



1962

## North Dakota Blue Sky Law - Licensing of Securities Dealers and Salesmen

Mark J. Butz

David E. Nething

Follow this and additional works at: <https://commons.und.edu/ndlr>



Part of the [Law Commons](#)

---

### Recommended Citation

Butz, Mark J. and Nething, David E. (1962) "North Dakota Blue Sky Law - Licensing of Securities Dealers and Salesmen," *North Dakota Law Review*. Vol. 38 : No. 3 , Article 9.

Available at: <https://commons.und.edu/ndlr/vol38/iss3/9>

This Note is brought to you for free and open access by the School of Law at UND Scholarly Commons. It has been accepted for inclusion in North Dakota Law Review by an authorized editor of UND Scholarly Commons. For more information, please contact [und.common@library.und.edu](mailto:und.common@library.und.edu).

## NORTH DAKOTA BLUE SKY LAW—LICENSING OF SECURITIES DEALERS AND SALESMEN

“The prevention of loss or injury to the innocent by the ruthless will of the enemies of society or of the archaic-minded is an obligation of the state . . . .”<sup>1</sup> With these words Justice Moore described the underlying policy of securities regulation. Bearing this expression of public policy in mind we will attempt to examine its application in North Dakota.

The high rate of activity in the nation’s securities markets has focused the attention of legislators, attorneys, businessmen, and the general investing public on the legal requirements placed upon those persons who seek to engage in the business of selling securities. In 1958 the Legislative Research Committee set out to consider the securities problem in North Dakota. At that time, the possibility of adopting the Uniform Securities Act was discussed in detail, as well as several modifications of the Act. A comparison was made of our securities laws with those of neighboring states and the committee concluded that some provisions might be meshed into the North Dakota law to further strengthen it.<sup>2</sup>

The 1959 and 1961 Legislatures adopted many of the proposals made by the L.R.C. to improve our law.<sup>3</sup> One of the most noteworthy pieces of legislation in this field was passed in 1961 requiring a written examination of all salesmen prior to being licensed to sell securities.<sup>4</sup>

The following will be confined to a discussion of North Dakota’s law compared with the Uniform Securities Act on the subject; the Securities Commissioner’s authority; and the position of the purchaser when the securities law is violated. Mention will also be made of recent legislation regarding the licensing of securities dealers and salesmen.

### VARIATIONS OF THE UNIFORM SECURITIES ACT AND THE NORTH DAKOTA LAW:

In an effort to provide uniformity of state security laws, the National Conference of Commissioners on Uniform State

---

1. *People v. Hoshier*, 9 Cal. Rptr. 697, 206 P.2d 882 (1949).  
2. Legislative Research Committee Report on Securities (1958).  
3. N.D. Cent. Code § 10-04.  
4. N.D. Cent. Code § 10-04-10 (2).

Laws approved the Uniform Securities Act in 1956. Alaska, Hawaii, Kansas, New Jersey, Oklahoma, and Washington have subsequently adopted it.<sup>5</sup> The Act is divided into four parts. The first three represent the basic "Blue Sky" philosophies: the fraud approach; registration of brokers-dealers, agents, and investment advisors; and registration of securities. The fourth contains the general provisions.<sup>6</sup>

The general requirements of registration of security dealers and salesmen are the same under North Dakota's securities law as under the Uniform Act.<sup>7</sup> However, additional requirements have been added to enable the Securities Commissioner to screen the applicants more thoroughly. The provisions require a disclosure of all past affiliation with the securities business,<sup>8</sup> and a listing of past employers and employment for the preceding ten years.<sup>9</sup> Further, references as to the personal character and business reputation of the applicant must be submitted to the Securities Commissioner by three persons on forms provided by the Commissioner.<sup>10</sup>

Under the Uniform Act, the Administrator may rule that a registered broker-dealer or agent be required to post a surety bond in amounts up to \$10,000 and submit to further conditions set by him.<sup>11</sup> In North Dakota, the Commissioner requires an indemnity bond or a deposit of cash from the dealer, covering himself, his agents, and his salesmen.<sup>12</sup> A bond is also required for self-employed salesmen.<sup>13</sup> The amount of the bond is not specified, but the current practice is to bond each salesman for \$500.00.<sup>14</sup> This sum may be increased since the Commissioner has the power to set the amount.<sup>15</sup> The North Dakota dealer's bond provides for the total aggregate amount of the surety's liability, such amount being the maximum whether one or ten salesmen under the bond are in violation of the security laws.<sup>16</sup>

The basis for recovery on the bond varies. It has been held

---

5. Uniform Securities Act (Table of states wherein act has been adopted) (hereinafter cited as USA).

6. *Ibid.*

7. N.D. Cent. Code § 10-04.

8. N.D. Cent. Code § 10-40-10.

9. *Ibid.*

10. *Ibid.*

11. USA § 202(e).

12. N.D. Cent. Code § 10-04-10 (1).

13. N.D. Cent. Code § 10-04-10 (2).

14. Interview With Morris Tschider, Ass'n't. Securities Commissioner of North Dakota in Bismarck, Nov. 22, 1961.

15. *Indemnity Insurance Co. v. Philippi*, 48 Ohio App. 2d 248, 192 N.E. 884 (1934).

16. *Supra* note 14.

in *Walsh v. Standard Accident Insurance Co.* that the bond supplied by a salesman requires the faithful and honest performance of all obligations and undertakings in the purchase or sale of securities.<sup>17</sup> In another jurisdiction recovery was denied where money for the purpose of investment was appropriated to the salesman's own use because the bond was not a source of relief in conversion or misappropriation.<sup>18</sup> Another instance denying recovery on the bond has occurred where the seller was outside of his employment, thus making the bond inapplicable.<sup>19</sup>

If a private individual has a cause of action against a securities salesman, he may sue on the bond, although it runs to the people of the state as sole obligee.<sup>20</sup> The Uniform Act provides that a suit on the bond must be brought within two years after sale or other act upon which it was based.<sup>21</sup> A suit cannot be brought in North Dakota after three years from date of such sale or contract for sale nor more than one year after the purchaser has received information as to matter or matters upon which the proposed recovery is based.<sup>22</sup>

To be granted a bond in North Dakota, the dealer is often required to provide collateral in the amount of the bond itself. As a result, new, small companies may find this a heavy burden.<sup>23</sup> In addition, the money pledged as collateral lowers the available capital and thereby affects the applicant's net worth which is scrutinized by the Commissioner.<sup>24</sup> In view of the present law, and the implied authority of the Securities Commissioner, economic inequities may result.

#### COMMISSIONER'S AUTHORITY:

"The Securities Commissioner must protect the unsophisticated purchaser from unfair and inequitable securities and the sale of securities in an unfair manner."<sup>25</sup> He has the power to issue or refuse the license required by all persons desiring to

---

17. *Walsh v. Standard Accident Insurance Co.*, 215 Cal. 587, 12 P.2d 16 (1932).

18. *Giles v. Welling et al.*, 100 Cal. App. 515, 280 Pac. 539 (1929).

19. *Sharp v. E. D. Leavett & Co. et al.*, 111 Cal. App. 634, 295 Pac. 1082 (1931). In this case the seller was selling real estate instead of securities, thus making recovery on the bond impossible.

20. *Green v. Fidelity Casualty Co.*, 261 Mich. 508, 246 N.W. 208 (1933).

21. USA § 202(e).

22. N.D. Cent. Code § 10-04-17 (1).

23. Interview With Morris Tschider, Ass't. Securities Commissioner of North Dakota in Bismarck, Nov. 22, 1961.

24. *Ibid.*

25. See Letter from Richard Pringle, Securities Commissioner of Kansas, Nov. 14, 1961.

sell securities.<sup>26</sup> His judgment will determine who will sell securities and consequently serve the public as investment counsel.

In North Dakota, a license will not be issued to a person who is not qualified under the provisions set down by statute.<sup>27</sup> As a condition precedent to the issuance of a license, the Commissioner shall be satisfied of "the applicant's good repute in business".<sup>28</sup> This requirement is not at all uncommon. A majority of states make "good repute in business" a prerequisite to the issuance of a license.<sup>29</sup>

It is within the Commissioner's power to investigate and determine whether the salesman's license should be revoked because of possible violations of the Securities Act.<sup>30</sup> The power to revoke a license, as well as issue one, lies with the Commissioner. A salesman will lose his privilege if it is discovered that his application to obtain such permit was in any way false or fraudulent.<sup>31</sup>

A permit to sell securities in North Dakota may be revoked if the seller violates any of the provisions of statutory law.<sup>32</sup> When the Commissioner sees fit to revoke a license for any reason, he must give the salesman an opportunity for a hearing.<sup>34</sup> He will usually preside at such hearing and determine if the revocation should be continued.<sup>35</sup> He will usually preside at such hearing and determine if the revocation should be continued.<sup>35</sup>

The fact that the Commissioner's authority gives him the 'last word' in granting licenses is exemplified by a famous California case. There it was held that "courts will not interfere with the commissioner's discretion in granting a license unless there are reasons tending to show fraud, corruption, improper motives or influences, plain disregard of duty, gross

---

26. *Intermountain Title Guaranty Co. v. Egbert et al.*, 52 Idaho 402, 16 P.2d 390 (1932).

27. N.D. Cent. Code § 10-04-10.

28. *Saunders v. State*, 172 Ga. 770, 158 S.E. 791 (1931).

29. See, e.g., Fla. Stat. § 517.12 (1959); Ga. Code Ann. § 97-104 (1955); La. Rev. Stat. § 51:710 (1960); N.D. Cent. Code § 10-04-10 (1961); Ohio Rev. Code Ann. § 1707.15 (g) (1955); Okla. Stat. tit. 71 § 41 (1951).

30. *Leach v. Daughtey*, 73 Cal. App. 83, 238 Pac. 160 (1925).

31. *Archer v. Securities & Exchange Commission*, 133 F.2d 795 (8th Cir. 1943).

32. N.D. Cent. Code § 10-04-12.

33. *Ibid.*

34. N.D. Cent. Code § 10-04-12.

35. *Ibid.*

abuse of power or violation of law had entered into or characterized his determination".<sup>36</sup>

There is a dividing line between authority and discretion. When the Commissioner revokes the certificate of a seller without due cause he is not acting within the scope of his authority.<sup>37</sup> There has been no litigation on this point in North Dakota and very little in the United States.<sup>38</sup>

The question of the Commissioner's liability has also seen very little litigation; but it has been held that he is not liable to the injured purchaser if he negligently issued a license to sell securities without proper investigation.<sup>39</sup> The purchaser in this situation must rely on the bond posted by the salesman as basis for his recovery.

In North Dakota, the Securities Commissioner is given a great deal of authority.<sup>40</sup> It is his duty to approve the registration of securities to be sold,<sup>41</sup> screen and approve the registration of all dealers, salesmen, and investment counsel,<sup>42</sup> and to faithfully administer all securities laws in the state.<sup>43</sup> While this authority is granted by statute, nothing is said of the problem regarding the moral turpitude of the individual salesman when the license is granted. The only solution here must stem from the general efforts of the Commissioner towards a more thorough investigation of the applicants.

#### POSITION OF THE PURCHASER WHEN THE LAW IS VIOLATED:

Regardless of the precautions taken by the Commissioner to prevent fraudulent sales, innocent purchasers often find themselves victims of "Blue Sky Law" violations. This has resulted in placing the primary responsibility for procuring a license to sell securities on the salesman himself. A person who sells impliedly represents that a permit therefore has been secured. If this representation is false, it is a negligent misrepresentation constituting actionable fraud.<sup>44</sup> This is also true of one selling securities issued by another, since it is the salesman's

---

36. *Doble Steam Motors Corporation v. Daugherty*, 195 Cal. 158, 232 Pac. 140 (1924).

37. *Lauren W. Gibbs Inc. v. Monson*, 102 Utah 234, 129 P.2d 887 (1942).

38. *Ibid.*

39. *Minter v. McSwain*, 126 S.C. 371, 119 S.E. 901 (1923).

40. See generally N.D. Cent. Code § 10-04 (1961).

41. N.D. Cent. Code 10-04-18.

42. N.D. Cent. Code § 10-04-10.

43. *Supra* note 3.

44. *Taormina v. Antelope Mining Corp.*, 2 Cal. Rptr. 656, 242 P.2d 665 (1952).

duty to determine whether the issuer of the securities has a permit from the Securities Commissioner.<sup>45</sup> The owner-broker or his agents may thus be held liable to the purchaser for the purchase price of the stock.<sup>46</sup>

In determining the validity of sales when the securities law is violated, courts have variously held the sale to be void, voidable, or valid.

#### VOID:

When the sale is held void, the rationale is that the object of the statute is to prevent improper persons from engaging in the business, therefore a contract made by such person in violation of the statute is void.<sup>47</sup> This is also true when the object of the statute is construed as regulatory to protect the public,<sup>48</sup> or in the interest of public policy.<sup>49</sup> Stock purchases have been declared void on such grounds as, a security issued without a permit is a blank piece of paper,<sup>50</sup> and a purchaser cannot impart validity to a void contract.<sup>51</sup> Contracts for sale of stock intentionally violating the "Blue Sky Law"<sup>52</sup> or contracts to issue stock during employment of the purchaser by the company when no permit has been issued<sup>53</sup> have been declared void. Sales in violation of the "Blue Sky Law" have been declared void even though the statute did not contain express words to that effect.<sup>54</sup>

#### VOID WHEN CONDITIONS VIOLATED:

Where a permit to sell or issue stock under certain conditions or in a specified manner has been granted by the Securities Commissioner, stock sold or issued in violation of the permit will be void.<sup>55</sup> Such has been the holding where: the permit required the sale to be for cash or twenty five percent in cash, balance in six monthly installments,<sup>56</sup> the permit requir-

---

45. *People v. Stowell*, 45 Cal. App. 2d 580, 114 P.2d 614 (1941).

46. *Downs v. National Share Corp.*, 152 Or. 546, 55 P.2d 27 (1936).

47. Annot., 87 A.L.R. 42 (1933).

48. *Supra* note 27.

49. Annot., 87 A.L.R. 42 (1933).

50. *Black v. Solano*, 114 Cal. App. 170, 299 Pac. 843 (1931).

51. *Pollak v. Staunton*, 210 Cal. 656, 293 Pac. 26 (1930).

52. *Schmidt v. Stortz*, 208 Mo. App. 439, 236 S.W. 694 (1922).

53. *Reno v. American Ice Machine Co.*, 72 Cal. App. 409, 237 Pac. 784 (1925).

54. *Kneeland v. Emerton*, 208 Mass. 371, 183 N.E. 155 (1932).

55. Annot., 87 A.L.R. 42 (1933).

56. *Lebal Co. of America v. Mastrup*, 51 Cal. App. 2d 232, 124 P.2d 348 (1942).

ed the stock to be placed in escrow;<sup>57</sup> the commissioner's consent of the sale was required;<sup>58</sup> and a copy of the permit was to be exhibited and delivered to each prospective subscriber or purchaser of securities.<sup>59</sup>

#### VOIDABLE:

To hold all illegal contracts void under all circumstances could lead to unfortunate results. It might protect a guilty defendant from his obligation to pay damages to an innocent purchaser.<sup>60</sup> Therefore, sale of speculative securities without having first obtained a permit authorizing such sale, as required by statute, has been held voidable for breach of the statute but not void for illegality.<sup>61</sup> Various states by statute<sup>62</sup> and court decisions<sup>63</sup> have declared sales made in violation of "Blue Sky Laws" voidable at the election of the purchaser. Such is North Dakota's position and also the more acceptable of the three. Time limits have been enacted within which the purchaser must make his election. These limits range from thirty days,<sup>65</sup> twelve months,<sup>66</sup> three years,<sup>67</sup> to five years.<sup>68</sup>

#### VALID:

New York,<sup>69</sup> Virginia,<sup>70</sup> and Ohio<sup>71</sup> have held sales made in violation of the "Blue Sky Law" to be valid. The New York court said the state statute relating to sale of securities was not intended to make void or voidable contracts with security dealers who violate the "Blue Sky Law" since penal provisions make violation of the statute a misdemeanor.<sup>72</sup> The Virginia court held that the portion of the act reciting "shall not be

57. *Herkner v. Rubin*, 126 Cal. App. 677, 14 P.2d 1043 (1932).

58. *Duntley v. Kagarise*, 10 Cal. App. 2d. 394, 52 P.2d 560 (1935).

59. *Regan v. Albin*, 219 Cal. 357, 26 P.2d 475 (1933).

60. Annot., 87 A.L.R. 42 (1933).

61. *Farror v. Hood*, 56 N.M. 724, 249 P.2d 759 (1952).

62. *Tomberlin v. Waycross Commercial Hotel Co.*, 41 Ga. App. 77, 152 S.E. 300 (1930) (aff'd in 173 Ga. 224, 160 S.E. 92, (1931); *Pelham v. Hopper*, 302 Ill. App. 51, 23 N.E.2d 389 (1939); *Waisbren v. Blink*, 207 Wis. 619, 242 N.W. 169 (1932).

63. *Westenhaver v. Dunnivant*, 225 Ala. 400, 143 So. 823 (1932); *Smith v. Crawford*, 228 Ky. 420, 15 S.W.2d 249 (1929); *Chambers v. Beckwith*, 427 Mich. 255, 225 N.W. 605 (1929).

64. N.D. Cent. Code § 10-04-17.

65. *Waisbren v. Blink*, 207 Wis. 619, 242 N.W. 169 (1932).

66. *Tomberlin v. Waycross Commercial Hotel Co.*, 41 Ga. App. 77, 152 S.E. 300 (1930), aff'd 173 Ga. App. 224, 160 S.E. 92 (1931).

67. N.D. Cent. Code § 10-04-17.

68. *Pelham v. Hopper*, 203 Ill. App. 51, 23 N.E.2d 389 (1939).

69. *Sajor v. Ampol Inc.*, 275 N.Y. 125, 9 N.E.2d 803 (1937).

70. *Waters and Martin v. Homes Corp.*, 136 Va. 114, 116 S.E. 366 (1923).

71. *Warrens People's Market Co. v. Corbett and Sons*, 114 Ohio St. 126, 151 N.E. 51 (1926).

72. *Supra* note 69.

construed to prevent the sale of purely speculative securities" showed the intention of the legislature was not to make void and unenforceable contracts made in violation of the Virginia securities law.<sup>73</sup> This interpretation was also evidenced by an Ohio court which declared such intent was to punish persons who did not comply with the provisions of the statute rather than to make the sales of stock void.<sup>74</sup>

#### PURCHASER'S RIGHTS AND LIABILITIES:

The purchaser's rights under contracts of subscription or sale have been resolved in the purchaser's favor when recovery of the purchase price is sought. Such is true because the penalties of the "Blue Sky Laws" are visited on the seller and the statutes are enacted for the benefit of the buyer. When the buyer is not in *pari delicto* with the seller, and he is generally not so regarded, the general rule is that within a reasonable time he may recover his money or property exchanged for the stock by tendering back the stock received by him.<sup>75</sup> Even when the purchaser persists in the notion that the stock possesses some validity, the corporation's debts will not be assessed against the purchaser for his error. To allow this would give the corporation an advantage when nothing is given in return.<sup>76</sup>

When the question of the purchaser's liability as a stockholder arises, jurisdictions have reached varying conclusions. No liability to the stockholder will ensue when the stock is issued prior to meeting the required conditions of the offering.<sup>77</sup> The same result is reached when the stock has not been registered as required by law<sup>78</sup> and when the stock is purchased through fraudulent inducement.<sup>79</sup> However, one who has definitely assumed the status of a stockholder by accepting and retaining his certificate and also dividends cannot escape liability to the corporation's creditors.<sup>80</sup> Retention of stock for a long period of time without protest<sup>81</sup> and participation in the

---

73. *Supra* note 70.

74. *Supra* note 71.

75. Annot., 87 A.L.R. 42 (1933).

76. Pollak v. Staunton, 210 Cal. 656, 293 Pac. 26 (1930).

77. Live Oak Cemetery Ass'n. v. Adamson, 106 Cal. App. 783, 288 Pac. 29 (1930).

78. Gill Printing Co. v. Goodman, 224 Ala. 97, 139 So. 250 (1932).

79. Stolte v. Kehrlie, 103 Cal. App. 128, 284 Pac. 221 (1930).

80. Parker v. Merritt, 164 Minn. 305, 204 N.W. 941 (1925).

81. Cox v. Hanson, 200 Wis. 341, 228 N.W. 510 (1930).

corporate affairs<sup>82</sup> by one who purchases stock sold in violation of "Blue Sky Laws" will estop him from denying stockholders' liability.

Legislation in North Dakota has been enacted to provide more complete protection for the purchaser. Such legislation also provides an atmosphere of security when the general public as individuals seek to obtain investment opportunities and will result in fostering a favorable climate of investment.

#### RECENT LEGISLATION:

The most significant step taken in this field by the 1961 Legislature was a statutory amendment requiring a written examination of all applicants for a security license.<sup>83</sup>

Those who have been continuously registered in the state since July 1, 1958 are not compelled to write the examination.<sup>84</sup> Other persons excused are those who have passed either the National Association of Securities Dealers or the New York Stock Exchange exams.<sup>85</sup>

Although exact statistics as to the pass-fail ratio could not be obtained, the results apparently verify the difficulty of the exam.<sup>86</sup> The Assistant Securities Commissioner feels that the examination is complete in detail and an excellent method of determining the applicant's knowledge of the field.<sup>87</sup>

A person attempting to take this exam would have little chance of passing without a good deal of preparation.<sup>88</sup> It is much more complete than the previously standard NASD exam.<sup>89</sup> In a memorandum issued by the Securities Commissioner,<sup>90</sup> two text books were recommended as study aids in preparation for the test.<sup>91</sup> An outline consisting of six pages is also available to the applicants.<sup>92</sup> The intended purpose of the outline is to give the applicant an idea of the basic fields he will be tested on. While it is not a source of study itself, it is a guide to other material.<sup>93</sup>

---

82. *Winfred Farmers Co. v. Smith*, 47 S.D. 498, 199 N.W. 477 (1924).

83. N.D. Cent. Code § 10-04-10 (2).

84. *Ibid.*

85. Interview With Morris Tschider, Ass't. Securities Commissioner of North Dakota in Bismarck, Nov. 22, 1961.

86. *Ibid.*

87. *Ibid.*

88. *Ibid.*

89. *Ibid.*

90. Office of the Securities Commissioner Memorandum No. 4, August 23, 1961.

91. Study Outline For State Securities Sales Examination.

92. *Ibid.*

93. *Ibid.*

North Dakota is only the second state to require such an examination. It is felt that other states will also realize the importance of this method of investigation and begin to utilize it soon.<sup>94</sup>

#### CONCLUSION:

Throughout this article, we have attempted to show some of the strong and weak points of North Dakota's "Blue Sky Law" on the subject of licensing dealers and salesmen. Our law is strong in many respects. Even so, we can improve on two aspects.

The first area is the bond. We would propose individual bonding of all salesmen. This will provide a more thorough investigation of the salesman before he is licensed. It may also lower the collateral requirements for the dealer.

The second area is solving the problem of moral turpitude in the business acts and representations of the salesman. Several methods are available, and perhaps all could be implemented at the same time. These would include a very strict administration of the laws by the Securities Commissioner; organized efforts towards educating their members by the States Attorney's Organization, Bar Association, a group effort by the securities dealers;<sup>95</sup> and the initiation of education programs for the public by the Securities Commissioner and the dealers themselves.<sup>96</sup>

The forward steps we have taken must be continued. The result will be the developing of proper economic growth and fostering fields of investment.

MARK J. BUTZ

DAVID E. NETHING

---

94. Interview With Morris Tschider, Ass't Securities Commissioner of North Dakota in Bismarck, Nov. 22, 1961.

95. *Ibid.*

96. Interview With Douglas Dunshay, Former Ass't Securities Commissioner of North Dakota in Grand Forks, Nov. 16, 1961.