Maurer School of Law: Indiana University
Digital Repository @ Maurer Law

Indiana Law Journal

Volume 47 | Issue 1

Article 14

Fall 1971

Blue Sky Restrictions on New Business Promotions, by James S. Mofsky

Hugh L. Sowards
University of Miami School of Law

It was a former SEC commissioner who, when describing the activities of his commission, remarked, "We can see that the dice aren't loaded, but we can't save a fool from his folly." In essence, the remark underscores the difference between the philosophy underlying the Securities Act of 1933 and that of most state blue sky laws. The 1933 Act, aside from its fraud prohibitions, ostensibly is concerned only with full and fair disclosure; the prospective investor is free to make his own judgment whether or not to buy. Conversely, the preponderance of state securities regulation is merit regulation which is concerned with saving a fool from his folly. Professor Mofsky's book contains a critical and refreshing analysis of the body of blue sky law with which new business has had to deal in the past and must deal with today.

Most regulators will not like this book. It represents an indictment, not only of the so-called standards contained in the laws, but of the manner in which those laws are administered and the standards applied. Professor Mofsky calls for an economic cost-benefit analysis of this regulatory area, as opposed to blithe acceptance on a face value basis. If, he proposes, such an analysis demonstrates to competent economists that the costs of merit regulation exceed its benefits, serious consideration should be given to its abolition. In that event, he would not have blue sky laws attempt to save a fool from his folly. In short, he would shelve the merit regulation approach altogether, on the ground that its net costs to society are too dear. This is another way of saying that people should be able to buy the securities they want to buy. Further, new business should be able to sell the securities it wants to sell. If in the offer or sale a lie gets by, if there is fraud or deceit, then is the time to regulate and punish. The emphasis in state securities regulation should be placed on strengthening of fraud enforcement rather than on what he considers undue restriction of new business enterprises.

If the suggested analytical study does reveal that the merit regulation game is worth the candle, the author argues forcibly that existing laws and standards should be applied on a consistent rather than on an ad hoc basis. Numerous instances are cited where the organizers of a new business venture, as well as their attorneys, were subjected to unnecessary confusion, red tape and frustration by regulators who gave varying interpretations of rules and regulations with no apparent purpose other than to regulate for the sake of regulating.

The indictment does not stop there. A well-reasoned argument is advanced that the excessive restrictions blue sky laws impose on new business have had an unintended but nevertheless anti-competitive effect on the securities industry. More particularly, the author demonstrates the manner in which large investment banking firms and their customers have received favored treatment to the economic detriment of the smaller securities dealers and their customers. A case in point is the private placement. Most blue sky laws afford some type of exemption permitting the issuing company to crawl before it walks, thereby increasing the company's prospects of success. But the bone in the throat of the organizers at this point is the frequent and severe limitation placed on compensation they may pay professional fund raisers.

> If private placement commissions to investment bankers were allowed without limitation on amounts, competition in the investment banking industry should result in competitive placement fees varying with the difficulty of the placement task and the degree of risk. Assuming that investors are apprised in the participation of an investment banker in a private placement and the amount of his fee, there is no apparent reason to interfere with the transaction . . . . [I]t necessarily follows that some marginal promoter and, a fortiori, all those whose implicit costs would be as great or greater than his, will be forced to turn for privately placed capital to New York or one of the other few states which do not proscribe commissions.[1]

The author makes an equally cogent argument respecting the blue sky restrictions surrounding public offerings by new business. The villains in the plot include the disproportionately high costs of marketing a new issue, undue restrictions on the permissible amount of promotion stock and the vague standards and attendant uncertainty which are often connected with regulation of the initial public offering price. Thus, ". . . regulation designed for a desirable public purpose has a tendency frequently found in bureaucratic regulations to proliferate exponentially,

1. J. Mofsky, Blue Sky Restrictions on New Business Promotions 22-23 (1971) [hereinafter cited as Mofsky].

generating new economic problems as the regulation grows."[2] Moreover, Professor Mofsky emphasizes that the exemptive provisions of most blue sky laws are of meager assistance to the organizers of a new venture seeking legal avoidance of registration. Here again, established businesses have a competitive advantage in raising funds. The exemption for securities listed on stock exchanges furnishes an apt illustration: listings are rarely, if ever, available to new business ventures. Similarly, most exempt transactions are of little benefit to the financing of most new businesses. Rather, as the author observes, in most instances they offer meaningful economic benefits only to existing public companies.

As might be expected, Professor Mofsky devotes a chapter of his book to reform of the blue sky laws. Until 1956, attempts made in the direction of a uniform blue sky law met with little success.[3] Furthermore, the author notes that although ". . . the legislatures of 25 states have enacted statutes which purport to be based upon the Uniform Securities Act . . . less than half the states have enacted all four parts of the Act, and even those states often do not treat the Act in a uniform manner."[4] This "uniformity," then, is not the answer to the legion of complex and diverse laws, rules and regulations with which new businesses and their attorneys still must deal when they go to market. Aside from the high cost of compliance produced by lack of uniformity, the policies of merit regulation, as Professor Mofsky points out repeatedly, may actually prohibit the new business from going to market. He does not contend this is necessarily wrong, if the benefits from such regulation outweigh its costs. What he does contend is that an in-depth analysis of the blue sky laws should be made to ascertain whether the existing body of blue sky law is really beneficial to public investors. Until the results of such a study are known, reform will not be meaningful.

The final 66 pages of Professor Mofsky's book contain charts. For the attorney engaged in securities practice, these charts are worth many times the price of the book. The first chart reflects the various types of blue sky laws adopted by each state. Additionally, it notes any part of the Uniform Securities Act adopted in each state as well as any other applicable law. Succeeding charts deal with exempt securities and exempt transactions on a state-by-state basis. Needless to say, countless hours of research must have gone into the preparation of this portion of the

2. *Id.* at 36.

3. The Uniform Sale of Securities Act was approved by the National Conference on Uniform Laws in 1929 but was adopted in full in only two states; in 1944 it was dropped by the Conference from its list of approved uniform laws. Twelve years later the final draft of the Uniform Securities Act was ready.

4. MOFSKY, *supra* note 1, at 73.

book and the securities attorney should warmly welcome the ready reference assistance when he begins the task of blue skying an issue.

Blue Sky Restrictions on New Business Promotions contains strong language. But these words needed to be written. It is time that someone questioned the very basis of state securities regulation. It is also time that someone pointed out the negative factors inherent in the administration of blue sky laws which in a very real sense control the destinies of new business ventures in this country. Professor Mofsky has done these things and done them well. More important, he is not content with criticism. Rather, in a common-sense vein he calls for a searching analysis of the worth of merit regulation. It is a fair prediction that most of his readers will agree with the necessity of such an analysis as a prerequisite to achieving a desirable balance between encouragement of new business financing and protection of the investment public in this important regulatory area.

HUGH L. SOWARDS†

† Professor of Law, School of Law, University of Miami, Coral Gables, Florida.