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By Barry K. Lake\*

# Corporate Rescission Offers Under the Nebraska Securities Act

## I. INTRODUCTION

A corporation's issuance in the state of Nebraska of its common stock, preferred stock, or debentures to a purchaser involves the sale of a security under the Nebraska Securities Act.<sup>1</sup> It can give rise to a need to rescind the issue if it does not comply with the Act.<sup>2</sup> This article will deal with the circumstances under which the sale of securities by a corporation may violate the Act; the necessity for a rescission offer when the Act is violated; and finally, the manner in which a corporate rescission offer should be made in order to comply with the Act. This discussion includes corporations in the developmental stage and operating companies which have sold securities to such a small number of investors that the securities will not be traded publicly.

## II. WHEN THE SALE OF CORPORATE SECURITIES VIOLATES THE NEBRASKA SECURITIES ACT

A sale of a corporation's securities may give rise to a violation of the Securities Act in a number of different ways. A violation occurs if the sale fails to comply with the registration provisions of the Act. In addition, whether or not registration is required, the disclosure and anti-fraud provisions of the Act apply to the sale.

### A. Violation of the Registration Provision

Section 8-1104 of the Securities Act states that it is "unlawful for any person to offer or sell any security in this state except securities exempt under Section 8-1110 or when sold in transactions exempt under Section 8-1111, unless such security is registered

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1. Securities Act of Nebraska, §§ 8-1101 to -1124 (Reissue 1977) [hereinafter cited as Securities Act].
2. A security is defined by *id.* § 8-1101 (12) to include "any note, stock, treasury stock, bond, debenture."

...”<sup>3</sup> A person is defined by section 8-1101(9) of the Act to include any individual, corporation, or unincorporated organization.<sup>4</sup> A sale is defined by section 8-1101(10) to include every contract to sell a security or an interest in a security for value.<sup>5</sup>

The effect of these statutory provisions is to require a corporation, or individuals acting for a corporation or a business that is to be incorporated, to register its securities with the Nebraska Department of Banking and Finance prior to selling any of its securities unless an exemption is available. Absent an exemption, this registration requirement applies whether the sale of securities is to one person or an infinite number. And since the term “value” includes anything of monetary worth, the sale of a corporation’s securities includes not only the issuance of securities for cash but also in exchange for property or services. The purpose of registering a securities offering with the Department is to require “the seller to make a full disclosure (through a written prospectus) as to the issuer’s business and all major factors pertaining to the particular securities so that the proposed purchaser can make an informed investment decision on whether to purchase a security.”<sup>6</sup>

A corporation claiming an exemption from registering securities has the burden of proving its existence.<sup>7</sup> The most common exemptions which are available to a corporation which desires to sell its securities to a relatively small number of investors are the transactional exemptions found in subsections 8-1111(1) and (9) of the Act. Section 8-1111(1) exempts “any isolated transaction, whether effected through a broker-dealer or not.”<sup>8</sup> An Interpretative Opinion issued by the Department<sup>9</sup> addresses the scope of “an

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3. *Id.* § 8-1104. The sale of securities is subject to dual regulation in the United States. On the federal level, the Securities Act of 1933, § 5, 15 U.S.C. §§ 77a to 77aa (1976) [hereinafter cited as 1933 Act], states that it is unlawful to sell securities unless a registration statement is in effect with the Securities and Exchange Commission (SEC) or unless an exemption to the registration requirement is applicable. Most state laws make it unlawful to sell securities unless a registration statement is effective with the respective state agency. Uniform Securities Act has been adopted or substantially adopted in 35 states. This article deals only with the Nebraska Securities Act, but practitioners should be aware that the same or similar registration requirements exist on the federal level and in all states in which the corporation sells its securities.

4. NEB. REV. STAT. § 8-1101(9) (Reissue 1977).

5. *Id.* § 8-1101(10).

6. *Hearing on L.B. 848 Before the Banking, Insurance, & Commerce Committee*, 75th Leg., 1st Sess. (April 13, 1965).

7. NEB. REV. STAT. § 8-1121 (Reissue 1977).

8. *Id.* § 8-1111(1).

9. The Director of Banking is given discretionary authority under the Nebraska Act to issue interpretive opinions. *Id.* § 8-1120(9).

isolated transaction”:

If a number of sales of securities over a reasonable period of time indicate that the seller has one general purpose in making this number of sales and the sales approximate the same aim and aren't so detached and separated [as] to form no part of a single plan, then the sales are not part of an isolated transaction and are not exempt from Section 8-1111(1).<sup>10</sup>

The Opinion states that the following transactions would qualify as isolated transactions exempt from registration:

- 1) A corporation sells stock to one passive investor in a twelve-month period.
- 2) An incorporation of a family farm.
- 3) An incorporation of an existing partnership.
- 4) An incorporation of a corporation which has three incorporators who are all shareholders of the new corporation. All three incorporators had a business relationship prior to the incorporation and no incorporator made solicitations to unknown investors to become incorporators. The shareholders could be involved in the operation of the corporation or passive investors.<sup>11</sup>

The Opinion states that the following transactions would not qualify as isolated transactions:

- 1) A promoter or development corporation sells stock in a development corporation to seven people over a twelve-month period. . . .
- 3) An incorporation of a business with three incorporators as shareholders to be actively involved in the business of the corporation and three other incorporator shareholders to be passive investors for a total of six shareholders. The incorporators that have become actively involved in the business solicited passive investors to become shareholders of the corporation within a two-month period. The passive investors who became shareholders of the corporation purchased individually and were contacted individually.<sup>12</sup>

This Opinion restricts a corporation's use of the isolated transaction exemption to issuers of securities to one individual over a substantial period of time to incorporators who have been operat-

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10. Neb. Dep't of Banking & Finance, Interpretative Opinion No. 2 (October 13, 1977). The Interpretive Opinion also lists the following exemptions:

5. Four individuals or four business entities involved in the oil business, whether through drilling, operating, professional geologists, or other oil business, form a joint venture to drill one oil or gas well. The joint venture is formed simultaneously and not as a result of one of the joint ventures [*sic*] soliciting investors to become members of the joint venture.
6. An oil promoter sells a working interest in an oil and gas well to one investor in a twelve-month period.

11. *Id.*

12. *Id.* The following was also listed as an example of a transaction that would not qualify for the isolated transaction exemption: "A promoter of a real estate limited partnership or working interest in an oil and gas offering solicits investors to invest in the limited partnership or oil working interest offering. He makes sales to four individuals of separate limited partnership interests or working interests."

ing the business under a different form of ownership, or to a very small number of incorporators who formed the corporation as a result of joint and bona fide negotiations between all incorporators.<sup>13</sup>

In addition to the isolated transaction exemption, section 8-1111(9) exempts

[a]ny transaction pursuant to a sale to not more than ten persons . . . in this state during any period of twelve consecutive months, if (a) the seller believes that all buyers are purchasing for investment, (b) no commission or remuneration is paid or given directly or indirectly for soliciting any prospective buyer, except to a broker-dealer registered under the provisions of sections 8-1101 to 8-1124, (c) a notice is given, stating the seller's name and address and a statement that all the conditions of this exemption have been met, and (d) no solicitations are made by newspaper, radio or television . . . .<sup>14</sup>

Rule 70 of the Department states the information that must be included in the notice given the Department pursuant to section 8-1111(9)(c) prior to any sales.<sup>15</sup> This exemption is frequently used by corporations to make a limited number of sales of their securities without registration.

Not all sales of securities to a relatively small number of investors are exempt from registration under the Nebraska Securities Act. In *Labenz v. Labenz*,<sup>16</sup> the defendant was hired by a newly-formed corporation to sell its securities for an eight percent com-

13. Although a departmental interpretive opinion does not have force of law, it should be given serious consideration by anyone attempting to comply with the Securities Act. The Department is given statutory authority to make interpretive opinions and an administrative agency's interpretation of a statute, over which it is given regulatory authority, is given considerable weight by the courts. See *ATS Mobile Telephone, Inc. v. Curtain Call Communications, Inc.*, 194 Neb. 404, 410, 232 N.W.2d 248, 252 (1975); NEB. REV. STAT. § 8-1120(9) (Reissue 1977).

14. NEB. REV. STAT. § 8-1111(9) (Reissue 1977).

15. Neb. Dep't of Banking & Finance, Rule 70 (1977), provides:

Pursuant to the notice requirements of § 8-1111(9) of the Nebraska Securities Act, the following conditions must be met:

- (a) Notice shall be filed with the Nebraska Department of Banking and Finance . . . .
- (b) Such notice shall be filed prior to any sales made in reliance on the section 8-1111(9) exemption.
- (c) The notice shall include the following information:
  - (1) the name and address of the issuer,
  - (2) the names and address of the individuals selling or promoting the offering,
  - (3) the business which the issuer is to be engaged in,
  - (4) the type of security being issued (common stock, limited partnership interests, debentures, etc.), and the total dollar amount of such securities,
  - (5) a statement that all of the conditions of section 8-1111(9) will be met.

16. 198 Neb. 548, 253 N.W.2d 855 (1977).

mission. He sold common stock to seven different individuals, including the plaintiff.<sup>17</sup> When plaintiff sued, alleging that the securities had not been registered in violation of section 8-1104, the defendant claimed that the sale was exempt from registration under either the section 8-1111(1) isolated transaction exemption or the section 8-1111(9) exemption for an offer to ten or fewer persons.<sup>18</sup> The Nebraska Supreme Court disagreed, holding that no exemption was available and that the sale of the unregistered stock violated the registration provisions of section 8-1104. The court said that a sale of a corporation's stock to seven individuals over a short period of time was clearly not an isolated transaction<sup>19</sup> and that the section 8-1111(9) exemption was not available because the defendant had received a commission but was not registered with the Department at that time as an agent of the issuer or a broker-dealer.<sup>20</sup>

## B. Violation of Anti-Fraud and Disclosure Provisions

Section 8-1102(1) states:

It shall be unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

(a) to employ any device, scheme or artifice to defraud;

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.<sup>21</sup>

This prohibition applies regardless of whether the sale of the corporation's securities is exempt from registration.

In effect, this provision prohibits two types of conduct in connection with the sale of securities. First, it prohibits a seller from defrauding a purchaser. Second, it prohibits the seller from either disclosing material false information or from failing to disclose material information to a purchaser. The second prohibition is much

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17. *Id.* at 548-50, 253 N.W.2d at 856-67.

18. *Id.* at 549, 253 N.W.2d at 856. Section 8-1111(9) was amended subsequent to the *Labenz* case and 10 sales, instead of 10 offers, are now permitted under the amended exemption. *See* L.B. 263, 85th Leg., 1st Sess. (1977) (effective date September 1, 1977). However, this subsequent amendment did not alter the effect of this case on exemptions from registration for small businesses.

19. 198 Neb. at 549, 253 N.W.2d at 857.

20. *Id.* at 550, 253 N.W.2d at 857. *See* NEB. REV. STAT. § 8-1111(9)(b) (Reissue 1977).

21. NEB. REV. STAT. § 8-1102(1) (Reissue 1977). *See* Securities Exchange Act of 1934, § 10(b), 15 U.S.C. §§ 78a to 78hh-1 (1976) [hereinafter cited as 1934 Act]; Rule 10b-5, 17 C.F.R. § 240.10b-5 (1978); 1933 Act, §§ 12, 17, 15 U.S.C. §§ 77f, 77e (1976). These are provisions under federal securities law which prohibit similar conduct in connection with the sale of securities.

more troublesome for the small corporation which raises money from a limited number of investors. Extensive written disclosure documents are rarely used in these circumstances and the sale is primarily, if not entirely, based upon oral statements by the seller. If the seller omits any material information about the corporation, the seller has violated the disclosure provisions of section 8-1102(1)(b).

### III. NECESSITY OF A RESCISSION OFFER WHEN A SALE OF SECURITIES VIOLATES THE ACT

#### A. Civil Liability

As previously noted, section 8-1104 prohibits a corporation from selling its securities without registration unless there is an exemption and section 8-1102 prohibits a corporation from defrauding or improperly disclosing material information to investors in connection with the sale of its securities. However, these provisions do not provide any penalties for violations. The corporation's civil liabilities for violations of the Act are found in section 8-1118(1), which provides:

Any person who offers or sells a security in violation of section 8-1104 or offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made in light of the circumstances under which they are made not misleading, the buyer not knowing the untruth or omission, and who does not sustain the burden of proof that he did not know and in the exercise of reasonable care could not have known of the untruth or omission, shall be liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent per annum from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns a security. Damages shall be the amount that would be recoverable under a tender less (a) the value of the security when the buyer disposed of it and (b) interest at six percent per annum from the date of disposition.<sup>22</sup>

If there is a violation of section 8-1104, the liability of a seller is absolute regardless of the corporation's culpability for failure to register its securities. *Labenz v. Labenz*<sup>23</sup> is an example of a situa-

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22. NEB. REV. STAT. § 8-1118(1) (Reissue 1977). There are also civil liability provisions under the federal and other state laws for failure to register securities and for fraud and failure to give adequate disclosure. For failure to register securities, see 1933 Act, § 12, 15 U.S.C. § 771 (1976); UNIFORM SECURITIES ACT § 410(a)(1). For fraud and failure to disclose adequate information, see 1933 Act, § 12(2), 15 U.S.C. § 77q (1976); UNIFORM SECURITIES ACT § 410(a)(2). Implied causes of action for civil liability have been found by federal courts under rule 10b-5 and the 1933 Act, § 17, 15 U.S.C. § 77q (1976). See 3 A. BROMBERG, SECURITIES LAW: FRAUD § 505, at 204.01; § 330, at 204.23 (1977).

23. 198 Neb. 548, 253 N.W.2d 855 (1977).

tion in which the seller of a corporation's securities may sell to relatively few investors and be held liable to those investors without reference to any intent or negligence on the part of the corporation in failing to register the securities offerings prior to sale.<sup>24</sup>

When there has been a violation of section 8-1102(1), a seller of the corporation's securities is liable to the purchaser, regardless of whether an exemption is available from registration under section 8-1104, if the following elements are present in connection with the sale: (1) the seller made material misrepresentations or omitted to state material facts to the purchaser; (2) the buyer proves that he had no knowledge of the material misrepresentations or omissions; and (3) the seller fails to prove that he had no knowledge of the material misrepresentations or omissions and, in the exercise of reasonable care, could not have had knowledge of them. Thus, a seller charged with violation of the anti-fraud and disclosure provisions of section 8-1102 must prove both good faith and lack of negligence in disclosing or failing to disclose material information.

Section 8-1118(1) provides that damage liability for violating the Act is upon the person who offers or sells the security. However, section 8-1118(2) states:

Every person who directly or indirectly controls a seller liable under subsection (1) of this section, every partner, officer, or director, or person occupying a similar status or performing similar functions, or employee of such a seller who materially aids in the sale, and every broker-dealer, issuer-dealer, or agent who materially aids in the sale shall also be liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.<sup>25</sup>

Therefore, the civil liability provisions of section 8-1118(1) extend beyond the individual seller to the corporation itself, its officers and directors, regardless of their involvement in the sale, and to any employee of the corporation who materially aids in the sale of the corporation's stock. The corporation and the individuals are absolved from liability if they can prove they did not know—and did not act in a negligent manner in failing to discover—that the seller sold securities without registration or made material misrepresentations or omissions in connection with their sale. Considering the burden placed upon a corporation and its officers and directors under section 8-1118(2), and in light of a corporation's re-

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24. NEB. REV. STAT. § 8-1118(1) provides for a cause of action for a purchaser against a seller of unregistered securities sold in violation of section 8-1104 irrespective of the seller's culpability. Since the plaintiff sued the seller of the corporation's securities for selling unregistered securities in violation of section 8-1104, the question of the corporation's intentional or negligent failure to register was not at issue.

25. NEB. REV. STAT. § 8-1118(2) (Reissue 1977).

sponsibility for its employees and a director's and officer's responsibility to the corporation and its shareholders under state corporation law, it will be a rare circumstance indeed where a corporation and its officers or directors can meet the necessary burden of proof to be excused from liability under section 8-1118(1).<sup>26</sup>

When a corporation unlawfully sells its securities without registration or proper disclosure, section 8-1118(1) and (2) give the purchaser a put against the seller, the corporation, and its officers and directors. If the corporation operates in a profitable manner it is unlikely that the purchaser will sue for a return of his money because there is no economic incentive to do so. However, if the corporation does not operate profitably, the investor is likely to sue. Under these circumstances, all the risk of the investment is placed on the corporation, its officers and directors.<sup>27</sup>

The civil liability provisions of the Securities Act give rise to a number of strong incentives for a corporation to make rescission offers to persons who have purchased its securities in a transaction which violates the Act. The corporation's officers and directors naturally would like to have the cloud of their individual liability to the purchasers removed. The shareholders of the corporation would have the same desire with respect to removing the corporation's liability. The Act provides a vehicle for curing this civil liability. Section 8-1118(3) states in part:

No person may sue under this section (a) if the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at six percent per annum from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within 30 days of its receipt, or

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26. See *Doyle v. Union Ins. Co.*, 202 Neb. 599, 277 N.W.2d 36 (1979); *Fowler v. Elm Creek State Bank*, 198 Neb. 631, 254 N.W.2d 415 (1977). See generally Shaneyfelt, *The Personal Liability Maze of Corporate Directors and Officers*, 58 NEB. L. REV. 692 (1979); *Corporate Directors Guidebook*, 33 BUS. LAW. 1591 (1978).

27. In addition to the express civil liability provisions of the Securities Act, civil liability also exists for the corporation and its officers and directors under common law where a corporation sells its securities in a fraudulent manner and without proper disclosure. See *Fowler v. Elm Creek State Bank*, 198 Neb. 631, 254 N.W.2d 415 (1977). The purchasers of debentures of a bank holding company, which was in default in payment of interest and principal on the debentures, sued its directors claiming fraud in connection with the sale of the debentures and negligence in fulfilling their corporate duties. The court held the directors liable for damages because the directors knew or should have known that the corporation's financial condition was deteriorating, that the purpose of issuing the debentures was to bolster the financial condition of the corporation, and that these facts would have to be concealed or misrepresented in order to sell the debentures. *Id.* at 638, 254 N.W.2d at 419. Since the directors had authorized the sale of corporate debentures without disclosing these conditions to investors, they were held liable to the purchasers. See Shaneyfelt, *supra* note 26, at 696-97.

(b) if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within 30 days of its receipt.<sup>28</sup>

In addition to curing the liability for damages, there are other incentives for making a rescission offer which indirectly result from this liability. A corporation with a substantial contingent civil liability resulting from a Securities Act violation may be unable to obtain funds from any source until the liability is removed. Not only would financial institutions refuse to loan additional funds, but the contingent liability might trigger default provisions in existing loan agreements of the corporation. The corporation would be unable to sell its securities to the public, and the Department would probably hesitate to register an offering where the corporation had such a contingent liability. In addition, the officers, directors, and employees' ability to obtain financing for their own individual needs might be affected because of their individual contingent liability as control persons under section 8-1118(2).

#### **B. Potential Proceedings Brought by the Nebraska Department of Banking and Finance**

The Securities Act provides that the Department may impose various sanctions on persons who have violated the Act.<sup>29</sup> Section 8-1108.01(1) gives the Department authority to issue an administrative cease and desist order against any person who it believes has unlawfully sold securities without registration.<sup>30</sup> A cease and desist order prohibits a person from selling securities in the future without registration of the securities unless an exemption is available. A practical effect of the order is that the corporation and its controlling persons often receive adverse publicity which may have a more long-range, adverse effect on the corporation and its controlling shareholders than the order itself.

Section 8-1116 provides for various civil sanctions which the Department may seek for violations of the Act. These sanctions include a restraining order, a temporary or permanent injunction against a corporation and its controlling parties, and appointment

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28. NEB. REV. STAT. § 8-1118(3) (Reissue 1977). See UNIFORM SECURITIES ACT § 410(e). There is no statutory authority for curing civil liability for a violation of the federal securities laws; however, there are a host of reasons why a rescission offer should cure such liability. See generally Bromberg, *Curing Securities Violations: Rescission Offers and Other Techniques*, 1 J. CORP. L. 1 (1975).

29. For criminal penalties under the other state securities laws, see UNIFORM SECURITIES ACT § 409 and under federal law, 1933 Act, § 24, 15 U.S.C. § 77x (1976).

30. NEB. REV. STAT. § 8-1108.01(1) (Reissue 1977).

of a receiver for the corporation's assets.<sup>31</sup> The latter sanction may be particularly shocking to controlling parties since the receiver may appoint an outsider to operate the corporation.

Section 8-1117(1) provides a criminal penalty for a willful violation of the Securities Act of up to five years imprisonment or a fine of \$10,000 or both for each violation.<sup>32</sup> Sections 28-1216 and -1217 provide for additional criminal sanctions for fraudulent representations in connection with the sale of securities.<sup>33</sup>

The Department has issued an Interpretive Opinion stating its position with respect to the necessity of making a rescission offer for a violation of the registration or the anti-fraud/disclosure provisions of the Act.<sup>34</sup> In its opinion, the Department states it will take administrative, civil, and/or criminal actions against any person who has sold securities in violation of the Act unless a rescission offer is made in compliance with the Department's requirements.<sup>35</sup>

The opinion states that when a corporation has unlawfully sold its securities without registration, the corporation must register its rescission offer with the Department. When the corporation has unlawfully sold its securities in violation of the anti-fraud/disclosure provisions, but not in violation of the registration provisions, the corporation must make a rescission offer which complies with section 8-1118(3) and file the offer with the Department for its examination.<sup>36</sup> The Department has no statutory authority to require a rescission offer or to require that the offer be registered with the Department, but, as a practical matter, a corporation and its controlling persons are inviting a host of governmental actions against themselves if a rescission offer is not made in compliance with the Department's requirements.

It should be noted that a rescission offer does not cure the criminal liability provided by the Act and the Department may still take administrative and/or civil action even if the rescission offer is made. But if an offer is made, the chances of departmental action would seem to be substantially lessened.

Given the civil remedies available to purchasers, the administrative and civil sanctions available to the Department, and the Department's position with respect to the necessity of making a rescission offer, a corporation which has sold its securities unlaw-

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31. *Id.* § 8-1116.

32. *Id.* § 8-1117(1). The Department is given authority to refer evidence of willful violations to the Attorney General or respective County Attorney. *Id.* § 8-1117(2).

33. *Id.* §§ 28-1216 to -1217.

34. Neb. Dep't of Banking & Finance, Interpretive Opinion No. 7 (February 1979).

35. *Id.*

36. *Id.*

fully must make an offer if it is to remain a viable entity. The option of abandoning the corporation is not a satisfactory alternative for individuals who are prospectively liable, since by doing so, they do not avoid personal liability.

The obligation to make a rescission offer is not infinite and may be avoided if the statute of limitations has run with respect to the securities violations. A purchaser's right to sue for damages under the Act terminates two years from the date of purchase.<sup>37</sup> However, the common law right to sue for fraud extends beyond this two-year period and the statute of limitations for criminal sanctions for willful violations of the Act is five years.<sup>38</sup> Furthermore, the Act contains no specific statutory limitation on the Department's authority to impose civil sanctions for these violations. In light of the Department's position, when no rescission offer is made, it is likely that the obligation to make an offer runs for at least a period of five years from the date of the last securities violation.

#### IV. RESCISSION OFFERS UNDER THE NEBRASKA SECURITIES ACT

##### A. Registered Rescission Offers

###### 1. *Registration Statement and Prospectus*

A corporate rescission offer is registered with the Department in a manner similar to the registration of any corporate securities offering.<sup>39</sup> To register a corporate rescission offer by qualification,<sup>40</sup> a registration statement and prospectus, including the information required by section 8-1107, plus any other material information about the offering and corporation should be filed with the Department. Other material information would include a complete discussion of the offer and reasons for making it, including

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37. NEB. REV. STAT. § 8-1118(3) (Reissue 1977).

38. See *Fowler v. Elm Creek State Bank*, 198 Neb. 631, 632-33, 254 N.W.2d 415, 417 (1977); NEB. REV. STAT. § 8-1117(1) (Reissue 1977).

39. See Neb. Dep't of Banking & Finance, Interpretative Opinion No. 7 (February 1977). For an example of a rescission offer registered with the Department, see Qualification Registration Statement of Solar, Inc., File No. 0039 (Neb. Dep't of Banking & Finance, Nov. 25, 1978). The rescission offer must also comply with federal and other states' securities law where the securities were sold in violation of those laws. For a discussion of making a rescission offer in compliance with both federal and numerous state securities laws, see Bromberg, *supra* note 28.

40. A registration statement may be filed by notification under NEB. REV. STAT. § 8-1105 (Reissue 1977), by coordination under *id.* § 8-1106, or by qualification under *id.* § 8-1107. Any securities offering may be filed by qualification; however, a registration statement by qualification is normally filed where no registration statement in connection with the offering is filed with the SEC and the conditions of registration by notification are not met.

possible civil and criminal liability of the persons making the offer.<sup>41</sup> It is particularly important that the prospectus accompanying the rescission offer include all material information about the offer. Otherwise the offer will not achieve its purpose of curing civil liability for past securities violations because it will itself violate the anti-fraud/disclosure provisions of section 8-1102.<sup>42</sup>

In addition to the statutory registration statement and prospectus, a written offer to rescind, as required by section 8-1118(3) to cure civil liability, should be filed with the Department and should include a method for the security holders to indicate whether they wish to rescind. Prior to the time the prospectus and written offer to rescind are given to investors, the Department must have registered the rescission offer.

## 2. *Funding the Rescission Offer*

The Department requires that as a condition of registering a rescission offer, the corporation show that it has the ability to fund it.<sup>43</sup> Normally the Department requires 100 percent cash funding of the offer, but under circumstances in which it was substantially cash funded and was in the best interest of the security holders, the Department has allowed a less than 100 percent cash-funded offer.<sup>44</sup>

Section 8-1118(3) does not specify the source of the funding of a rescission offer which cures civil liability; accordingly, the Department does not require the corporation or other parties potentially

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41. The Department's requirement of a corporate rescission offer as a condition of receiving absolution is based upon a shareholder's statutory right to receive a refund under section 8-1118(1) and absolution given anyone making the offer to refund under section 8-1118(3). The Department actively enforces its rescission offer requirement so as to provide a deterrent to securities violations and to provide investors with the proper disclosure which they did not receive when they originally purchased the investment. To allow absolution absent the corporation admitting civil liability would encourage the sale of securities in violation of the Securities Act.

42. There is no statutory authority under the Nebraska Securities Act for a seller to sue a defrauding purchaser for damages for a violation of NEB. REV. STAT. § 8-1102 (Reissue 1977), or Rule 10b-5 of the 1934 Act, its federal counterpart, but the federal courts and state courts with similar statutes have consistently implied a civil cause of action for such violations. However, the standard of culpability for an implied cause of action for damages is generally much higher. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Greenfield v. Cheek*, 3 BLUE SKY L. REP. (CCH) ¶ 71,440 (Ariz. Ct. App. Sept. 19, 1978).

43. Neb. Dep't of Banking & Finance, Interpretative Opinion No. 7 (February 1979).

44. See Qualification Registration Statement of Solar, Inc., File No. 0039 (Neb. Dep't of Banking & Finance, Nov. 25, 1978).

liable under section 8-1118(3) to fund the offer.<sup>45</sup> The possible sources of funding a corporate rescission offer include the persons civilly liable for the unlawful sale of securities, *e.g.*, the seller, the corporation, control persons, other shareholders of the corporation, and unaffiliated third parties. As a practical matter a corporation in the developmental stage or one with a small operation rarely has the funds to make a rescission offer. Its primary or only source of funds has been contributed by the purchasers of its stock and the corporation has these funds fully invested in working assets. Furthermore, legal restrictions on the repurchase by a corporation of its own securities may also limit the corporation's ability to fund an offer.<sup>46</sup> As a result, in most circumstances, a corporation must fund an offer by soliciting funds from its controlling persons or unaffiliated third parties.

Since the persons funding the rescission offer will normally receive the securities of the rescinding security holders in return for funding the offer, care must be taken when seeking funds that the Act is complied with, especially where the source of funding is unaffiliated third parties. Otherwise the primary purpose of the rescission offer, that of curing civil liability, will not be accomplished since additional civil liability will be incurred.

### *3. Who Must Receive a Rescission Offer?*

The Department requires that any registered rescission offer must be made to all purchasers of the corporation's securities who have a cause of action for damages under section 8-1118. Excluded from the rescission offer would be those parties denied a cause of action under section 8-1118(4) for either participating in the securities violation or for acquiring the securities with knowledge of the violation.<sup>47</sup>

### *4. Amount and Duration of the Rescission Offer*

Section 8-1118(3) provides that a person may cure his civil liability by making a written offer to refund the consideration paid, plus six percent interest from the date of payment for the purchase, less the amount of any income on the security to the security holder. The amount of the rescission offer registered with

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45. Neb. Dep't of Banking & Finance, Interpretative Opinion No. 7 (February 1979).

46. *See* NEB. REV. STAT. § 21-2005 (Reissue 1977) (restricts repurchase by a corporation of its own stock to the extent of its unreserved and unrestricted surplus and prohibits a repurchase which would make the corporation insolvent).

47. Neb. Dep't of Banking & Finance, Interpretative Opinion No. 7 (1979).

the Department would be the sum of the amount due each security holder under section 8-1118(3).

The Department requires that a registered rescission offer give a security holder a minimum of thirty days from receipt of the written offer to rescind the purchase. The corporation must pay all rescinding security holders within a reasonable time after the period for rescission has ended.<sup>48</sup>

#### *5. Verification of the Rescission Offer to the Department*

Once a rescission offer is completed, the corporation must verify to the Department that the offer has been consummated in compliance with section 8-1118(3) and the Department's additional requirements.<sup>49</sup> The purpose of the verification is to ensure that all security holders who were entitled to a rescission offer did in fact receive the written offer and prospectus, and that those who rescinded received the proper payment for their securities. The verification may be made by an independent third party who has transmitted the offer or examined the records of the offer, *e.g.*, a certified public accountant or an escrow agent, or by the corporation itself supplying records of the offer to the Department.

#### **B. Rescission Offers Not Registered with the Department**

Although a rescission offer for a corporate securities offering violating the anti-fraud/disclosure requirements of section 8-1102, but not the securities registration provisions of section 8-1104, need not be registered with the Department, such a rescission offer is made in a manner similar to a registered rescission offer. In order to cure the civil liability, a written offer must be made in full compliance with section 8-1118(3). Further, in order to avoid another violation of section 8-1102, all material information must be disclosed to security holders in connection with the offer. If the Department has investigated and required a rescission offer, it will normally require that written disclosure documents be filed for its examination. The funding and verification requirements of a registered rescission offer must also be met.

### V. CONCLUSION

The sale of securities by a corporation without registration or without proper disclosure may give rise to civil liability on the part of the seller, the corporation itself, and its officers and directors, and may also subject them to possible administrative, civil, and

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48. *Id.*

49. *Id.*

criminal action by the Nebraska Department of Banking and Finance. A corporation can cure this civil liability and reduce the chances of action being taken by the Department if it makes a rescission offer in compliance with the Securities Act to investors who purchase the securities in connection with the violations of the Act. Depending upon the nature of the violation, the rescission offer may have to be registered with the Department in a manner similar to any corporate securities offering and in all cases, full disclosure must be made to the purchasers.