Michigan Law Review

Volume 52 | Issue 2

1953

Corporations - Securities Act of 1933 - Stock Sale to Employees as a Public Offer

Paul B. Campbell S.Ed.
University of Michigan Law School

CORPORATIONS—SECURITIES ACT OF 1933—STOCK SALE TO EMPLOYEES AS A PUBLIC OFFER—The Securities and Exchange Commission sued to enjoin defendant corporation from offering stock for sale to its employees without first complying with the registration requirements[1] of the Securities Act of 1933. Defendant claimed that its offer was not a public offer and therefore it came under a class of transactions which were exempt[2] from the registration requirements. The offer was made to about 500 of the company's 7,000 employees. The company classified the offer as one made only to "key employees." The court of appeals affirmed[3] the trial court's judgment[4] for defendant. On certiorari, *held*, reversed, two justices dissenting.[5] In the absence of a showing that the employees to whom the stock was offered had knowledge making the protection of the act unnecessary, this was a public offer and therefore the registration requirements of the Securities Act of 1933 had to be fulfilled. *Securities & Exchange Commission v. Ralston Purina Co.*, 346 U.S. 119, 73 S.Ct. 981 (1953).

Since the passage of the Securities Act of 1933 the problem of what constitutes a public offering has been a difficult one for the courts, the Securities and Exchange Commission, and corporations contemplating limited stock offers. The courts have never been inclined to accept the view that in order to have a public offering the offer must be made to the populace at large.[6] But having

[1] 48 Stat. L. 77 (1933), 15 U.S.C. (1946) §77(e), provides that unless a registration statement is in effect as to a security, it shall be unlawful to use the mails for buying or selling the security.

[2] 48 Stat. L. 77 (1933), 15 U.S.C. (1946) §77(d), provides that §77(e) shall not apply to any transactions by an issuer not involving a "public offering."

[3] SEC v. Ralston Purina Co., (8th Cir. 1952) 200 F. (2d) 85.

[4] SEC v. Ralston Purina Co., (D.C. Mo. 1952) 102 F. Supp. 964, noted 51 MICH. L. REV. 597 (1953).

[5] Chief Justice Vinson and Justice Burton dissented without opinion. Justice Jackson did not participate in the case.

[6] ". . . the word public 'is one familiar to everyone, but of the most varied and indefinite connotations. In its broadest meaning the term "public" distinguishes the populace

rejected this standard they have found themselves groping for an adequate alternative. In an early advisory opinion the Securities Division of the Federal Trade Commission ventured to say that an offering to fewer than twenty-five persons usually would not be a public offering.[7] Far from lifting the fog, this only added to the confusion because corporations tried to avoid the intent of the law by offering large blocks of securities to limited numbers of individuals and to insurance companies. The SEC attacked these schemes but often was at a loss for standards by which to adjudge the transaction a public offer. However, the government was favored when the burden was placed on the corporations to prove that their prospective issues of securities did not involve an offer to the public.[8] The courts also said that the statute would be strictly construed against corporations because they were claiming under an exception to the general policy of the act.[9] The SEC won a further advantage when it was ruled that the commission's interpretation of what constitutes a public offering is entitled to great evidentiary weight.[10] The general counsel for the SEC has issued a list of factors to be considered in determining whether a securities offer is made to the public.[11] These standards are broad enough to fit nearly every case which the commission might want to prosecute, but as a result they lack any great amount of meaning. What is the present attitude of the courts in cases involving the question of public offer? Due to the vagueness of the commission's criteria, the courts apparently have not gone too far in using them as standards. Instead they have adhered to the prior rules of (1) putting the burden of proving the exception on the corporation, (2) construing the statute against the corporation, and (3) giving great weight to the SEC determination.[12] But the courts' ultimate standard seems to be one not strictly called for by the language of the act. The result in a given case now depends primarily on whether or not the court decides that the offerees are in need of the information which is required to be supplied in connection with registration.[13] This bears no particular relation to the question of whether

at large from groups of individual members of the public segregated because of some common interest or characteristic. Yet such a distinction is inadequate for practical purposes. . . .'" SEC v. Sunbeam Gold Mines Co., (9th Cir. 1938) 95 F. (2d) 699 at 701.

[7] MCCORMICK, UNDERSTANDING THE SECURITIES ACT AND THE S.E.C. 101 (1948).

[8] Campbell v. Degenther, (D.C. Pa. 1951) 97 F. Supp. 975; SEC v. Sunbeam Gold Mines Co., note 6 supra.

[9] SEC v. Sunbeam Gold Mines Co., note 6 supra; Corporation Trust Co. v. Logan, (D.C. Del. 1943) 52 F. Supp. 999.

[10] Campbell v. Degenther, note 8 supra.

[11] Counsel proposed four factors to be considered in determining whether securities are exempt as not being a public offering. They are (1) the number of offerees and their relationship to the issuer, (2) the number of units offered, (3) the size of the offering, and (4) the manner of offering. Release No. 285, Jan. 24, 1935, quoted in 1 CCH FED. SEC. LAW SERV. ¶2266.17.

[12] See cited cases in notes 8, 9, and 10 supra.

[13] In the 1934 amendments to the Securities Act of 1933 it was proposed to exempt offers to employees. This was rejected because it was felt that employees may be in as great a need for the protection afforded by the law as other members of the public. H. Rep. No. 1838, 73d Cong., 2d sess., p. 41 (1934). The courts rely on this congressional action

there is an offer to the general public, since in one case a single offeree may be in need of such knowledge whereas in another case 1,000 offerees may not be. Nevertheless, the courts have not ceased paying lip service to the concept of public offering, because of the possible constitutional problem involved if registration were required before a private offering.[14] This is not meant as an attack on the courts' altered standard. For it is only by such a liberal reading of the statutory terms that the courts have succeeded in giving proper recognition to social and economic needs for which the legislature has not expressly provided.

Paul B. Campbell, S.Ed.

as evidence of a legislative intent that the judiciary solve the public offering problem by applying a need-for-information test. Thus it has been held that registration must take place even when the offer is restricted to present stockholders of the company, if there are many such stockholders. Merger Mines Corp. v. Grismer, (9th Cir. 1943) 137 F. (2d) 335 (1,100 stockholders).

[14] The original California blue sky law made no exception from the registration requirements for cases where there was no public offering. The statute also left a wide measure of discretion in the commissioner as to whether he would issue a permit. This law was declared unconstitutional as a contravention of the inalienable right to acquire, possess, enjoy, and protect property. The law would have required a permit prior to a private sale of securities. People v. Pace, 73 Cal. App. 548, 238 P. 1089 (1925).