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

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The following portion of the Book Review Section is comprised of three separate reviews of Professor James S. Mofsky's Blue Sky Restrictions on New Business Promotions. The reviews are written by one who represents those regulated, one who regulates and an academician. Professor Mofsky's message is most certainly a controversial one, and to devote but one review to his book would do a disservice not only to the field of securities law but to Indiana Law Journal readers as well. Similarly, as other books become available which, like Professor Mofsky's, contain messages of controversial import, the Board of Editors will endeavor to compile several reviews providing critical analysis of the authors' messages. In this manner we hope that the Indiana Law Journal will provide a forum for in-depth criticism of new and controversial ideas in various fields of the law.

THE BOARD OF EDITORS

BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS. By James S. Mofsky, Associate Professor of Law, School of Law, University of Miami, Coral Gables, Florida. Matthew Bender & Co., New York, N.Y., 1971. Pp. X, 168, appendices, charts and bibliography. \$12.50.

The basic argument of this treatise is that regulatory provisions like blue sky laws, which may be designed in good faith to benefit the public, frequently display results and effects totally unintended by the originators of the legislation.¹

This passage from *Blue Sky Restrictions on New Business Promotions* is indicative of the rather partisan nature of Professor Mofsky's theme. His specific criticisms of state blue sky laws are that: (a) present private offering exemptions in state securities laws are so restrictive that they provide little exemption for financing new business promotions; (b) public offerings to finance new business promotions are largely prohibited by the expense of registration and the denial of registration by state administrators exercising "merit regulation"; and, (c) established companies are given a competitive advantage in raising capital by exemption or through simpler registration procedures.

With respect to the exemptions available for offerings to a limited number of offerees if no commission or other remuneration is paid for soliciting prospective buyers, the author states:

It is difficult to understand how an offering and sale to 40 or 50 financially sophisticated persons who can fend for themselves would create greater dangers than an offering and sale to ten financially inexperienced widows. Yet the latter placement would be permissible in the Uniform Securities Act jurisdiction whereas the former offering would be prohibited.²

The Uniform Act in § 402(b)(9) exempts offerings to not more than ten persons *other than those* designated in § 402(b)(8) which exempts offerings to a bank, savings institution, trust company, investment company, insurance company, pension or profit sharing trust or other financial institution or institutional buyer. Admittedly, many such sophisticated investors would not be interested in a highly speculative new business promotion but offerings to them are excluded from the ten offerees in the limited offering exemption. The fact that the limited offering exemption is widely utilized is demonstrated by experience in

1. J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 20 (1971).

2. *Id.* at 27.

Illinois, one of the more strict regulatory states. In that state, under an exemption for offerings to not more than 25 persons, 1,357 reports were filed in 1970 covering an aggregate dollar amount over 97 million dollars.

Concerning the author's conclusion that there are almost insurmountable difficulties in public offerings for new business promotions, some perspective might be gained by noting that in the fiscal year ended June 30, 1970 over 1,104 offerings were filed under SEC Regulation A, which applies to issues not exceeding 300,000 dollars, since amended to permit offerings up to 500,000 dollars. Underwriters were not used in 594 of these issues, and reports of sales under Regulation A that year aggregated over 116 million dollars. However, the author is generally correct in saying that public offerings for new business promotions are difficult to obtain since they are relatively expensive and may be prohibited or subjected to onerous escrow provisions in some states.

Mofsky's conclusion that "established publicly-held firms have been given some degree of competitive advantage in raising capital"³ because companies with a proven record of operation are treated more favorably under state securities acts seems inconsistent with his basic hypothesis that regulation may have unintended and costly effects. The classes of exempt securities and the standards for special registration procedures under state securities laws have been carefully tailored to include securities of established companies with a record of operation. In these situations the public usually may invest with a knowledge of operational results, and state administrators are able to focus their time and attention on those issues where investors are most likely to encounter a high degree of risk or fraud.

In discussing possible areas of reform in blue sky laws, the author is critical of the standards of competency and financial responsibility for brokers and dealers, stating that :

With respect to competency, most of the states prescribe examinations that are so simple they may be successfully passed by a person with very little training, experience, and knowledge.⁴

The examinations are not extremely difficult, but they are not as easy as this statement suggests. Practically all securities salesmen selling corporate securities are required to pass the examination of the National Association of Securities Dealers and most states requiring an examina-

3. *Id.* at 61.

4. *Id.* at 74.

tion accept the N.A.S.D. examination. The failure rate for registered representatives during the period 1963-1971 averaged between 25 and 35 per cent.⁵ However, the basic point is well taken that standards for engaging in the securities business as a broker-dealer should be raised, and major steps have recently been taken toward that end, including a proposal by the SEC to increase minimum capital requirement from 15,000 to 25,000 dollars for dealers engaged in the general securities business.⁶ Moreover, other steps are currently being taken by the N.A.S.D. and the New York Stock Exchange.

The book makes little mention of the primary purpose underlying the enactment of both state and federal securities laws—the protection of investors. In order to create and maintain investor confidence in new issues of securities which provide capital for legitimate enterprises, it is essential that investors be protected against offerings of fraudulent securities. The Federal Securities Act of 1933, being based on the concept of “full disclosure,” requires the filing of a registration statement with the SEC and delivery of a prospectus containing prescribed information to each purchaser. In contrast, most state securities acts are based, in varying degrees, on the so-called “qualifications” or “merit” concept, authorizing administrators to *deny* registration on specified grounds. A basic philosophical difference centers on whether investors are sufficiently protected by the furnishing of a prospectus which enables them to determine the merits of a particular investment or whether state administrators should be authorized to deny the public offering of issues deemed not to be “fair, just and equitable.”⁷ If one agrees that state administrators should have authority to deny the public offering of issues under the application of statutory standards, it seems apparent that those standards should be specific enough to avoid arbitrary denial of registration and to assure that speculative but honest and legitimate companies are afforded an opportunity to obtain financing. If it serves no other purpose, Professor Mofsky’s book focuses attention on the need to assure that state securities laws do not deny legitimate business promotions an opportunity to obtain needed capital under reasonable conditions.

GORDON L. CALVERT†

5. In the state of Washington the failure rate of those taking the examination has been over thirty per cent.

6. SEC Exchange Act Release No. 9288 (Aug. 13, 1971), proposing amendment of SEC Rule 15c3-1, 17 C.F.R. § 240.15c3-1 (1970).

7. This is the standard provided in many of the state securities laws.

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