THE NEW JERSEY SECURITIES ACT

New Jersey, like every other state located in a thickly populated area of great business and industrial activity, is a fertile field for vendors of questionable securities. Furthermore, proximity to one of the world's great financial centers makes it a most convenient base from which to carry on unlawful practices in all parts of the country by use of the mails, telephone and telegraph. During the recent period of inflation, the enforcement by New York and Pennsylvania of laws designed to prevent fraud in connection with marketing stocks drove great numbers of dishonest promoters into New Jersey and brought about such a serious condition of affairs that its legislature, in 1927, after a study of the situation, replaced an unworkable act with one which, as amended and supplemented during the three following years, is still in force. This left Nevada and Delaware as the only states which had not followed the lead of Kansas and adopted some form of legislation with a like object and the latter has since fallen in line, although its law is not particularly effective.

England, notwithstanding opposition to the first proposal,

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1 Sec. 1, Chap. 79, Laws of 1927.
3 Chap. 79, Laws of 1927; Chap. 344, Laws of 1929; Chap. 51 and 52, Laws of 1930; Chap. 226, Laws of 1931.
4 Chap. 133, Laws of 1911, State of Kansas.
5 Alabama, 1919 Maine, 1913 Ohio, 1913
6 Arizona, 1912 Maryland, 1920 Oklahoma, 1919
7 Arkansas, 1915 Massachusetts, 1921 Oregon, 1913
8 California, 1913 Michigan, 1913 Pennsylvania, 1923
9 Colorado, 1923 Minnesota, 1917 Rhode Island, 1923
10 Connecticut, 1921 Mississippi, 1916 South Carolina, 1915
11 Delaware, 1931 Missouri, 1913 South Dakota, 1913
12 Florida, 1913 Montana, 1913 Texas, 1913
13 Georgia, 1917 Nebraska, 1917 Utah, 1919
14 Idaho, 1913 New Hampshire, 1917 Vermont, 1917
16 Indiana, 1920 New Mexico, 1921 West Virginia, 1913
17 Iowa, 1913 New York, 1921 Wisconsin, 1913
18 Kentucky, 1920 North Carolina, 1911 Wyoming, 1919
19 Louisiana, 1912 North Dakota, 1913 Washington, 1923

The above list indicates the years in which the statutes were enacted, but very few of them now exist in original form, the great majority having been extensively amended or superseded by new legislation.

*A special committee of the British Board of Trade in 1895 considered and rejected as dangerous "every suggestion for a public inquiry by the registrar or
enacted measures intended to prevent and punish the practices above mentioned long before any serious thought was given to the matter here or in the Canadian Provinces, all of which now have such laws.

Experience has shown that many of the problems arising in connection with dishonest stock selling schemes have exclusively distinctive characteristics and a review of the statutes on the books of the different governmental units will disclose variations in type, also special provisions drawn with the idea of meeting difficulties peculiar to a given geographical section. The outstanding features of these laws can be divided, roughly, into three classes:

I. **Regulation**
   A. Those which require that the securities be registered, qualified or licensed.
   B. Those which require that the dealer or seller be registered, qualified or licensed.

II. **Injunction** (New York, New Jersey, Maryland and Delaware).

III. **Publicity** (English Companies Act).

The administration of a law containing IA and/or IB features is usually placed in the hands of a commission or commissioner specifically empowered to issue and revoke licenses, qualifications and registrations. Type II, on the other hand, contains no such provisions and the injunction is the principal weapon provided for combating fraud. The Attorney-General has invariably been charged with the task of enforcement. A law which depends on publicity (type III) as one of its effective characteristics is the English Companies Act passed in 1929. The groundwork of this bill was laid in a report by a committee of the Board of Trade and it succeeded another statute enacted in 1908. Although no licensing, qualification or registration of stock issues or of those engaged in distribu-

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other official authority into the soundness, good faith and prospects” of a proposed promotion.

"An Act to consolidate the Companies Acts, 1908 to 1928, and certain other enactments connected with said Acts" (10th May, 1929) (19 and 20 Geo. 5, Ch. 23).
ting them is required, every company about to offer shares for sale to the public, must file certain information with the Registrar, which is available to any person wishing to see it, and not only are the promoters, officers and directors held responsible for the correctness thereof, but severe personal penalties may be imposed on them for any frauds to which they have been a party. The fundamental theory of this legislation is to give full publicity to the material facts of all plans for financing corporations, place an affirmative personal responsibility on the promoters, officers and directors and punish them for failure to live up to it.

In the United States there are two schools of thought with respect to securities fraud legislation, one favoring the regulatory type and the other advocating injunctive statutes. Critics of the latter say that the official in charge of enforcement has no way of knowing what is going on and acts only when a matter is specifically brought to his attention, so that proceedings are usually started during or following the consummation of a scheme, which in effect is to lock the barn after the horse is stolen.

Critics of the former say that it is paternalistic and attempts through a licensing authority to dictate how and where the investor's money is to be employed, with the result that many persons rely too much on the governmental sanction without making proper investigations of their own. It seems impossible to destroy the impression in the public mind that an issue which has been favorably passed on by a commission or commissioner is in some way guaranteed as a business proposition by the state. The assertion is also made that no man or body of men can review with any degree of efficiency the mass of applications coming before them under regulatory statutes, so that registrations or licenses are frequently given to issues or sales organizations not entitled to them. Moreover, it is comparatively easy to present a financial set-up which cannot be criticized when the application is filed, and after the license has been granted there is nothing to prevent stock from being sold in a fraudulent manner until, as under an injunctive act, the matter is once more brought to the attention of the licensing officer. He then finds himself in the position of having to lock
the barn against a thief who originally came in at his express invitation.

Recently, in some states that require licensing or registration, an injunctive provision has been added, but it cannot yet be said whether this reveals a trend away from regulation. Other factors, however, indicate that publicity, the injunction and more strict personal accountability on the part of promoters, officers and directors, under both the civil and criminal law, will be emphasized in the future.

Evolution of securities fraud legislation and developing efficient enforcement thereof have been slow processes in every state, because of the lack of court opinions and other precedents to serve as guides in formulating policies of administration. The so-called Martin Act⁸ was passed by the New York Legislature in 1921, but nothing of any real value was accomplished until 1925. The Pennsylvania Securities Act became a law in 1923, but adverse judicial decisions destroyed its effectiveness until many important sections had been redrafted.⁹ With the hope of avoiding similar trouble, the small staff assigned to administer the New Jersey statute during the first two years gave very careful study to preparation of the few suits that could be instituted, and as a result of an earnest effort to discover and eliminate weaknesses before attention was directed to them by reported opinions, every section of the original act was eventually amended or supplemented.

The New Jersey law is of the injunctive type and does not require any publicity. Provision is made for compelling full disclosure to prospective investors by prohibiting the use or employment of any deception, misrepresentation, concealment, suppression, fraud, false pretense, false promise or fictitious or pretended purchase or sale in connection with the issuance, sale, purchase, offer to purchase, promotion, negotiation, advertisement or distribution of securities.¹⁰ That the legislature intended the above to apply only to material facts was indicated

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⁸ Chap. 649, Laws of 1921; Chap. 21, Art. 23-A, Sec. 352-359g of the Consolidated Laws.
¹⁰ Sec. 2.
in *Stevens, Attorney-General v. Adelphia Finance Service, Incorporated, et als.* 11 Four individuals organized this company and became its officers as well as a majority of the Board of Directors. The capitalization was 20,000 shares of preferred stock with a par value of $25.00 and 60,000 shares of common stock without par value, all of the voting power being vested in the latter. Pursuant to a resolution, 40,000 shares of the common stock were turned over to the organizers at 10 cents a share, and a campaign was started to sell to the public not only the remaining unissued stock but also that owned by the Board members personally, at $15.00 a share, an advance of 14,900% over the price at which they had bought. The same sales organization was used to handle both, but none of the aforementioned manipulations was disclosed, except through a statement made to some purchasers indicating that the stock in question had been sold to the officers at a "nominal figure," in lieu of salaries, so as to reduce overhead. No buyer knew what the actual consideration was, and one testified she thought a "nominal figure" meant $1.00 per share, which would have meant that the company's treasury had received $40,000.00 instead of $4,000.00. There was never any contract or definite understanding as to what services these men were to perform without salaries or for what period of time. Their affidavits said the idea was to insure continued control of the company by the organizers and permit a comparatively small portion of their stock to be resold at a figure which would partially compensate for services in completing the organization and acting as officers. There was no restriction, however, against selling all of the stock, and at $15.00 a share it meant a profit of $600,000.00 for something entirely undefined. The failure to disclose the transactions above described was held to be a violation of the act, and when the defendants tried to excuse themselves by claiming that no sales were made except after all inquiries had been fully answered, the court said, "The obvious way to inform purchasers would have been to set it forth in their circulars and on their subscription agreements. This they did not do—and it is inescapable that they were guilty of suppression and concealment of these material facts."

"107 N.J.Eq. 222; 152 Atl. 460 (Ch. 1930)."
The responsibility for enforcing the Securities Act is placed with the Attorney-General, and by the provisions thereof he is empowered to subpoena witnesses and examine them under oath, also compel the production of such records, books, documents, accounts and papers as may be relevant. He may undertake an investigation upon complaint or whenever he believes it in the public interest to do so, and his authority was upheld in *Katzenbach, Attorney-General v. Tomadelli Electronic Corporation*. The Chancery Court, through the medium of an opinion later adopted by the Court of Errors and Appeals, emphasized the fact that the Attorney-General was entitled to the prescribed reports and information whenever it appeared to him, not to the Court, that any person had engaged in, was engaging in, or was about to engage in an illegal practice, or whenever he, not the Court, believed it to be in public interest that an investigation should be made. "It rests absolutely with him," says the opinion. "He need not in the first instance allege and establish the guilt of the defendants of fraudulent sales."

In response to a subpoena served by the Attorney-General on an organization formed under the statute respecting associations not for pecuniary profit, the President appeared and produced a specimen copy of a certificate of membership providing for the payment of certain sick and death benefits. After asserting that this was the only instrument issued by the association, he declined to produce any of the books, records, and other papers called for and refused to give testimony as required. The reason advanced was that the certificate did not come within the meaning of any of the terms used in Section 2 of the Securities Act. Appropriate proceedings were instituted, and it was held that forming an organization under the statute in question did not excuse the proper officers from appearing and making discovery. The association's functions and how it came into being were immaterial at that juncture.

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12 Sec. 3.
13 102 N.J.Eq. 186, 140 Atl. 26 (Ch. 1928); aff. 104 N.J.Eq. 217, 144 Atl. 920 (E. & A. 1929).
14 Chap. 181, Laws of 1898 as amended and supplemented.
If an investigation indicates that there has been, is or is about to be a violation of the law, the Attorney-General may, by appropriate proceedings in the Court of Chancery, cause the offenders to be permanently enjoined from continuing the illegal practices and even from promoting or selling any securities within or from the state. A receiver may also be appointed to liquidate the affairs of the offenders under judicial supervision. Stevens, Attorney-General v. James J. Wallace, trading as Wallace & Company, et al. was the first suit in which the Court of Chancery handed down a written opinion discussing the practices declared by the statute to be unlawful and it also happens that this case has, up to the present time, been productive of more litigation than any other. The bill of complaint was filed against a number of individuals who were carrying on a business that purported to furnish to subscribers located in all parts of the United States and Canada, an impartial, expert financial advisory service. As a matter of fact, the defendants were doing nothing more or less than unloading worthless or practically worthless stocks at unconscionable profits by recommending them in their literature. They strenuously contended that the New Jersey courts had no jurisdiction, because not a single sale had been made to anyone in that state, but an injunction issued under section 6, nevertheless, and a receiver was appointed under section 7, subsection a. He refused to allow certain claims because they did not arise by reason of the use and employment by the defendants of practices declared to be illegal and an appeal was taken from his decision. There has been a certain amount of confusion as to just what property a receiver appointed under the Securities Act may take into his possession and to whom he should make distribution. This can

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16 Sec. 6.
17 Sec. 7.
18 106 N.J. Eq. 352, 150 Atl. 835 (Ch. 1930).
19 A receiver appointed under Section 7, subsection (a) is empowered to take into his possession all the goods and chattels, rights and credits, moneys and effects, lands and tenements, books, records, documents, papers, choses in action, bills, notes, and property of every description, derived by means of any practice declared to be illegal and prohibited by this act, including also all property with which such property has been mingled, if such property cannot be identified in kind because of such commingling.
20 9 N.J. Misc. 351, 155 Atl. 539 (Opinion by Chancery Receiver 1930).
easily be cleared by observing that section 7 is divided into four parts, each respectively authorizing the appointment of a receiver for a an individual, b a corporation, c a partnership, company or association, and d a trust. Subsections b, c and d say that all the property of the organizations shall vest in the receiver, who shall distribute the assets in accordance with the provisions of the General Corporation Act so far as they are applicable and who shall also have all the powers and duties conferred upon receivers by that statute. On the other hand, the receiver of an individual under subsection a takes only the property derived by means of illegal practices, also such property as has been mingled therewith, if it cannot be identified in kind. Payment, furthermore, is made only to those who establish an interest by reason of the use and employment of illegal practices. This is not arbitrary or discriminatory, because the distinction between a natural individual and one whose existence or power to do business depends on franchises or privileges conferred by the state is reasonable. The sovereign exercises a larger power over the latter and may deal more drastically with those involved.\textsuperscript{21} In the \textit{Wallace} case all the defendants were individuals and it was subsection a to which the Court of Errors and Appeals referred when affirming the receiver's decision.\textsuperscript{22}

It was urged without success on argument of this appeal that the exceptants (appellants) had been denied due process of law and a further contention was that if, on distribution, the creditors whose claims arose out of fraud were allowed a priority over contractual creditors, the statute denied to the latter the equal protection of the laws in violation of the Fourteenth Amendment of the United States Constitution. This, too, was held to be without merit.\textsuperscript{23}

\textsuperscript{21} Stevens, Attorney-General v. Ira M. Havens, et als., unreported memorandum filed Sept. 12, 1932; Chancery docket 76, page 15.
\textsuperscript{22} 111 N.J.Eq. 406, 162 Atl. 646 (E. & A. 1932).
\textsuperscript{23} "Here appellant seems to concede that the Securities act, \textit{supra}, is a legislative enactment permitted by the police powers of the state, but he urges that if such act is to be construed as requiring and permitting only claimants whose rights and claims accrue through and from the inhibited fraudulent practices proscribed by the act to participate in the funds so illegally and fraudulently obtained and accumulated, to the exclusion of all other creditors, then the act is unconstitutional because it is 'unreasonable, arbitrary and illusory.'

"We conclude that this ground is wholly unsubstantial and without merit in reason and law, for the reason that from the beginning and ever since, the law
The appellants also argued that the receiver's refusal to allow contractual claims constituted a violation of article 4, section 7, paragraph 11, placitum 7 of the State Constitution prohibiting special laws granting exclusive privileges, because a preference in favor of the claims based on fraud was thereby created. But it was stated that this had been answered to the contrary in the discussion of the preceding point.

Before leaving this subject, it should be noted that to allow the enforcement of subscriptions to stock, the further sale of which had been restrained as fraudulent, would create an anomalous situation, and a petition filed by receivers asking permission to proceed with pending suits at law and institute new ones on other such subscriptions was dismissed.24

Section 6, it has been noted, authorizes the issuance of an injunction not only against continuing the illegal and prohibited practices or engaging therein or doing any acts in furtherance thereof, but also from issuing, selling, offering for sale, purchasing, offering to purchase, promoting, negotiating, advertising or distributing any securities within or from this state.

very righteously has been that a thief shall not profit by his nefarious and criminal acts and the property in such ill-gotten gains, never, in law, resides in him, but always remains in the victim from whom he took them. So likewise is the law respecting property obtained from another by fraudulent means and practices. In all such cases the law immediately sets up a constructive trust—the malefactor holding such property, in the eyes of the law, in trust for the use and benefit of those who contributed of their properties thereto through and because of such fraud.

"In 39 Cyc. 170, it is said: 'Constructive trusts arise by operation of law and not by agreement or intention and are not within the statute of frauds or statutes prohibiting parol trusts. Fraud, actual or constructive, is the basis of such a trust and a court of equity will not permit a person to shield himself behind the statute of frauds in order to perpetrate a fraud.'

"Our reports are full of cases where this doctrine has been asserted and employed."

"In the case before us the legislature has declared that certain practices are fraudulent and prohibited; the court below has found that such charges as against the defendants were established and that finding is not here attacked; the funds in the hands of the receiver are the result of and, it may be said, the reward of such fraudulent activities and created and accumulated in the hands of the defendants because of such practices and from the property of a large number of claimants who were the victims of such practices.

"We conclude that, by all reason and precedent, the title to such funds is in these parties and never was, and is not now, in the defendants and therefore never was legally answerable for the general debts of the defendants." Stevens, Attorney-General v. James J. Wallace, et als., supra, at p. 413.

The opinion of the Chancery Court in *Stevens, Attorney-General v. Washington Loan Company, et al.* was adopted by the Court of Errors and Appeals, and with respect to this provision the following comment was made:

"The legislature intended that the court should not only stop the fraudulent practices under investigation, but as well suppress the swindlers and swindling companies by enjoining them from further dealing in any securities in this State. A less drastic injunction—one directed against fraud in a definite stock would simply mean to these dextrous operators a shift to another company and as easily accomplished as changing their hats."

John Doyle and Charles Doyle, the two promoters of the Washington Loan Company, were included as defendants, and a brief outline of the facts brought out by the investigation will be interesting as an illustration of the tangled situations that result from too persistent attempts to make something out of nothing. The corporation was organized through dummies, to deal in securities, the authorized capital being 10,000 shares of no par value. John Doyle subscribed for 5,000 shares to be paid for in three years at the following prices:

First 3,500 at $1.00 per share  
Second 750 at $2.50 per share  
Third 750 at $5.00 per share

The remaining 5,000 shares were to be sold to the public in this manner:

First 1,000 at $10.00 per share  
Second 1,000 at $12.50 per share  
Third 1,000 at $15.00 per share  
Fourth 1,000 at $17.50 per share  
Fifth 1,000 at $20.00 per share

The Doyles, as a matter of fact, took down only 2,775 of the 5,000 shares assigned to them and paid $3,337.50 therefor. John Doyle sold 1,100 of their shares to "responsible and important

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*107 N.J.Eq. 94, 152 Atl. 20 (Ch. 1930); aff. 109 N.J.Eq. 128, 156 Atl. 420 (E. & A. 1931).*
men in the community,” where they would do the most good.

The Washington Loan Company eventually issued a total of 7,635 shares, and the balance over the 2,775 taken by the Doyles were bought by the public at fancy prices, some as high as $17.50 per share. It also created a two and a half million dollar $8\%$ debenture bond issue, of which $160,000.00 worth was sold on the installment plan. A short time prior to the filing of the Attorney-General’s bill, the cash receipts from stock and bond sales were $71,392.09, of which all but $1,289.84 had been spent in commissions, salaries, organization, and other expenses. This depletion was brought about by the payment of a $20\%$ commission on the sale of bonds and stocks as soon as 25\% of the subscription had been paid in, and Charles Doyle had the commission contract. They next formed the Washington Loan Company of Atlantic City, with an authorized capital of 500 shares at a par value of $100.00 each. It was supposed to engage in the small loan business but never functioned. Prior to this, one of the Doyles had agreed to buy for $7,500.00, seventeen mortgages, with an aggregate face value of $99,600.00, on seventeen parcels of land in the Jersey pine belt, six miles from a State highway, accessible only by a narrow sand trail, and which had been purchased by the mortgagor for $50.00. It was agreed to sell these mortgages to the Washington Loan Company at a profit of $12,500.00, and this organization then assigned them to the Washington Loan Company of Atlantic City for 334 shares of its stock at $300.00 a share. Thereafter the Washington Loan Company, on its books and statements, carried the worthless stock as an asset of $100,200.00, while the Washington Loan Company of Atlantic City carried the mortgages as an asset of $99,600.00. Thus the bogus mortgages did double service. The foregoing manipulations, as well as others which there is not sufficient space to describe, were suppressed and concealed in advertising and offering the stock of the Washington Loan Company for sale to the public.

It was urged that the Washington Loan Company of Atlantic City was not culpable because all of its stock had been sold only to the Washington Loan Company, but the Court observed that the mischief aimed at was the vicious practice of cheating in securities and that the statutory sweep included all
who participated in the deception.

"To give this sanction would open the way wide to every crooked company to escape the statute. Notice of a fraudulent issue of stock, available to a co-swindler for sale, pledge or to obtain a false credit, as in the present case, would furnish immunity from prosecution. The loop hole is not in the statute. The act is comprehensive in its reach for the evil it strikes at and it pertinently denounces as illegal any fraud, any false pretense or any fictitious or pretended purchases or sale in connection with the issuance * * * negotiation or distribution * * * of any stocks; and any corporation which has engaged in, is engaging in, or is about to engage in any of the practices declared to be illegal is subject to restraint."

It was concluded that the Washington Loan Company of Atlantic City, the Washington Loan Company, and the two Doyles had violated the Securities Act, and all came under its ban.

The matter of procedure was settled by Stevens, Attorney-General v. Associated Mortgage Company of New Jersey,26 which the Court of Errors and Appeals also affirmed, adopting the opinion written by the Chancellor sitting in Equity. This case, incidentally, is the first one in which any authorities were referred to, all previous opinions having based their conclusions on general equitable principles without citations. The defendants contended that the hearing on the return day of the order to show cause was merely preliminary and that they were entitled to another at a later date, but this was denied under the provisions of Section 6, which authorizes the court to proceed in a summary way to hear the affidavits, proofs and allegations offered on behalf of the parties. This procedure is akin to that established for some time under the General Corporation Act, a statute having similar provisions with respect to insolvent corporations.27 A subpoena ad respondendum need not be is-

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26 107 N.J.Eq. 297, 158 Atl. 461 (Ch. 1930); aff. 110 N.J.Eq. 70, 158 Atl. 343 (E. & A. 1932).
27 Pierce v. Old Dominion etc. Smelting Co., 67 N.J.Eq. 399, 410, 58 Atl. 319 (Ch. 1904).
sued, because process is merely the means of compelling a defendant to appear in court, and it need not necessarily be a subpoena or other writ; it may be an order or notice. Every state has the power to prescribe a reasonable notice which shall be given in order to subject a defendant to the jurisdiction of its tribunals.28

The financial acrobatics executed by the promoters of the Associated Mortgage Company were, if anything, more complicated than those described in the preceding case. On forming the corporation, 9,000 of the 20,000 authorized common shares were issued to the entrepreneurs for their services, but no estimate as to the value thereof was ever made. A contract was entered into, providing for the payment of a 25% commission on sales of stock, and when $111,110.00 worth had been sold, the cost of organization and distribution aggregated $51,882.28. The President received several thousand common shares for nothing, and later sold 745 of them back to the corporation at $5.00 each, payment being made in cash from capital because earnings had been insufficient to allow it to be taken out of surplus. Circulars issued in connection with the stock offering stated that dividends had been paid consistently. As a matter of fact, the earnings from operations at the time these circulars came out were $1,728.00, while dividends totaling $3,401.02 had been paid. Thus it is apparent that there was absolutely no justification for such procedure, and if the cost of selling securities, organization expenses, and operating overhead is considered, there was in reality a deficit of $43,429.67. Approximately 9,000 shares of common stock were issued gratis to certain salesmen for the purpose, it was said, of procuring members of a so-called Advisory Board. They were sold by the recipients at from $5.00 to $15.00 a share, but the company got none of this money. One of the circulars listed, under the heading “Directors and Advisory Board,” the names of eighteen different prominent men with their vocations and titles. A great proportion of them were in reality merely stockholders and had no interest or voice in the management. Their only value was as window dressing in the sale of securities.

28 In re Martin, 86 N.J.Eq. 265, 273, 98 Atl. 510 (Ch. 1916).
The defendant advertised and offered its capital stock in units of one share of preferred and two shares of common, no par, at $150.00 per unit, but concealed and suppressed from prospective purchasers the above described transactions and the condition of affairs resulting therefrom. Other matters not reviewed here should also have been disclosed, and the Court, in holding that the Securities Act had been violated, observed that the officers and directors were chasing a will-o' the-wisp, endeavoring to work an age-old scheme of transmuting base metal into gold, of conceiving that something could be made out of nothing, in which effort they were unsuccessful, and such of the public as had invested in their securities, to use a modern phrase, had been left holding the bag.

Just what instruments come within the meaning of Section 2 is a question that is bound to recur from time to time. Stevens, Attorney-General v. Liberty Packing Corporation, et als., discussed one phase of it and held that an agreement to lease rabbits which purported to pay for their offspring a profit of $56.00 a year over a period of ten years, upon an investment of $175.00, and a contract to sell rabbits and buy back their offspring at $1.00 apiece for ten years upon an investment of $300.00 both came within the purview of the act. They were written assurances for the return or payment of money. A review of all surrounding facts showed that it was impossible to perform either and that the guarantees were worthless. The scheme was accordingly branded a pure swindle, in which the money of new purchasers was used to placate earlier victims, only to collapse when there were no more to plunder. It came specifically within the definition of fraud under the Securities Act, being a promise or representation as to the future which was beyond reasonable expectation and unwarranted by existing circumstances. Some of the breeders and purchasers of contracts objected to the action of the Attorney-General and represented to the Court that they did not seek the protection of the State. They then asked that the defendant be allowed to carry on, but such

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29 111 NJ.Eq. 61, 161 Atl. 193 (Ch. 1932).
30 35 Cyc. 1283; State v. Gopher Tire and Rubber Co., 146 Minn. 52.
objections by individuals never relieve the State from its right and duty to protect its citizens through the police power.\textsuperscript{32}

Section 1 of the supplement, passed in 1930, provides that service, substitute for personal service in this State may be made, among other ways, by registered mail addressed to the last known place of business, residence or abode within or without this State. \textit{Stevens, Attorney-General v. Television, Inc., et als.}, held such a service to be valid.\textsuperscript{33} It was argued that the suit was in personam and that there could be no personal judgment without personal service within the State.\textsuperscript{34} This was admitted to be true as a general proposition, but attention was directed to the fact that the Fourteenth Amendment of the United States Constitution, which declares that no state shall deprive any person of life, liberty, or property without due process of law, had not been invaded, because denying a license to defraud was not a deprivation of either liberty or property. It was not a case of seeking personal recovery against the defendants but an action to foreclose them. The State did not ask anything of them and wanted nothing, but having driven them out, it sought assurance, by the injunction, that they would not return except to show that they were not guilty of the offense with which they were charged.\textsuperscript{35}

\textsuperscript{32}"The objects, then, are to prevent fraud and unfair dealing in securities, as well as to prevent honest people, free from sinister influences, from investing in uncertain, ephemeral, 'get-rich-quick' stocks and securities. In other words, it is a statute designed, in part, to protect credulous persons against their own inherent weakness—a weakness akin to the gambler's hope of winning a prize. We think it is well settled that both of these objects, within constitutional bounds, properly come within regulations prescribed by the police power of the state. Clearly, the state has the right to protect its citizens against impositions and frauds. Just how far the state may go in acting as a guardian for its incompetent and improvident citizens is not so definitely established." Hornaday v. State, 208 Pac. 228.

\textsuperscript{33}111 N. J. Eq. 306, 162 Atl. 248 (Ch. 1932).

\textsuperscript{34}Pennoyer v. Neff, 95 U.S. 714.

\textsuperscript{35}"If they do not avail themselves of the opportunity to contest the merits, they cannot, on a special appearance, be heard to assail the power of the state to enforce its police regulations against marauders, nor, question the court's jurisdiction to banish them for failure of service of process within the state, which they have made impossible or for want of a hearing before condemning, to which they refuse to respond. The statutory process puts them on notice. They have their choice of appearing and proving their innocence or the consequences, by staying away. They may submit to our jurisdiction or decline; in either event they will be estopped from denying it.

"That the state has the power to ordain against imposition in the sales of fraudulently represented securities is established law. Hall v. Geiger-Jones Co.,
There was no merit in the contentions\textsuperscript{36} of the corporate
defendant that it was immune from the jurisdiction, because it
had not applied to qualify under the General Corporation Act
in New Jersey and that selling its capital stock was not doing
business there. It was not charged with doing business in any
state, but was denounced for swindling and was entitled to no
privilege of being judged by the courts of its domicile, because
they had no jurisdiction over the subject matter.\textsuperscript{37}

In all appeals, except those of certain claimants in the
Wallace litigation, supra, the Court of Errors and Appeals
adopted the Chancery opinions, and they \textit{ipso facto} have be-
come pronouncements of the appellate tribunal.

The judicial discussions of several important constitutional
questions resulting from a receiver's rejection of certain claims
have already been reviewed. The original statute's title was
also considered from that angle and upheld with the comment
that a more comprehensive one would be difficult, if not impos-
sible, to suggest.\textsuperscript{38}

Perhaps the most vexing problem in connection with mar-
eting and promoting securities is the employment of dishonest
methods by those who locate in a given state and sell exclu-
sively to persons living outside of its territorial jurisdiction.
Many statutes do not contain provisions designed to cope with
these situations, and no loop hole in securities fraud legislation

\begin{footnotes}
\item[36] Union Trust Company v. Sickels, 109 N.Y. S. 262; Wilson v. American
  Police Car Co., 65 N.J. Eq. 730, 55 Atl. 997 (E&A 1903).
\item[37] See XVIII CORNELL LAW QUARTERLY, No. 3, at 435.
\item[38] "This question of titles of legislative acts being or not being, in consonance
  with the constitutional requirement has never been more tersely and exactly defined
  than by the opinion of Mr. Justice Garrison, in Gottuso v. Baker, 80 N.J. Law
  520, in which it was held, and ever since has been followed as a precedent, and
  without dissent, by our judiciary, 'under our constitutional provision the title of an
  act is in the nature of a label by which the object of the act is displayed; it is not
  a table of contents or an index to everything that the statute enacts.'" Stevens,
\end{footnotes}
has been taken advantage of by stock swindlers to a greater extent than this one. It goes without saying that for the laws of any governmental unit to be so loosely drawn as to allow such operators to find sanctuary within its borders is entirely wrong, and New Jersey, by an appropriate amendment, has brought them within the purview of its legislation. This was a most important enactment, because, as said at the outset, the State's proximity to one of the world's great financial centers, makes it an unusually convenient base from which to carry on activities in all parts of the country. If the amendment had not been adopted, there would be no machinery to stop the operations above described. The constitutionality of the statute's title as amended was assailed in Stevens, Attorney-General v. Home Brewery, Inc., et als., and Heddon v. Hand was cited in support of the defendants' contention, without success. It was also relied on as an authority in urging that a jurisdiction conferred only upon the law courts had been unconstitutionally vested in Chancery by the legislature. This contention, too, was held to be without merit.

89 A preliminary restraint had been issued under Chapter 344, Laws of 1929, enjoining the defendants in the language of the statute from selling any securities within this State. While the injunction was in force they sold stock to persons outside of New Jersey although the sales were promoted here. Proceedings were instituted with the object of having them adjudged in contempt, but it was held that the act as it then stood did not ban such operations. Before this opinion was handed down Chapter 52, Laws of 1930 had been enacted and the court said that as amended the statute would ban such activities. Stevens, Attorney-General v. Wrigley Pharmaceutical Company et als., 9 N.J. Misc. 385. 154 Atl. 403, (Ch. 1931).

40 112 N.J.E. 513 (Ch. 1933).
41 "The defendants assail the constitutionality of the act under which these proceedings are prosecuted. The original act of 1927 (P.L. 1927, p. 132) prohibited the fraudulent sales of securities within the state. In 1931 (chapter 236) the act was amended to prevent the sale in other states 'from within this state.' The title of the amending act is entitled as an amendment of, reciting the title of the original act. The amendment extends the subject-matter of the original act, it does not introduce an additional subject foreign to the original title as in Heddon v. Hand, 90 N.J. Eq. 583, relied upon to support the point that the amendment transgresses, paragraph 4, section 7 of article 4 of our constitution, in that the object is not expressed in the title." Stevens, Attorney-General v. Home Brewery, Inc., et als, supra at page 516.
42 "The prevention and redress of fraud is equity's birthright. Chancery came into being because the law courts failed or refused to take cognizance of unconscionable conduct. The prevention of fraudulent imposition upon individuals or the public is exquisitely within chancery's province and its weapon the injunction. The act dealt with, in the cited case, conferred jurisdiction upon chancery to suppress existing evils, public nuisances (crimes), a subject of redress peculiar to the law courts, in the criminal division, and consequently inhibited by the constitution.
Home Brewery, Inc., was organized with a capitalization of 1,000,000 shares, par value $1.00, by two individuals who bought a brewery for $237,500.00, although only $7,500.00 was paid in cash, the balance being taken care of by mortgages. One of them became President of the company, which bought the contract for 200,000 shares of its stock. A selling organization was given a call for 300,000 shares at $1.00 each and an option for 250,000 more. This outfit directed most of its activities toward unloading for the promoter his allotment of 200,000 shares, without disclosing to purchasers that they were buying personally owned stock, the proceeds of which did not go to the corporation. Only 437 shares of unissued stock were sold as against $15,000.00 worth of the personally owned block. The court particularly called attention to a pro forma balance sheet attached to one of the circulars, in which the value of the brewery with machinery and fixtures had, "by some peculiar mental twist common to promoters," been written up to over a million dollars in spite of the fact that none of the directors thought enough of the proposition to invest one cent of his own. All the risk was passed on to the public, and the Vice Chancellor who heard the matter said: "... the directors maintain that the brewery property is of the value as represented ... in the misleading statement, and that the company has a surplus of $600,000 and upwards. That is a pretense and absurd, and to use it as a basis for future sales of stock would be a fraud.”

A review of the cases which have been decided under the Securities Act shows that those engaging in unlawful practices always try their best to avoid making misrepresentations. They are too easy to detect and usually are not necessary anyway, because the average American has such an optimistic imagina-

The Securities act on the contrary, is purely preventive, protecting individuals as members of the public from the racketeer in securities, suppressing him, it is true, but only as a preventive measure against further fraud. The act is not redressive; it has penalties, but their vindication is left to the criminal courts. The receivership provision is not redressive against the culprit, but a means of gathering the loot for restoration to his victims. In none of these features does the act infringe upon the inherent jurisdiction of the law courts, civil or criminal. The law courts redress wrongs; equity apprehends and prevents them, and that cardinal distinction of the two jurisdictions was observed by the legislature in committing to chancery the enforcement of its newly adopted policy of arresting fraud instead of redressing it after the harm is done.” Stevens, Attorney-General v. Home Brewery, supra, at page 516.
tion that if given a few favorable facts under the right circum-
stances, he will automatically work himself into a frame of mind
to buy. The wise operator, who knows how to take full advan-
tage of this characteristic, will, after outlining the proposal in
a proper setting, direct his best efforts toward seeing that all
unfavorable information is concealed from the prospective vic-
tim. Thus, when the sale has been consummated only a mini-
mum amount of direct evidence relating to any of his activities
can be found. A good illustration of this is Rex v. Kylsant43
wherein the English Court of Criminal Appeal said:

"This is one of those difficult cases, but not im-
possible cases, which have occurred from time to time
in the course of company transactions, where a docu-
ment has been put forward in order to be acted upon
(prospectuses and other things), and put forward in
such a form that though it stated every fact correctly,
fact by fact, and everything was correctly stated by the
card, yet the true effect of what was said was com-
pletely false and completely misleading."

When opening to the jury in the above case, the Attorney-Gen-
eral quoted as follows from Aaron's Reefs v. Twiss:44

"If by a number of statements you intentionally
give a false impression and induce a person to act upon
it, it is not the less false although if one takes each
statement by itself there may be a difficulty in showing
that any specific statement is untrue."

Gluckstein v. Barnes,45 another English case, which concerned
a company and its prospectus, is authority for the following:

"My Lords, it is a trite observation that every
document as against its author must be read in the
sense which it was intended to convey. And every-
body knows that sometimes half a truth is no better
than a downright falsehood."

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43 Law Times Reports; Vol. 146, Number 3764.
45 82 L.T. Rep. 393; (1900) A.C. 240 at page 250.
Another outstanding feature of stock swindles generally is that very seldom can any one thing be pointed out as the deciding factor in a given case. Many acts, having no particular significance individually, will go to make up a course of conduct which possesses all the elements of fraud only when viewed as a whole.

The Attorney-General, although charged with the responsibility of enforcing the New Jersey Securities Act, is given no authority therein to supervise the general activities of corporations or their management and may concern himself with such matters only in so far as they affect the sale of securities. The rule is easy to state and although its application in practice is sometimes difficult, he must always keep in mind that his activities are limited to those prescribed by the law.

The original idea of the sovereign in creating the entity known as a corporation was to provide an instrumentality through which a number of individuals could more conveniently carry on and participate in the earnings of a given business or industry. Great numbers of companies were organized, however, for no other reason than to make it possible for the promoters to fill their pockets by manipulating stock and unloading it on the public. The New Jersey Securities Act and other statutes of a similar nature were adopted by the various states, because old laws were absolutely incapable of combating the many vicious practices which came hand in hand with the benefits of corporate existence. The theory of such legislation is that if healthy industries and prosperous business conditions are to be maintained, the employment of dishonest methods in organizing corporations and marketing their securities must be definitely and completely suppressed.

Richard C. Plumer.

Newark, N. J.