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Review of Pennsylvania Legislation 1939 - Banking and Finance Pennsylvania Securities Act

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adequate remedy for the imposing of double liability on stockholders under the Act of 1876, and that the mere plurality of defendants does not require the assumption of jurisdiction by a court of equity. This case also holds that the secretary of banking, as receiver of a closed bank, now has the power to enforce double liability by assessment made by him, without recourse to any court for a decree authorizing such assessment.

JOSEPH P. McKEEHN*

b. Pennsylvania Securities Act

The protection of investors has long occupied the legislative mind. Statutes, including those popularly known as "Blue Sky Laws," have been adopted to prevent the unwitting public from transforming good money into securities of questionable value. In Pennsylvania, the first such statute, enacted in 1923,1 was repealed and supplied by the Act of 1927,2 which was in turn replaced by the Pennsylvania Securities Act of 1939.3 The new Act substantially codifies the earlier ones, but makes certain additions and changes. Like its predecessors, it is based on the police power of the State and should withstand attacks on constitutional grounds.4

The principal purpose of the Act is to protect the public from frauds, and to effectuate this, it provides a system for the registration of those who deal in or sell securities. It sets forth definitions, exemptions, penalties for violations, and the powers and duties of the Pennsylvania Securities Commission.5 Instead of requiring the registration of securities, it regulates their sale by the registration of dealers and salesmen. Instead of passing on the price or merits of a securities issue or on the expediency of particular plans of financing, it contemplates investigations to determine whether the securities are being offered to the public honestly and in good faith, without an intent to deceive or defraud.6

"Security" is defined by Section 2 (a) in sufficiently broad and general terms to embrace, in addition to stocks and bonds, virtually all types of formal obligations, including, for example, certificates of deposit. The definition of a "sale for value" contained in Section 2 (b), which is derived principally from the Fed-

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1Act of June 14, 1923, P. L. 779.
2Act of April 13, 1927, P. L. 273, 70 PURD. STATS. § 1, et seq., as amended.
3Act of June 24, 1939, P. L. 748, 70 PURD. STATS. § 31, et seq.
5The 1923 Act was administered by the Commissioner of Banking, but Section 30 of the Act of 1927 created the Commission in substitution.
eral Securities Act of 1933, covers, in addition to its usual meaning, offerings of securities as well as the solicitation of an offer to buy, but not preliminary negotiations or agreements between an issuer or underwriter.

Individuals and companies must be registered either as dealers or salesmen, and must secure registration certificates before engaging in the sale of securities or in the issuance or publication of a prospectus. A company selling securities issued by itself through its officers or employees is a dealer and must register as such, and its employees as salesmen. The present definitions of dealer and salesman are broader than those set forth in the prior Act. Thus, the new Act specifically includes persons who induce holders of securities to dispose of them in order to raise money to purchase their investments. This addition is included to prevent vendors of certain instruments which have been held not to be securities, such as whisky certificates, from fraudulently persuading security holders to change their investments. This enacts into the law the administrative interpretation under the prior Act. As a further deterrent, a new Section, 21, expressly forbids persons from fraudulently inducing the exchange or disposition of securities.

The procedure for registration is substantially similar to that provided by the prior Act. One important change is that a dealer’s application must be accompanied by a financial statement. Another is that the decision of the Commission refusing registration, like other decisions, must be in writing and must fully state the grounds therefor. An applicant is registered as a dealer for the current calendar year where the Commission is satisfied that he is of good repute and that his proposed plan of business is not unfair, unjust or unequitable. The present Act specifically prohibits any change in the dealer’s plan of business as contained in the application unless the Commission is first satisfied as to its fairness, whereas the prior Act reached a comparable result by holding that a dealer could sell only such securities as were contemplated by his application. A salesman is registered as such upon satisfactory evidence of his good repute, fitness and qualification. No individual may at the same time be a salesman of more than one dealer and the registration is terminated when the salesman leaves the employ of the dealer.

In order to avoid undue burdens on the transfer of securities, the Act exempts certain transactions, as, inter alia, sales of government securities, judicial sales, sales by enumerated classes of fiduciaries, isolated sales by an owner, distribution of stock dividends, and sales of securities issued by domestic building and loan associations and by non-profit corporations. When a Pennsylvania company, or one which has at least half of its paid in capital invested, employed or used in this State, sells its own securities at an expense of at least three per cent of the proceeds

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9 The applicant’s plan of business was held unfair under the evidence in N. R. Bagley Co., Inc. v. Cameron, 282 Pa. 84, 127 Atl. 311 (1925); National Industrial Finance Co. v. Penna. Securities Comm., 35 Dauphin. 350 (1930).
realized, such sales are likewise exempted, as are sales of its own securities by a Pennsylvania corporation with capital under $25,000, or with not more than twenty-five stockholders. In these cases, however, a statement must first be forwarded to the Commission containing the facts relied on to bring the proposed transaction within the exemption. The burden of proving the applicability of an exemption clause rests squarely on the person claiming the exemption.10

There are new provisions relating to consent to service of process upon the Commission. Such consent is now limited to cases involving violations of the Act and, as to Pennsylvania "companies," to those having no office in Pennsylvania at which process may be served. In civil cases service is consented to only in the county where the defendant's principal office is located, if he then has one; in criminal cases to the county where the cause of action arose, and in injunctive proceedings brought by the Commission, to Dauphin County. Such service is valid as to causes of action arising while the defendant was doing business in Pennsylvania, even though the defendant has since terminated such activities.11

A notable improvement is in the strengthening of the anti-fraud provisions. As already mentioned, Section 21 has been added to prevent unscrupulous persons from thriving by fraudulently trading customers out of good securities and selling them weaker issues. The Commission is empowered to prohibit the issuance or publication of any prospectus which in its opinion "contains any statement that is fraudulent," false, misleading or otherwise likely to deceive a reader thereof." Section 14 grants the Commission the power to investigate the activities of dealers by requiring a dealer to file with it a list of securities which such dealer has sold in the state within the preceding six months, and if it appears that any of such offerings either "(a) have not been made honestly, or (b) have not been made in good faith, or (c) have been made with intent to deceive or defraud," or (d) have been made without the dealer having a reasonable amount of information about the issuer thereof," the Commission may prohibit the dealer from selling such securities in this State." The terms "fraud," "fraudulent" and "fraudulent practice" are defined in Section 2 (1) with the proviso that the usual meaning of the terms as accepted in courts of law or equity is not limited thereby.

Observance of the Act is compelled by:

(1) Empowering the Commission to revoke a dealer's or salesman's registration, where, after hearing, it has reasonable cause to believe said dealer or salesman was guilty of fraud or fraudulent practice. Said

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12Added by the Act of 1939.
13The prior Act did not so individualize the grounds for prohibition. Under the prior Act, this prohibition was possible only if the intent to deceive accompanied the acts of bad faith. See N. R. Bagley Co., Inc. v. Cameron, 282 Pa. 84, 127 Atl. 311 (1925).
14Added by the Act of 1939.
revocation or temporary suspension of a dealer's registration affects the salesman of said dealer similarly;

(2) The establishment of severe criminal penalties. In Section 22 certain enumerated violations, such as selling securities without being registered, or making any false statement of fact in a prospectus, or being guilty of any fraud or fraudulent practice, constitute a misdemeanor punishable by a fine of not more than $5,000 or imprisonment for not more than five years, or both.16 Other violations constitute a misdemeanor punishable by a fine of not more than $1,000 or imprisonment for not more than one year or both.

Two new important powers are conferred upon the Commission. Section 26 now gives it authority to promulgate rules and regulations, including rules of practice, and to institute proceedings on behalf of the Commonwealth for injunctions against any persons violating the Act. In addition, the Commission has power to summon witnesses and to require the production of records relating to the matter under investigation. In the event its subpoena is disobeyed, it may invoke the aid of the court in a contempt proceeding.

Section 18 sets up the procedure for judicial review. Under the prior law, only a dealer, salesman or agent was empowered to appeal from a decision of the Commission. Now any person aggrieved by such a decision may appeal to the Court of Common Pleas of Dauphin County, by means of a petition specifying the action and decision complained of and the objections thereto. To this petition, the Commission can file an answer alleging the grounds for its decision. These constitute the pleadings. The record of the proceeding before the Commission, upon which the case is heard, is certified to the Court. No testimony is taken before the Court, but, in proper cases, the record may be remitted to the Commission for additional testimony. If there is evidence to support the Commission's decision, it will be affirmed.16 A further appeal may be taken to the Supreme Court.

The experience of the last few years has disclosed abuses and unfair practices in the securities business, as in other businesses, which only regulation can correct. The dealer occupies practically a fiduciary relationship to the customer. The latter places confidence and trust in the dealer and relies on his superior knowledge and skill in the matter of investments. The present legislation is not completely adequate, and there still remain many problems of investment control. However, the Pennsylvania Securities Act, in its present form, is designed to go far in pro-

15Under the prior Act, the maximum sentence was two years.
tecting the purchasing public from the marketing of securities involving a delibe-
rate purpose to deceive.

HERMAN A. BECKER

II. CORPORATIONS

One important change and several minor alterations have been made in the
Business Corporation Law.1 A new Section (320) has been added to Article
III.2 The purpose of this Section is to facilitate carrying out corporate reorgani-
zation plans by making it possible to amend the charter and take certain other
corporate action without the need of a shareholders' meeting. It provides that
where a business corporation has a plan of reorganization or arrangement con-
firmed by order of court pursuant to the Federal Bankruptcy Act, it shall then have
full power to effect the plan and orders of court and so any act provided thereby
without further action by its directors or shareholders. Such power may be exer-
cised as directed by the court by the trustee, receiver, master, or other representa-
tive. The Act enumerates various proceedings that may be taken in this manner,
such as altering the by-laws, reconstituting the board of directors, amending the
articles, dissolving, etc. It is, however, expressly provided that such corporation
cannot increase its indebtedness or its authorized capital stock except after the
approval of its shareholders at a meeting held in accordance with the provisions
of the Business Corporation Law.

Sections 202 and 1002 were amended by adding that the corporate name of
a domestic or foreign corporation may be the same as another domestic or foreign
corporation authorized to do business in the state if such other corporation has
failed for three successive years to file with the Department of State or Revenue
a report or return required by law.

A slight change has been made in the wording of Section 901 to make it
clear that two or more foreign business corporations may enter into a merger or
consolidation, and that domestic corporations may do so with foreign corporations.

Section 1011.1 has been added to Article X and provides that any court having
criminal jurisdiction in Pennsylvania may issue its subpoena with clause of duces
tecum upon any foreign corporation registered to do business within the Common-
wealth, which may be served in the manner provided by the act for the service of
process upon foreign corporations. It is further provided as an amendment to
Section 1013 that the certificate of authority of a foreign corporation may be re-

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*Special Deputy Attorney General assigned as Counsel to the Pennsylvania Securities Com-
mission. This article was prepared and is published with the approval of Mr. Walter C. Miller,
Chairman, and Commissioner Raymond A. Cox, of the Pennsylvania Securities Commission.