Critical Legal Cases for Chapter 41

41.2 Definition of a Security: Yes, the Dare sales scheme is a security that should have been registered with the Securities and Exchange Commission (SEC). In *SEC v. W.J. Howey Co.*, the U.S. Supreme Court defined an "investment contract" as a scheme that involves (1) an investment of money (2) in a common enterprise (3) with the profits to come solely from the efforts of others. The Supreme Court stated that this definition should be broadly and flexibility construed.

The court applied the Howey test in the instant case and held that the Dare multilevel sales scheme was an investment contract. There was obviously an investment of money in a common enterprise. The only difficult issue was whether the Dare plan derived profits for the investors from the efforts of others. The court held that the word "solely" should not be read literally. The court held although investors must exert some effort—mainly convincing friends, neighbors, and others to attend the Adventure Meetings—primarily their profits came from the efforts of others, i.e., from the efforts of the Dare people at the meetings to convince the attendees to sign up and pay money for one of the Adventure levels.

The court held that the Dare multilevel sales scheme was an "investment contract" and therefore a security that had to be registered with the SEC before it was sold. The court held that Turner had sold unregistered securities in violation of securities laws and granted an injunction against Turner from selling any more Dare plans.

Note: Previous purchasers could sue to rescind the purchase agreement and recover the money they paid. *Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, **Web** 1973 U.S. App. Lexis 11903 (United States Court of Appeals for the Ninth Circuit).

41.3 Intrastate Offering Exemption: No, the issue of securities by McDonald Investment Company (McDonald) does not qualify for the intrastate offering exemption from registration. The company met most of the requirements for an intrastate offering exemption, such as (1) the company was a resident of Minnesota, i.e., it was incorporated in Minnesota; (2) its principal place of business was in Minnesota; (3) it was doing business in Minnesota with over 80 percent of its assets located in the state and over 80 percent of its revenues derived from within the state; and (4) the purchasers of the securities were all residents of the state. However, to qualify for the exemption, at least 80 percent of the proceeds from the offering must be invested in the state. Here, the entire proceeds from the securities issue were invested in loans on real estate and other assets located outside the state of Minnesota. Because of this fact, the Court held that the transaction did not qualify for an intrastate offering exemption from registration and issued an injunction prohibiting the continued sale of the securities.

Note: Investors who purchased the securities could also rescind their purchase agreement. *Securities and Exchange Commission v. McDonald Investment Company,* 343 F.Supp. 343, **Web** 1972 U.S. Dist. Lexis 13547 (United States District Court for the District of Minnesota).

41.4 Transaction Exemption: No, the sale of the Continental securities by Wolfson and his family and associates does not qualify for an exemption from registration as a sale "not by an issuer, underwriter, or dealer." The Court held that an issuer includes any person who directly or indirectly controls the issuer. In this case, Wolfson controlled Continental. He was its largest shareholder, made the policy decisions for the corporation, and controlled and directed the company's officers.

The court found that the defendants had tried to conceal the sale of the securities by selling them over an 18-month period through many different brokers. The court held that these sales constituted a major "distribution" of Continental securities that should have been registered with the Securities Exchange Commission if the sales did not qualify for an exemption from registration. The court held that the securities sales did not qualify as a sale "not by an issuer" because Wolfson had been found to have been in control of the issuer of the securities—Continental. The court held that Wolfson and his family and

associates should have registered the securities with the SEC, and that they had violated Section 5 of the Securities Act of 1933 because they had not registered the securities.

Note: On the witness stand, the defendants took the position that they operated at a level of corporate finance far above such “details” as securities laws and were too busy with “large affairs” as to bother themselves with such minor matters as securities laws. The court, obviously, rejected this defense. *United States v. Wolfson*, 405 F.2d 779, **Web** 1968 U.S. App. Lexis 4342 (United States Court of Appeals for the Second Circuit).