1979, University of California: In Memoriam

Ralph C. Hoeber, Business Administration: Los Angeles
1898-1978 Professor of Business Law, Emeritus

Professor Hoeber brought to his service on the Los Angeles campus from 1955 to 1965 a breadth of maturity of experience, scholarship, and teaching that materially strengthened the Department of Business Administration.

A native of Portland, Oregon, Dr. Hoeber received his B.A. degree in economics with honors (1921) and his M.A. degree (1923) at the University of Oregon. After some teaching at the University, he entered Stanford University Law School where he was awarded the J.D. degree in 1927. From 1927 to 1938, until joining the U.C.L.A. faculty, he was a member of the faculty of the University of Hawaii in business administration and economics (sometimes chairman). During the last two years of his tenure at Hawaii, he was on leave: the first year, with the rank of visiting full professor at the Stanford University Graduate School of Business Administration, he represented Stanford under a contract with the Mutual Security Administration at the University of the Philippines; the second year he was a Visiting Lecturer at U.C.L.A. He also took leave during the war (1942 to 1943) to serve as economist for the Office of Public Administration and for the Bonneville Power Administration.

While at Hawaii, he took leave to pursue further graduate study and was awarded the Ph.D. degree in economics at the University of Wisconsin in 1953, where he also served as visiting professor of economics (summer 1953). His dissertation, "The Development of Public Utility Regulation in Oregon," has had profound influence on regulation in Oregon and elsewhere. It was published by the University of Wisconsin in Land Economics (1957) as "The Role of the Courts in Public Utility Regulation." Professor Hoeber continued publication in American Business Law Journal; and, as time permitted, he worked on his textbook on business law for which McGraw-Hill offered a contract in 1974 expressing enthusiasm for Dr. Heober's originality and mode of expression.

To his colleagues, and especially to his many students, these attributes were well known. From the outset, Dr. Hoeber gave himself with dedication as a teacher. From 1929 to 1931, he was called back by his alma mater to teach and head the speech division. While practicing law, he taught night courses. He helped organize the new school of business at Hawaii. He taught with success at the University of the Philippines. The economics department at Wisconsin invited him to teach at its summer session on completion of his doctorate. At U.C.L.A. despite two heart attacks, he has given completely of himself to his teaching. He has taught with great success in undergraduate courses, in graduate classes, and in our executive program for senior managers. As shown by our systematic evaluations written by students at all levels, Professor Hoeber was an outstanding teacher.

Dr. Hoeber found time to give active leadership to his professional colleagues in the regional and national business law associations, having been named honorary president of the National Business Law Association. He received recognition in many forms, including listing in Who's Who in the West, American Men of Science, and Dictionary of International Biography. The forthcoming publication of his text will provide a fitting monument to a distinguished career.

Professor Hoeber leaves his wife, Ethel, herself a career teacher, whose collaboration and faithful support sustained his prodigious efforts as a productive scholar and teacher.

George W. Robbins
William F. Brown, Jr.
Albert Gordon

BLUE SKY LEGISLATION IN THEORY AND PRACTICE

A Thesis

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by

Ralph C. Hoeber

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Chapter I

Nature of Blue Sky Laws - Their Aim.

There are at least three theories of the origin of the term "blue sky" movement. One theory holds that the movement was so christened because it "designed to clear away the clouds and fogs from the simple investor's horizon"[1]; according to another theory the origin of the term lies in the attempt to curb operators whose promises are "as limitless as the blue sky"[2]; a third theory believes that the term alludes to the fact that the blue sky movement aims to stop the swindling operations of promoters who offer as security nothing but the blue sky above.[3] However valuable and promising the blue sky is to mankind, it has no economic value to the individual. Which account the reader prefers to accept is, of course, immaterial; only let him beware of confusing the term "blue sky law" with the so-called "blue laws", as the latter have for their purpose the observance of the Sabbath by business houses. If the metaphor "blue sky movement" is neither accurate nor scientific, it at least is picturesque and suggestive. Just what it suggests, and what it involves, will be the subject of this thesis.

The term "blue sky laws" has sometimes been stretched to mean "fraud acts". The latter simply aim to make the prosecution of fraud, once committed, easier (1) by putting in written statutory form the unwritten common law of fraud, and (2) by requiring the fraudulent concerns to file certain facts with

1. The Nation, Vol. 96, No. 2942, Ap.3, 1913, p. 344
2. Louisville "Post", quoted in Lit. Dig., Feb. 10, 1917, Vol. 54, p. 325
3. Lit. Dig., Ap. 26, 1913, Vol. 46, p. 936.

state officials so that the state will have the evidence with which to prosecute. Such a law is the recent blue sky law of New York.

Strictly speaking, a blue sky law is that kind of legislation which aims to prevent fraud in the sale of securities by providing that no person or company may sell securities not exempted by law until such person or company has received a permit to sell such securities from a designated state officer or official body. The permit is not to be granted unless the various steps, qualifications, conditions imposed by the law have been met and complied with by the applicant. In this thesis, wherever a distinction is necessary, the class of legislation described in the above paragraph will be referred to as fraud acts, and the kind defined in this paragraph will be known as blue sky laws.

It will be noticed that the definition just given says the aim of blue sky legislation is the prevention of fraud. This, at least, is the purpose which the statutes themselves declare. The Arkansas statute is entitled in part: "An act to prevent fraud in the sale and disposition of contracts, stocks, bonds, or other securities sold or offered for sale within the state of Arkansas". The California statute purports to be "An act providing for the regulation and supervision of companies, brokers, agents, and sales of securities as the same are herein defined, and to prevent fraud in the sale of securities". Among the list of states having statutes for the avowed purpose of preventing fraud are Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Mexico, New York, New Jersey, Oklahoma,

Oregon, South Carolina, Utah, Virginia, West Virginia, and Wyoming. New Hampshire has a law designed "to protect the public against the sale of worthless securities." Some states entitle their statutes merely acts to regulate investment companies. But even in the statutes having such titles, the word "fraud" appears often, and provisions against and penalties for fraud are provided.

That this is the purpose of the laws has been recognized by the courts on several occasions. Mr. Justice McKenna said:[1] "It will be observed therefore, that the law is a regulation of business, constrains conduct only to that end, the purpose being to protect the public against the imposition of unsubstantial schemes and the securities based upon them. Whatever prohibition there is, is a means to the same purpose". In the State V. Agey[2], the court found that "The intent of the statute is to protect our people, under the police power, from fraud and imposition...."

If this is the purpose of blue sky legislation, then certainly the purpose is legitimate. But it sometimes happens that the declared purpose and the actual purpose or the effect of the declared purpose are different. In a decision declaring the Michigan law unconstitutional, the District Court of Michigan said:[3] "We take judicial notice of the common understanding that this 'Blue Sky Law' was intended, as is said by the Attorney-General, 'to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and

1. In Hall v. Geiger-Jones Co., 242 U. S. 550
2. 171 N. C. 831; 883 S. E. Rep. 727
3. In Alabama v. N. O. Transp. Co. et al v. Doyle, 210 Fed. 173

other like fraudulent exploitations'. If just this intent had been carried into effect by the act as passed, these cases would not be here; but scrutiny of the law discloses additional and very different effects."

Arizona, Idaho, Montana, Tennessee and Vermont are not satisfied with preventing fraud. Their statutes provide that not only must the applicant transact his business according to a "fair, just, and equitable plan", but his business must be of such a nature as to "promise a fair return" in the eyes of the corporation commission. It is submitted that such a provision is contrary to the purpose of blue sky legislation, out of harmony with the American spirit of enterprise, and economically unwise in that it stifles legitimate business merely because the element of uncertainty exists. Most businesses can promise, at their inception, no adequate return. Only the established houses can predict with safety a net return. Were this test of an assured return applied to industry, no oil wells would be sunk, no patents marketed.

Speaking from his ripe experience as commissioner of the Federal Trade Commission, Mr. Huston Thompson said in a hearing before the Committee on the Judiciary of the House of Representatives:[1] We realized at the outset that you can not say to a corporation 'You must stop the sale of this stock simply because of the speculative value.' In the case of one concern which had only a piece of unproven territory and the machinery on it, while they were merely speculative from that point of view, suddenly struck a well that brought in

1. "Proposed Federal 'Blue-Sky' Law". Hearings on H.R. 188, Serial 6, Part I., 1919, p. 27

one thousand barrels a day. We determined in our minds, too that it would not be right to stop speculation; that the point is not to stop speculation, but to let the purchaser know what is behind the speculation."

Precisely that has been the aim and effect of the California blue sky statute, according to Governor Johnson. In his 1917 message to the California Legislature, Governor Johnson said:[1] "It is not the purpose of the law, nor has the state attempted to remove the ordinary hazard of business, nor to limit the rights of the public to engage in speculative enterprises, so long as they are fairly conceived and honestly conducted. In authorizing the issuance of securities the state does not, and manifestly can not, determine whether the project will certainly succeed; but the state does insist that the prospective investor shall be fairly and accurately informed of the character of his investment, and that the money which he invests shall be actually put to work for him, and not diverted into the pockets of the promoter, and that an honest effort will be made to project along practical business lines."

A recent article in the "Bankers Magazine"[2] points out that laws should not seek to curb the sale of stock having no present value. "Quite frequently", runs the article, "a useful purpose is served by the sale of securities which have little or no present value, but whose prospective value is very great. Indeed, if the sale of securities of this character is to be stopped, it will tend quite seriously to impair the development of many enterprises. The only harm to the individual results

1. Page 21-2
2. Jan., 1922, vol. 104, p. 12.

from the offer of securities of prospective value as if they had a present value. After all, about the only thing necessary in offering securities to the public is that the truth shall be stated in all cases." That this is not the conclusion of banking interests alone is proven by the expressed views of many other authorities. One of these follows.[1] "The provision requiring the auditor to determine whether the security offered for sale promises a fair return to the investor should be stricken out.-- This provision seems to me an excess of benevolent paternalism. Perhaps it is proper for the state, in the exercise of its police power, to determine whether the plan of business of the investment company, its contracts and organization, are free from fraud. When it has done this and has provided such information concerning the value of the security as will enable an investor of average understanding to exercise his judgment intelligently, the state has done its full duty."

The provision requiring the administrative official to be satisfied that the venture promises fair returns should be stricken from the statutes containing it. The purpose of blue sky legislation is not to assure the investor an income: it is to assure him, so far as humanly possible, against the element of fraud. This means two things: (1) prevention of fraud if possible; (2) successful prosecution if prevention is impossible What machinery has been devised to realize these aims, and to what extent the aims have been realized, we shall see in succeeding chapters.

1. R. S. Spilman in 49 Am. Law Rev. 394 (1915)

Chapter II

Fraudulent Sale of Securities; Extent of the Evil; Two Methods of Preventing It; A Typical Case of Fraud.

The extent to which fraud has been perpetrated upon the public in recent years cannot be estimated with any degree of certainty. "Current Opinion"[1], summarizing the findings of Harry F. Guest as printed in the New York "Globe", says that one half billion dollars is lost annually in the United States through the sale of worthless securities. An article in the "Outlook" at the beginning of this year says:[2] "It is estimated that the people of these United States lost $500,000,000 during 1922 in stock swindles and worthless stocks, and the unfortunate part of it all is that in most cases the people who lost the money could ill afford to do so."

This estimate the Capital Issues Committee refuses to accept. Let the Committee speak for itself.[3] "The estimate of $500,000,000 annually devoted to the purchase of such fraudulent and worthless stocks seems to the committee to be too conservative. This sum represents sheer waste and net loss to the people and the nation, not only of dollars but of morale, confidence, and incentive to save. The nation's loss can not be measured alone in money values, but in terms of those things which make for good citizenship."

Perhaps the most reliable estimate was made by the "World's Work". This publication spent a good deal of money

1. Nov. 1922, p. 659
2. Jan. 10, 1923, p. 104
3. Capital Issues Committee in its report to Congress on Feb. 28, 1919, Document No. 1836, 65th Congress, 3rd Session

and much time and effort to get the material for a series of articles entitled "Pirates of Promotion" which the magazine ran from October, 1918 to March, 1919. In its last article[1] there appears a list of get-rich-quick promotions. This list, we are told by the editors of that publication, was "compiled from the comprehensive records of the 'Financial World', which has the most complete data on these parasites of the country that we know of". A summary of the list follows:

Partial list of get-rich-quick promoters.

Total capitalization in oils companies	$468,900,000
" " " industrial "	988,250,000
" " " mining "	708,226,365
" " "miscellaneous "	834,727,000
Grand total capitalization	3,000,103,365

Whether we estimate the amount of fraud at one half billion or at three billions, wide as these limits are, matters very little. It is clear that whatever the exact figure, the extent of fraudulent sales is considerable. It is to minimize the extent of fraudulent sales in securities that the states, one after another, have adopted blue sky measures. And the worst feature is not the extent of such sales, but the incidence thereof. It is the small investor, the one who has saved a few hundred or few thousand dollars, who has not the technical knowledge to know in what securities safety lies, and who is afraid to consult a reputable banking house for fear he will be charged for information given him or for fear that the bank

1. World's Work, March 1919 vol. 37 pp 513-18

will not care to concern itself with the petty affairs of such a small depositor (perhaps he is not even a depositor) -- it is such a person who falls victim to the glib-tongued salesman. After all, we must not blame the victim too much. He sees the bank as a competitor when it comes to searching for lucrative investments. Why should the bank point out to him where he may get eight or ten or twelve or fifteen per cent, when it might just as well say: "You deposit your money with me. I will pay you three or three and one half per cent, and then invest your money at ten or twelve per cent and pocket the profits". It connot be denied that the banks and trust companies have been too busy making eyes at the large investors. When they welcome the small investor as eagerly as they welcome the large, then many of our problems will be solved. It is a process of two-fold education: educating the small investor to get the advice of a reputable banker before investing, and educating the bank and trust companies to welcome the small depositor or investor. Many people never will be educated to the point of seeking expert advice; they are too greedy to be satisfied with the small return offered by indorsed investments. On the other hand, many people can be so educated. Our task is not be seek to accomplish the impossible; but it is to do that which can be done. Let us educate those who can be educated

Some advance, to be sure, is being made in this line. A number of leading periodicals have departments which answer the investment questions of their readers. "Do you know that as a reader of 'Review of Reviews' you may ask us for counsel with regard to your investments?" advertises the magazine by

that name. The "World's Work" and "Century Magazine" each have a page entitled "Investment Questions and Answers". "Scribner's" has an "Investor's Service Bureau" which answers the questions of its readers. Many other journals have a section which, while it does not answer questions, presents articles of help to the bewildered investor. Thus "Literary Digest" has a section entitled "Investments and Finance", and "Harper's" one called "Business and Financial". Much good is done by these periodicals to the class of people who read them. But the field of service is limited. It is just a beginning. Let the banks and investment houses follow the lead of the magazines in which they advertise and make known to all mankind their eagerness to help the petty investor.

But because much can be done by education, we do not need to put our sole reliance in it. A number of articles have appeared from time to time in banking and financial journals attacking the philosophy of blue sky laws on the ground that education is better than legislation. The matter is not an "either..or" proposition. Why cannot both education and legislation be resorted to? There is nothing incompatible between the two. Indeed, the two work together admirably in this field as in so many others. Education is a gradual process; its fruits take long to ripen. Legislation may be made effective at once. The former may be the more fruitful in the end; the latter is more productive at the outset.

Innumerable examples might be given of fraudulent sale of stock to an intelligent, but too credulous, public. From all these examples the writer will select but one typical case -

that of T. J. Foster of International Correspondence School and International Text Book fame.

Foster started as a publisher of a mining paper which conducted a department of instruction in mining. The success of this led to the idea of running a school to give instruction by mail in many other branches. This was the birth of the correspondence school idea for Foster. He then organized the International Correspondence School of Scranton. It was an educational and commercial success. But Foster was fired by an ambition to be a financier on a larger scale. He organized the International Text Book Company, with a capitalization of $10,000,000. Students of the correspondence school were solicited to buy the stock of the text book company, and of other concerns which Foster later promoted. One of these was the Lackawanna Coal and Lumber Company, capitalized with $15,000,000 worth of bonds and $12,000,000 worth of stock. Dividends were paid from the capital stock supplied by the stockholders themselves. Securities were issued many dollars in excess of the property on which they were based. In one case a farm in New Jersey was purchased for $25,000 and $300,000 worth of bonds sold against it. All the money the receiver found when he took charge was $150.

This is the story the "World's Work"[1] tells of T. J. Foster and his promotions aggregating $150,000,000. The International Correspondence School, now under management of leading Scranton business men, is a sound and valuable concern. But when the stockholders took it over, they advanced

1. Jan., 1919. Vol. 37, pp 319-20

$500,00 to save the school. Practically all the money invested in Foster's $150,000,000 worth of promotions has been lost. The feeling of those who bought stock in Foster's promotions was well summed up by a Canadian frontiersman: "If I put faith in him it was not so much because I considered his financial literature particularly favorable, but rather because having been one of his students, I felt that this man who founded a rather philanthropic institution and steered it safely through several crises, could not well be an imposter".

Foster's corporations were mainly Pennsylvania concerns. It might be mentioned here that Pennsylvania has no blue sky law. It had a law regulating the securities of insurance companies during Foster's days, and more recently it has adopted a law licensing companies selling securities on the partial payment or installment plan. Blue sky law, however, it has none. One is tempted to ask if an adequate blue sky law would not have prevented the swindles of this arch-crook. At least a permit would have been granted to sell $300,000 worth of bonds against a $25,000 farm. But the efficacy of these laws will be discussed later. Here it was desired merely to describe a typical case of "high finance" - such an episode as the blue sky laws are designed (whether effectively or not) to guard against.

Chapter III

History of the Blue Sky Movement
The Oregon Blue Sky Law

The conception of blue sky legislation began with Joseph N. Dolley, at that time bank commissioner of Kansas. Before becoming bank commissioner Dolley had led a varied life. He was born in Boston in 1861. Much of his early life was spent at sea with his father, an old-time skipper. Tiring of the sea, Dolley sought a land career. He migrated to Kansas and became a clerk in a country store. Before quitting the store he became the proprietor of it. From the merchandising business he went into the banking business. With all his work he yet found time for politics, for he managed several political campaigns in Kansas. It was this versatile man who was the father of blue sky legislation.

First as a business man, and then as a bank commissioner, Mr. Dolley observed the fake investment schemes flourishing about him. Now when Dolley became bank commissioner, "he held to the view that, if the law didn't say so in so many words, it meant that he was not only expected to protect the people against dishonest or insecure depositories for their money but also to protect them from those dishonest men who sought to induce them to invest their savings in unsound and insecure schemes of any character".[1] Accordingly, some time around 1910 he established a bureau in his department for the purpose of advising the people of Kansas, without charge to them, as to the value of stocks, bonds, and other forms of securities offered

1. Harry F. Kohr in "Technical World", 17:36, March, 1912.

to them for investment. Believing that the evil might be cured only by striking at the root with the ax of legislation, Dolley drafted a law to aid him in his work of ridding the state of swindlers. This law was passed by the Kansas Legislature in 1911; and thus was the blue sky movement born. The law was given wide publicity. The citizens of other states urged their legislatures to protect them as the people of Kansas had been protected. One state after another passed blue sky laws until a regular blue sky law fevor set in. Soom fourteen states "obeyed the impulse". Among the early states were West Virginia, Missouri, Montana, North Carolina, Ohio, Vermont, Oregon, South Dakota, Arkansas, Florida, California, Georgia, Idaho, and Iowa.[1] Mr. Dolley went out of office, and the 1913 legislature amended the act quite materially. In 1915 the entire act was repealed and a new speculative securities act was passed. In 1919 the new act was amended - this time but slightly.

So that is the history of the Kansas law and of the beginnings of the movement which it started. This movement has spread until today[2] only four states - Colorado, Delaware, Nevada and Washington - have no trace of a blue sky law. The governors of two of these states recommended the passage of such a law. Governor Sweet of Colorado, in his innaugural address of 1923, said:[3] "I favor the enactment of an effective Blue Sky Law to the end that the investing public may be protected from the frauds and misrepresentations of wild-cat

1. Lit. Dig. 48:367
2. That is, up to the 1923 sessions of the state legislatures. The 1923 session laws were not available at the time this thesis was written.

speculations and that only stocks and securities representing legitimate enterprises may be offered for sale."

Governor Hart's third message[1] to the legislature of Washington contained a similar passage. Said the Governor: "I recommend the enactment of a good law that will protect the innocent investor from the machinations of a corrupt and fraudulent vendor of stocks and other securities, but so safeguarded as not to retard the development of our latent resources, nor to interfere with legitimate investments."

Four states, we found, have no blue sky laws at all. Two other states have what might be called embryo or quasi blue sky laws. One of these laws, that of Alabama, provides merely that "each person dealing in stocks and bonds --- shall first procure a license", for which he must pay $50. The other law, that of Louisiana, is an act to regulate not securities or the company's issuing them, but to regulate "itinerant or traveling agents selling stocks and bonds".

Three states - Maryland, New Jersey and New York - have what we have called "fraud laws". All the other states - 39 of them - have actual blue sky laws. These range from the very mild to drastic and sweeping measures.

The history of the Oregon act must be of special interest to the citizens of our commonwealth. Let us consider it, then, in some detail.

There was submitted by initiative petition to the voters of Oregon a blue sky law to be voted on at the general election of November 5, 1912. The returns on this measure[2] showed

1. Delivered early in 1923. pp. 15-16 of his message
2. Oregon Blue Book, 1913-14, p. 143

Yes, 48,765; no, 57,297. The vote was thus rather close; but still the majority against the bill was large enough to show the voters were opposed to it.

Every student of political science knows that election returns, unless interpreted, may sometimes be valueless - indeed, they may seem to point to a conclusion just the opposite from the real situation. It would seem that this is the case with the figures given above, for Governor Oswald West, in his 1913 biennial message[1], told the legislature that the blue sky law "proposed at the last election failed to pass, not because the voters were opposed to such protective legislation, but because it apparently created a new office and carried an appropriation."

The governor then recommended that the legislature pass such a law as the people had, through error (according to the governor at least), failed to pass. "This is a question", ran the message,"which merits your careful attention, and I earnestly hope you will favor legislation which will drive from our State the many bogus concerns which are preying upon our citizens.

"It should not be forgotten, however, that the passage of such an act will throw a vast amount of work and investigation upon someone and the work cannot be carried on successfully without reasonable appropriation."

The legislature apparently agreed with the governor's interpretation of the cause of the measure's defeat at the hands of the voters for H. B. 434 was introduced in both

1. To 27th Legislative Assembly regular session. p. 19

houses of the assembly (Feb. 3 in the House[1]; Feb. 17 in the Senate[2]), referred by each body to its committee on the Judiciary, there debated and amended, reported back, and passed by each house (Feb. 15th in the House; Feb. 26th in the Senate). The vote in the House of Representatives stood: yeas - 45; nays - 6; absent - 9. The vote of the Senate was : yeas - 25; absent - 5. The measure was signed by the governor on February 26th, 1923 and filed with the Secretary of State the same day. And thus Oregon joined the rapidly swelling ranks of blue sky states.

The legislative history of a particular bill cannot be said to be of absorbing interest. It was included in this thesis not only for the purpose of historic completeness, but for the purpose of showing that the bill was not rushed through the last minute of the session, but was considered with deliberation from February 3rd to February 26th. In this respect it had the advantage over the blue sky bills of some other states. Colorado, for example, passed its law "during the last hours of the session", to use the words of Governor Amos[3]. "In the haste attending the closing of the session it was overlooked that this bill contained provisions in conflict with other important measures-- " This did not happen in Oregon. But all new legislation is experimental. It was not to be expected that the new law would be so satisfactory as to prove in no need of amendment.

The original act of 1913 was amended the very next session of

1. House Journal for 1913
2. Senate Journal for 1913
3. Governor's message to Colo. Assembly, 1915, p. 8

the legislature (1915). The 1913 act distinguished between Domestic Investment companies, Foreign Investment companies, and stock-brokers. This was an unserviceable distinction. The 1915 amendment included all under "Dealers". Other changes too, were made. The 1915 amendment, for instance, allowed more liberal exemptions from the operation of the act. Again, the original law makes the criterion of whether a permit shall be granted the corporation commissioner's belief that the business is founded upon a"safe, fair, just, and equitable plan"; the amendment makes the criterion a "sound moral character and good business repute." The amendment, too, changed the maximum amount of the fine which might be levied.

The act of 1913, as amended in 1915, was again amended in 1921. This amendment made a few minor changes. One of them was the change in the filing fee. The law previously had fixed this fee at $5; the 1921 amendment made it 1/10 of one percent upon the face value of the securities, with a minimum limit of $5 and a maximum limit of $100. A new provision was added to the law - that of protection in case of interim certificates. This feature will be discussed in the chapter dealing with the specific features of various blue sky laws.

The last (1923) session of the legislature again amended the act. The writer made a personal call upon the corporation commissioner in an attempt to get a copy of this amendment, but the literature is not yet off the press. One feature of the new amendment was, however, referred to by the commissioner. It is a provision allowing the issue of non-par stock. This provision, now gaining such wide popularity, was

vigorously denounced by the corporation commissioner.

No attempt has been made in this chapter to give an appraisement of the Oregon law. The writer was concerned merely with giving such an account of the history of that law as could be gleaned from the documents to which he had access - the session laws, the House and Senate journals, the governor's reports, the Oregon Blue Book, etc.

Chapter IV

Arguments Against and For Blue Sky Legislation

As the title of this chapter indicates, the arguments against blue sky legislation will be considered before the arguments for such legislation. This is in line with fastening the burden of proof upon those who advocate a change. As was pointed out in Chapter III, nearly every state has some sort of blue sky measure. He who would have the states reverse their action must present convincing arguments for such procedure.

The first argument against the theory of blue sky legislation is "caveat emptor". This is a well known legal maxim meaning "let the buyer take care" or, as it is sometimes translated, "let the buyer beware." It is claimed that this is a proper maxim of business. Why should the government shield those who negligently refrain from examining that which they are about to buy? Such a policy on the part of a government would spell irresponsibility and incompetency on the part of its citizens. Their powers of investigation and judgement would atrophy. When a man buys some stock or bonds, let him investigate them first and then exercise his own best judgement.

To this argument two answers may be offered. First, the doctrine of caveat emptor has fallen down in other fields of business regulation. The unmistakable tendency is toward a restriction in the application of that maxim. Thus, at early common law, if the owner of a horse, in exhibiting the animal

to a prospective purchaser, kept turning the animal around so as to constantly keep his blind eye out of the purchaser's view, the vendee had no recourse at law. He should have been wise enough to discover the trick. Again, if some woolen cloth was offered for sale, there was no implied warranty as to quality or title. But today the buyer of the horse would have recourse at law, and the woolen cloth must be of usual merchandisable quality. The pure food and drugs acts are other examples of the breakdown of caveat emptor. Common law did not provide adequate protection to the public against abuses in connection with the production and sale of food. "It had accordingly been reenforced and supplemented by federal statutes, and by numerous state statutes and municipal ordinances, regulating the manufacture and sale of articles of food with a view to the preservation of health and the prevention of fraud".[1] Some of these statutes require that a permit be obtained before sales can be made. A more common method of regulation is to require inspection by public officers. A permit obtained from the government, inspection by its officials - this is surely far from the cry of "let the buyer beware."

But after all, this discussion of caveat emptor so far has been strictly academic. The truth is that it is not necessary to attack the doctrine. Whether the doctrine is wise or not is not at stake. As securities are actually bought and sold today, there is no room for the application of that doctrine. The promoters of fly-by-night concerns never say :

1. 26 Corpus Juris 751

"Here is our stock. We make no representations concerning it. It is up to you to examine the facts in the case." Anyone who has ever seen any literature published by these companies realizes that they are filled with statements, not of opinion and prophesy merely, but of facts. Even where facts are not misstated, they are placed in such light as to give wrong impressions, and "a representation literally true is actionable if used to create an impression substantially false".[1] When these facts are misrepresented, or when a wrong impression is intentionally given, then the element of fraud enters in. And when there is fraud, caveat emptor does not apply. "The purchaser buys at his own risk, unless the seller gives an express warranty, or unless the law implies warranty from the circumstances of the case or the nature of the thing sold, or unless the seller be guilty of fraudulent misrepresentation or concealment in respect to a material inducement to the sale."[2] This conclusion is substantiated by other text-book writers. Williston [3] says in effect: If a person makes a statement of fact, which statement is untrue, for the purpose of inducing and does thereby induce a sale, the seller is liable. Caveat emptor does not apply.

One of the clearest statements of the law is found in the leading case of Fargo Gas & Coke Co. v. Fargo Gas & Electric Co.[4] In that case Corliss, J., said: "When parties deal at arm's length, the doctrine of caveat emptor applies;

1. 26 Corpus Juris 1100
2. Story, "Sales", 3d ed. Sect. 348; Bouvier's Law dictionary, Vol. I., p. 438
3. "On Sales", p. 260
4. 4 North Dakota 219 (Year 1894)

but the moment the vendor makes a false statement of fact, and its falsity is not palpable to the purchaser, he has an undoubted right to rely on it."

Here then is the practical situation: To induce people to buy their securities, fly-by-night concerns make false statements of fact[1]; as soon as they do this, the law of fraud, and not the doctrine of caveat emptor, applies.

The second argument against the blue sky legislation is that the permit given to sell an issue of stock is interpreted by the buying public as an indorsement of those securities, even though eleborate precautions are taken to guard against such an interpretation. Most states require that the certificate giving permission for the sale "recite in bold type that the issuance of this certificate is permissive only and does not constitute a recommendation or indorsement of said securities".[2] In Oregon the Certificate of Agency[3] has printed in red diagonally across the black type of the sheet these words: "The Corporation Commissioner by this certificate in no wise recommends securities offered for sale by the holder hereof". Then at the bottom of the page appear these words in still larger red type: "This certificate is not a recommendation of the holder or the security offered for sale by him and any use or exhibition of same for such purpose is a violation of the Dealer's permit".

1. Such as: "We have already sunk a shaft and operations are going along without disturbance"; "All the prominent geologists in the state assure us that there is oil in paying amounts"; "last year we paid 15% dividends". All these are statements of fact - not opinion; and they are statements of past or present fact.
2. Quoted from the California act of 1914, Sect. 5
3. See Appendix for copy of this certificate.

That there is always the danger of having the license interpreted as an indorsement cannot be denied. It is this danger which Mr. B. W. Palmer, counsel for the Capital Issues Committee, had in mind when he answered the question "Will not the effect of such legislation be to inspire confidence in the innocent and ignorant purchasing public in stock issues?" as follows: "I think this, that if there is anything in the nature of a license or approval, or anything of that character, then an opportunity would be created whereby the public could be deceived".[1]

The opponents of blue sky legislation can find arguments in the utterances of the proponents. In one of his gubernatorial messages[2], Governor Johnson, after denouncing the opposition to the California law as "malignant assaults", puts forth the following claim: "Through the operation of the law, it is true, the state has lost corporate enterprises from which other states are now suffering. On the other hand California has gained investments which have organized as California corporations because of the protection afforded their business reputation and standing. Just as stocks and bonds of utilities approved by the Railway Commission have been more salable and brought higher values because of the approval of that commission, so the stocks and bonds of California corporations that have been issued and sold under the Corporation Commissioner have almost uniformly found a readier market than other securities not only in California, but elsewhere." This result is desirable for all eminently

1. Hearing before the Committee on the Judiciary, 66th Cong. 1st Session on H.R. 188, Serial 6, Part I, p. 118
2. Message of 1917, p. 21

honest and safe securities. But will not the poorer securities which pass inspection gain more than the better ones? Everyone knows the standard securities - those listed on stock exchanges, reported in investment manuals, backed by firms of long standing - lack the element of fraud. They gain little in public estimation by passing the inspection of the state official. If any class of securities gains by this recognition, it is poorer, less known, and less desirable security. It seems to the writer that instead of congratulating ourselves upon the fact that the certificate acts as an endorsement and provides a "readier market", to use Governor Johnson's phrase, we ought to do all in our power to prevent the certificate from being construed as an endorsement and recommendation.

Oregon has adopted one way to remove, or at least to minimize, this danger. Massachusetts has adopted another way. There is a provision in the Massachusetts law which prohibits the advertisements from making any reference to the fact that the law has been complied with. Thus in one way on another states have sought to prevent the danger of which we have spoken. Whether or not they have succeeded entirely in preventing it is not the question, or course. No human ingenuity could do that. The question is merely whether or not the danger is so great as to overbalance the good which the permissive feature does. No figures are available on this point at all. It is the writer's unsupported opinion, however, that for every dollar lost through misrepresenting

the permit as an indorsement, dozens of dollars are saved the investor through the weeding our process which results from requiring the promoter to refrain from selling until he has passed inspection.

A third argument against blue sky legislation may be passed lightly by. This argument holds that there is no one capable of judging the worth of any issue.[1] But we have already shown that the true purpose of the class of legislation under discussion is not to pass upon the value of securities: sound blue sky legislation aims merely to detect fraud. The former has to do with opinion; the latter has to do with fact. This distinction is elementary in the common law of fraud.[2]

That blue sky legislation depresses legitimate business is the fourth contention of its opponents. Governor Bamberger[3] was right when he told the legislature of Utah that "In the enactment of such a law the provisions should be selected with extreme care in order that legitimate development may not be hampered." But hawe the provisions been selected with such care by our various state legislatures? The argument for and against this point amounts to about the "'tis!" and "'taint!" arguments of schoolboys.

On one side we hear such claims as the following:

"...it can be safely stated that the amount of good accomplished by any or all of the so-called Blue Sky acts in the thirty-odd states which have such statutes on their books

1. See Franklin Escher's article "Overcast Blue Sky Legislation" in Harpers Weekly, Vol 57, May 31, 1913, p. 24 for this contention.
2. See, for instance, 12 Ruling Case Law 244.
3. Gubernatorial Message of 1919, p. 7

is infinitesimal in comparison with the amount of expense and annoyance which they entail upon legitimate business."[1]

"In endeavoring to reach the dealer in unsound securities, these statutes have been given so wide a scope that they cover any and all transactions, and seriously interfere with, if not prevent, a sound investment banking business. I know definitely of a number of cases where business which would have been of mutual advantage has been prevented on account of the passage of these acts."[2]

"Mr. Cromwell (President of New York Stock Exchange) spoke of the blue sky laws as cumbersome and as being obstacles to the distribution of bona-fide securities."[3]

From the other side we receive the following reports:

"The clean business interests of the state have manifested and expressed hearty sympathy with the law and with the work which the commission is endeavoring to do. They have also co-operated with the commission to an admirable extent. Legitimate business is greatly aided by an efficient administration of a law of this kind and the occasional cry that business is being hurt by the enforcement of the law comes from those whose business will not stand investigation."[4]

"Legitimate dealers are in hearty accord with our efforts to protect the public against the sale of worthless securities."[5]

"Worthy investments are not hindered."[6]

"Very few legitimate dealers criticise its requirements, for they believe that it is in the interest of honest investments and consequently is an advantage to their business."[7]

1. Report of Committee on Legislation, Investment Bankers Association Proceedings, 1919, p. 122
2. A. B. Leach, Pres. of I.B.A., Proceedings, 1915, pp. 20-21
3. Albert W. Atwood in Sat. Ev. Post, May 6, 1922, Vol. 194, p. 4
4. First Annual Report, State Securities Commission, of Minn.
5. Report of Division of Investment Securities for New.Hamp.
6. First Annual Report, Dept. of Securities as a Separate State Dept. Ohio
7. Report of Bank Commissioner of Vermont for 1915.

To these voices we can add one from our own state. The late Governor Withycombe, in his message to the 30th session (1919) of the legislature, says of the blue sky law that "it has not obstructed the establishment and expansion of legitimate enterprise."

With such opposed voices as these, what are we to conclude? Why simply this: Some states have required too much red tape, too much data to be filed by all concerns, no matter what their standing. Other states have realized that a minimum amount of information filed with the enforcing officer is sufficient for a "first round". If there is anything to arouse the suspicions of the official in this material (and it is said that the ear-marks of fraud are easy to discover by the experienced), then he should have full power to require as much additional information as is sufficient to convince him either one way or the other. Most laws are good or poor not as they are written, but as they are enforced. Blue Sky Laws are no exception to this rule. Given a law with certain definite minimum provisions, plenty of discretionary power, and a capable administrator to use this power - and you have a wonderfully effective weapon to eliminate fraud. Such states as have this combination find that the law does not hinder legitimate business - that it is welcomed by such business; such states as do not have this combination may have a different experience.

We have just discussed an objection to blue sky legislation from the vendor's view-point. Let us now consider an objection in behalf of the vendee. "Each man knows best in what he wants to invest; no censorship should be applied to his decision, no limitation to his choice." Thus runs this objection. But it is safe to assert that no sane investor has ever objected because the government keeps him from being robbed. And this, as we have repeatedly pointed out, is all that blue sky legislation seeks to do. If these laws prohibited speculation, this objection would be well founded. So long as the aim remains merely prohibition of fraud, so long as the vendee is allowed complete freedom in his choice of Honest stock, no investor is going to claim that the state is interfering with his liberty and freedom of action.

Blue sky legislation is objectionable, not only because it results in the evils considered in the various arguments above, but because it is so unnecessary. It is unnecessary, says this sixth objection, because the common law allows recovery for fraud and because there is a national statute prohibiting fraudulent use of the mails. The statute[1] referred to provides that: "Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell... any obligation or security of....any company, corporation, or person...shall,

1. Revised Statutes, Ar. 5480, as amended by Act of 1889, c.393 (Found in U. S. Compiled Statutes, 1916, Ar. 10385.)

for the purpose of executing such scheme or artifice or attempting to do so, place...any letter...in any post-office or box...be fined not more than $1000, or imprisoned not more than five years, or both." Thus, the fraudulent company may be sued by the person who suffers from its fraud, and also if it use the mails in perpetrating the fraud, by the Post Office Department. Surely this is adequate to prevent fraud.

That is not prevention at all; at best it is merely punishment. It is like locking the stable door after the horse is stolen. Fraudulent promotions are usually put over by short campaigns. By the time "fraudulent intent" can be proven, the damage has been done. Even if the promoter can be prosecuted successfully, the loss to the investor is not repaired. The money is usually squandered, and there is no property which may be seized. In Chapter II we gave atypical case of this, on a chicken ranch purchased for $25,000, bonds to the extent of $300,000 were issued, and all the receiver found when he took charge was $150. Prosecution, either by the unfortunate investors or by the government, or by both together, could not return to the investors their hard earned savings.

And even if there are adequate assets, the matter is not improved a great deal. The average investor cannot afford the time and money necessary to carry on an expensive law suit. And even if they could, see how the courts would be littered up with suits. Here are 500 people who were so unfortunate as to invest in the Lotta Fraud Mining Company. What would happen if all 500 brought suit? The Post Office Department is

behind now in its prosecutions.[1] And it can prosecute only those companies who use the mails. The investor who is personally solicited cannot look to the government. Where the government is successful in its prosecutions, the promoter is fined or put in prison for a short term of years. "He can then come back into the game. Nova A. Brown, who was tried recently for his D & C promotion - but not convicted because of a 'hung jury' - had already engineered another promotion while waiting trial."[1]

A homely saying has it that an ounce of prevention is worth a pound of cure. That maxim, so true generally, is particularly true when applied to fraudulent sale of securities, for the pound of cure is so difficult to administer.

So far we have been considering the theoretical arguments against and for blue sky legislation. The final argument with which we shall deal concerns itself not with theory, but with the practical operation, of such legislation. This argument, shortly stated, is this: Blue sky laws have been a failure where they have been tried. This serious indictment has been brought by magazine writers, governors, banking groups, and others. Here are some of the assertions and some of the pieces of evidence upon which such assertions are founded:

"Most of the blue sky laws put it up to State authorities to protect you and me against swindles. Most of them don't work." These words appeared in large letters at the head of an article in Collier's[2] by William E. Hooper.

1. World's Work, vol. 37, p. 512. (March, 1919)
2. Issue for June 3, 1922, p. 6

"The present law governing the sale of securities in this state (Nebraska) is in its operation in many instances much worse than no law". This is quoted from Governor McKelvie's message of 1921.[1]

"The present blue sky law has been in effect since 1913, but because of its weakness it remains practically impotent. I recommend, therefore, that more effectual and drastic provisions be written in to safeguard investors. If it is not the purpose of the legislature to do this, the law should be repealed and the securities department abolished."[2]

"As a matter of 'Blue Sky' information, it is reported in the press that S. C. Pandolfo, president and promoter of the Pan Motor Co. of S. Cloud, Minnesota, has been found by the Federal Court guilty of using the United States Mails in a scheme to defraud. Approximately $9,500,000 of the stock of the company had been disposed of by alluring advertisements, clever salesmen, etc., to about 70,000 victims. A sentence of ten years in the Federal Penitentiary and a fine of $4,000 was reported imposed.

"Elaborate plant arrangements, false figures, etc., cleverly used, apparently blinded the 'Blue Sky' officials. It is understood that during the trial it was brought out that the stock of the company was sold in practically every state in the Union, over thirty of which have 'Blue Sky' laws in some form or another, many very strict in their requirements."[3]

(Note: Fairness demands that it should be pointed out that no matter how strict the blue sky laws of states other than Minnesota are, those states are powerless to prevent a foreign corporation from using the mails to sell securities within their boundaries. Only the national government has power to prevent that. But this does not, of course, excuse the blue sky officials of Minnesota for their failure to discover the fraud. This much should be said in justice to them: (1) Pandolpho started operations in Minnesota in the spring of 1917, whereas the blue sky law did not go into operation until July 1st of that year. (2) The Commercial Club of St. Cloud, Minnesota passed and published a resolution stating that President Pandolpho "has been thoroughly investigated by us and found not only honest to a fault, but a man of great capabilities." The president of the club was reported as saying that if St. Cloud undertook to advertise the municipality as much as the Pan Motor Co.[4] had already advertised it, it would cost at least $2,000,000. Possibly the pressure of civic pride may explain the inactivity of the Minnesota officials.)

1. Page 20
2. Gov. Donahey's message of 1923 to the Ohio Legislature.
3. I.B.A. Bulletin, Jan. 15, 1920. Vol.VIII, no.9, p.150
4. World's Work: Jan., 1919

An illustration of where a blue sky law worked, but failed to work soon enough, is found in the case of Giles P. Corey. This man started a fake scheme to present the development of The Negro Race in film. "Corey was arrested under the 'blue sky' law of Illinois, but not until he had sold a good part of the company's $1,000,000 capital stock on promises of 1,000 to 3,000 percent return. He paid a fine of $1,000 rather than stand trial."[1]

In answer to this testimony showing the ineffectiveness of blue sky laws, the friends of such legislation make two claims: (1) No law on any subject can be universally enforced. The test of any law is not whether it absolutely stops the evil it is aimed against. The test is rather: Is the net amount of good accomplished by the law sufficient to warrant the existence of the law? Not, does it work in all cases; but, does it work in a sufficient number of cases to justify both the trouble and expense it causes to the state and its citizens? These friends claim that blue sky laws have worked in far the greater number of cases, and that they have thus clearly justified themselves. (2) The list of authorities saying that blue sky legislation has not worked well is far overbalanced by the list of those saying the laws have worked well. Here is a small part of the latter list:

"The law passed last year has had 'most gratifying results.' Under this law, many concerns which were selling worthless or highly speculative stock left the state before the law became operative and a number of others have been refused registration, and prevented from doing business in this state."[2]

"The State has a law, ably administered by our Banking Department--etc. In former years any promoter with a wildcat stock selling scheme could come to Maine and fleece our citizens of their savings. I suppose in many of our counties there are

1. World's Work: Jan., 1919.
2. Gov. San Souci's message to the 1922 R.I. legislative assembly, p. 18

almost enough beautifully engraved worthless stock certificates of oil, land, gold and silver mining and other companies to paper the walls of the Capitol. Today to a considerable extent our citizens are protected from these frauds, and during 1922 new promotions with capital totaling $104,000,000 were refused admission to our state." 1

"...we believe that the 'Blue Sky' laws of this state as it now stands, has saved to the citizens of our state, many times the expense of maintaining the department, and we believe it will continue to do so."2

The voices which tell us of the operation of the Oregon act seem to be quite unanimous in praise of the measure.

"In 1912 the United Wireless Company sold in Oregon $800,000 worth of stock that turned out to be worthless. In the same year the Columbia River Orchard and Irrigation Company disposed of bonds with a par value of a million and a half in the same state. The bonds were not worth the paper they were printed on. The promoters of both concerns were prosecuted, but their punishment did not restore the vanished dollars.

"In 1913 and 1914 the United States Cashier Company attempted to sell stock in Oregon. Before it could insert its fingers into the pockets of unsophisticated owners of legal tender, the state's Blue Sky commissioners ordered it to move on. It did, and the federal authorities are now on its trail. The Coin Machine Manufacturing Company, the Sessens Diving Bell Company and thirty others of similar foliage departed for greener pastures." 3

"During the year it drove from the markets of the State an aggregate total of $59,564,104 of worthless, doubtful or unproven securities. The peddlers of air and the vendors of words have for the most part sought new pastures, while those who are engaged in honest corporate business remain."4

"The 'Blue Sky' Law passed at the last session of the legislature has been in effect long enough to show its many most admirable features and develop its numerous defects. It has driven from the state during its short life worthless securities to the amount of $60,000,000." 5

"...the Corporation Department merits commendation for its business like and economical administration during the last two years." 6

1. Innaugural address of Gov. Baxter of Maine. 1923. p. 27
2. Annual report of State Securities Comm-n, S. Dak. June 30, 1923
3. Editorial in Sunset Magazine. Vol 34. p. 344, Feb. 1915
4. First Report of Corporation Commissioner of Oregon. p.6
5. Gov. Watts 1915 report to 28th assembly p. 30

"The corporation department also is entitled to commendation for the successful administration of its affairs and the economy of its maintenance. The so-called blue sky law has furnished the investing public with reasonable protection against the unscrupulous promoter and the stock jobber." [1]

To extend this list of quotations would be tedious and quite useless. All this goes to prove merely a conclusion which we reached some pages back; namely, that blue sky legislation per se is neither good nor bad, and that the results will be either good or poor according as the particular law under consideration is well written and administered. Since part of the success of a law depends upon the provisions of that particular law, it will be time well spent to consider in detail the specific features of the various blue sky laws in existence, with a view to determining which are acceptible features and which are not. This will accordingly be the subject of one of the succeeding chapters, Chapter VII. But the fact that no state having a blue sky law has ever reversed its action, and the fact that every year more states have enacted such legislation - these two facts tend to show that blue sky laws are practical in their application. The burden of proof is on those who attack the system.

1. Gov. Withycombe's 1919 report to 30th assembly p. 20

Chapter V

Constitutionality of Blue Sky Legislation

Almost from the dates of their enactment the constitutionality of the blue sky laws has been assailed. It is not the purpose of this thesis to trace the history of the ligitation, nor yet to go deeply into the constitutional questions involved, and that for two reasons: First, because those subjects have been admirably treated elsewhere[1]; Second, because that is a question for a thesis in law, rather for a thesis in economics. No account of blue sky legislation, however, would be complete without some reference to the constitutional question, because that question has loomed so large in the history of the movement. When, for instance, the acts of several states had been declared unconstitutional by their respective state tribunals, a decided check was given to the progress of the movement. But when the United States Supreme Court found the statutes of Ohio, South Dakota and Michigan to be constitutional the retarded progress was again given an impetus.

Blue sky laws have been attacked on the following grounds:

1. They deprive one of property without the due process of law.

2. They deny the equal protection of the laws.

3. They are a violation of the commerce clause of the federal constitution.

1. See, for instance, "The Annotated Blue Sky Laws of the United States." , ch. III. on the constitutionality. By John M. Elliott, of the Columbus, Ohio Bar; Counsel for Dept. of Banks and Banking of Ohio.

4. They delegate legislative and judicial power to an executive officer.

5. They are laws of a general nature but do not operate uniformly.

6. They are not within the police power of the state, being unnecessary for the protection of the health, safety, morals, or welfare of the people.

7. They grant to citizens of one state rights, privileges, or immunities not granted to the citizens of another state.

The decisions which finally established the constitution- of typical blue sky laws were: Hall v. Geiger-Jones Co. [1], which declared the Ohio law constitutional; Caldwell v. Sioux Falls Stock Yards Co.[2], a South Dakota case; and Merrick v. N.W. Halsey & Co.[3], a Michigan case.

The first few contentions listed above were considered in detail by the court in the Hall v. Geiger-Jones Co. case. Mr. Justice McKenna delivered the opinion of the court. Justice Reynolds delivered a dissenting opinion.

Concerning the first contention listed above, the court said in part: "We know that in the concept of property, there are rights of its acquisition, disposition, and enjoyment, - in a word, dominion over it. Yet all of these rights may be regulated." The court then goes on to show that the blue sky law is "to protect the public against the imposition of unsubstantial schemes and the securities based upon them.

1. 242 U.S. 539; 61 L. ed. 480; 37 Supt. Ct. Rep. 217
2. 242 U.S. 559; 61 L.ed. 493.
3. 242 U.C. 568; 61 L.ed. 498.

Whatever prohibition there is, is a means to the same purpose, made necessary, it may be supposed, by the persistence of evil and its insidious forms and the experience of the inadequacy of the penalties or other repressive measures." Upon authority the court held "that the prevention of deception is within the competency of government."

Thus the government has a right to regulate such business if it does it not in an unlawful way. Appellees held that the way was unlawful because too much discretion had been given the Superintendent of Banking. But the court held that such phrases as "bad business repute" and "fraudulent transactions", though very real and tangible, cannot adequately be defined by law, and so discretion must be allowed the enforcing officer.

To the appellees contention that the law protects certain individuals (the possible purchasers) from the exercise of their own "defective judgment" the court answered: (1) that it was doubtful if the purchasers would consider this an infringement of their freedom of choice; (2) there are examples in legislation of unsolicited protection; (3) the law does not so much stop a man from using his judgment as it protects him "against counterfeits of value".

The second contention listed above was then considered by the court - namely, that the statute denied the equal protection of the law. Various parts of the law were cited by appellees to prove unequal protection; the fact that issues of banks, trust companies, building and loan associations organized in the state were exempt while othere were not; the fact that

issues listed in manuals approved by the commissioner were exempt, while others were not; etc. The court held that all these discriminations "are within the power of classification which a state has". By quoting a previous case, the court pointed out that "a state 'may direct its law against what it deems the evil as it actually exists without covering the whole field of possible abuses, and it may do so none the less that the forbidden act does not differ in kind from those that are allowed.--- If a class is deemed to present a conspicuous example of what the legislature seek to prevent, the Fourteenth Amendment allows it to be dealt with although otherwise and merely logically not distinguishable from others not embraced in the law.'"

In answer to the contention that blue sky laws were a burden to interstate commerce, the court held that the provision that "no dealer shall, within this state, dispose" of certain foreign securities without first being licensed has only an indirect effect upon interstate commerce. There is no prohibition upon bringing into the state such securities - only upon their sale or disposition. "It is a police regulation strictly, not affecting them until there is an attempt to make disposition of them within the state. To give them more immunity than this is to give them more immunity than more tangible articles, are given, they having no exemption from regulations the purpose of which is to prevent fraud or deception."

In like manner the other constitutional objections have been disposed of by the courts. Accordingly, Mr. Reed, counsel

of the Investment Bankers Association of America, in an opinion delivered to that organization[1] concludes: "The most important conclusion which can be drawn with reasonable certainty from the opinions is that no typical Blue-Sky law, as applied to the business of dealing in securities, violates, the Federal Constitution either the Fourteenth Amendment or the interstate clause."

Particular blue sky laws may be unconstitutional because of unusual and arbitrary features; but the constitutionality of typical blue sky laws is now settled beyond dispute.

1. Quoted in Elliot, "Annotated" etc., p. 37-8

Chapter VI.

Common Features of Blue Sky Laws.

In the last chapter the phrase "typical blue sky law" was used. If we were to examine a typical blue sky law, or if we were to make a composite or synthetic blue sky law, we would find that such a law would have, composing its skeleton or framework, the following features:

1. Certain companies or corporations, or the securities of those companies or corporations, are exempted from the operation the law.

2. Before securities not exempt can be sold within the state, the companies issuing and selling them must secure a permit from a designated state official or commission. This provision holds true except for one or two states.

3. The application for this permit must be accompanied by a certain amount of information. Additional information is called for periodically (monthly, quarterly, yearly) or at the discretion of the administrative official. Most states have provisions which govern the amount of publicity to be given this information.

4. The administrative official must apply to this information certain tests or criteria set forth in the law. If, in his judgment, the issue is of such a nature as to meet the required test, he is then to issue a permit allowing the sale of that issue; if the issue does not meet with the standards determined by the law, the official is to refuse the permit,

and the company is thereby restrained from selling the issue.

5. A company which feels itself aggrieved by the decision of the administrative official may appeal from that decision. Usually a certain court is designated as having jurisdiction in appeal cases.

6. Provisions are made for the collection of certain fees. These fees have come to make a considerable part of the revenue of certain states.

7. Those who violate the act, or who, while seeming to comply with it, make false and fraudulent statements, are to be fined or imprisoned or both.

These are the provisions common to all blue sky laws. The fraud laws of Maryland, New Jersey and New York do not, of course, have these same provisions. The fraud laws provide, in general, that securities may be sold without a permit. But "if it shall appear to the attorney-general" that fraud is being practiced or is about to be practiced in the sale of securities, that officer may conduct an investigation and require the person or company investigated to file certain information. If it then appear to the attorney-general that fraud is actually being practiced or is about to be practiced, he may, according to the Maryland and New Jersey acts, "issue ...an order requiring the party guilty thereof to cease and desist therefrom;" according to the New York law, he may bring an action against the person or company. Preliminary injunctions are provided for, and appeal to the courts in case of injustice. In Maryland, any person who offers for sale or

sells contrary to a restraining order is to be fined not more than $10,000 or imprisoned not longer than two years, or is to both be fined and imprisoned. In New York a person who disobeys an order of the court is fined $1000. "Such penalty shall be cumulative". The New Jersey act mentions no specific fine or term of years; it simply makes a violation of the act a "high misdemeanor". Having examined the details of the three fraud acts, we shall from this point on confine our attention to the strictly blue sky form of legislation.

We found that the blue sky laws had some seven common features. These features, according to Vice-President Lewis B. Franklin, of the Guaranty Trust Company of New York[1], may be resolved into two more general features. These two features are (1) Publicity, and (2) Supervision. Both these features are essential; the former without the latter would not make a blue sky law. We have already quoted Wm. E. Hooper as saying in a recent number of Collier's Magazine; "Most of the Blue-Sky laws put it up to State authorities (i.e. "Supervision") to protect themselves." The plan suggested is simply to print on the stocks and bonds certain pertinent facts: as, what the issuing company does, what is to be done with this money, how many securities in all the company has sold in the past, etc. The writer argues from analogy for the justification of his proposed law, for he cites the pure food law which requires packages to be labeled in a similar fashion. It does not prohibit bad goods: it labels them and then lets buyer decide on

1. Lit. Dig. Vol 46, p.936, Ap. 26, 1913.

the merits. Blue sky laws do not do this. "There's where blue sky laws overreach themselves." The weakness of this analogy should not blind us to the immense importance of publicity. A report of the general counsel of the Investment Bankers Association of America[1] says that "This requirement (publicity) standing alone is practically prohibitive of two-thirds of the frauds". When this publicity is accompanied with a certain amount of regulation - as the filing of monthly and annual statements, the limitation on promoters' profits provided by some state laws, the regulating of advertisements, etc. - then we have true blue sky legislation. How important <u>regulation</u> is was brought home to the writer in an interview with the corporation commissioner of Oregon. Said that official: "It is a conservative estimate to say that fully 80% of the applications received by this office are modified in some way at our request."

1. "Proceedings", I.B.A. of America, 1915, p. 191

Chapter VII

A Comparative Study of Specific Blue Sky Features - Features Not Common to all Blue Sky Laws.

The writer of this thesis has studied all the blue sky laws of all the states, both in their original and in their amended forms. To get a basis for any kind of comparative study, it was of course necessary to have an outline of the main points upon which the various blue sky laws differed. The following chart was therefore adopted:

I. Avowed purpose of the act.
II. Persons affected by act.
III. List of companies and securities exempt from operation of the act.
IV. Enforcing officer.
V. Items to be included in statement of information.
VI. Criteria to be used by enforcing body; tests to be employed in determining whether permit shall be granted or not.
VII. Penalty for violation of act or for giving false information.
VIII. Provisions for appeal.
IX. Fees collected.
X. Provisions for giving publicity to information.
XI. Provisions for bringing suit against violator.
XII. Special provisions for agents and brokers.
(Include fees of agents and brokers under IX.)
(Include fines for agents and brokers under VII.)
XIII. Notes on the administration of the law.
XIV. Unique provisions found in some blue sky laws.

With the help of this chart an outline was made of the law of every state. Uniformity was secured by giving the same symbol to the same feature in every state. Thus, the amount of fees to be collected appears under IX in the outline of the law of Arizona, Florida, Oregon, and every state having a blue sky law. If, then, we care to find out what the highest fee

charged is, what the lowest, and what the average, all we shall have to do is to look under IX in the various outlines, compare the figures contained thereunder, add them etc. We have already discussed fully items number I (see ch. I), and XIII (see ch. IV), and, to some extent, item number VI. We shall consequently omit any further discussion of the purpos of the acts and of the success of their operation, and we shall make very brief the discussion of the criteria or tests employe to determine whether a permit should be granted or not.

II. Persons affected by act.

The laws of some states say the act applied to "foreign and domestic investment companies"; other acts apply to "dealers and "agents"; others apply to investment companies, dealers, brokers, and agents - with a distinction in the terms and different provisions for each. A comparative study is made more difficult because the same term means different things in different states. In some states an investment company is the issuing house, a dealer one who sells the stock of other houses; in Oregon dealer applies to both the issuer and the seller. And so it goes. About all that can be said is that nearly all of the states have provisions applying to both issuers and houses selling stock which other concerns have issued. To distinguish between the two, we shall call them issuer and broker. Now whild nearly all the states have provisions for both issuers and brokers, the provisions in some states, as in Indiana, differ for these two classes, while the same provisions are

applicable to both classes in other states, as in Oregon. The purpose of having different provisions for the two classes is, of course, to prevent duplication of effort. If the issuing house files a thorough report about its securities, the broker should not be required to file the same material. On the other hand, there is reason for having the brokers file as complete information as is at their command. If the issuing company is a foreign corporation which has not applied for the privilege of selling its own stock within the state, and brokers selling this stock are not required to file such information, then the administrative official will not have much information about those securities.

The Oregon act applies to "dealers", and the term dealers includes everyone selling "securities of whatsoever kind or character"...providing that any company selling its own securities "shall be considered a dealer within the meaning of this act." Thus the term dealer applies to both issuers and brokers. Since the law applied to both alike, brokers as well as dealers are required to file "a statement in substantial detail of the assets and liabilities of the corporation proposing to issue such securities, or such a statement thereof as shall be prescribed by the corporation commissioner." If the issuing company has already filed a detailed financial statement, the qualifying phrase, "or such a statement thereof as shall be prescribed by the corporation commissioner", would seem to give the commissioner authority to dispense with a detailed statement from each broker selling that particular

issue. On the other hand, if the issuing company had not filed a statement, the commissioner would undoubtedly require the brokers to obtain from the company and to file with him such a statement. A liberal law allowing the administrative official considerable discretionary power would seem to solve this difficulty of issuer and broker.

The laws of a few states apply to the issues of certain kinds of companies only. The Connecticut law, for instance, applies only to oil and mining companies, and then only if their mines, plant, or property is not situated within the state. The laws of some other states apply to all companies and corporations except certain exempt ones, such as banks, public utilities, etc. Florida is such a state. Its law applies to "every Corporation, other than municipal Corporations, State and National Banks, Trust Companies, Public Utility Corporations...etc. The more usual method, however, is the Oregon one. This method makes the law apply to <u>all companies</u>, whatever their nature, but exempts certain kinds of <u>securities</u>, such as the securities of banks, public utilities, etc. The securities, rather than the companies selling them, are exempt. The argument for exempting companies is that they would not buy and sell fraudulent securities. Banks, to give one example, are allowed to deal in only certain kinds of securities. Why then make the law applicable to banks? The argument for exempting securities is that if the security is fraudulent it does not matter who sells it, for it is the character of the security and not of the selling agency which robs the buyer;

if the security is honest it does not matter how questionable the concern which sells it. Furthermore, the companies exempted by those laws which exempt companies rather than securities deal almost exclusively in the securities exempted by the other class of acts. And hence, these companies do not come under the operation of the law anyway. To exempt securities rather than companies seems the sounder principle to the writer.

This subject leads naturally to a discussion of the next point in the chart; namely,

III. List of companies and securities usually exempt from operation of act.

On this point a great deal of uniformity exists. Some states make but five or six exceptions, others ten or twelve. But the state exempting ten or twelve kinds of securities is pretty sure to exempt those exempted by the other state. There is a rather general consensus of opinion as to what securities should surely be exempted. Some states merely extend this list. A careful analysis of the history of exemptions disclosed to the writer that the tendency is one of ever greater liberality. More and more securities are being removed from the operation of the law. The following is a rather extended list of the more usual exemptions:

(a) Securities issued by national, state, municipal governments. Some laws add those of taxing bodies, school districts, etc.
(b) Those issued by national and state banks.
(c) By trust companies.
(d) Public utility corporations.
(e) Insurance and surety companies.

(f) Corporations not organized for profit.
(g) Real estate mortgages and notes issued thereon.
(h) Commercial paper.
(i) Securities listed in manuals and approved stock exchanges.
(j) Building and loan associations.
(k) Sales at public auction.
(l) Judicial sales.
(m) Isolated transactions; sold by bona fide owner, and not a part of repeated transactions.
(n) Increase of stock sold and issued to stock holders; also stock dividends.

Most all states exempt the first six classes listed above. Some states it is true, such as Arizona and Georgia, are not that liberal; other states, such as Illinois, exempt nearly the entire list. The tendency toward increased liberality in exemptions seems sound to the writer. Experience has demonstrated, for example, that while a bank may "go to the wall", and investment in its securities prove to have been unsafe, yet there is very little opportunity for fraud in the sale of bank stock. State and federal regulation of banks makes such practice almost impossible. If the purpose of blue sky legislation were to remove the element of risk, then exemptions should not be allowed, for risk may appear in investing in the most honest of businesses. But the purpose of blue sky legislation is not that; it is, as we have found merely, to prevent fraud. While it is unsafe to say that fraud is found only in mining companies, companies to manufacture visionary and impractical patents, etc., it is safe to say that fraud almost never is found in connection with the securities listed above. Where fraud might conceivably be found, but where experience shows it is almost never found, it is better not to apply the act, lest, in seeking to make the law apply to every conceivable situation, we make it so burdensome and clumsy that it will apply in no case.

A unique method of dealing with the exemption problem is that adopted by the Illinois law. Georgia recently has repealed its old blue sky law and adopted one patterned after the Illinois law. The Illinois law, to put the matter briefly, classifies all securities under four headings. Class "A" securities are " securities, the inherent qualities of which assure their sale and disposition without the perpetration of fraud." This class includes eleven kinds of securities, some of which are: government; bank; public utility securities of any state which has a "law regulating such utilities and the issue of securities"; securities appearing in any list of securities dealt in on the New York, Chicago, and Boston stock exchanges (the law formerly recognized the exchanges of Baltimore, Philadelphia, Pittsburg, Cleveland, and Detroit, but the 1921 amendment dropped these); securities the current price whereof "shall have been quoted from time to time for not less than a year next preceding offering for sale thereof" in market reports, newspapers of general circulation in Illinois or an adjoining state; issues of non-profit organizations; notes or bonds secured by mortgage lien upon real estate, and upon tangible or physical property where such mortgage is assigned with securities to purchasers; negotiable promissory notes; etc.

Class "B" securities include those "the inherent qualities of which, or in the nature of one or of both parties to the sale thereof, assures their sale and disposition without the perpetration of fraud". Included in this class are: isolated

sales by bona fide owners; increased capital stock distributed to stockholders without the payment of any commission or expense; securities sold to trust companies, insurance companies, etc; those sold or offered for sale at any judicial or bankruptcy sale.

Class "C" securities are those based on an established income. Class "D" securities include all others.

Now the securities in classes "A" and "B" are exempt from the operation of this act. Thus Georgia and Illinois are among the states which are most liberal in allowing exemptions. Only five items must be included in the information filed for class "C" securities, while sixteen conditions must be met before class "D" securities may be sold. Theoretically this classification system is excellent; and practically it seems to work in Illinois - at least the banking interests have given the measure a great share of cooperation.[1] The only objection to such a system is the immense complexity of it. The complexity of the law is shown by the "Revised Instructions for Preparing Statements" given at the end of the law in Elliott's compilation. Securities in class "C" must answer twenty-one questions, and some of these are subdivided (there are eight subdivisions under question 6, for instance). For class "D" there are twenty-eight questions. These questions must be answered according to certain forms - and the forms are numerous. Altogether, the instructions and forms take 44 pages of the book.

In some of the state laws the exemptions seem arbitrary,

1. I.B.A. of A., Proceedings, 1921, p.253.

even discriminatory. Thus in West Virginia the law applies to ordinary industrial bonds secured by mortgage, but not to "notes secured by mortgages on real estate located in this state." Why is this distinction made? As R. S. Spilman says[1] "The only essential difference between the favored note and the penalized bond would seem to lie in the absence from the note of a seal. The distinction is certainly not in accord with common law traditions."

Oregon is among the more conservative states in her exemption provisions. Her law provides exemptions for the following securities:

(a) Bonds of United States or of any foreign government, or political subdivision thereof, or of any state or territory of the United States, or of any municipal corporation[2] of such government, state or territory.
(b) and (c) State and national bank and trust company stock.
(g) Mortgages purchased or sold in their entirety.
(h) Commercial paper and acceptances eligible for rediscount at a federal reserve bank.
(i) Securities listed on such stock exchanges, or securitie or companies listed in such standard manuals as the commissioner may approve, and securities of subsidiary companies and successors of such listed companies.
(m) Securities held as an investment by bona fide owner; sale not to be in the course of repeated or continuing transactions of a similar nature.

1. 49 Am. Law Rev. 394
2. In the 1923 session of the legislature there was introduced a bill (S.B. no. 215) which sought to bring exclusive dealers in municipal bonds under the blue sky law. "These securities", says the "Oregon Voter" for Feb. 17, 1923, p.47 (271), "in some cases representing a very desirable investment, but more frequently of a doubtful character, have been sold on what is alleged to be misrepresentation as to their limited security" According to the "Oregonian" for May 20, 1923, S. B. no. 215 was to take effect May 24th. Municipal bonds are no longer in the exempt list, therefore.

IV. Enforcing officer

A list of the states having blue sky laws, together with the officials who enforce that law, follows:

Arizona	Corporation Commissioner
Arkansas	Bank Commissioner
California.....	Corporation Commissioner
Connecticut	Bank Commissioner
Florida	Comptroller and Attorney-General
Georgia	Chief Examiner
Idaho	Formerly, Bank Commissioner. Since 1919, Department of Commerce and Industry.
Illinois	Secretary of State(Dept) Chief Clerk Securities Department (Title)
Indiana	Formerly, Auditor. Since 1920 Securities Commissioner
Iowa	Secretary of State
Kansas	Bank Examiner and Charter Board
Kentucky	Banking Commissioner
Maine	" "
Maryland	Attorney General
Massachusetts ...	Public Utilities Commission
Michigan	Securities Commission
Minnesota	" "
Mississippi	Secretary of State
Missouri	Bank Commissioner
Montana	Investment Commissioner
Nebraska	Formerly, State Trade Commission
New Hampshire ...	Insurance Commissioner
New Jersey	Attorney General
North Carolina ..	Insurance Commissioner
North Dakota	Bank Examiner
New Mexico	State Bank Examiner
Ohio	1913-17, Department of Banks and Banking 1918-20, Commissioner of Securities 1921 on, Department of Commerce, Chief Division of Securities.
Oklahoma	State Issues Commission
Oregon	Corporation Commissioner
Pennsylvania	1917-20, Insurance Commissioner 1921 on, Bank Commissioner
Rhode Island	Bank Commissioner
South Carolina ..	Insurance Commissioner
South Dakota	Securities Commission
Tennessee	Secretary of State

Texas	Secretary of State and Commissioner of Insurance and Banking
Utah	State Securities Commissioner
Vermont	Bank Commissioner
Virginia	Corporation Commissioner
West Virginia ...	Auditor and Insurance Commissioner
Wisconsin	Railroad Commissioner
Wyoming	State Examiner

An examination of this list shows that in some states one man enforces the law; Other states are evidently afraid to entrust such discretionary powers in the hands of one man, so a group of men- a commission - is given the responsibility. Some states, as Kansas and New Hampshire gave these new duties to an officer created by some former law; other states, as Oregon, created a new office by their act. The officer most frequently entrusted with the administration of the act is the Bank Commissioner. Ten states have done this. The explanation of this is not so much that a bank commissioner is the most logical person to enforce the act, but that the first blue sky act was passed as a result of the activities of the bank commissioner of Kansas.[1] Other states copied the act of Kansas, and of course copied the provision concerning the administrative official.

The next most popular body is a securities or issues commission. Six states have such a commission. Five states have placed their law in the hands of the Secretary of State. Four states have placed the burden upon the insurance commissione and an equal number have placed it upon a corporation commissione Among the last four comes Oregon. The selection of a corporation commissioner seems a peculiarly happy one. As we shall see

1. See the History of Blue Sky Movement, Ch. III

later, the matter of incorporation and of selling securities subsequent to incorporation are closely bound up with each other. It seems logical therefore to place both these matters in the same hands. And in the average state there will be plenty to do to keep this department entirely occupied. It is not necessary to make it a subdivision of some other department, as of the secretary of state or insurance commissioner. When it is realized that over half of the wealth of the country is controlled by corporations[1], the necessity of having a department to control these corporations, in turn will become apparent.

Whatever officer is given control of the act does not so much matter so long as that officer is free from corrupting influences.[2] His office is not a political job. It is rather a sacred trust which he should approach in the spirit of honesty and impartiality, and to which he should bring specialized knowledge which is the fruit of years of experience.

In order to get a man of demonstrated ability, there must be adequate compensation attached to the office. As Charles J. Andre, Secretary-Treasurer of the National Association of Securities Commissioners, says[3]: "No one, regardless of his previous experience, can handle the work of a 'Blue Sky' department to the best advantage unless he has had experience in that particular line. So far, this field of activity has not offered any particular inducements, and until it does, the

1. Unpartizan Review, vol. 12, pp. 100-15 (1919)
2. Editorial in "The Nation", vol. 96, p. 345 Ap. 3,1913
3. I.B.A. Bulletin, vol. VIII, no. 9. p. 149. Jan. 15,1920

the office will continue to be filled with whatever timber is available." It may be possible to get a public spirited man to give his services as governor for very little compensation. But there is no glory, no prestige, in being a corporation commissioner. Much of the work is dry and uninteresting. If we want good "timber", we must pay for it in money.

V. Items to be included in the statement of information.

It will be remembered that the third common feature of blue sky laws is this: "The application for this permit must be accompanied by a certain amount of information". Just as it was possible to compile a list of securities most often exempt, so it is possible to make a list of the items most often required in the statement of information. Such a list follows:

(a) Names and addresses of the officers of the company or corporation.
(b) Name and location of the company.
(c) A statement of the financial condition of the company; a list of the assets and liabilities; statement of earnings.
(d) The plan of doing business.
(e) Copies of the securities to be sold.
(f) Copies of contracts governing sale.
(g) A copy of every prospectus and of all advertising matter.
(h) A provision allowing the administrative official to call for such additional information as is not provided for in this list, but which would help him in making his decision.
(i) A copy of the articles of partnership or incorporation.
(j) A copy of the mortgage or instrument creating the lien.
(k) A copy of the laws under which the company was incorporated.
(l) A copy of the charter and by-laws of the corporation.
(m) A statement of the general character of the securities.
(n) The price at which the securities are to be sold.
(o) The amount of commission to be paid.
(p) Names of agents.

Some states require nearly all of this information to be filed; others require but very few of the items. Among those requiring but little information are such states as Georgia, Maine, Massachusetts, Minnesota, and Montana. All that Georgia definitely requires, for instance, is "A statement under oath showing the name and principle place of business of such dealer, and the names, residences and business addresses of all persons interested in such securities as principals, officers, directors or trustees, including the name, residence and business address of an agent residing in this state, if any". Further on in the act we find that "The Secretary of State may at any time order a dealer to file with him evidence, including an official statement of assets and earnings, copy of dealer's contract showing his compensation, or other information in relation to any security the dealer is offering for sale..."

Georgia and Illinois, as has been said before, divide securities into four classes. Classes "A" and "B" are exempt; for class "C" five items of information are required - items (a), (b), (c), (k) of the list given above, and a statement of the amount of indebtedness; for class "D" many more items are required - items (a), (c), (d), (e), (j) and (i) are required by the Georgia law and items (m) and (p) by the Illinois law.

To show the great degree of uniformity, the requirements of three state laws are put down side by side. These may be

called typical blue sky states.

Kansas	Kentucky	Oregon
(a)	(a)	(a)
	(b)	(b)
(c)	(c)	(c)
(d)	(d)	
(e)	(e)	
	(f)	
(g)	(g)	(g)
		(h)
(i)	(i)	(i)
(j)		
	(k)	
(l)	(l)	
		(m)
(p)		

Much of the information required by some of the states is quite useless. Useless information should be rigorously ruled out, for it merely means added expense and trouble. Such an item is (k) above. As R. S. Spilman says in the American Law Review[1]: "No good reason is apparent why a foreign investment company should be required....to file a copy of the laws of the state under which it is organized." If one hundred New York corporations file in Kentucky, the state Banking Commissioner will have the pleasure of filing away one hundred copies of the incorporation laws of New York. Oregon apparently thinks that while Kansas and Kentucky demand items (d), (e), (f), (j), (k), (l), and (p), such items are not essential. It would seem that in most cases Oregon is right, especially since the law of that state includes item (h). If it is desirable to get any of items included in the Kansas and Kentucky laws, item (h) gives authority to require them. Item

1. 49 Am. Law Rev. 394 (1915)

(e) might well have been included in the Oregon requirements however, since it is certain that the corporation commissioner would require a copy of the securities in all cases. Such information is essential.

The principle of the Georgia law seems correct, though that state has gone too far in the application of that principle. The sound principle requires the filing of as little information as is absolutely essential, and then gives the official enforcing the law the power to require such additional information as is pertinent and desirable in each individual case.

VI. Criteria to be used by enforcing body; tests to be employed in determining whether a permit shall be granted or not.

We have already said that the test should not be whether the business promises a fair return, but whether or not the element of fraud is present or is likely to be present. Let us see how various states have sought to embody this test.

Arkansas, Michigan and Rhode Island simply say in effect: "The permit is to be granted in the absence of fraud", or, to put the matter negatively, "The permit is not to be granted if the securities are fraudulent or if they would work a fraud upon the buyers". Great stress is laid by some writers upon the value of the phrase "work a fraud". They claim that what is not actually a fraud in the eyes of the law might yet result in fraud, and hence the phrase "work a fraud" gives much added safety to the public.

Massachusetts denees a permit for the sale of securities

which are fraudulent or would result in fraud. Fraud is then defined so as to include promises made in bad faith. This definition is important, for it settles for Massachusetts a controversial point of law.

Kentucky also refuses a permit where the plan of business is fraudulent or would work a fraud. It provides, in addition for cancellation or revocation of license in case of (1) bad business repute, (2) violation of the act, (3) illegitimate business or fraudulent transactions, Georgia and Iowa have similar provisions for revocation.

The Wyoming law says: "If the State Examiner shall find that the promoter's literature is not misleading, or calculated to deceive the purchaser or visitors, he shall issue a permit for the sale of such securities."

Some states use phrases that are far from being legal phrases, - phrases that are very general. A Florida corporation for instance, must contemplate "a fair, just and equitable plan for transaction of business". The Wisconsin statute provides that the commissioner shall be satisfied of the "Good business reputation" and the "fair and equitable" business methods of the applicant. Maine, New Hampshire, Ohio, and Oregon all have the phrase "good repute" or "sound character" in their laws. Mr. H. R. Richards severely criticises these phrases in the Wisconsin Law Review[1]. I quote from him at some length. Speaking of the Wisconsin statute, Mr. Richards says:

"The objection lies in the vagueness of the statute, What, for example, are the standards for judging "good business

1. Wisconsin Law Review, Vol II, no. 2, p. 97-9. Jan., 1923

reputation", not only of the corporation or firm, but its members?

"By what standard is the commissioner to determine whether or not 'the business methods of the applicant are fair and equitable'? ----Suppose the applicant is refused, and he appeals to the court for an order directing the commission to grant him a certificate? The words 'fair and equitable' are not technical terms. By sec. 1753-6 (2) the reports and findings of the commission are made prima facie evidence of the facts therein stated. The finding that business is not fair and equitable is not a finding of fact; it is rather a characterization of business practices. What is to be regarded as fair and equitable is not a moral question, but a legal one. What is fair between parties dealing at arms length may not be fair between persons standing in a fiduciary relation. Will the court order a permit to issue, if the applicant has observed the standards usual in business, or conducts his business on a plan regarded as permissible by business usage in his particular calling; or will it refuse the order on the ground that the commission's judgment will stand unless it sets up an unreasonable standard of conduct?

"It is quite likely the courts will take the latter view and sustain the commission, if we can judge from their decisions in other situations where commission rulings have been in question. The consequence is that the commission becomes an arbiter of business, and determines its methods. This is a wide departure from the common law, where the only limitations on the activities of business were fraud and the violation of penal statutes."

Kansas and Nebraska have each a rather extended list of tests to apply. The 1921 amendment to the latter state's blue sky law gives the following nine tests which must be met:

1. Compliance with the law.
2. The proposed plan of business must not be unlawful, unfair, etc.
3. Good business repute of applicant must be established.
4. Must not be mere money-getting scheme.
5. Investors must be adequately secured against unlawful dissipation and misapplication of funds.
6. There must be no fraud.
7. Literature must not be misleading.
8. Securities must not be fraudulent in form.
9. There must be sufficient net assets.

There is a great deal of duplication in the various tests set out above. The more simply a law is phrased, the more effective is the law.

The Oregon law provides that the corporation commissioner shall issue a certificate when the applicant shall have complied with the law and shall have satisfied the commissioner of his moral character and good business repute; provided, however, that the commissioner may prohibit the sale of any issue if fraud or misrepresentation is used in connection therewith.

Perhaps the entire matter could best be reached by this simple provision; that the administrative official shall issue the certificate when the applicant has demonstrated (1) compliance with the law, (2) the sound moral character of the selling house, and (3) the absence of fraud in the securities themselves. This threefold test would seem to take care of all the problems arising in connection with the issuing of a certificate.

VII. Penalties Imposed for the Violation of the Law.

The fines imposed by the various statutes vary all the way from $50 to $10,000 maximum, and from 60 days in jail to 10 years in the penitentiary. Most states provide for either a fine or an imprisonment or both. Two states - Idaho and Tennessee insist that both a fine and imprisonment shall be meted out for false statements. Some states, as Arkansas, Maine, and New Hampshire provide one punishment for any violation of the act; others set different maximums for different offenses. Ohio, for instance, provides a fine ranging from $100 to $5,000 or imprisonment up to one year of both for false statements, while all other violations of the act receive a

a fine of from $50 to $1000 or 60 days or both. Again Florida punishes false statements to the extent of $5000 or 5 years , or both, while those who are guilty of non-compliance with the act are let off with a $1000 fine or a one year term or both. This distinction between the punishment provided for false statements and for non-compliance with the act, with the lesser punishment for the latter offense, is quite general. Just why the person who has complied with the act but offered false information in complying with it should be fined more than the person who makes no attempt to comply with the act at all, is not quite clear. Perhaps the theory of it is that the latter person is less dangerous to the public than the former, for the latter has no certificate, and so the public will beware of buying from him.

One state, Iowa, makes this distinction between non-compliance with the act and false statements, and then recognizes two kinds of false statements; false statements to the government and false statements to the clients or public. The former kind is about five times as reprehensible as the latter, if we are to judge by the difference in the penalities attached to the two.

The most complicated penalty feature is that found in the law of Rhode Island. The following schedule applies:

For not registering.....$300 Maximum
Selling when permit was refused....$500 to $5,000 or 5 years or both
Selling after order allowing sale was cancelled... $100 to $5,000 or 5 years or both
Violating orders of commission....$50 to $1000 or 5 years maximum or both

Newspapers are guilty only if they publish advertisements after they have been notified by bank commissioner.
Other violations....$500 maximum or one year maximum.

The schedule given above varies according to the offense. Indiana varies her schedule according to the offender. Public indignation in that state is greater against a fraudulent dealer than against a fraudulent salesman, and greater against the issuing company than against either of these.

Utah has the unique feature of allowing both the state and the injured client to sue. The former may impose a fine or imprisonment term; the latter may recover the purchase price plus all the damages, and may do this "without proof of actual or constructive fraud."

One or two states punish those who fail to obey subpoenas. Wyoming fines such offenders $500 or puts them in jail for 90 days or punishes them in both manners.

A very few states set no special fines or imprisonment terms. Georgia and Louisiana both call the giving of false statements "misdemeanors". The punishment for misdemeanors is provided for in other legislative acts.

This brings us down to the Oregon act. As usual, we find Oregon among those states having the least complicated features. Sec. 6848 of Oregon Laws provides that "Any dealer who shall violate any of the provisions of this act shall be deemed guilty of a crime and upon conviction thereof shall be fined for each offense not more than $5,000 or by imprisonment in the state penitentiary for not more than five years, or by both such fine

and imprisonment at the discretion of the court." Then, lest one who complies with the act and yet makes false statements to his client should not be covered by the above provision, the following one is added in sec. 6854: "If any dealer or any person with intent to induce the purchase of any of the securities mentioned in section 6838 shall, accompanied by any writing or token, or note or memorandum thereof, knowingly or recklessly with intent to deceive or defraud, conceal any fact materially affecting the value of any of such securities, he or they shall be guilty of a crime and upon conviction thereof shall be punished by a fine of not more than $1,000 or by imprisonment in the county jail for not more than twelve months, or by both such fine and imprisonment, at the discretion of the court, and shall be liable in damages to any party who has been occasioned loss thereby."

VIII. Provisions for appeal.

The statute of nearly every state, though not quite of every one, provides for appeal from the decision of its administrative officer. This seems just, for an administrative officer is not the equivalent of a court. In Hall v. Geiger-Jones Co.[1] it was argued that arbitrary power was given the state official to decide which companies should receive a permit and which should not. But the court held that the power given was not arbitrary because there is a presumption against wanton action on his part, and because the statute affords judicial review of his action. To the court, apparently, the provisions

1. 242 U.S. 539, 61 L. Ed. 480, 37 Sup. Ct. Rep. 217

providing for judicial review are of great importance.

In one state the District Court is to review the action of the state's official, in another the Circuit Court. In this state appeal is taken to the Supreme Court, in that to the Court of Common Pleas, in the other state to the Chancery Court. One state(North Dakota) provides that review shall be exercised by the District Court and appeal taken from that tribunal to the Supreme Court. In Massachusetts the dissatisfied applicant is first given a public hearing by the public utilities commission. If he is not satisfied with the result of that hearing he may appeal to the court. Montana allows the plaintiff to take his appeal from the investment commissioner not to the court, but the State Board of Examiners.

As a rule the burden of proof would rest on the plaintiff. Illinois to make sure that it will lie on the plaintiff's shoulders, expressly stipulates that "the burden shall rest upon the plaintiff to prove his right to sell securities in this state." Georgia, on the other hand, in her 1913 law (this law was repealed by act of 1920) put the burden of proof on her Secretary of State. That law provided that when a dealer gets an order not to sell securities, he may apply to the Judge of the Superior Court of the Atlantic Circuit for an order addressed to the Secretary of State to show cause why his ruling should not be reversed. To place the burden upon the plaintiff is the sounder policy. Logically he should bear the burden of proof because he seeks to change a course already determined upon. He who advocates something new, a change of policy, should prove his ground. But there is a better reason

still for placing the burden of proof upon the plaintiff: it makes law enforcement easier.

The Oregon statue too has a section (6841) providing for judicial review of the decision of the corporation commissioner. The section reads: "Any person aggrieved by any decision of the corporation commissioner under this act shall have his appropriate remedy, provided by existing law, in any court having jurisdiction for the correction of such decision, if the same be erroneous or unjust or without jurisdiction."

IX. Fees collected.

When a company files an application for a permit it is charged a filing fee. In some states this is the only fee charged. Wyoming, for instance, charges a filing fee of $25. No other fees are collected. Other states charge a great variety of fees: examination fees, fees for filing statements, etc. A number of states exact different amounts from issuing companies, brokers, and agents. Wisconsin charges the issuing company a flat sum of $10, plus $1 per thousand of stock issued; charges brokers $25; and charges agents $3. Some states charge a high fee, others a low one. West Virginia charges but $2 to $5; Tennessee collects sums ranging from $10 to $500. The tendency is for states to pass amendments to their blue sky laws so that they may exact greater sums from their companies and corporations. Utah, for example, in her original law set the maximum at $25. A very short time thereafter this maximum was again raised - this time to $200.

Some states levy a flat tax of so many dollars - often

$25, while others levy a proportional one - either 1/10 th or 1/20 th of 1% of the capital stock to be issued. Among the proportional states we find Oregon. Her statute provides that "Any person, partnership, corporation or association applying for such permit shall pay a filing fee of one-tenth of one percent upon the face value of the securities for the sale of which application is made". The applicant is never to pay less than $5 nor more than $100, however. In addition to the filing fee, there is a charge made for examination of the applicant. A nonresident or foreign applicant must pay the actual expenses of the examiners plus a perdiem of $10 (Sec. 6480), while dealers "residing or doing business in this state" are charged $50 for each examination (Sec. 6846). Just why there is this distinction is not clear to the writer. Perhaps the expense of examining out-of-state candidates varies and so a flat rate cannot apply. Why not then charge a varying rate for domestic concerns too? To have a uniform tax provision for both kinds of corporations seems just; and to make the rate vary with the actual expense of examination seems sounder than the policy of levying an arbitrary rate.

Several states require the applicant to go bond. Sometimes the amount of the bond is set at a certain sum, and sometimes it varies in proportion to the amount of securities to be sold. Oklahoma, Texas, and Virginia have a rather good feature in this connection. They require the applicant to go bond for 10% of the stock to be issued (providing such bond be not less than $1,000 nor more than $100,000) so that people who buy

through misrepresentation on the part of the applicant can recover on this bond.

The fees charged under the operation of the blue sky law are now forming a recognized and respectable part of the income of the state. Governor Ferris, in his 1915 message to the legislature of Michigan, congratulated the people upon the fact that the blue sky law had brought into the state's coffers the previous year the sum of $14,000. As states have amended their laws to enable the levying of larger fees, and as the number of corporations and the amount of their capitalization have steadily grown, the profits of blue sky legislation have grown correspondingly. Blue sky officials, however, should not spend too much time complimenting themselves on their financial showing or congratulating the public on its new source of revenue, lest both officials and the public forget that the primary purpose of this class of legislation is not revenue, but regulation - not the increase of public funds, but the prevention of private fraud.

X. Provisions for giving publicity to information.

After the information required by statute is given into the hands of theproper state official or officials, what shall be done with it? Of course, the official will make use of it in determining whether or not a permit shall be granted. But what about the stockholders and the general public? Shall they have access to the information?

Some of the state laws provide that only the actual

investors shall have access to the records of the company. But an examination of these laws shows that the records spoken of in those laws are not the records (information) filed with the administrative official, but the books and accounts of the companies. The Idaho statute says that the "books and accounts of such company shall at all times during business hours, except on Sundays and legal holidays, be open to the inspection of stockholders and investors in said company or investors in the stocks, bonds or other securities by it offered for sale and to the bank commissioner and his deputies." The Iowa statute has virtually the same wording on this point. It would seem that these provisions might well be made a part of the general corporation laws of the state rather than a part of the blue sky laws.

While examination of the books may give the investor's certain degree of protection, it does not give the <u>prospective</u> investor any protection. What is needed is information given to the prospective investor, as well as information given to the actual investor. Yet the same kind of information might not do for both. A stockholder may have the right to know the secrets of the business of which he is part owner, but the general public does not have that right. Business is like a game of bridge. Some cards may well be exposed; but if all hands are laid down, there is no game left to play. The Missouri statute seeks to recognize this distinction by providing that the public may examine the information in the hands of the bank commissioner, while the stockholders have the right to examine the books of the company.

Most of the states provide that the public shall have access to the information filed in the state capitol, but attach certain qualifying conditions to that privilege. Thus California says that "all papers, documents, reports", etc., shall be open to public inspection unless, in the judgment of the commissioner, "the welfare of any company, broker, or agent" or "the public welfare" demands withholding of such information. In Montana, all papers are open to the "inspection of any one affected by this Act", except that the commissioner may withhold information the disclosure of which, "in his judgment", is not required for the best interests of its stockholders and the public welfare."

Perhaps the phrase "any one affected by this Act" means "any prospective investor". If it does, the Montana act is similar to the Minnesota act. The latter provides that persons applying to the commission for information must show "that they are entitled to the information to aid them in determining the desirability of the investment offered". The commission is furthermore instructed not to reveal the text of any formula, process, patent, copyright without written consent of the corporation, and it shall not reveal the information at issue in any court unless upon order of the court. In this way Minnesota seeks to protect the corporation as well as the prospective purchaser of its stock.

A few states provide not only that the information shall be open to public inspection, but that the state official shall take pains to make the public inspect it. South Carolina, for

instance, says that all information shall be open to the public, and then provides that the commissioner may issue the information in pamphlet form. In Michigan the commission may publish such information "as it deems would be of public interest or advantage".

There is no provision at all in the Oregon statute concerning publicity of information. A section should be included on this point that the public may know just who is entitled to apply for information, and just what information will be given. And the corporation commissioner should take pains to advertise the fact that such information is available. If the investing public knew that it could get such information, it would apply for it. At the present time there is an oil company starting operations in an Oregon town. A great deal of publicity has been given the scheme. People have been advised to buy; people have been warned not to buy. But in no case were people told that they might get reliable information by writing to Salem. We said that blue sky features might be boiled down to two items: (1) Publicity, and (2) Supervision. In the opinion of the writer, Oregon has not made enough of this first feature. The law, and the administration of it, should be strengthened in regard to this point.

XI. Provisions for bringing suit against the violator.

More than a score of states require foreign corporations to file written and irrevocable consent that actions may be commenced against it. Kansas set the example in these words:

"Every foreign corporation before selling or offering for sale any speculative securities, in this state shall also file its written consent, irrevocable, that actions may be commenced against it in the proper courts of any county in this state in which a cause of action may arise, by the service of process on the Secretary of State, and stipulating and agreeing that such service of process on the Secretary of State shall be taken and held in all courts, to be as valid and binding as if due service had been made upon the company itself, according to the laws of this or any other state, and such instrument shall be accompanied by the seal of said foreign corporation, and shall be accompanied by a duly certified copy of the order or resolution of the board of directors, trustees, or managers of the corporation, authorizing the said secretary and president to execute the same."

Many of the states have copied the exact wording of this section, except for a few minor changes here and there, as, for instance, the name of the state officer against whom the process may be served.

The requirement of filing this "written consent irrevocable" may be a duplication of, or inconsistent with, other statutary provisions. In at least one state is this a fact. The blue sky law of West Virginia requires the filing of such ""written consent irrevocable", and designates the auditor as the official against whom process may be served. Now the code of that state[1] already appoints the auditor attorney in fact for foreign corporations. "Why this duplication?" we may ask ourselves. "And why has that state the "irrevocable" feature in the blue sky act but not in the code section?"

All these states referred to above require a special filing of this written consent. There is but one state, of the states having any provision about power of attorney, that does not require the filing of a special document showing consent. That state is West Virginia. There, mere compliance with the act

1. 24 a of Ch 54 of the code (i.e., Sect. 2918)

operates "ipso facto" to appoint the auditor of the state as attorney-in-fact, and this appointment is irrevocable.

A number of the states do not require the filing of written consent to have actions brought against the corporation. Among these states is Oregon. The Oregon statute provides[1] merely that the corporation commissioner shall report any violations

> "to the attorney general or to the district attorney having jurisdiction, who shall at once make an investigation of the case, and institute such proceedings in law or in equity in the name of the state in any circuit court having jurisdiction as may be appropriate to enforce the provisions of this act and to protect the interests of stockholders and other creditors and investors. The jurisdiction of the circuit court shall extend to the enforcements of any proper remedy now existing for the protection of any creditor, stockholder, bondholder or other person beneficially interested, and the suit, action or proceeding may be brought in any county in which any one or more of the parties reside."

XII. Special provisions for agents, salesmen and brokers.

Most of the states have somewhat different, and usually milder, provisions for brokers, salesmen, and agents than they do for issuing companies. The difference occurs usually in (1) the size of the fees and fines; (2) the amount of information that must be filed with state official; and (3) the criteria or tests applied to that information. We have discussed the first of these under a different heading. We shall now consider the second and third.

(2) Brokers and agents need usually file much less information than must the companies issuing securities which

1. Sec. 6847, Oregon Laws.

the brokers and agents handle. California, for instance, requires the issuing company to file financial statements, copies of securities, prospectuses, etc., in fact all the information listed in items (a) to (i) inclusive on pages 49 and 50. Agents and brokers, on the other hand, need file only their name and address, proof of good business reputation, the plan of their own business, and the articles of incorporation or association (if there are any). Massachusetts, Rhode Island, and Wisconsin have similar distinctions. In the first of the three states mentioned, issuing companies must file considerable financial information, while brokers and salesmen need merely give their name, residence, business address, and two letters of recommendation.

The purpose of this distinction has been pointed out earlier in this chapter[1]. That conclusion should be read again in connection with this.

(3). Just as agents and salesmen need file usually much less information than must issuers, so the tests applied to this information are usually less critical. The tests or criteria which the administrative official is to use for issuing companies and independent brokers was considered in section VI of this chapter. It remains now to point out that these tests are not always the ones applied to the agents and salesmen of the issuing companies and independent brokers. Let us cite two examples. The Wisconsin statute allows agents and salesmen to sell securities if their business reputation is good and if their general business methods are fair and equitable, while

1. See, "II. To whom does act apply?"

issuing companies must meet both tests, and in addition, must prove that their securities will not work a fraud upon the purchaser. Again, the Indiana statute allows revocation of the license of issuing companies to take place for any one of seven reasons - insolvency, fraud, bad business repute, unsound financial status, etc. There is but one standard for revocation of agents' licenses and that is merely dishonesty.

When the writer started his researches upon this subject he had hoped to carry them out further on this point of distinction between issuers, brokers, agents. But there is such a lack of uniformity in nomenclature that the subject is too confusing to untangle. In one state a broker is an agent for several issuing companies, in another state he is simply a man who buys and sells stocks; in one state a dealer means one who buys and sells stock, while in another the word includes issuing companies. This confusion of terms is merely one of the arguments often given for uniform state blue sky laws or for a national blue sky law. Other arguments for a national blue sky law will be considered in the next chapter.

XIII. Notes on the administration of the law. (See arguments against and for blue sky legislation, final argument pages 31-35)

XIV. Unique provisions found in some blue sky laws.

Heretofore we have discussed features found more or less generally in blue sky laws. The states differed in the official whom they selected to enforce the act, but each state selected some official or group of officials. The various statutes

differ as to what fees shall be charged, but all statutes levy fees. Not all states included in their laws provisions for publicity to the information filed by the applicants, but so many states have such a provision that it is by no means unique to any one state or group of states. Now we are ready to consider the provisions that are unique to one state or group of states. Our purpose in doing this will be to discover and call attention to some unique features which are meritorious and worthy of being copied by other states. The order in which we discuss these features must necessarily be more or less arbitrary. In general, the attempt has been to relate them to the points given in the chart on page 45, and then to follow the order of the chart.

One of these unique provisions has already been referred to. It is the principle of classification of securities. Illinoise and Georgia, we found, grouped their securities under four headings. The first two of these are exempt, and different provisions apply to the third and fourth. In an article printed in the Journal of Political Economy[1], James Waterhouse Angell of the University of Chicago says that the Illinois law "marks the advent of a new principle in American effort to solve the problem of misrepresentation and fraud in the handling of securities". This new principle of classification has been copied by Georgia.

Wisconsin, Oklahoma and Virginia have comparable features. In each of these states securities based on established value or income are distinguished from those based on prospective incomes. In Wisconsin the same provisions seem to apply to

both classes of securities, except that selling contracts and advertisements must say of the latter: "These are speculative securities." In Oklahoma and Virginia the same provisions do not apply to the two classes. In fact, their acts apply only to speculative securities. But as the tests of whether a security is speculative are so vague[1] every company will have to apply to the state official anyway to see if it comes under the act. To prove it does not come under the act, a lot of information will have to be given. What is the difference if, after an examination of this information, the official says "You are exempt" or "Here is your certificate"? The distinction therefore, seems valueless. Perhaps the writer has reached this conclusion because he is so far removed from those states. Sometimes a law in operation is vastly different from what the law seems to be when it is read on the statute books.

A provision found in the statute of but one state, Ohio, concerns the selling of real estate. The section referred to reads in part:

"Sect. 6373-15. No person or company, unless licensed in the manner and under the conditions applicable thereto hereinbefore provided for dealers, shall within this state deal in real estate not located in Ohio of which he is not the actual and bona fide owner and unless the 'commissioner' shall issue his certificate as provided in the following section, and prior to such issuance there shall, together with a filing fee of five dollars, be filed with the 'commissioner' an application for such certificate, and a written statement of the applicant

1. For instance, one test says speculative securities are those "into the specified par value of which the element of chance or hazard of speculative profit or possible loss equal or predominate over the element of reasonable certainty, safety, and investment.

containing a pertinent description of the real estate the sale of all or a part of which is sought to be made, and the nature and source of the title of the owner thereto, and the amount or value and the nature of the consideration paid or allowed by him therefor.."

This section must have grown out of some land scandal in the state of Ohio. What value of such a provision would generally be is not clear.

If a certain provision found in the Wyoming statute were found in the Oregon statute, it would be bitterly assailed today by certain people in the state of Oregon. That Wyoming provision reads as follows:

> "In any case wherein the value of the securities or contract hereinbefore enumerated are in any way dependent upon the present or proposed development of land or mines, oil or gas wells, the State Examiner may cause such investigation thereof as he may desire to be made by experts, from the appropriate departments of the state government or the State University, or both as the case may be."

Such a provision would be attacked in Oregon by certain people because these people are sinking an oil well where the geologists of the state university say no oil can be found. If the corporation commissioner were to be guided by these geologists, he would not have issued a permit to the concern. But as it is, the corporation commissioner has issued a permit on the supposition that no fraud is involved - that the money invested will be used for the actual drilling of the well and not for the purpose of lining the pockets of the promoter. If the public desires to speculate under those conditions, it may do so. It is up to each investor to investigate for himself the possibility of striking oil; the corporation commissioner is merely to investigate the possibility of actual fraud.

We have just said that the administrative officer of a blue sky law should take care that the money invested by the public does not go to line the pockets of the promoters. Some statutes have not allowed this precaution to be exercised at the discretion of the officer. Those states have limited the proportion of money invested which may go for promotion expenses and commission. Iowa says promotion expenses shall not exceed 10% in some cases and 15% in others. The 1919 law of Kansas allows the Charter Board to determine the maximum amount of commission at the time of granting the permit. Maryland (1922) limits the cost of promotion of insurance companies, including salesmen's commissions, to 5% of the subscription or selling price. It is further provided that this provision must be "plainly set forth in the stock subscription agreement or contract for the sale of stock".

Minnesota, too, sets the maximum which may be paid for promotion expenses and commissions. The First Annual Report of the State Securities Commission[1] shows that sometimes as much as 50% commission was paid to those on the "ground floor" to sell securities. "A company which commenced business under such circumstances had an impairment of 50% of its capital at the outset. Naturally it was difficult to overcome such an impairment and many failed to do so." The commission therefore set the limits as follows:

For mining and oil companies 20%
For industrial concerns 15%
For financial operations 10%

1. June 30, 1918

Other states which limit promotion expenses or commissions or both are Mississippi, Nebraska, Ohio, Virginia, West Virginia, and Wisconsin. The Ohio law formerly allowed 15% for such expenses; the 1921 amendment says not less that 85% in cash must go to the issuer, without deduction for any additional commission. Thus the law has been made more exact. Finally, West Virginia provides that promotion expenses of stocks must be limited to 10% of the par value, or of the selling price if that is less than the par value. Promotion expenses for bonds must not exceed 5% of the par value, or of the selling price if that is less. So in these various ways, ten states have sought to protect the investing public by limiting the amount of its money which may go to the promoters and salesmen.

The purpose of such limitation is the same in all these states. High commissions and excessive promotion expenses may be a part of a legitimate enterprise; but no fraudulent enterprise exists without them. That is where the "profit" comes in. If the investors' money were spent for normal expenses, there would be no use organizing a fraudulent corporation. A man will not take the risk of forming such a corporation and of being imprisoned for a mere salary. The promoter is after large gains, and the main source of gain is excessive promotion charges. To make the matter profitable, the securities must be sold in large amounts. This requires clever and dishonest salesmen. The loyal services of such people can be secured only by paying exceedingly high commissions. Louis H. Obbrreich, of the Indiana Legislature Information Bureau, says on page 43 of a pamphlet entitled "The Control of Corporate Finance":

"The reasons for the bad showing of the companies in which these losses have occurred have been traced to that same evil element which is present in all 'blue sky', 'high finance', and 'get-rich-quick' operations, whether they happen to be industrial companies, insurance companies, or banks."

A short list of the reasons is then given. At the head of this list, printed in italics, are these two: "High commissions to stock salesmen, excessive promotion and other organization expenses". If these two evils can be prevented, it is thought that one of the strongest incentives to fraudulent promotions will be removed. That is why a number of the states prohibit excessive commissions and promotion charges.

One state seeks to protect in this respect not only the public, but also the promoter and his agents - parties who usually are able to take care of themselves all too well. Section 4 of the Texas law says: "The commission or promotion fee shall be paid to the agent or promoter as the stock is sold by him and paid by the purchaser. The stock shall be considered as paid for when paid for in cash, property or labor." Perhaps, after all, this provision is not so solicitous for the welfare of the promoter or agent as it reads. Perhaps the purpose of that provision is to prevent promotion fees and commissions from being paid before they are earned. Often stock is most easily sold on the partial payment plan. Fake promoters are prone to take their share out of the first payments, and to take this share with them out of the state. Investors are then left with the consolation that they were wise enough not to pay for the stock in one payment.

In three states, not only is the amount of commission limited, but the price of the securities is fixed by law, or by the commissioner created by the law. Minnesota allows its commission to limit the price at which securities shall be sold by an investment company or dealers or agents of either. In Indiana the commission has not only this power, but it has the power to determine the amount to be paid for patents, copyrights, trade marks, and good will. It has the right, furthermore, of limiting the amount of securities which may be issued.

If the reader thinks that the Indiana statute gives the commission too much power, let him read the Nebraska statute. Section 11 of the 1919 act provided that "no stock shall be sold at less than par value or above par, except with the permission of the commissioner, and all stock must be paid for either in money, in property, or in the services at their actual market value. No watered or bonus stock or security shall be issued. All common and preferred stock shall have equal voting power. Section 7 of the law of 1921 has virtually the same provisions, but the language is, if anything, stronger, for that act says that "In no instance is stock to be given except for value received...", etc. Thus, not only is the maximum price of the securities set, as in Indiana, but the minimum price is also set. Manner of payment and voting privileges are also determined. When states regulate to this extent, the question inevitably presents itself: How far will they go? No one can answer that question, though many have sought to answer the question: How far should they go?

The purpose of this paper is not to discuss the philosophy of governmental regulation, but to point out how far governmental regulation has gone along one certain line,- regulation of investment companies - and to estimate wherever possible the effectiveness of this regulation.

Lest a corporation refrain from starting operations without paying back the money it has received as subscriptions, the Mississippi blue sky law requires a corporation to pay back all its subscribers if it has not organized within two years of the date of its permit or secured an extension of another two years. This provision is unique to that one state.

In the typical fraud case we examined, that of T. J. Foster and his promotions, we discovered that dividends were paid out of the capital stock advanced by the investors themselves. These "dividends" actually paid, lured other people to invest. It is just such an evil which the Nebraska Statute seeks to prevent. That statute declares that "No applicant receiving a permit under this act shall declare a dividend in any amount whatsoever, unless such dividend has been earned".

One of the things sometimes cited as a side benefit of governmental regulation of public utilities is the improved accounting methods which such regulation forces upon the concerns. If this is admitted to be a beneficial result, then the same laudable result can be claimed for the blue sky laws of at least three states. The Wyoming law[1] is the most general, the least specific, of the three state laws regulating accounting methods. It provides merely that the accounts of companies issuing or guaranteeing any speculative securities "shall be kept in

a business-like and intelligent manner and in sufficient detail so that the State Examiner...can ascertain at any time the financial condition.." of the company. The Utah statute[1] gives to the commission the "power to prescribe the manner and form in which every licensed dealer's books of account shall be kept.." Tennessee does not leave it to her enforcing official to prescribe the accounting method to be used. The law itself[2] prescribes double entry, monthly trial balances, etc.

So far we have gotten through the unique points related to the first five points in the chart on page 45. The point we have just considered, for instance, is related item "V" for it concerns the manner in which some of the information included under "V" is to be written up and presented. Item "VI" concerns the things the administrative official shall do and consider before he grants a permit. Related to what the official shall do before granting a permit, is a provision unique to the state of Maine.[3] That state requires its bank commissioner, before he shall grant a certificate, to publish once in the state paper and once in a newspaper of general circulation where the dealer's place of business is located an advertisement giving the name of the applicant and his address. If no objections are filed within two weeks, the certificate may be granted. Perhaps the origin of this provision lies in the custom found in some foreign countries of requiring the publishing of the marriage bans!

1. Sect. 13
2. Sect. 9
3. Sect. 12

We have already mentioned in connection with item "VII" of the chart that some states allow the administrative official to issue subpoenas to witnesses. Among these states are Montana, Nebraska, North Dakota and Wyoming. Nebraska fines anyone who fails to answer a subpoena $100; North Dakota is more severe, for the fine is $500 or more.

Sometimes a person in league with the officers of a corporation poses as a disinterested outsider. He represents himself to be a heavy investor in the corporation. His only regret is that he has not more money to sink into it. Being a benefactor of mankind, and desiring to share his opportunities with the world, he gives his "inside information" ("One of the engineers told me they have almost struck oil now") gratis. But alas! instead of being an investor, he is a trickster and a knave. He has been paid for dissembling his "information". This trick the Ohio statute[1] seeks to avoid. If it cannot prevent the trick, it seeks to redress the wrong as far as possible. The statute provides, in short that whoever advised any one to buy a security and then is paid a commission or reward for giving such advice, unless he tells the buyer that he is being paid for giving the advice, shall be liable for the amount of damages the buyer may suffer by acting upon the advice given him.

That all the states collect fees in the enforcement of their blue sky laws, we found when we discussed item "IX" o f the chart. But the states do not all make the same disposition of these fees. A few of them provide that the fees shall go

1. Sect. 6373-13

into a special fund, rather than the general fund of the state, and that the department enforcing the blue sky law must be maintained out of that fund. South Dakota has such a law. One sentence of it reads: "The expenses of the commission shall ..be limited to the money received by it in the fees". But the 1918 Report of the State Securities Commission maintains that the department should be put on an appropriation basis, and that fees should revert to the general fund. "Out of the present plan of maintaining the office out of fees", runs the report, "there may be a tendency to overlook the public interest with a view of maintaining the office". There should be eliminated, thinks the commission, "any possibility of official action for the sake of fees."

In this connection it is interesting to see what the Oregon law is. Section 6848 creates a corporation fund in these words:

"All fees herein provided for shall be collected by the corporation commissioner and by him shall be turned into the state treasury; all fees so turned into the state treasury shall be credited to a special fund to be known as the corporation fund, which is hereby created and set aside for the purpose of paying all salaries and expenses incident to the conduct of the corporation department and necessary for carrying this act into full force and effect."

It would seem that the corporation department of Oregon might well be put on the appropriation basis. The tendency years ago was to put every officer on a fee basis. The tendency today is in the opposite direction. An officer does his duty better in every direction when the unequal stimulus of varying fees for different duties is removed. Some departments of government are exceedingly valuable to society. Yet the income they

could derive from fees might be exceedingly small. To make them depend upon those fees would seriously curtail their efficiency - to the great loss and detriment of society. Then, too, the special fund basis requires an elaborate bookkeeping system. The appropriation basis greatly simplifies the system of accounts. The present tendency toward appropriation basis should therefore receive the public's support.

A number of states regulate the advertisements that licensed companies run in the papers. At least three states require that all advertisements shall bear serial numbers. These states are Indiana, North Carolina and Oregon. Illinois and Massachusetts do not allow advertisements to make reference to the fact that the blue sky law has been complied with. The 1921 amendment of Ohio allows such reference in neither printed advertisements nor oral representations. In Mississippi reference to receiving a permit may be made; but if it is made, the advertisement must also print these words: "The Secretary of State does not recommend the purchase of the security of this or any other company."

The First Annual Report of the State Securities Commission of Minnesota (1918) says of the Minnesota blue sky law: "It should also be amended so as to prohibit newspapers publishing advertisements of securities which are not exempt from the operation of the law and which have not been licensed or approved by the commission". A similar recommendation was made in the 1918 report of the State Securities Commission of South Dakota. "We...recommend", reads the report ,"that commission be granted power to supervise newspaper advertising in so far as related

to the sale of securities. Some of the most vicious schemes cannot now be prosecuted because no agent or representative comes into the state. The subscriber is asked to send his money by mail and a very large sum is lost annually by investments induced by glowing advertising. This proposition is recommended by the Associated Advertising Clubs of America, and was endorsed by the National Association of Securities Commissioners. In fairness it should be stated that our best newspapers refuse this class of advertising and the law would only affect those who are inclined to disregard the public interest."

Despite the general endorsement of such a measure, very few states have adopted it. But our records show that one state at least has such a provision. The Michigan act[1] makes it "unlawful for any newspaper published in the State of Michigan to advertise the sale of any stocks, bonds or securities which have not been approved by said commission or which are not exempt under the provisions of this act".

The Oregon statute has no such provision. It does, however, prohibit dealers from advertising unless they have a permit.[2] This effectively controls advertising when the dealer is within the state. But when the dealer is without the state, no control is provided. It is therefore, recommended by the writer that Oregon follow the example of Michigan and prohibit Oregon newspapers from advertising the sale of any securities not approved or exempt. The presumption in regard to exempted securities is, of course, that they are not fraudulent. There

1. Section 14
2. " 6843. Oregon Laws.

seems to be no reason for regulating the advertisements concerning such securities, therefore.

Four states require that agents must go bond. By its 1922 statute, Maryland ruled that agents promoting insurance companies mustgive a surety bond of 10% of the proposed maximum capital. Oklahoma and Texas have identical provisions on this point. In both of these states corporations must give a 10% bond on the amount of stock to be issued, provided that the bond shall not be less $1,000 nor more than $100,000. And the 1920 amendment to the Virginia statute requires all promoters must furnish a bond. Persons who suffer loss through misrepresentation may sue on this bond.

The Virginia amendment just referred to has for its purpose, of course, the restoration to the purchaser of his money invested. It is not enough that the fraudulent corporation be fined. That does the particular investor no good. Ohio realized this fact and so blandly ruled that companies advertising securities or receiving profits from the sale of any securities are liable for whatever damage the buyer suffers as a result of acting on any untrue statements in such advertisements or representations. Theoretically such a measure is highly commendable; but actually it is not of much importance, for most fraudulent companies do not leave enough assets behind to compensate the unfortunate investors. For that reason the Virginia statute makes the company go bond. There are two things to levy against in that state: such assets as there are, and the bond. Whether promoters in Virginia find difficulty in getting a surety company to bond them, the writer does not

know. But he rather suspects they do. If so, the bond provision may result in hampering legitimate promotions as well as fraudulent ones.

Another unique feature to be considered is the escrow feature of some states. Professor James Waterhouse Angell says in the Journal of Political Economy[1] that the Illinois law marks the advent of two new features - classification of securities and escrow provisions. "The Illinois law now requires" he writes, "that if any securities are issued against the intangible assets - patent rights, good-will, promoters' fees, etc - this fact must be declared and the securities delivered in trust under an escrow agreement. This provision is unknown in most states, and if a corporation wishes for any reason to escape it and still sell its securities, it has the whole United States except Illinois, as a market."

The quotation refers to section 12 of the Illinois law. This section provides that securities issued against intangible assets shall be delivered in escrow to a bank or trust company "under an escrow agreement that the owners of such securities shall in case of dissolution or insolvency not participate in the assets of the corporation until after the owners of all other securities have been paid in full."

At the time Professor Angell wrote his article, at least one state had an escrow clause, for Kansas adopted one in 1919. In the same year in which the article appeared (1920), three other states adopted similar provisions. These states were

1. April, 1920, 28:307

Georgia, Indiana, and Kentucky. At least three other states have, by this time, such provision. They are South Carolina, South Dakota, and Virginia. In addition, a number of other states which have no such provision in their law are yet operating as if they did. If there is no such law, the state officials need merely threaten not to grant the certificate unless the corporation voluntarily places the securities in escrow with a bank or trust company.

This list of unique features has become, perhaps, unduly long. Yet the writer has felt justified in allowing himself to go into detail on this subject, for he has felt that here, if anywhere, a service might be rendered by research work which has sought to discover all the various additions and improvements to blue sky legislation which have made the blue sky laws (together with all the amendments to these laws) of the 39 blue sky states.

Let us conclude this list of unique features, then, with a last memorandum. This time Oregon herself shall show the way. Oregon's contribution to this list is found in Section 6847 of her Oregon Laws. This section provides that whenever a dealer sells but does not deliver a security - but delivers instead any sort of interim certificate - that dealer shall prove to the commissioner that there is full security beyond the certificate. These securities must be segregated from all other assets. The dealer must then make monthly reports showing his assets and liabilities, including all outstanding interim certificates. In this way the person who buys a security but

does not receive it, who must content himself with an interim certificate, is as fully protected as he who has his security placed in the vault in his bank. This provision has proved very effective where applicable. It is not, of course, applicable to bond houses which deal in exempted securities. Recently a prominent Portland bond house failed. It had issued a great number of these interim certificates without having to account for them to any state authority because the bonds dealt in were municipals and so exempt. The funds had been misappropriated - causing a loss to hundreds of investors. There has been a great deal of agitation since that time for the extension of this interim certificate regulation to houses not now subject to state regulation.

Chapter VIII

National Blue Sky Legislation

We have already had occasion to hint at the two great defects of state blue sky legislation as it exists today. The first of these great defects is lack of uniformity; The second is their impotence in interstate transactions.

As to lack of uniformity, we have seen time and time again how the various blue sky features differ from state to state. In one state a certain issue will be exempt, in another it will not be exempt. In one state certain items of information must be given, while in another state other items must be added. Here a corporation may word its newspaper advertisements in whatever manner it chooses, there it must include certain words in every advertisements, while in yonder state the only requirement is that certain other words be excluded. Imagine any typical company which is organized on a national scale and sells its securities in a score of states. What endless trouble and anxiety those twenty blue sky laws - each one different - must cause! It is not enough that the twenty laws be read: but the rulings of those twenty state officials must also be ascertained, for the same clause in two different states may lead to two different rulings.

In order to help the members of the Investment Bankers' Association of America to comply with the many state laws, the counsel of that organization outlined a certain procedure which must be followed in every blue sky state in which the members

care to sell their securities. Eight steps to be followed were outlined. The first four of these read:[1]

> "In considering the question of a particular dealer offering or selling securities in a particular state, the dealer's attorney should:
> 1. Examine the statute of the state.
> 2. Ascertain if the securities in question are within the statute.
> 3. Ascertain if the dealer is within the statute.
> 4. If within the statute, get the rulings and, so far as possible, the views of the State Commission or official as to the course to be taken by the dealer under the statute."

And then the dealer was advised to go through the same procedure in every state in which he cared to offer or sell his securities! Indeed, every dealer would have to have a legal department for this, if for no other purpose. And the indications are that the legal department would find plenty to do to keep itself busy.

We have called the lack of uniformity one of the "great defects." That it is a great defect is realized by no one more than by the officials who have to enforce the various state laws. Mr. John B. Sanborn of the State Securities Commission of Minnesota said at the first annual convention of the National Association of Securities Commissioners[2] that "a great many of the corporations which come before me are obliged to finance themselves throughout the several states of the Union. They often sell stock in a great many states. To make them comply with varying legislation in each of the states amounts sometimes almost to persecution and is an interference with legitimate enterprise". He then asks why there is not the same uniformity

1. Quoted in Elliott's "Annotated Blue Sky Laws," p.42
2. Proceedings of the First Annual Convention of the National Association of Security Commissioners, 1918 p. 10.

among blue sky laws as there is among insurance laws. The states have substantially similar insurance laws, "so that at the present time it is not difficult for an insurance company, which has complied with the laws of one state, to comply also with the laws of another.--- The reports of examination made by one insurance department are accepted by all the other insurance commissioners".

We will use a statement made by Mr. Sanborn as a conclusion of this point of lack of uniformity. That sentence will bear repetition. It is: "To make them comply with varying legislation in each of the states amounts sometimes almost to persecution."

The second great defect of state blue sky laws was given above as their impotence in interstate transactions. We anticipated our discussion on this point back on pages 31, 32 and 33. There we quoted what the I.B.A. "Bulletin" had to say about the Pan Motor Company. "It is understood that during the trial it was brought out that the stock of the company was sold in practically every state in the Union, over thirty of which have 'Blue Sky' laws in some form or another, many very strict in their requirements." We followed this quotation with a note saying: "Fairness demands that it should be pointed out that no matter how strict the blue sky laws of states other than Minnesoat are, those states are powerless to prevent a foreign corporation from using the mails to sell securities within their boundaries. Only the national government can do that."

This, then, is what we mean by the impotence of state laws when it comes to interstate transactions. If a fraudulent concern is organized in a state having no blue sky law, or if it is organized in a state having a blue sky law and by deceiving the blue sky officials of that state succeeds in getting a permit, it has the whole nation to prey upon. True, it cannot open an office in another blue sky state, for then it would come under the blue sky law of that state. But what is to prevent it from advertising its securities in the newspapers of that state and then using the mails to deliver the securities which were purchased through the mail? We found hardly any states had a provision whereby advertisements of foreign corporations were regulated. And even if every state had such a provision, what would prevent the corporation from securing a mailing list of "prospects" and send its literature to those prospects through the mail? Or what is to prevent the outside corporation from advertising in an outside paper and sending that paper through the mail?

These statements are no figments of the imagination. Such methods are used every day of the year in order to defeat the operation of blue sky laws. Mr. W. E. Wilson, Bank Commissioner of Kansas, one who has had opportunity to observe the operation of the law of the premier blue sky state, substantiates our indictment of the impotence of state blue sky laws in the words:[1]

"Of course there is one very great difficulty in this connection, and that is with newspapers printed in other states and sent in here by mail. We have not been able to control

1. Proceedings of the National Association of Supervisors of State Banks, 1919. p. 105

such advertisements, or to prevent fly-by-night concerns from opening up an office in an adjoining state and flooding this state with unfair and misleading advertisements, whereby a considerable amount of money is enticed from Kansas people. It does not make any difference where the paper is published if the company doing the advertising is in Kansas, nor does it make any difference where the advertiser is if the paper is published in Kansas, - in either case the state can get action, and effectively, but the trouble lies where both the advertiser and the paper are across the line. A great deal has been done by persuasive methods, and many papers refuse to print advertisements of speculative security until the advertisement bears the stamp of approval of the department in the state where offered, but there are other papers whose only requirement is plenty of cash."

This is the experience not only of Kansas, but of every blue sky state in the Union.

Note: Just as the author finished writing the above sentence, the mailman brought a copy of the "Hearings on H.R. 7215"-a national blue sky bill introduced in the First Session of the 67th Congress. This pamphlet is full of testimony by state officials to the effect that they are powerless to enforce their state laws when the fraudulent concern stays outside the state and conducts its fleecing business by mail. This statement of the State Securities Commission of Alabama is but typical: "In handling the administration of the Alabama law I very soon found that there was a great class of offerings of securities - i.e., through the United States mails - which the State law could not reach. I also found that the far greater part of the offerings of 'speculative securities' was made through the United States mails; and moreover that there was and is no possible way for the States to in anywise control or regulate this, notwithstanding the fact that a large proportion of these are essentially fraudulent."[1]

In these hearings Representative Denison told of a man in Indiana who had entered into a contract to purchase a lot of stock in a corporation located outside the state. When he found that the stock was fraudulent, he ordered the bank to stop payment on his check. The corporation wrote that he must send the money, for they would hold him to his contract. The unfortunate purchaser replied that they were selling fraudulent stock in violation of the laws of Indiana. The parties came back very promptly with a letter saying: "You are very much mistaken. We understand the laws of the State of Indiana, and we understand that we can not go into your state and sell this stock, but we are doing an interstate business and nobody can touch us except the Federal Government."[2]

1. Page 50 of the Hearings.
2. Hearings, pp. 27-8

And this is not all. It is not enough that these fraudulent concerns carry on their nefarious business unrestrained. Where local officials attempt to stop their offerings, these concerns have, with a flippancy and audacity that passes belief, sometimes threatened personal suit for damages upon the basis of interference with interstate commerce.[1]

Oregon too has suffered from the practices of these outside concerns. Mr. T. B. Handley, the recently retired corporation commissioner, is reported as having said in effect: "In Oregon during the past two or three years there have been offered for sale stocks and securities involving many millions of dollars. In most cases these stocks were promoted by non-resident concerns and sales were made through the use of the mails. In none of these latter cases has the corporation commissioner been able to act, due to lack of proper jurisdiction."[2]

The only agency which has this jurisdiction is the federal government. For this reason, a national blue sky law has been advocated of late by many competent authorities and interested parties. The American Bankers' Association has gone on record[3] as saying: "We favor a Federal blue sky law". The I.B.A. of America has let it be known[4] that it is not opposed to the right kind of a federal law (with the reservation, of course, that it be the judge of what a right kind of law is). The state security officials of 38 states have endorsed a national bill, and even the state official of some non-blue sky states have approved it.[5]

The advocates of a national blue sky law point out that by adopting a national law we would be following merely the

1. Hearings, p.55
2. "Oregonian", Nov. 13, 1922, p. 11
3. Current Opinion, Aug., 1922, p. 259
4. Proceedings, 1918, p. 72-3
5. Hearings, p. 22

example of England, France, Germany, Italy, Belgium, and of some of the British dominions.[1] England, it seems, has had such a law since 1900, and the Consolidated Company's Act of 1908 (8 Ed. VII., ch. 69) has been praised by a number of writers.

With such precedents abroad, and such agitation at home, it is slight wonder that every session of Congress a number of blue sky bills are proposed. One of the first ones was introduced in the 65th Congress, 3d Session (Feb. 25, 1919 - March 4, 1919). This bill, H.R. 15447, was entitled: "An act to require publicity in prospectuses, advertisements, and offers for sale of securities." In the 1st Session of the 66th Congress, two blue sky bills were introduced. One of these was H.R. 188. From the hearings on this bill we have quoted several times in this thesis. In the 2d Session of the same Congress Mr. Volstead introduced the first of his blue sky bills. In the 3d Session Mr. Denison introduced the first of his five bills on this subject. In the 67th Congress, 1st Session, five bills were introduced. One of these was H.R. 7215. It is from the hearings on this bill that we have recently quoted. But it was not until the 2d Session of that Congress that a bill was introduced which was debated in the House, and which created comment throughout the United States. This bill, one of three blue sky bills introduced that session, was H.R. 10598 - popularly known as the Denison Bill.

1. Congressional Record, 67th Cong., 2d Session, Ap. 25, 1922 page 5963. Provisions of the Eng. act given in Hearings on H.R. 188, p.37 and 63, and in Wisc. Law Rev., Vol.II. No. 2, Jan. 1923, p. 90

The first bills Mr. Denison fathered met with little favor among the banking interests and with the Postmaster General and the Department of Justice. But these bill formed the basis of a discussion between a committee of the Securities Commissioners' Association and one from the I.B.A. of America. We are told[1] that "the conference nearly blew up the first day." It was hard for the state blue sky officials and the bankers to get the same view-point. But harmony was restored, and as a result, amendments to the bill were incorporated which made the bill satisfactory to all parties. This bill was not passed at the last session. But because of the favor which the movement for a national blue sky law has gained, we may confidently expect either that bill or some substitute bill to be passed in the near future.

Strictly speaking, the Denison Bill is not really a blue sky bill at all. It does not require, as did H.R. 188, that certain items of information be filed with the national government; nor does it require that a permit be obtained from the government. All that it does is to make unlawful the use of the mails, railroads, telegraph and telephone lines, or any other agency of interstate commerce for the purpose of advertising, selling, or delivering in a blue sky state any securities not exempted by the act unless the person or company using such agency of interstate commerce shall have complied with the law of that state.

The precedent for such a provision is to be found, of cours in the federal control of liquor sales in dry states prior to national prohibition. The "original package act" of 1890

1. Mr. Osgood, in I.B.A. of Am., Proceedings" for 1922, p 204

provided

> "That all fermented, distilled, or other intoxicating liquors or liquids transported into any State or Territory or remaining therein for use, consumption, sale, or storage therein shall, upon arrival in such State or Territory, be subject to the operation and effect of the laws of such State or Territory enacted in the exercise of its police powers, to the same extent and in the same manner as though such liquids or liquors had been produced in such State or Territory, and shall not be exempt therefrom by reason of being introduced therein in original packages or otherwise."

In 1915 another act was passed prohibiting the transportation of liquor into states where its sale was prohibited. This, it is held, is equivalent to prohibiting the sale of securities in states where such sale is prohibited.

The Denison Bill would not apply to all securities. The following securities are exempt from the operation of the act. (The letters to the right refer to the corresponding exemptions in the list given on pages 49-50 of this thesis.)

1. Securities issued or guaranteed by the United States or any state or political subdivision or agency thereof having the power of taxation. (a)

2. Securities issued by foreign governments. (a)

3. Issues of Federal government agencies, such as national banks. (b)

4. Public utilities issues if regulated by national or state government. (d)

5. Securities issued by non-profit organizations. (f)

6. Securities listed on leading organized stock exchanges in the United States. (i)

7. Issues of state banks and trust companies under state supervision. (b) and (e)

8. Any bonds or notes secured by a first mortgage lien on real estate or leasehold when the entire mortgage, together with all the bonds or notes secured thereby, are sold or offered for sale to a single purchaser or at a single sale. (g)

9. Negotiable promissory notes or commercial paper maturing within twelve months from date of issue. (h)

10. Issues of profitable, solvent, and tried companies. Such companies are specifically defined.

The following transactions are exempt from the operation of the proposed bill:

1. Judicial sales, bankruptcy sales, public auction. (k) & (l)

2. Sales by a pledgeholder of securities in good faith as security for a debt.

3. Isolatedttransactions by an owner, not an underwriter, for his own account when not made in the course of repeated and successive transactions of a like character. (m)

4. The distribution by a corporation of stock dividends; new stock issues by a corporation to its own stockholders or creditors in connection with a bona fide reorganization; and increased capital stock sold by a corporation entirely among its own stockholders. (n)

5. Sales made to any bank, insurance company or to any corporation, or to any dealer or broker actually engaged in buying and selling securities as a business.

6. Exchanges of shares between corporations in connection with consolidations or mergers.

It will be noticed that the only securities not included in our exempt list on pages 49-50 are those under item 10, and the only transactions not included in our list are those under 2, 5, and 6. Two of these exemptions - ten and five - are included in a few state laws. So the only new exemptions are those provided for under transactions 2 and 6.

It has been estimated[1] that this list will exempt about 90% of the business of legitimate houses. This accords strictly with the conclusion which was reached earlier in this thesis

1. I.B.A. of A., "Proceedings" for 1922, p. 204

concerning exemptions provided by state laws: namely, that the tendency is for ever greater liberality in the matter of exemptions.

There are additional sections in the bill which provide for the enforcement of the act. There is a section on the manner of prosecution; one providing for appeal; and one allowing the imposition of fines. But with these we are not interested. They are mere matters of detail.

What would happen if the Denison Bill became a law? Would the two great defects of state blue sky legislation be remedied? There is no doubt in the mind of the writer that the second defect would be remedied. No longer would the state officials be powerless to control the activities of outside corporations within their state. The sale of no security could be solicited or consumated unless the person offering that security first complies with the law of the state in which the offer or sale is made. The outside corporation would be in exactly the same position as any corporation within the state. So this simple bill which creates no new office, provides for no appropriation, contravenes no state law, would supplement and effectively remedy one of the two great defects of state blue sky laws as a system of legislation.

But what of the other defect cited? Would the Denison Bill remove the lack of uniformity among the state measures? The answer must be: In itself, the bill is powerless to do that. It changes no state law in the slightest degree. Even the list of exemptions does not affect the state lists. If a state refuses to exempt a security exempted by the national act, the

national government does not interfere. It merely refuses to lend its aid in the state's attempt to control the sale of that security. With regard to that particular security, the state would be in exactly the same position under the Denison Bill as it is today without that bill as a law. Therefore, since the bill would effect no change in state laws, it cannot per se bring about this desired uniformity.

It has been said[1] by the advocates of the Denison Bill that they hope the bill, if it becomes a law, will form the basis for uniform state laws. But what features could be copied from the national law? Merely the list of exemptions, the size of the fine, and one or two minor details! There is nothing in the bill about the amount of information to be filed, the criteria to be applied before a permit will be granted, the provisions for giving publicity to the information filed. A glance at the chart on page 45 will remind the reader how many state blue sky provisions the national law does not contain. In none of these matters, therefore, could the national law set an example. The only hope for uniformity among state blue sky laws would be not the example of the national act, but the process of education. Just as we have a uniform sales act and more or less uniform insurance laws, so we may eventually get uniform state blue sky laws. But any hope for immediate action along this line is entirely visionary. Just as uniformity amongst state incorporation laws - so long recognized as desirable, nay essential - has not been brought about not is like to be brought about, so is uniformity amongst state blue

1. I.B.A. of Am., "Proceedings" for 1922, p. 204

sky laws a thing of the distant future - a thing perhaps never to be realized.

We have just likened the problem of state blue sky legislation to the problem of state incorporation laws. The problems are so similar for both kinds of legislation that a discussion of one of these fields of legislation naturally calls up a discussion of the other. The problems are "similar", did we say? We might have been less reserved in our statement and still have been accurate, for indeed the problems are identical. Uniformity and power to handle outside corporations are the problems of state incorporation legislation just as they are of state blue sky legislation. Just as these problems will not be solved in the field of blue sky legislation until we have a national blue sky law which is more than a law supplementing diverse state blue sky laws, say some people, so, say the same people, these problems will not be solved in the field of incorporation legislation until we have a national incorporation law. And what is more, say these very same people, these two fields of legislation are so related, the one to the other, that they are really not two fields at all, but one and the same field. We need a national incorporation law, say these people in conclusion, and as part and parcel of it, we need a blue sky feature.

In view of these arguments, it seems fitting that this thesis should be concluded with a chapter on national incorporation. In this chapter the writer will endeavor to show how a national blue sky feature might be made a part of a national incorporation law.

Chapter IX.

National Incorporation

This question of national incorporation has been hotly debated for the last several years. To adequately record the arguments brought out for both sides would require not one chapter, but many. An entire thesis could be devoted to this task, and the thesis might well be a doctor's thesis. Coming, as it does, merely as a culmination of a discussion of blue sky legislation, this chapter will hit some of the "high points" only. The material given herein will be not so much the result of original research work as it will be a summary of other, and far capabler, investigators.

The first point to be disposed of is the question of constitutionality. Has Congress the power to create industrial corporations?

If there is such power, it comes of course from the clause giving Congress power to regulate commerce among the several states. The power of Congress to create corporations as a means to the exercise of this regulation has been affirmed in the case of a bank for the purpose of carrying on the fiscal operation of the government; of a railroad corporation for the purpose of promoting commerce among the states; of the construction of public highways connecting several states, either roads or bridges. [1]

1. McCullock v. Maryland, 4 Wheat. 316; Osborn v. Bank of United States, 9 Wheat. 738; Pacific Rr. Removal case, 115 U. S. 1; Ind. v. U. S. 148; Leexton v. No. River Bridge Co. 153 U. S. 525.

If the United States can create corporations to aid in interstate commerce in the above cases, then why, asked George W. Wickersham[1] when he was attorney-general of the United States, "why has it not necessarily full power to authorize the formation of corporations to conduct other forms of interstate commerce, - not merely transportation, but that character of interstate commerce dealt with in the Sherman anti-trust law and described in the decisions of the Beef Trust[2] and Danbury Hat[3] cases?"

Sydney D. Moore Hudson asks virtually the same question in a copy of the Political Science Quarterly.[4] "Now if corporations may be erected", queries Mr. Hudson, "as has been affirmed in the case of railroad and bridge companies, in order to facilitate the carry on of interstate commerce through the provision of more adequate instrumentalities thereof, why may they not be erected in order to facilitate it by providing a more efficient organization for those who carry it on - a result which incorporation indubitably accomplishes?" Mr. Hudson's entire article is a masterly proof of this thesis: "that Congress has authority to create commercial corporations to carry on an interstate and foreign business, to confer upon such corporations authority to manufacture articles to be passed into such commerce, and to exempt all their operations and private-legal relations from any state control whatsoever".

1. Address before the Ky. State Bar Association, July 7, 1909. Printed in a pamphlet entitled: "State Control of Foreign Corporations."
2. Swift & Co. v. U.S., 196 U.S. 375-98
3. Loewe v. Lawlor, 208 U.S. 274-304.
4. Vol. 26, p. 76 (1911)

Mr. Roland Carlisle Heisler, of the University of Pennsylvania Law School spent all his time for an entire year on this subject of constitutionality of national incorporation. In a monograph entitled "Federal Incorporation"[1] he comes to this conclusion: "But however the question may be decided from an economic standpoint, constitutionally there seems no valid objection".

And just as no valid constitutional objection may be raised against national incorporation, so none may be raised against the blue sky features of such a law should Congress care to legislate in that manner. A brief[2] prepared for and by the Capital Issues Committee, the Secretary of the Treasury, and the chairman of the Federal Reserve Board and of the Federal Trade Commission, quotes from a number of cases on parallel points. The brief then says: "In the light of the above decisions, the board is of opinion that Congress could constitutionally empower an administrative body to investigate the business of persons selling stock in interstate commerce, and if it were proven that such stock was without value, to issue an order prohibiting the further sale of the stock in interstate commerce, giving the parties the right of court review as in the commission act. If the stock have substantial value, however, it will probably not be competent for Congress to prohibit its sale, though it could regulate it by authorizing the administrative body to prevent fraud or misrepresentation in connection with the sale." And since fraud and

1. p. 16
2. Printed in Hearing on H.R. 188, pp. 50-63

misrepresentation is exactly what blue sky legislation - whether state or national - should seek to prevent, national blue sky legislation would be constitutional.

Professor Heisler was quoted above as saying: "But however the question may be decided from an economic standpoint, constitutionally there seems no valid objection." Having allowed Professor Heisler to dispose of the constitutional question, we shall now seek to dispose of the first question Mr. Heisler's statement suggests - the economic question.

Undoubtedly the most able article on this subject is the one Henry R. Seager wrote for the "Unpartizan Review"[1]. Some five economic arguments in favor of federal incorporation are given in that article. These arguments, expanded here and there by the present writer, follow.

1. In the future the Federal government will have to look largely to taxes on corporations for revenue. With national incorporation a fact, such tax levied will be easily accomplished. The name and address of the corporation and of its officers, together with pertinent facts as to capitalization and business magnitude, will be on file in the government's vaults. With such information as this on hand, the government could easily levy and collect the corporation tax.

Of course, this is sometimes cited as an argument against national incorporation. It is contended that the states should have the right to tax corporations. It is true that the states, as well as the federal government, need revenue. The proper procedure would be to centralize administration of the tax,

1. Vol. 12, pp. 100-115 (1919)

and then to turn back a part of the proceeds to the states. This is Professor Seligman's suggestion. Central administration is logically justified, however, in that corporations today, as we shall soon see, are national rather than state in scope. And we shall also see that the variations in state corporation laws are vexatious in the extreme to corporations operating a number of states. One of the most irritating of these variations is the difference in the tax laws of several states. This cause of irritation would be removed by a national incorporation law.

2. Modern corporations are not created for the purpose of getting huge capital, but for the purpose of getting immunity from personal liability (though somewhat, also, for the purpose of getting greater permanency). Statistics show that most corporations are for a small capitalization. Of the corporations created in New York state on a typical day, one half had a capitalization of $15,000 of less. State incorporation encourages the formation of corporations for the sole purpose of getting immunity from personal liability. This is an undesirable development.

3. Half the wealth of the country today is controlled by corporations. This is too large a problem for the states to handle. As George W. Wickersham said: "No one state can effectively grapple with abuses of the vast power which modern conditions have placed in the hands of those who control great corporate enterprises." [1]

1. "State control of Foreign Corporations." Page 20

4. Corporations today are national in scope. The rapid spread of means of communication and transportation has held out to every corporation the opportunity of expansion. Some of our larger corporations operate in every state in the Union. This means they are subject to forty-eight laws. Surely such national concerns should be regulated by the national government.

The corresponding argument against national incorporation is that many corporations are tiny concerns selling in two or three states only. Why make them incorporate nationally? There is weight to this objection.. Perhaps the objection may be answered, however, in two ways: (1) We should discourage incorporation for such small concerns. Today when three of four members of the same family desire to start up a business, they take out incorporation papers for the minimum amount of capitalization. Such practice should be discouraged. The federal law might refuse to incorporate concerns for less than $100,000 capitalization. (2) It might be desirable to allow the states to incorporate the small concerns, while the national government reserved the right to incorporate the large interstate businesses. Some such provision might conceivably be worked out if found desirable.

5. The states vie in the laxness of their incorporation laws merely for the purpose of encouraging corporations to form within their boundaries so they can collect the incorporation fee. Even if most states have strict laws, one or two states may effectively block the good state laws. New Jersey was for years known as the "mother of trusts". Any concern which found

Massachusetts, or Virginia, or Illinois too inquisitive simply filed its papers in New Jersey and then went back to Massachusetts, or Virginia, or Illinois to operate. Delaware has an official pamphlet showing the advantages of incorporation in Delaware - "advantages" meaning of course the "laxness" of her laws. The pamphlet boldly advertises that "no state has on its statute books more complete and liberal corporation laws than these". This liberality is well illustrated by the following letter written and published by a Delaware trust company.[1]

"If you will send us the enclosed form entitled' memoranda for preparing the Certificate of Incorporation and By-Laws', the name of your proposed company, the names and addresses of at least three parties who will act as incorporators (none of whom need be residents of this state), the amount of authorized capital you desire, par value of the shares, and a brief statement of the object and purpose of the company, we will prepare you a charter and all the papers connected with the organization of your company, and forward to you for execution by your parties. After they are executed and returned to us, we will have the charter granted, organize your company by proxy here, electing the board of directors whom you will designate, and then forward the records of organization to you, with a draft of directors' minutes outlining the action necessary to be taken by your directors at their first meeting, which may be whenever you desire."

The same laxness exists in South Dakota. A trust company of that state writes: "In nineteen cases out of twenty we are able to get the charter into the mails within ten hours after the application is received".[2] With such speedy service assured, no corporation need fear that the purpose of its organization and the honesty of its securities will be inquired into. With such states as New Jersey, Delaware, and South Dakota in the

1. Printed in "Unpartizan Review", vol. 12, p.105
2. Ibid, p. 107

Union, no hope lies for strictness in state incorporation. These states will defeat the good done in all the other states combined. And they will continue in this policy of laxness so long as states are allowed to compete in their efforts to encourage incorporation within their boundaries merely to reap a lucrative revenue therefrom.

"The most conspicuous defects in the incorporation law which American states have enacted as a consequence of this pernicious competition are the following:

"(1) They encourage the use of dummy incorporators and dummy directors, by failing to impose adequate personal responsibility on incorporators and directors.

(2) They make no effort to cause the nominal and the actual capital of a corporation to correspond, either when the corporation is first launched or afterwards.

(3) They impose no special restrictions on the activities of unscrupulous promoters, with the absurd result that our main reliance for the protection of innocent investors is the Post Office department enforcing the law against using the mails to defraud.

(4) They do not require annual reports.

(5) They impose no adequate restraint on the issue of bonds.

(6) They permit holding companies with their inevitable tendency to diffuse responsibility and confuse the interests to be protected.

(7) Though they incorporate businesses to be carried on all over the United States their guiding motive is not the best interest of the whole country but 'revenue only'"[1]

If the right of incorporation were taken from the states and given to the Federal Government, these evils would be done away with.

Let us consider the defects of state incorporation from a little different view-point. Some pages back it was said that the two chief defects of state incorporation, as of state blue sky legislation, were lack of uniformity and impotence in interstate transactions. The latter defect has been considered

1. H. R. Seager in "Unpartizan Review" vol. 12, pp 107-8

rather fully, for it was shown how a business house which desired to operate in one state and found the corporation laws of that state "unfavorable" would simply incorporate in another state and then operate as a corporation in the state of its choice. But the other defect - lack of uniformity - has not been sufficiently stressed.

Were this thesis not already overburdened with quotations, a very long quotation from an address[1] by Horace L. Wilgus would be included. Every bit of the material between pages five and nine would be worth transferring to this paper. Mr. Wilgus shows instance after instance of how the corporation laws of the states have varying and conflicting provisions. We are told how in some states the original holder of shares is relieved from liability on the shares by the transfer thereof, while in other states he continues liable for debts incurred while a shareholder, and in still other states he is liable not only for these debts, but for future debts contracted within a year afterwards. In some states creditors have certain rights and privileges which they do not have in other states. A man may become a creditor of a foreign corporation under the supposition that the protection offered by that state law is about the same as that offered by his own state, only to find this supposition incorrect and himself a poorer man.

Not only is there this confusion in the rights of the public: there is the same confusion in the rights of the corporations themselves. In one state a corporation is taxed

1. "Should there be a Federal Incorporation Law for Commercial Corporations?"

on its paid up stock; in another it is taxed on its stock and bonded debt; here on its gross receipts; there on its net earnings; elsewhere it pays a specific tax; in some states it pays the same as domestic corporations, in others more. Franchise rights, property rights, legal processes - all these and many more differ in the various states. If anything, there is more, rather than less, diversity in state corporation laws than in state blue sky laws. And the only hope in getting uniformity seems to lie in national incorporation.

Were the United States to pass a national incorporation law, it would be following the example of Germany, Australia, and Canada, and of the English Companies Act which authorizes the formation of companies to operate in the colonies.[1] What these greatest of trading companies have found necessary and desirable, cannot be an unwise policy nor an idle dream, thinks Mr. Wilgus. Thus argument and experience together prove the wisdom of national incorporation.

Assuming that we have established the wisdom of Federal incorporation and of Federal blue sky legislation, let us see how these two work together. Every concern, before it could become a corporation, would have to receive a charter from the national government. In this charter the government could lay down such safeguards as it cared to concerning the issue of securities. These safeguards would be the blue sky features. How admirably these blue sky features may be included in a

1. Ibid, p. 57

in a national incorporation law is shown by a "Proposed National Incorporation Law" which Horace L. Wilgus[1] drew up. There on pages 62 to 65 and 123 to 124 will be found some typical blue sky features. Regulations there are concerning the issuing of prospectuses. Officers and directors are made personally liable in damages for any fraud. No permit, it is true, is required by the plan of Mr. Wilgus. But there is no reason why that, and all other typical blue sky features might not be included. The charter would create merely the corporation; a permit might easily be required for each and every issue of stock after incorporation is accomplished. But such permit would not be nearly as necessary under Federal as under state incorporation. When careful scrutiny shall replace the blind indifference of state officials in granting charters, it is safe to predict that a large proportion of fraudulent concerns would never see the light of day. The trouble with the American system today is that it begins at the wrong end. First we allow fraudulent concerns to incorporate, and then we seek to prevent them from selling their securities. The matter is put very neatly by Mr. H. P. Wright, who was for thirty years an investment banker of Kansas City. Mr. Wright says:[2] "Another great difficulty with practically all of the 'blue sky' legislation is that it attempts to take cognizance of these securities only at the time when they are to be offered to the public. It seems to me that the scrutiny might better first be

1. Title of pamphlet: "A National Incorporation Law."
2. Hearings on H. R. 188, p. 145

directed to the time when these corporations are born. It seems to me that it is very inconsistent for a state to permit a corporation to be created, with assets consisting of hopes and sunshine and dreams and other intangible stuff of similar value, and then pass 'blue sky' laws with a world of lumbering and ponderous machinery to prevent the stock in the corporation from being sold to its citizens."

We have therefore reached this conclusion from our discussion: A wisely written and well administered Federal incorporation law will of itself greatly reduce the evil of fraudulent corporations; if this is not protection enough, then such blue sky features as are necessary may be included in the incorporation law. With an effective Federal incorporation law in existence, perhaps these blue sky features may be very mild - such as requiring prospectuses to contain certain items of information, and holding officers and directors liable if any of this information is fraudulent. But if need be, these blue sky features may be as stringent as in any of our present state laws. Much of the information which the states now require before issuing a permit would already be filed with the national government, for most of this information would be required before a charter could be issued. It would be a simple matter to require the little additional information which the government would need in order to have sufficient facts as a basis for issuing permits. Nor would the issuing of these permits be such an immense task as to be utterly impossible. It must be remembered that the most popular

federal blue sky bill today exempts nine tenths of all securities issued. This, coupled with the fact that small corporations would be discouraged, would make the task a moderately easy one.

Thus it is possible that a wise Federal incorporation law would solve not only most of our state and national corporation problems, but also those vexing state and national blue sky problems which are engaging the attention of the entire nation, and which demand an early solution.

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1921

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