offerings where the number of offerees does not exceed 25, and offerings to existing security holders.

Appropriate exemptions are provided for certain aspects of offerings which must be registered. Thus, up to

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80 Supra, n. 68, § 26(b) (1). The limits of the isolated transaction exemption are extremely difficult to define. Presumably, it refers to a single securities transaction not connected with other securities transactions. Because of the substantial overlap with section 26(b) (13), the usefulness of this exemption is generally restricted to offers and sales by controlling stockholders and to offers and sales by stockholders not in a control position without the intervention of a broker-dealer.

81 Supra, n. 68, § 26(b) (2) (A). The manuals recognized for the purpose of this exemption are listed in rule S-3.

82 Supra, n. 68, § 26(b) (2) (B).

83 Md. Laws 1963, ch. 68, § 26(b) (3). This exemption permits a controlling person to dispose of securities through a broker-dealer so long as the broker-dealer does no more than sell the securities to customers who place unsolicited orders for them. Obviously, the usefulness of this exemption as a means of distributing large blocks of securities without registration is severely limited.

84 Supra, n. 68, §§ 26(b) (8), 26(b) (9). See notes 85 and 86 infra.

85 Supra, n. 68, § 26(b) (8). Institutional buyers include banks, savings institutions, trust companies, insurance companies, investment companies, pension or profit-sharing trusts, and broker-dealers. The relaxation of the registration safeguard when such entities are the offerees is justified, of course, on the ground that they do not need its protection.

86 Supra, n. 68, § 26(b) (9). The private offering exemption is one of the most important parts of the law. It permits an issuer or controlling person to offer securities in any amount to 25 persons during any 12-month period, provided that the offeror is satisfied that the buyers are purchasing for investment. The rationale of the exemption rests on two bases: that the offering is not likely to be large enough to justify the expense of registration and that the offerees are likely to be either sophisticated investors or persons with personal knowledge of the affairs of the issuer of the securities.

87 Supra, n. 68, § 26(b) (11). The exemption perhaps is necessary in cases where preemptive rights are involved, but it seems desirable even in cases where such rights do not exist on the theory that the existing security holders of the issuer have a stake in the business which they ought to be permitted to protect and forward through additional investment without the restriction of registration.
10 preorganization subscriptions may be taken provided that the securities thus offered may not be sold until they are registered;\textsuperscript{88} securities for which a registration statement has been filed may be offered but not sold before the registration statement becomes effective;\textsuperscript{89} and offers and sales may be made to and among underwriters before the registration statement is even filed.\textsuperscript{90}

Also exempted are what might be called “forced sale” situations in which such security holders as executors, administrators, sheriffs, marshals, receivers, trustees in bankruptcy, guardians, conservators and pledgees are permitted to sell without registration.\textsuperscript{91}

If no exemption is available, a security must be registered before it can be offered for sale.\textsuperscript{92} There are three kinds of registration provided by the Act, but it is important to note that regardless of the way in which a security is registered, almost without exception it must be sold by means of a prospectus.

The most common used form of registration is called “registration by coordination”, the reference being to a filing coordinated with a similar filing with the United States Securities and Exchange Commission.\textsuperscript{93} Because of

\textsuperscript{88} \textit{Supra}, n. 68, § 26(b) (10). The purpose of this exemption is to permit the formation of a corporation. The collection of a group of promoters necessarily involves an offer of the securities of the corporation at a time when registration would be impossible.

\textsuperscript{89} \textit{Supra}, n. 68, § 26(b) (12). This exemption permits the offering of securities during the time after the registration statement has been filed with the Commissioner and the prospectus is being completed and amended. If a pre-effective written offer is made, the preliminary prospectus must be delivered to the offeree, and the final prospectus delivered at or before confirmation, payment, or delivery of the security, whichever first occurs. Sections 26(b) (12), 20(c), 22(d).

\textsuperscript{90} \textit{Supra}, n. 68, § 26(b) (4). Since firm commitment underwriting involves a sale of the securities by the issuer or selling security holder to the underwriters, negotiation with and among the underwriters would necessarily involve offers to sell the securities. No purpose would be served in requiring registration in such cases, and certain information about the offering necessary for registration would be unknown until such negotiations were completed.

\textsuperscript{91} \textit{Supra}, n. 68, §§ 26(b) (6), 26(b) (7).

\textsuperscript{92} \textit{Supra}, n. 68, § 19. The filing fee for all registrations is 1/10% of the maximum aggregate offering price, but no less than $25.00 and no more than $250.00. Section 23(b).

\textsuperscript{93} \textit{Supra}, n. 68, § 21. Many states permit registration by coordination only where a registration statement has been filed with the S.E.C. under section 6 of the Securities Act of 1933, 15 U.S.C.A. § 77(f). Section 21(d) permits the use of this form of registration in any case where “the documents required by any regulation adopted by the Securities and Exchange Commission under Sections 3(b) or 3(c) of the Securities Act of 1933 have been filed with said Commission in connection with the same offering.” Principally, this extends the availability of the coordination procedure to filings under Regulation A, which is a qualified exemption from registration for certain small offerings. See S.E.C. Reg. A, 17 C.F.R. §§ 230.251-230.203 (1963 Supp.).
the fundamental similarity between the Maryland Act and the Federal Securities Act, there is every reason to avoid duplication of effort in cases where filings are made concurrently with the S.E.C. The procedure in registration by coordination is simplified to the point where all that is required is the filing of a one-page registration statement together with three copies of the federal prospectus. The registrant undertakes to file copies of all amendments to the federal prospectus and to notify the Commissioner when the federal registration statement has become effective. Ordinarily, registration in Maryland is effective simultaneously with federal registration. The simplicity of this procedure dictates its use in every interstate offering of securities. There is no advantage, and there are quite a few disadvantages, in using either of the other methods of registration to register an interstate offering.

The two remaining methods of registration are used almost exclusively for intrastate offerings. Since such offerings are exempt from federal registration, registration by coordination is not available.

"Registration by notification" is available for a very limited number of offerings where the issuer has been in business for at least five years and has shown average annual earnings of at least 5% on its equity securities. It provides for a somewhat abbreviated prospectus and an automatic effective date. Because very few companies which meet the rather stringent earnings requirements for this type of registration offer their securities purely locally, this type of registration is not often used.

94 Supra, n. 68, § 21(b). The filing must be accompanied by the filing fee prescribed in section 23(b) and by a consent to service of process if one is required by section 38(g).
95 Supra, n. 68, §§ 21(b) (4), 21(c).
96 Supra, n. 68, § 21(c).
97 The filing fees for all types of registration are the same. See note 92 supra. The prospectus used in registrations by notification and qualification must meet the requirements of Rule S-1, as well as the requirement of Rule S-5 that it contain certified financial statements, which are not required under Regulation A. Quarterly sales reports must be filed by registrants in cases of registration by notification and qualification. Rule S-4.
99 3 Mo. Code (Cum. Supp. 1962) Art. 32A, § 20(a) (1). This form of registration is also available for non-issuer distributions if any security of the same class has ever been registered under the Act or if the security being registered was originally issued pursuant to an exemption under the Act. Rule S-1, paragraph 3.
100 Supra, n. 98, § 20(d), provides that such registration statements automatically become effective on the tenth full business day after the filing of the registration statement or the last amendment. See, however, note 107 infra.
101 During the fiscal year ended June 30, 1963, only 2 registrations by notification had been filed with the Division of Securities.
The third type of registration, and the one used in nearly all intrastate offerings, is "registration by qualification". The obvious need for effective regulation of offerings of unseasoned securities by local issuers, involving, as it often does, unsophisticated investors, makes this kind of registration a most important, and sometimes time-consuming procedure.

Registration by qualification requires the filing of a simple form describing the offering, a number of exhibits which should include every material contract not made in the ordinary course of business, and a detailed and comprehensive prospectus. Rule S-1 sets forth in detail the matters required to be described in the prospectus, among which are the business, property, capitalization and management of the issuer, the securities being offered and the method of offering them, and any transactions between the issuer and certain "insiders". Also required to be included are financial statements certified by an independent public accountant.

The normal procedure is for the Commissioner to study the prospectus in light of the exhibits and rule S-1, and to write a detailed "letter of comment" pointing out what he believes to be the deficiencies in the prospectus. The registrant then submits a second draft of the prospectus, and the process continues until the Commissioner is satisfied that the prospectus may be used. He then declares the registration statement effective by order. Essentially the same procedure is followed in the case of registration by notification. In both cases the resulting prospectus must be delivered to prospective investors at the time of

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103 Supra, n. 99, § 22.

104 Rule S-5. The S.E.C. experience with the question of "independence" is summarized in S.E.C. Accounting Series Releases Nos. 47 (January 25, 1944) and 81 (December 11, 1958).

105 The Commissioner does not approve a prospectus. Section 29(a) (2) provides that the fact that a security is effectively registered does not constitute a finding by the Commissioner that any document filed is true, complete and not misleading. Rule S-1, paragraph 9, requires that a legend to this effect appear on every prospectus.

106 Supra, n. 99, § 22(c).

107 Supra, n. 99, § 20(d), provides that registration statements by notification become effective ten days after the filing of the registration statement or the last amendment. Since the Commissioner cannot permit a registration statement to become effective if the prospectus is deficient, and it is usually not possible to correct the deficiencies in the preliminary prospectus within ten days, the registrant is required to file delaying amendments to the registration statement to prevent a stop order being entered on the automatic effective date. Ultimately, an order accelerating effectiveness is entered. This conforms closely with S.E.C. procedure.
the first written offer, confirmation of sale, payment, or delivery of the security, whichever event first occurs.\textsuperscript{108}

The grounds for denying, suspending or revoking the effectiveness of a registration statement apply to all three kinds of registration and are enumerated in section 24 of the Act.\textsuperscript{109} The most important ground is that the registration statement is incomplete, false, or misleading in any material respect.\textsuperscript{110} Since the prospectus is a part of the registration statement, it too must be complete, true and not misleading. Also of importance is the provision which permits the Commissioner to enter a stop order against an offering if it “has worked or tended to work a fraud upon purchasers or would so operate”.\textsuperscript{111} This of course covers the situation where the fraud inheres in the methods used to sell the securities rather than in the registration statement.

A registration statement remains effective until the offering is completed or terminated.\textsuperscript{112} In cases of registration by notification and qualification, the registrant is required by the rules to supplement the prospectus when material developments occur that would render it misleading,\textsuperscript{113} to revise it at approximately annual intervals to keep current the information contained in it,\textsuperscript{114} and to file quarterly reports of sales and other matters.\textsuperscript{115}

\textbf{Administrative, Civil and Criminal Remedies}

In the first instance, of course, the enforcement of the Act is the responsibility of the Commissioner. He is given broad investigative and enforcement powers. He is permitted to make such examinations of the books and records of registered broker-dealers as he deems necessary,\textsuperscript{116} and to conduct investigations to determine whether any person has violated or is about to violate any provision of the

\textsuperscript{108} Supra, n. 99, §§ 20(c), 22(d). The use of the prospectus may be dispensed with as to securities no longer being offered as part of the registered offering, such offers being exempt transactions under section 26(b)(13).

\textsuperscript{109} Such grounds include: violations of the Act, the rules, or an order in connection with the offering, section 24(a)(2)(B); a stop order or injunction against the offering, section 24(a)(2)(C); illegality of the issuer's enterprise or method of business, section 24(a)(2)(D); and certain technical grounds relating to the form of registration, the filing of amendments, and the payment of fees, sections 24(a)(2)(F), (G), (H).

\textsuperscript{110} Supra, n. 99, § 24(a)(2)(A).

\textsuperscript{111} Supra, n. 99, § 24(a)(2)(B).

\textsuperscript{112} Md. Laws 1963, ch. 68, § 22(f).

\textsuperscript{113} Rule S-1, paragraph 10(c).

\textsuperscript{114} Rule S-1, paragraph 10(b). The actual requirement is that when a prospectus is used more than 9 months after its effective date, the information in it must be as of a date not more than 16 months prior to its use.

\textsuperscript{115} Supra, n. 99, § 23(g) and Rule S-4.

\textsuperscript{116} Supra, n. 99, § 17(d).
Act and to aid in the enforcement of the Act. In an investigation the Commissioner has the power to subpoena witnesses and to compel the production of books, records and other documents.

The circumstances under which the registration of a broker-dealer or agent may be denied, suspended or revoked have been touched upon earlier, as have the provisions governing similar administrative actions with respect to the registration of securities. The Commissioner also has the power to deny or revoke certain of the exemptions specified in the Act. In exercising these powers the Commissioner is required to afford an opportunity for a hearing and to make a decision based upon written findings of fact and conclusions of law.

The conduct of such proceedings is governed by the Maryland Administrative Procedure Act. Appeals from final action by the Commissioner may be taken in accordance with the Administrative Procedure Act and the Maryland Rules of Procedure.

Administrative remedies are available only against registrations or to withdraw exemptions from registration. When the registration requirements are ignored, the violator cannot be dealt with administratively, and the Commissioner is authorized to apply to a court of equity for injunctive relief. In connection with such relief, the court may appoint a receiver for the defendant or for his assets.

Willful violation of the Act is a crime, and violators may be prosecuted by the State's Attorney, acting either on reference from the Commissioner or on his own volition. Conviction may carry a fine of up to $5000 or imprisonment for up to 3 years.

A very necessary supplement to the administrative, injunctive and criminal sanctions provided by the Act is the statutory civil liability set forth in section 34. It is not surprising that a defrauded or misled purchaser should have a civil right of action against the seller. Beyond this, however, the purchaser has a similar right of action whenever the registration requirements of the statute have

117 Supra, n. 99, § 31.
118 Supra, n. 99, § 31(b).
119 See text, supra, beginning at note 59.
120 See text, supra, beginning at note 109.
121 Supra, n. 99, §§ 26(b)(9), 26(c).
122 Supra, n. 99, §§ 18(f), 24(c), 26(c).
123 4 Md. Code (1957) Art. 41, §§ 244-256. See also rule A-3 as to procedure in contested cases.
125 Supra, n. 124, § 32.
126 Supra, n. 124, § 33.
127 Supra, n. 124, § 34(a)(2).
been violated in connection with either the offer or the sale.\footnote{Supra, n. 124, § 34(a) (1).} Still further, the purchaser's right of action is not against the seller alone, but against every person controlling the seller, against every one of its partners, officers and directors, and against every employee of the seller, every broker-dealer and every agent who materially aids in the sale.\footnote{Supra, n. 124, § 34(b).} The purchaser has two years to bring suit, during which time he has what amounts to a guarantee against loss: if the market value of the security rises, he probably will not sue, but if it falls, he most likely will sue and recover the purchase price plus interest at the rate of six percent.\footnote{Supra, n. 124, § 34(e). This subsection also provides a method whereby the seller may advise the buyer of his rights under this section and offer to rescind or pay damages. If the buyer owns the security and does not accept the rescission offer within 30 days, he cannot sue under section 34. If the buyer no longer owns the security and does not reject the offer of damages within 30 days, he cannot sue under section 34.} The purpose of such a provision is, obviously, to make violation of the Act an unacceptable business risk.

**Scope of the Act**

The application of the Act to transactions occurring in part outside of Maryland and to situations existing on its effective date is defined with unusual precision.

Securities transactions are commonly interstate transactions, and the normal proclivity of securities to find their way across state lines is intensified in Maryland's case by the proximity of the District of Columbia. The territorial limitations upon the applicability of the Act are stated in section 38. For example, section 38 says that a transaction subject to the Act takes place whenever an offer to sell securities originates from Maryland or is directed into Maryland and received here. When a sale takes place in response to an unsolicited offer to buy, the Act applies only when the offer is made in Maryland (that is, it originated from Maryland or is directed into Maryland and received here) and when it is accepted in Maryland. Acceptance takes place in Maryland when it is communicated to the offeror in Maryland and has not been communicated previously to him elsewhere.

The solution to the problem of imposing a whole regulatory system upon brokers, issuers and investors in medias
res is contained in the transitory provisions of section 40. With one exception, these provisions are of little interest now since the last transitory period expired on October 1, 1962. However, there are serious problems connected with inhibiting the free sale of securities by the imposition of registration requirements. For instance, a stockholder who purchased securities at a time when the State had no law restricting his disposition of these securities could well complain if he suddenly found that he could not sell them without an expensive and perhaps impossible registration. An issuer or underwriter engaged in a public offering that commenced prior to the effective date of the Act would also have cause to complain if the offering had to be halted until registration could be effected. The solution to these problems is to exempt from the registration requirements any security “sold or disposed of by the issuer or bona fide offered to the public” on or before August 31, 1962. New offerings of such securities by an issuer or underwriter after that date are not entitled to this exemption.

The foregoing has been a kind of prospectus on the Maryland Securities Act, subject to the caveats, to which all prospectuses are subject, that it does not purport to be complete and further that it does not bear the stamp of approval of the Division of Securities. The purpose here has simply been to give the reader an introduction to the Act, with the feeling that the lack of a comprehensive securities law in Maryland has left a large segment of the Bar unaware of the possible application of such a law to commonplace situations and uncertain as to how it should be approached. To do more and attempt an appraisal of the effectiveness of the law, or to focus too closely on some of its complexities would be both premature and inappropriate. What can be said is that the year since the law became effective has demonstrated that it is a sound and excellently drafted piece of legislation, which, well administered, should fulfill its purpose: to provide investors with the facts necessary to make intelligent decisions and to assure that persons in the securities business measure up to reasonable standards of competence, financial responsibility and professional conduct.

123 Supra, n. 124, § 40(a), permitted broker-dealers registered under the old ‘Blue Sky Law or exempt from registration thereunder to continue to do business provided they filed an application for registration on or before October 1, 1962.
124 Supra, n. 124, § 40(c).