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State Securities Regulation: Investor Protection Versus Freedom of the Marketplace

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STATE SECURITIES REGULATION: INVESTOR PROTECTION VERSUS FREEDOM OF THE MARKETPLACE

Anxious to discover new ways to make their money work, few Americans can resist the temptation to invest in new and promising business ventures. Consequently, businesses frequently offer securities, certificates of ownership in enterprises entered into for profit,[1] that attract a wide variety of investors. Ranging from the seasoned to the amateur, these investors with varied financial resources, have one common aim. Promoters and issuers, acutely aware of this elusive goal, describe the merits of their offerings in prospectuses, hoping to interest these potential purchasers. Dishonest sellers may attempt to dupe the innocent, unsophisticated buyers by disseminating misleading statements to them. To prevent and discourage these possible frauds,[2] the state and federal governments provide regulation of the sales of securities.

Unsatisfied with the tangle of intricate state regulations,[3] the federal government enacted legislation to protect investors trading in securities via interstate channels[4] but specifically preserved the concurrent right of the states to draft securities legislation.[5] Unlike the diverse and inconsistent standards of the states,[6] the standards codified in the Securities Acts of 1933

1. A security has been defined by the United States Supreme Court as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1945). *See also* Tcherepnin v. Knight, 389 U.S. 332, 338-39 (1967); SEC v. Joiner Leasing Corp., 320 U.S. 344, 351 (1943). See note 56 *infra*.

2. From the banking panic of 1907, which according to some commentators "served as the catalyst for reformers to condemn promoters of speculative ventures," through the 1929 crash and more recent scandals, swindlers have continually preyed on the American investing public. For historical perspectives, see L. Loss & E. COWETT, BLUE SKY LAW 3-10 (1958), and J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 9-22 (1971). For an examination of recent securities fraud, see J. KWITNY, THE FOUNTAIN PEN CONSPIRACY (1973); Robertson, *Those Daring Young Men of Equity Funding*, FORTUNE, Aug. 1973, at 81; and SEC Staff Study of the Financial Collapse of the Penn. Central Co. [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶78,931, at 82,003 (Aug. 3, 1972).

3. For the legislative history and debates, see H.R. REP. No. 85, 73d Cong., 1st Sess. (1933).

4. 15 U.S.C. §§77a-77aa (1970). The first bills introduced in Congress were patterned after state securities statutes. *See* Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 31-33 (1959). The final decision, of course, adopted the British disclosure principles that still operate today. *Id.* at 34-49. *See generally* 1 L. Loss, SECURITIES REGULATION 121-28 (2d ed. 1961). This protection also extends to intrastate offerings which comprise part of the interstate transaction.

5. 15 U.S.C. §77r (1970). "Nothing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person."

6. The state standards were generally based on "merit regulation," a term used to describe the state securities laws that grant their administrators "the power to analyze the securities to be offered, the terms of the offering, and the business of the issuer for purposes of determining, according to certain formal and informal rules, whether the securities are too speculative [or questionable] for public sale." J. MOFSKY, *supra* note 2, at 7 n.8. Mofsky uses the term to refer to "the whole array of rules allowing subjective discretion by state administrators with respect to the regulation of securities." *Id.*

and 1934 furthered uniformity and certainty in the regulation of securities.[7] Focusing on "full and fair disclosure" principles,[8] the federal government proposed that so long as the investor was provided with all the "material" facts,[9] that issuer should be allowed the opportunity to present his offering to the public.

State legislatures, although having recognized the problem in the early 1900's,[10] continue to require a scrupulous supervision of state securities transactions that looks to the merits of specific proposals. The vast majority of states, therefore, have taken issue with the policy of the federal statutes, reasoning that even full disclosure, through the use of numbers and graphs, can disguise securities fraud and dupe the state investor.[11] Under the resulting state merit regulation schemes, state agencies evaluate the risk or financial soundness[12] of the issue before any security may be offered for sale in the state.

State merit regulation of securities has been deemed paternalistic by courts, legislatures, and commentators.[13] Known as "Blue Sky Laws,"[14] the state securities statutes can be better understood from a historical viewpoint. They developed when the only means existing for regulating securities transactions[15] was the common law remedy of fraud, which was generally in-

7. The Securities Act of 1933, 15 U.S.C. §§77a-77aa (1970); The Securities Exchange Act of 1934, 15 U.S.C. §§78a-78hh-1 (1970).

8. The disclosure and registration requirements are found in 15 U.S.C. §77g (1970).

9. See text accompanying notes 147-156 *infra.*

10. Kansas in 1911 was the first state to enact securities laws, but by 1913, 23 other states, including Florida, had adopted similar statutes. L. Loss & E. COWETT, *supra* note 2, at 7-10. *See also* J. MOFSKY, *supra* note 2, at 19-20.

11. A number of commentators have argued that prospectuses are often overly complex and therefore beyond the comprehension of the average investor. *See, e.g.,* Rickenbacker, *Prospectuses: Useless and Unread,* 24 NATIONAL REVIEW 1132 (1972). See note 161 *infra.*

12. The New Hampshire statute is a prime example of this paternalistic policy: "If the commissioner is of the opinion that such securities are of such a character that there is a serious financial danger to the purchaser in buying them, or that the circulars and advertisements do not disclose pertinent facts sufficient to enable intending purchasers to form a correct judgment of the nature and value of the securities, he may prohibit the dealer from selling or offering the securities, or any of them, or in any way advertising the same." N.H. REV. STAT. ANN. §421:27 (1968).

13. "These are paternalistic laws enacted by the States under the police power and are the type of laws that are entitled to vigilant enforcement by the courts . . . ." Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 441 (Fla. 3d D.C.A. 1975). For a comparative analysis of state provisions, see Bloomenthal, *Blue Sky Regulation and the Theory of Overkill,* 15 WAYNE L. REV. 1447 (1969).

14. The term's origin is unknown, but these laws may have acquired this label because they attack "speculative schemes which have no more basis than so many feet of 'blue sky,'" Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917). One writer noted: "Unlike the physicist beside me in the airplane, the readers of this review should know that blue sky law has nothing to do with aviation." Bromberg, Book Review, 12 J. LEGAL EDUC. 127, 127 (1962).

15. *See* Bateman, *State Securities Registration: An Unresolved Dilemma and a Suggestion for the Federal Securities Code,* 27 SW. L.J. 759, 762 (1973). "The shocking strictness and breadth of administrative discretion in this regulation of the flow of capital and of investment opportunities available to the public is better understood in the light of the conditions prevailing at the time of its adoption." *Id.* at 765. The commentator refers to the following prevailing pre-1933 factors: a complete absence of federal securities laws:

effective in the era of caveat emptor.[16] Since their inception in 1913,[17] the Florida Blue Sky laws have undergone constant and significant modification.[18] The present Florida law is based on the Uniform Sale of Securities Act,[19] which Florida enacted in a modified form in 1931.[20] Although the Uniform Sale of Securities Act was withdrawn from the approved Uniform Acts in 1944 due to its obsolescence in the face of intervening federal regulation,[21] the Act remains the basis of Florida law.[22]

The search still continues, however, for effective legal means to combat securities fraud.[23] The Regulatory Reform Act of 1976[24] repeals the present merit regulation securities law as of July 1, 1980,[25] insuring legislative action and directing a new approach to securities regulation in the near future. Two major bills have been proposed to the Florida legislature; one is based on merit regulation[26] and the other is based on disclosure standards.[27] The Florida legislature now must choose the form of securities regulation that will best serve Florida.

Both the Comptroller's Office, which administers the securities laws

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the presence of only a few sophisticated investors within a public that is otherwise ignorant and uneducated; and a strong government control of the economy. *Id.* at 765-66.

16. *See generally* L. Loss & E. Cowett, *supra* note 2, at 3-10; J. Mofsky, *supra* note 2, at 16-17; Shulman, *Civil Liability and the Securities Act*, 43 Yale L.J. 227 (1933).

17. 1913 Fla. Laws, ch. 6422. The Act created an "Investment Company Board" for supervision and regulation of domestic investment companies. The constitutionality of the Act was upheld in *Ex Parte* Taylor, 68 Fla. 61, 66 So. 292 (1914).

18. The Act has been amended repeatedly, starting with the adoption of a modified version of the Uniform Sale of Securities Act in 1931. *See* Reckson, *A Comparison of the Florida and Uniform Securities Act*, 16 U. Miami L. Rev. 351 (1962).

19. The Uniform Sale of Securities Act was approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association in 1929. National Conference of Commissioners on Uniform State Laws, Handbook and Proceeding 171-204 (1929).

20. 1931 Fla. Laws, ch. 14,899.

21. The Uniform Sale of Securities Act originally had been adopted in whole or in part by seven jurisdictions, but the entry of the federal government into the field of securities regulation rendered the Act obsolete. L. Loss & E. Cowett, *supra* note 2, at 230-31. The Act was withdrawn from the list of approved Uniform Acts in 1943. Handbook of the National Conference of Comissioners on Uniform State Laws, Laws and Proceedings of the Fifty-Fourth Annual Conference 390 (1944).

22. The title of the Florida Act is "Sale of Securities Law," Fla. Stat. §517.01 (1975).

23. Although the Uniform Securities Act, approved by the National Conference of Commissioners on Uniform State Laws, has been enacted in some form in over ten jurisdictions, it has met with substantial modification in most all jurisdictions. L. Loss & E. Cowett, *supra* note 2, at 235-36. "[T]here is such diversity among the various state requirements that the most 'uniform' provision of the acts may be their title." Goodkind, *Blue Sky Law: Is There Merit in the Merit Requirements?*, 1976 Wis. L. Rev. 79, 83. These widespread differences and constant modifications suggest that no specific statute has been found entirely satisfactory. For example, see the discussion of California's revisions in Edwards, *California Measures the Uniform Securities Act Against Its Corporate Securities Law*, 15 Bus. Law. 814 (1960).

24. Fla. Stat. §11.61 (Supp. 1976).

25. 1976 Fla. Laws, ch. 168, §3(2).

26. Fla. S. 1415 (Reg. Sess. 1976, introduced by S. Dunn).

through the Florida Division of Securities,[28] and the Florida Law Revision Council, which has recently studied the Blue Sky laws, agree to the need to modify present law.[29] The Comptroller's Office urges the legislature to retain merit regulation,[30] while the Law Revision Council proposes statutes modeled after the federal philosophy of full and fair disclosure.[31] A comparison of the proposals may help to clarify which will best satisfy the state's needs.

This note traces the operation of state securities laws and outlines problems and inadequacies surrounding merit regulation. Different types of securities registration will be examined as well as the applicable exemptions, anti-fraud provisions, and policy considerations. A proposed modification to Florida's securities laws based on merit regulations will be questioned, followed by recommendations for a proposed modification to Florida's securities law based on disclosure principles.

PRESENT LAW

Registration Procedures

Under Florida law, the issuer of securities must satisfy the statutory merit standards to qualify to sell his offering in Florida. This can be accomplished in any of three ways. First, registration by qualification requires issuers to demonstrate the financial legitimacy of their offerings.[32] A second means is registration by coordination, which allows any security for which a registration statement has been filed with the Securities and Exchange Commission (SEC) to obtain concurrent registration in Florida,[33] subject to the state department's stop orders.[34] This method of registration removes direct supervision of the registration from Florida authorities. If this injunctive power is exercised, a security may be registered on a national stock exchange and sold to Florida residents through out-of-state brokers and secondary markets,

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27. Fla. H.R. 2304 (Reg. Sess. 1976, introduced by the Committee on Commerce).

28. The Florida Division of Securities hereinafter will be referred to as the department or agency.

29. See text accompanying notes 23-27 *supra*.

30. Deputy Comptroller Edward P. Mahoney has written: "Based on our experience in securities regulation, in-depth conversations with high ranking officials with the SEC, and discussions with many securities commissioners in other states, we believe merit review is essential in protecting the public." Letter from Edward P. Mahoney to author (Oct. 8, 1976). See note 130 *infra*.

31. James S. Mofsky, Professor of Law at the University of Miami and reporter for the Law Revision Council's proprosal, has written several articles arguing against merit regulation. *See, e.g.*, Mofsky, *Reform of the Florida Securities Law*, 2 FLA. ST. U. L. REV. 1 (1974).

32. *See* FLA. STAT. §517.09(1) (1975).

33. *See id.* §517.08(1).

34. *See id.* §517.08(4)-(5). If the issuer fails to comply with the requirements of the section (obtaining a commitment from a federally registered underwriter to sponsor the sale, or providing a three-year prior continuous business record), the registration can be suspended without notice. Additionally, if the promoters' expenses or profits exceed twenty percent of the price of the security, the department may suspend registration.

even though it has failed to meet Florida's standards. Since securities registered with a national exchange are otherwise specifically exempt from the provisions of this Act,[35] concurrent registration may seem to impose an unnecessary burden on the issuer and the department if the security is approved for registration by the national exchange. The Florida agency, however, should be entitled to notice of these securities transactions because, if complaints arise, the agency should have sufficient information to enable a timely response and investigation. The final form of registration in Florida is by announcement. This permits securities to be offered for sale in the state if they have been sold publicly outside the state for one year or longer.[36] The department requires financial statements and basic disclosure of business records from these applicants,[37] but in practice merely authorizes secondary offerings registered in other jurisdictions that already may have been sold to Florida residents. Although merit regulation more decisively and comprehensively controls registrations by qualification, those registering through other channels remain subject to the pervasive merit quality control administered by the department through its broad powers.

The Florida supreme court long ago announced: "[The Securities Act's] purpose is to protect the public against fraud and the statute will be given a broad and liberal interpretation to effectuate that purpose."[38] To impede an issuer's attempt to mislead or delude the investor, Florida law provides that the department shall record the registration only if the sale "would not be fraudulent and would not work or tend to work a fraud upon the purchaser, and that the terms of sale of such securities would be *fair, just and equitable,* and that the enterprise or business of the issuer is not based upon unsound business principles."[39]

To aid in its administration and enforcement of the vague statutory language, the Florida Division of Securities has established certain guidelines and rules.[40] The statutory language "fair, just and equitable"[41] refers to the effect the prospectus has on the potential investor and "shall not be used in any narrow, technical sense."[42] If the issuer is only in a developmental

35. *Id.* §517.05(6). See note 68 *infra.*

36. *Id.* §517.091(1).

37. *Id.* §517.091(3). This particularly relates to the "isolated sale" exemption that permits disposal of securities by the owner merely for his own account, if no promotional scheme or motive is involved. *Id.* §517.06(3).

38. McElfresh v. State, 151 Fla. 140, 144, 9 So. 2d 277, 278 (1942). Other Florida courts have agreed that the statutes are primarily "designed to protect the 'naive and unsophisticated investor' against unscrupulous dealers." Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 441 (Fla. 3d D.C.A. 1975). The United States Supreme Court has affirmed this principle: "Here the clear legislative purpose [of the Securities Act of 1933] was protection of innocent purchasers of securities." A.C. Frost & Co. v. Couer d'Alene Mines Corp., 312 U.S. 38, 43 (1941).

39. FLA. STAT. §517.09(7) (1975) (emphasis added).

40. FLA. STAT. §517.03 (1975) empowers the Department of Banking and Finance, Division of Securities to establish rules and regulations to enforce the Statute. *See generally* 1 FLA. ADMIN. CODE 3E-20; [1976] 1 BLUE SKY L. REP. (CCH) ¶¶13,601-13,657.

41. FLA. STAT. §517.09(7) (1975).

42. 1 FLA. ADMIN. CODE 3E-20.15; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,625.

phase and therefore has limited data to support the offering price or financial soundness of the company, "the Commissioner will make a determination, based on all factors."[43] To meet the "fair, just and equitable" standard the issuer in a promotional or developmental phase must contribute with promoters and insiders at least fifteen percent of the total equity investment[44] and grant voting rights to all common stock.[45] The issuer must satisfy specific prerequisites if any stock options or warrants are offered to the underwriters,[46] directors, officers, or employees,[47] and make no offer of preferred stock or debt securities to such persons.[48] Furthermore, the commissioner can require that all or part of the proceeds from the sale of these securities be escrowed until "certain stipulations are met."[49] This list seems to construe the "fair, just and equitable" language in a narrow, technical sense, which the rules elsewhere forbid. Arguably, the department has merely established minimum criteria as guidelines for itself and prospective issuers. Although these specific minimum prerequisites are technical, the "fair, just and equitable" language may still be construed broadly if the overall picture of the issue fails to satisfy the general standards. And yet while these impositions on the issuer struggling to raise capital may attempt to assure promoters' minimal financial stake in the offering and the investors' voting franchise, the rules actually tend to be arbitrary, unduly restrictive on the "free market,"[50] and ineffective against sophisticated, intricate schemes.[51]

43. *Id.*

44. 1 FLA. ADMIN. CODE 3E-20.04(1); [1976] 1 BLUE SKY L. REP (CCH) ¶13,614. If, howhowever, the offering is supported by a firm commitment of an underwriter duly registered under the Securities and Exchange Act of 1934 and the net worth of the issuer is in excess of $100,000, then there is no minimum equity requirement. Total equity investment is defined as the total of the par value of all the securities to be offered plus any surplus. "Obviously such phrases as 'sound business principles,' 'grossly unfair terms,' and 'fair, just and equitable' leave a good deal to the administrator's imagination." L. Loss & E. COWETT, *supra* note 2, at 67.

45. 1 FLA. ADMIN. CODE 3E-20.05; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,615. If, however, the corporation has been in business for two years prior to registration, has awarded dividend rights equally between voting and nonvoting stock, and has made full disclosure to the prospective purchaser that his stock is nonvoting, the denial of voting rights might not be considered unfair, unjust, or inequitable. No new corporation could meet these conditions and therefore such entities are denied the option of issuing or selling nonvoting stock.

46. 1 FLA. ADMIN. CODE 3E-20.06; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,616. There is a five-year limitation on all such options and warrants and the number of shares covered cannot exceed ten percent of the shares presently being offered to the public.

47. 1 FLA. ADMIN. CODE 3E-20.07; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,617. If the warrants exceed ten percent of the shares to be offered, the issuer must satisfy the Commissioner as to the fairness of any other financial arrangement.

48. 1 FLA. ADMIN. CODE 3E-20.09; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,619. This is a general rule imposed on any new offering if there is no evidence of after tax earnings.

49. 1 FLA. ADMIN. CODE 3E-20.08; [1976] 1 BLUE SKY L. REP. (CCH) ¶13,618. The regulations make no attempt to define "stipulated requirements," leaving them to a case-by-case determination.

50. Economic speech may also be entitled to first amendment protection. See text accompanying notes 175-193 *infra*.

51. For an overview of how these intricate plans are effectuated in total disregard for securities laws, see J. KWITNY, *supra* note 2. See note 194 *infra*.

The standards lend the Comptroller's Office another kind of broad power. They allow the department the opportunity to dictate a maximum offering price to the issuer by stating a figure above which the sale would no longer be fair, just, and equitable. This limits his ability to raise the necessary capital and thereby defeats the purpose of his registration. The task of raising fifteen percent of the equity may be beyond the means of an earnest, but poor, promoter,[52] while the impulsive, but monied, speculator, willing to gamble despite the possible loss of capital, can satisfy this requirement to assure the authorization of his registration. Because few, if any, investment advisors have ever isolated the factors that accurately forecast financial futures, one wonders if the Florida agency can perform the task.[53] Despite the good faith effort of the administrators to establish objective standards and eliminate much of the agency's discretion, these administrative rules create unreliable, rigid requirements[54] that act as barriers against issuers and the free flow of economic information.[55] Moreover, these merit standards discriminate against issuers on grounds that do not necessarily reflect financial soundness or predict financial success.

The majority of the case law engendered by the Florida Blue Sky laws has not involved attacks on the merit regulation standards or the commissioner's discretionary powers, but rather on violations for failure to register the security at all. A number of cases have attempted to discern whether the unregistered sale even involved a "security."[56] Frequently, this situation will

52. Professor Mofsky details just such a hypothetical business dilemma in Mofsky, *State Securities Regulation and New Promotions: A Case History*, 15 WAYNE L. REV. 1401 (1969). "The issuer is severely limited in raising capital and retaining control if the needed funds are raised via the limited offering exemption. Similarly, if he takes the public offering route, he is seriously limited in the number of shares he may take as a reward for his promotional activities and continued interest in the firm." *Id.* at 1415.

53. "[State] administrators are no better able than anyone else to evaluate the riskiness of a given venture. If they were, it is unlikely that they would be administering the securities law rather than maximizing their wealth in some more profitable way." Mofsky, *supra* note 31, at 30. See note 167 *infra.*

54. In a recent article, a state securities official conducted a three-year follow-up study comparing financial statistics of issuers granted registration with issuers refused registration. Despite the author's claim that merit regulations weeded out the riskiest issues, the figures were inconclusive and erratic. The data showed that some issuers who were refused registration performed as well or better than registered issues in a number of categories. It simply was not possible to forecast future financial pictures from the complex independent variables. *See generally* Goodkind, *supra* note 23.

55. See text accompanying notes 175-193 *infra.*

56. The Florida supreme court first noted: "Of necessity, no definition of a security can be given to fit all cases. The thing sold will in each case have to be examined to determine if it falls within the purview of the statute." McElfresh v. State, 151 Fla. 140, 144, 9 So. 2d 277, 278 (1942). *Compare* Lapidus v. Rever, 174 So. 2d 459 (Fla. 3d D.C.A.), *cert. denied*, 183 So. 2d 210 (Fla. 1965) *with* Bond v. Koscot Interplanetary, Inc., 246 So. 2d 631 (Fla. 4th D.C.A. 1971) (in which the court adopted the Supreme Court's test of a security). See note 1 *supra. See also* Florida Discount Centers, Inc. v. Antinori, 232 So. 2d 17 (Fla. 4th D.C.A. 1972); Frye v. Taylor, 263 So. 2d 835 (Fla. 4th D.C.A. 1972); Mofsky, *The Expanding Definition of "Security" Under the Blue Sky Laws*, 1 SEC. REG. L.J. 217 (1973).

In criminal cases when the definition of "security" became the crucial factor, a judge's

arise when the investor faces a loss and sues to have the sale rescinded or voided and the purchase price refunded.[57] The purchaser is using the statute for the purpose of financial advantage, although the issuer may have satisfied the purpose behind the "fair, just and equitable" standards of the department. In other words, the issuer can be penalized and held civilly liable because he did not fulfill the requirements of the letter of the law – failed to prove this security or transaction fell within a statutory exemption –[58] although he satisfied the spirit of the law – disclosed material facts and operated on sound finances.

Unintentional violators of the statute may be fined as heavily as intentional violators. If the spirit of the law remains paramount, these "violators" have been unjustly disciplined. If the purpose of the law is to maintain a free, but honest and safe, state securities market, the marketplace has not been contaminated. Only if the purpose of the law is to create absolute liability, regardless of the intent of the issuer and fairness of the offering,

finding that the items in question were securities "amounted to a partial, if not a total, directed verdict of guilty, and as a consequence, stripped the appellant of his right to have the jury determine this crucial and vital issue." Miller v. State, 285 So. 2d 41, 42 (Fla. 2d D.C.A. 1973), *cert. denied*, 292 So. 2d 367 (Fla. 1974). *Accord*, Roe v. United States, 287 F.2d 435 (5th Cir. 1961), *cert. denied*, 368 U.S. 824 (1961). If the judges are confused as to the definition of a security, one wonders how a lay jury can be expected to evaluate the offer in legal terms.

The definitional problem no longer exists in condominium sales because FLA. STAT. §718.504 (Supp. 1976) explicitly outlines the disclosure required of sellers and specifies remedies for misleading statements.

57. FLA. STAT. §517.21 (1975) states that any sale made in violation of this chapter is voidable at the election of the purchaser. The statute makes the seller and every director, officer, or agent of the seller who participated or aided in the sale jointly and severally liable upon tender of the securities. The statute has been interpreted to require inducement on the part of the superior, principal, or employer to create liability beyond the individual seller. *See* Frye v. Platinum Coast Aviation, Inc., 298 So. 2d 522 (Fla. 4th D.C.A. 1974), in which the employer was unaware of the salesman's activities so as to preclude the employer's liability. The agent was simply acting outside the scope of his employment, although the dissent reasoned that the common law rule of agency had been overturned by the statute. "Nevertheless, it is clear in this state that an officer, director or agent of a seller in order to be held personally liable for the sale of illegal securities must engage in some act or acts which induces [*sic*] the purchaser to invest." In another case, the defendant's signing of a debenture as an attesting witness was found insufficient inducement to create liability. *See* Ruden v. Medalie, 294 So. 2d 403, 406 (Fla. 3d D.C.A. 1974). Nevertheless, it has been stated that: "Section 517.21 reflects a broad legislative policy against unlawful security sales by making all persons involved in such sales civilly responsible regardless of whether such person is actually acting for the seller or is himself making the sale." Frye v. Taylor, 263 So. 2d 835, 841 (Fla. 4th D.C.A. 1972).

If the purchaser no longer has possession of the alleged security, the statute provides that recovery must be had through another means since the purchaser is required to surrender the document back to the seller before the purchase price need be refunded. *See* Sloane v. Merrill Lynch, Pierce, Fenner & Smith, 221 So. 2d 451 (Fla. 3d D.C.A. 1969).

58. *See* FLA. STAT. §§517.05-.06 (1975). FLA. STAT. §517.17 (1975) states: "[T]he burden of establishing the right to any exemption shall be upon the party claiming the benefit of such exemption." The court in Data Lease Fin. Corp. v. Barad, 291 So. 2d 608 (Fla. 1974), ruled that a reorganization for tax purposes "is not necessarily" within the meaning of the corporate reorganization exemption.

have these offenders been punished accordingly.[59] This criticism may also be leveled against judicial enforcement of the federal securities laws. One may respond that without this kind of liability, too many issuers may fail to register, rely on their own judgment of fairness and disclosure, and thereby defeat the preventive element within the law meant to deter litigation of the quality and adequacy of the registration. Nevertheless, the statute should allow these issuers, who in good faith erroneously rely on the statutory exemptions, to submit their prospectuses to the agency if challenged in court. If the prospectus is found to comply with the statute, civil liability should not result.

Exemptions

Every statute regulating securities outlines a list of specific securities and transactions to which the statute does not apply.[60] In Florida,[61] even a security exempt from registration may be sold only by a registered dealer unless the transaction itself is specifically exempt.[62] The statute exempts federal, state, or local government securities;[63] securities issued by foreign governments;[64] securities of corporations such as national banks that act as instruments of government;[65] and public service utility securities,[66] charitable organizations' securities,[67] those registered in major stock exchanges,[68] and other miscellaneous securities.[69] It is presumed that these securities, except

59. In Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436 (Fla. 3d D.C.A. 1975), the court did not require scienter, effectively enforcing a brand of strict liability.

60. "No two of the state acts are identical. And the amount of variation and frequently unnecessary complexity in both substance and verbiage is staggering. For example, when all the permutations are charted, there are some 2800 exemptions in the forty-seven statutes." L. Loss & E. COWETT, *supra* note 2, at 18-19. One writer even noted: "Too often filings are made when exemptions exist." Gray, *Blue Sky Practice—A Morass*, 15 WAYNE L. REV. 1519, 1525 (1969).

61. *See* FLA. STAT. §§517.05-.06 (1975). See note 58 *supra*.

62. *Id.* §517.12(1). Some of the exempt transactions include judicial and personal representative sales, corporate reorganizations, specific notes, bonds, and mortgage exchanges, private and limited offerings. *See id.* §517.06. These exemptions are described in more detail in Robinton & Sowards, *The Florida Securities Act: A Re-examination*, 12 U. MIAMI L. REV. 1 (1957).

63. FLA. STAT. §517.05(1) (1975).

64. *Id.* §517.05(2).

65. *Id.* §517.05(3).

66. *Id.* §517.05(4). These securities are issued by governmental bodies. Although the legislature doubted that these corporations would intentionally offer inadequate prospectuses, public utilities have been known to fail in this regard.

67. *Id.* 517.05(5). This exemption applies to corporations organized exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit.

68. *Id.* §517.05(6)-(7). This exemption, though, is subject to department scrutiny and may be denied under the merit principles previously discussed. See text accompanying notes 32-55 *supra*.

69. *Id.* §517.05(8)-(10). These include securities of state banking institutions, securities with fixed returns which have been public for more than five years, and securities of nonprofit agricultural cooperatives.

the charities' offerings, have inherent financial stability that justifies their being offered in Florida without registration. Some of these securities may be selling at fair market value due to their controlled administration and trading, but that in itself may not be sufficient to insure the financial reliability that Florida merit regulations require. The legislature, in other words, exempts securities regulated under disclosure and other policies in foreign jurisdictions, while enforcing merit regulations on Florida securities that will be selling side by side these less restricted ventures.

This inconsistency pinpoints an integral policy determination that the legislature has failed to explain. Is the intent of these statutes to prevent fraud or to protect the investor as much as possible against financial loss?[70] While these objectives need not be mutually exclusive, neither should they be confused. The distinction is important because it suggests that where the legislature has determined that certain securities offerings are not deceptive, disclosure by itself will be an adequate safeguard. Judging from the majority of regulated exemptions, Florida appears to favor the protection against fraud rationale, although the merit regulations embodied in the same statute requiring financial soundness suggest a more prominent influence from the second rationale, protection against financial loss. Although it is true that once fraud is prevented, financial risk may be lessened, this is by no means a necessary corollary. State administrators may not even have the capabilities to foretell financial failures or successes.[71] If they do not, the goal of preventing financial loss of investors might best be eliminated from the statute altogether. But if merit regulation prevents dubious issuers from registering, it has served a worthwhile function. Moreover, the government securities would certainly comport with the merit criteria and the securities registered on the stock exchanges are still subject to department scrutiny and stop orders. In the end, however, the agency's job should not entail insuring the solvency of businesses.

The Anti-fraud Provisions

In addition to various controls over the registration of securities, the Florida securities law incorporates certain general anti-fraud provisions to attack any deception or misrepresentation that might have gone undetected during registration or that might have arisen in an unregistered transaction.[72]

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70. "The purpose of [securities] statutes . . . is to protect investors in securities not from financial loss generally, but from fraud." State v. Minge, 119 Fla. 515, 527, 160 So. 670, 675 (1935). The scope of this directive from the Florida supreme court may not yet be fully appreciated by the legislature. One analyst argued: "In fact, none of the regulation described is designed to prevent 'fraud'; rather, it is concerned primarily in limiting the promoter's participation in the event the venture is successful. If the venture is unsuccessful the extent of the promoter's investment, the amount of cheap stock, stock options, and the extent of dilution will be of little, if any, consequence. [T]he blue sky regulation at best may in a few instances save some assets for the investors upon diquidation." Bloomenthal, *supra* note 13, at 1482.

71. See note 53 *supra* and note 162 *infra*.

72. *See* FLA. STAT. §§517.19, .301 (1975).

The statutes apply to all transactions involving any security,[73] and grant the department broad powers of investigation.[74] The courts are empowered to grant temporary or permanent injunctions against those charged by the department with violations of the statute, and all assets of such offenders may be impounded.[75] Although basically repetitive and disjointed, the anti-fraud provisions demonstrate a legislative intent to prevent fraud, equipping the agency with not one but two similar statutes to effectuate that end.[76] The second statute resembles the federal anti-fraud statute,[77] allowing the Florida courts to draw upon the abundant federal interpretations of the statutory language.[78] The federal provision applies to all securities in interstate commerce; thus, both of Florida's anti-fraud provisions create a cause of action probably available already under federal law.[79] The state provisions underscore the inadequacy of the registration requirements while highlighting the legislature's recognition of the heart of the problem, unlicensed public duplicity.

Because of the paucity of prosecutions for violations of the anti-fraud provisions, little case law has developed regarding the requisite intent to defraud. However, in another context, prosecutions for failure to register, this scienter element has been deemed an unnecessary allegation.[80] At least prior to the Supreme Court ruling in *Ernst & Ernst v. Hochfelder*,[81] Florida courts did not require plaintiffs to prove an intent to defraud in suits seeking rescissions of securities transactions.[82] Simple negligence, the *Hochfelder*

73. *Id.* §517.19. (Even though a transaction may be exempt from registration, it is never exempt from the anti-fraud prohibitions under Florida law. *Id.* §517.301. The same is true under the federal statute, assuming jurisdiction is present. 15 U.S.C. §77q (1970). *See* Bell & Goodman, *Corporate Law and Securities Regulation*, 28 U. MIAMI L. REV. 922, 933 (1971).

74. *See* FLA. STAT. §517.20 (1975).

75. *Id.* §517.19(7).

76. *See id.* §§517.19, .301.

77. 15 U.S.C. §78j (1970) (originally enacted as Act of June 6, 1934, ch. 404, §10, 48 Stat. 891).

78. It is quite conceivable that the federal and Florida readings of the statute will be markedly inconsistent. For example: "Appellant concedes there are no Florida cases supporting his contention but says the Federal cases relating to identical securities anti-fraud statutes hold to the view he presents. We don't agree with the Federal decisions he relies on. Moreover they are not binding on us." Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 440 (Fla. 3d D.C.A. 1975).

79. The fact that courts have found little difficulty in identifying some interstate element in any securities transaction in such cases as Myzel v. Fields, 386 F.2d 718, 727 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) (any use of the mails or phones), suggests the possibility of federal preemption. *See* Armstrong, *The Blue Sky Laws*, 44 VA. L. REV. 713 (1958); Friedman, *Searching for a Blue Sky Remedy—A Forum Shopper's Guide*, 15 WAYNE L. REV. 1495 (1969). Existence of a state remedy, furthermore, does not bar recovery under rule 10b-5. Wolf v. Frank, 477 F.2d 467 (5th Cir.), *cert. denied*, 414 U.S. 975 (1973); Popkin v. Bishop, 464 F.2d 714, 718 (2d Cir. 1972).

80. State v. Houghtaling, 181 So. 2d 636, 638 (Fla. 1966).

81. 425 U.S. 185 (1976).

82. Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 440 (Fla. 3d D.C.A. 1975). The rationale of this decision is questionable, however, particularly because it failed to make a distinction between civil and criminal prosecutions under the statute.

Court held, will not create a cause of action under the federal anti-fraud provision in private actions for damages.[83] This ruling supports the anti-fraud purpose of those sections of the statute, denying relief to those investors who attempted to use the statute as insurance against losses if there was no fraud. Although Florida courts applying state laws are not bound by these federal interpretations,[84] the Supreme Court ruling will be considered.

Despite the apparent absence of a scienter requirement in Florida, there are only a limited number of cases that represent legal actions instituted by the Florida agency against defrauders. While one might attribute this to limited investor fraud in Florida,[85] it more likely reflects the agency's overemphasis on evaluation of those issuers at registration and insufficient emphasis on investigation of fraud. Merit regulations, however, may discourage a significant number of risky issuers from registering, thereby limiting the time-consuming and costly evaluations and investigations. Accordingly, the time allocated to evaluating the proposed issues may actually lessen the need for ex post facto investigations.

Many states,[86] including Florida,[87] have enacted provisions that apply to fraudulent trading; frequently these additional clauses merely have reiterated or elaborated on the prior state law. The state legislatures might assume that these supplementary provisions act as greater deterrents, provide additional remedies for violations, and enhance the regulatory powers of the state agency. An issuer tending to work a fraud, however, will hardly be deterred by one more anti-fraud provision if he is equally culpable under another. More regulation could result in less enforcement if personnel are given broader duties to perform within the same limited time and budget. The statutory language already grants substantial discretion to the department, making any new regulations which are meant to broaden its powers unnecessary. The additional provisions accomplish none of the functions intended, while creating inconsistencies in the law and adding to litigation of collateral issues. Ultimately, one statute is sufficient because, should the agency object to the registration,[88] the finding can be couched in whatever statutory language is convenient.

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83. 425 U.S. at 193.

84. Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 440 (Fla. 3d D.C.A. 1975).

85. But see note 194 *infra*.

86. For example, Arkansas, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, Oregon and Wisconsin have enacted such provisions.

87. *See* FLA. STAT. §517.09(7) (1975).

88. The same complaint has been registered against the SEC's enforcement of its disclosure policies. These critics claim that the federal agency, in effect, enforces its own merit regulations when reprimanding issuers for inadequate or faulty disclosure statements, rather than limiting itself to enforcing full and fair disclosure requirements. "Theoretically, at least, the SEC only requires 'proper disclosure' for a firm to sell its securities." Roberts, *Securities Bill May Be Legislative Headache*, FLA. TREND MAGAZINE, Feb. 1975, at 67. Larry De Frances, one-time enforcement attorney with the Florida Division of Securities, stated, "this is not true. If firms do not meet the equivalent of merit standards as informally established by SEC officials, the SEC tends to drag its feet on approving a prospectus, thus

Denials of Registration and Remedies

Recognizing a need to protect the investor from unscrupulous dealers, the legislature has granted the administrator wide discretion in determining the ultimate fate of the registration of an issue. The department may deny, revoke, or suspend the registration of any security if it determines that any portion of the statute has been or may be violated;[89] and the registration may be revoked if the issuer appears insolvent or fraudulent.[90] Similarly elastic grounds for suspension include the issuer's bad business repute, unsound financial affairs, and questionable business principles.[91] This cryptic list creates uncertainty for the issuer attempting to comply with the statute, while inviting charges of abuse of discretionary power if irregularly enforced by the agency. This, as well as the selective control over registration, unnecessarily exposes the agency to charges of corruption and bribery.[92]

The issuer can appeal to a court of "proper jurisdiction"[93] if its registration has been denied, suspended, or revoked. Although Florida case law fails to reveal any such proceedings challenging the state agency, due perhaps to the small percentage of disqualified applicants,[94] other jurisdictions provide some insight into the area. Following general principles of judicial review of administrative actions, most courts refuse to interfere with the agency's discretion unless there has been a serious abuse of discretion.[95] Since the United States Supreme Court's 1917 decision in *Hall v. Geiger-Jones Co.*[96] upheld the constitutionality of Blue Sky laws, the grants of discretionary power have withstood repeated challenges.[97] The Arkansas supreme court ruled that if the commissioner's findings are supported by substantial evidence, "then those findings of fact are conclusive."[98] Although the court agreed that some of the defendant's violations were not enumerated in the statute, it continued by stating: "[T]hose charges which cannot specifically be found in the statutes

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forcing a firm to make the desired change. The SEC accomplishes outside the law what the current blue sky law accomplishes within it." *Id.*

89. FLA. STAT. §517.11 (1975).

90. *Id.* §517.11(1)(a).

91. *Id.* §517.11(1)(e)-(g).

92. The ex-comptroller of the state of Florida, Fred O. (Bud) Dickinson, Jr., was indicted on multiple counts of extortion and tax evasion in relation to the granting or withholding of bank charters. Miami Herald, Nov. 26, 1974, §1, at 1, col. 2.

93. FLA. STAT. §517.24 (1975) allows for appeal of the agency's determination in the Circuit Court of Leon County, with the possibility of a second appeal to the proper district court of appeal.

94. See note 120 *infra.*

95. *See, e.g.*, Selig v. Novak, 256 Ark. 278, 506 S.W.2d 825 (1974); Dobel Steam Motors Corp. v. Daugherty, 195 Cal. 158, 232 P. 140 (1924); Blue v. Division of Corporations, 88 Cal. App. 2d 485, 48 P.2d 80 (1935). *But see* Mayflower Sec. Co. v. Bureau of Sec., 64 N.J. 85, 312 A.2d 497 (1973).

96. 242 U.S. 539 (1917). "It is to be remembered that the value of securities consists in what they represent, and to determine such value is a complex problem even to the most skillful and informed." *Id.* at 552.

97. The Florida statute's constitutionality was unsuccessfully challenged in McElfresh v. State, 151 Fla. 140, 9 So. 2d 277 (1942). See note 17 *supra.*

98. Selig v. Novak, 256 Ark. 278, 285, 506 S.W.2d 825, 829 (1974).

are covered by general language and reinforced by case law which has been developed over the years to protect the public from unethical conduct."[99]

Similarly, if there is a difference of opinion over the fairness or merits of the issue, the courts have consistently deferred to the agency's determination.[100] The California supreme court reasoned that it was manifest from the provisions of the statute that discretion reposed in the commissioner whenever "there [was] room for a reasonable difference of opinion."[101] A Michigan court upheld the commissioner's refusal to register the plaintiff's issue, deferring to the "special qualifications and experience" of the commissioner in passing on the feasibility and fairness of certain financial enterprises.[102] The Iowa supreme court explained the need for undefined standards and broad discretion:

> [I]t becomes immediately apparent that for [the state securities laws] to prescribe in detail the rules and regulations essential for the attainment of its purposes in each case would be a practical impossibility. Of necessity the legislature was compelled to delegate to the Secretary of State . . . discretion comparable to the complexities of the situations it was designed to remedy. Otherwise in this and other similar situations such legislation would be rendered practically impotent.[103]

The courts have not always been consistent, however, in their deference to administrative agencies.[104] The Iowa supreme court, despite its own dictum, ordered the agency to register plaintiff's securities.[105] In a similar situation, when an issuer was refused registration in Pennsylvania because the securities commission did not approve of plaintiff's plan of business, the state supreme court reversed, noting that "[t]his is a matter of business expediency also outside of the commission's province."[106] When a dealer in securities

99. *Id.* at 285, 506 S.W.2d at 830.

100. *See generally* Hayden Plan Co. v. Friedlander, 97 Cal. App. 12, 275 P. 253 (1929); Investment Reserve Corp. v. Michigan Sec. Comm'n, 238 Mich. 606, 214 N.W. 311 (1927); State v. Dep't of Commerce, 174 Minn. 200, 219 N.W. 81 (1928); Schumann v. 250 Tenants Corp., 317 N.Y.S.2d 500, 65 Misc. 2d 253 (1970). *But see* Insuranshares Corp. v. Pennsylvania Sec. Comm'n, 298 Pa. 263, 148 A. 107 (1929).

101. Doble Steam Motors Corp. v. Daughtery, 195 Cal. 158, 165, 232 P. 140, 143 (1924).

102. Investment Reserve Corp. v. Michigan Sec. Comm'n, 238 Mich. 606, 612, 214 N.W. 311, 313 (1927).

103. Independence Fund of N. Am., Inc. v. Miller, 226 Iowa 1101, 1104-05, 285 N.W. 629, 631 (1939). In that case, after the plaintiff's application for registration had been denied, the court eventually found "no such showing of financial unsoundness as would, under circumstances of this case, justify the refusal." *Id.* at 1106, 285 N.W. at 632.

104. *See, e.g.*, Data Access Systems, Inc. v. State, 63 N.J. 158, 305 A.2d 427 (1973); Mayflower Sec. Co. v. Bureau of Sec., 64 N.J. 85, 312 A.2d 497 (1973). One flagrant abuse was reported in a California circuit court: "When a mutual water company applied for a permit [to issue and sell stock] it was denied unless the company agreed to put in cumulative voting, the Deputy saying 'I don't care what the statute [exempting mutual water companies from the cumulative voting requirement] says, the Commissioner's policy is to have cumulative voting and you either have it or you don't get a permit.'" Edwards, *supra* note 23, at 819.

105. Independence Fund of N. Am., Inc. v. Miller, 226 Iowa 1101, 285 N.W. 629 (1939).

106. Insuranshares Corp. v. Pennsylvania Sec. Comm'n, 298 Pa. 263, 266, 148 A. 107, 108 (1929).

was suspended by a commission because he failed to renew his brokerage license on time, the New Jersey supreme court found the public had not been harmed by this technical violation and reversed the plaintiff's suspension.[107]

These incompatible decisions are not surprising in light of the varied interpretations invited by vague merit standards. Even if the objective requirements which have been substituted for them by state securities commissions had been successful in alleviating the confusion and uncertainty, rigid objective standards have no place in determining the fairness of proposed issues when a flexible case-by-case determination is mandated by the statute.[108] Thus, there is a need for a compromise in which less arbitrary regulations could fulfill the same functions, while infusing more uniformity and order into this body of the law.

In addition to upholding the general constitutionality of Blue Sky laws, the Supreme Court has had occasion to discuss the abuse of discretionary powers by the SEC. In *Jones v. SEC*,[109] the SEC sought to require an applicant for registration to appear at an investigative hearing, although the issuer had withdrawn his application. The Court did not see how any right of the public could be affected by the applicant's withdrawal, since presumably the purpose of the statute was to protect the investor.[110] The Court reprimanded the agency for its infringement of the applicant's rights and warned of the need to restrict discretionary administrative power:

> Arbitrary power and the rule of the Constitution cannot both exist. . . . And if the various administrative bureaus and commissions necessarily called and being called into existence by the increasing complexities of our modern business and political affairs, are permitted gradually to extend their powers of encroachments — even petty encroachments — upon the fundamental rights, privileges and immunities of the people, we shall in the end, . . . become submerged by a multitude of minor invasions. . . .[111]

Whatever the SEC's motive for ordering this hearing, the Court's posture was firm and clear. The Court directed its statement at the agency's abuse of its subpoena powers, but the breadth of the warning should attract the attention of the state and federal regulatory bodies.

The Supreme Court has not always taken such a restrictive view, however, and the federal courts have often deferred to the findings of the SEC.[112]

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107. Mayflower Sec. Co. v. Bureau of Sec., 64 N.J. 85, 312 A.2d 497 (1973).

108. In evaluating the California merit standards, Professor Marsh of U.C.L.A. law school "voiced his objection to the 'fair, just, and equitable' standard on the ground not that it was too vague but that it was too rigid, that the commissioner had established specific little rules that had to be followed by the deputies who could not really exercise basic judgment on the merits of the security as a whole." Edwards, *supra* note 23, at 823.

109. 298 U.S. 1 (1936).

110. "The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions." SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953).

111. 298 U.S. at 24. The SEC presently may be allowed to conduct this kind of hearing, although the principle of the case still stands.

112. *See, e.g.*, SEC v. Chenery Corp., 332 U.S. 194 (1947); Wolf Corp. v. SEC, 317 F.2d

The SEC in *SEC v. Chenery Corp.*[113] had rejected the corporation's reorganization plan because the management could materially alter the ultimate allocation of new securities among the various existing classes of stock. The Supreme Court acknowledged the agency's experience and expertise, upheld the denial of registration, and stated: "It is the type of judgment which administrative agencies are best equipped to make. . . ."[114]

In another context, however, broad administrative power may play a positive role in the regulation of intrastate securities transactions. The administrator's essential purpose is not so much to choose securities that will prosper, but rather to ferret out those that are likely to fail. The threat of merit evaluation is meant to deter all but the soundest business propositions and inject an element of deterrence into the law. If it succeeds, then fewer issuers will apply for registration, less money will need to be spent on evaluations, and investors will be protected from arduous and expensive trials against these disreputable issuers.

To authorize these inquiries, the legislature has insured that there is virtually no limitation on the agency's investigative powers in respect to present and pending registrations.[115] The department is empowered to compel the production of all papers of the issuer if it deems an investigation proper.[116] If the issuer refuses to comply with these orders, the agency may revoke the registration[117] and during the investigation may order the suspension of the sale of the security.[118] The grounds for revocation, however, are open to a wide range of interpretations from the divergent people in charge of the agency which intervenes at its own discretion, and the issuer applying for registration is entitled to a hearing only before the order is made final.[119] The

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139 (D.C. Cir. 1963); Archer v. SEC, 133 F.2d 795 (8th Cir.), *cert. denied*, 319 U.S. 767 (1943); Boruski v. SEC, 321 F. Supp. 1273 (S.D.N.Y. 1971).

113. 332 U.S. 194 (1947).

114. *Id.* at 209.

115. The highest court in the state of New York, responding to litigation attempting to curtail the investigative powers granted to the administrator of the securities laws, ruled: "We cannot agree that the Legislature intended to grant the courts the authority to judicially review the Attorney General's exercise of discretion in dealing with a [blue sky law] violation." People v. Bunge Corp., 25 N.Y.2d 91, 98, 250 N.E.2d 204, 206, 302 N.Y.S.2d 785, 788 (1969).

116. FLA. STAT. §517.11(1)(h) (1975).

117. *Id.* §517.11(3).

118. *Id.* §517.11(4).

119. *Id.* §517.11(5). FLA. STAT. §517.20(1) (1975) states that the department may appoint an examiner if a hearing is conducted. Though a hearing may be provided, FLA. STAT. §517.20 (1975) hearing procedures fail to protect against the adverse impact of publicity. When the Florida Securities Commission sought an injunction for violations of chapter 517, the court ruled: "In our view, the provisions of section 517.19, F.S.A., do not require notice of hearing to a party being investigated by the Securities Commission before the Commission determines to seek injunctive relief. At this stage of the proceeding no right, duty, privilege or immunity is being impaired, and full due process is afforded by the trial of the issues in the Circuit Court." Florida Peach Orchards, Inc. v. State, 190 So. 2d 796, 798 (Fla. 1st D.C.A. 1966). New York state courts have reached the same conclusion. See People v. Bunge Corp., 25 N.Y.2d 91, 250 N.E.2d 204, 302 N.Y.S.2d 785 (1969). One writer added: "[R]ealities involved in the marketing of securities are such that for all practical purposes

potential for irregular use of this power seems contrary to the need for certainty in this area and the objective of prevention of litigation.

Some of the most significant effects of the Florida procedures are revealed by the statistics issued by the Florida Division of Securities. During the past five years there have been 5,670 applications for registration,[120] with more than ninety-three percent of those applying permitted to register and sell their securities in Florida.[121] Over seventy-four percent of those applications made effective were registered by means of qualifications.[122] The data reveal that under merit regulations, or perhaps despite them, the great majority of issuers applying for registration are not disqualified after evaluation by the department. The substantial work and inquiries resulted in the withdrawal or dismissal of less than seven percent of the applicants on the average for the past five years. In addition, the majority of cases tried for violations of the chapter deal with unregistered securities.

These figures lead to several possible conclusions to explain the low rate

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the proceeding is not an adversary one and Commissioners have no real restraint on their authority other than their own self-restraint." Bloomenthal, *supra* note 13, at 1484-85.

120. Letter From Edward P. Mahoney, Deputy Comptroller of Florida, to the author (Oct. 25, 1976), stating:

Fiscal Year 1975-1976		Permits Made Effective	
Total Applications Received	940	Qualifications	692
Withdrawals and Dismissals	35	Coordinations	211
Total Securities Applications Made Effective	905	Announcements	2
			905
Fiscal Year 1974-1975			
Total Applications Received	753	Qualifications	592
Withdrawals and Dismissals	64	Coordinations	96
Total Securities Applications Made Effective	689	Announcements	1
			689
Fiscal Year 1973-1974			
Total Applications Received	795	Qualifications	628
Withdrawals and Dismissals	38	Coordinations	127
Total Securities Applications Made Effective	757	Announcements	2
			757
Fiscal Year 1972-1973			
Total Applications Received	1403	Qualifications	906
Withdrawals and Dismissals	69	Coordinations	398
Total Securities Applications Made Effective	1334	Announcements	30
			1334
Fiscal Year 1971-1972			
Total Applications Received	1779	Qualifications	1098
Withdrawals and Dismissals	181	Coordinations	476
Total Securities Applications Made Effective	1598	Announcements	24
			1598

121. *Id.*

122. *Id.*

of registration failures. First, the merit regulations may discourage any questionable issuers from even attempting to register.[123] If this is true, then enforcement needs to focus on those securities being traded unofficially and not on those registering. These investigations would necessarily involve inquiries into unregistered brokers,[124] further promoting the purpose of the statute in regulating the entire state securities industry. In the absence of merit regulation, equally thorough investigations of an increased number of registrations may be needed because those borderline offerings discouraged by merit regulation would otherwise be allowed to register. If issuers fail, the investor may sue alleging some sort of fraud that, even under the disclosure statute, will create more litigation.

Second, most present issuers may be willing to deal with the agency and decrease their offering price to qualify for registration rather than withdraw the offering. This suggests that the department is more concerned about limiting risk by lessening cost than in preventing fraud, exposing itself to charges of graft while deviating from the legislative intent to stop fraud. There is a third exploration that the overwhelming majority of all securities offered for sale in Florida are legitimate.[125] If this contention has substance, the present merit standards burden the state with a significant expense resulting in only marginal and superficial benefits to the state's investors.[126] A combination of these and other factors have persuaded the state legislature to undertake a revision of the law.[127]

Alternative Regulatory Procedures

There are a number of options open to the state, but essentially the legislature must choose between merit evaluation and disclosure standards. A third option, the present Uniform Securities Act, provides for registration and evaluation of securities, but only pursuant to merit standards.[128] A majority

123. These issuers instead may rely on an exemption or estoppel defense if brought to court. If the plaintiff-buyer participated in the affairs of the corporate issuer to a substantial degree, the defendant may offer proof of plaintiff's actions to raise an estoppel against his bringing suit. The policy assumes that corporate insiders will have access to more facts than any prospectus would be required to disclose. "The Court in each [estoppel defense] case outlined the degree of control that would be necessary by reason of direct participation in the affairs and management of the corporation as a stockholder, officer, or director, in order for the defense of estoppel to be available." Dokken v. Minnesota-Ohio Oil Corp., 232 So. 2d 200, 203 (Fla. 2d D.C.A. 1970). *See also* Krasny v. Richter, 211 So. 2d 612 (Fla. 3d D.C.A. 1968).

124. Fla. Stat. §517.12 (1975) requires registration of all those who sell securities from offices within this state or who sell securities in the state from offices without the state.

125. Securities fraud in Florida has been detailed in depth. See note 194 *infra*.

126. The Regulatory Reform Act of 1976, 1976 Fla. Laws, ch. 168, §5(5), directly opposes legislation of this kind, inquiring: "Is the increase in cost more harmful to the public than the harm which could result from the absence of regulation?"

127. See text accompanying notes 23-27 *supra*.

128. 2 U.L.A., Uniform Securities Act §301. *See generally* L. Loss n E. Cowett, *supra* note 2, at 245. The study did not specifically consider the policy considerations underlying state securities laws.

of states have adopted the Uniform Securities Act, but with so many substantial modifications to make meaningful comparisons impossible.[129]

The Merit Standard Proposal

The Comptroller's Office supports the adoption of certain statutory revisions, but in essence these proposals still cling to the general merit regulatory scheme.[130] The bill, while distinguishing a "sale" of a security from an "offer to sell," which the present law does not,[131] only reinforces present incongruities without illuminating any of the darker passages of the statute. Indeed, a number of exemptions endorse full and fair disclosure as sufficient protection against fraud without mandating an additional inquiry into the financial safety factors usually identified with merit standards.[132]

In an attempt to promote a more thorough enforcement of the statute, the Comptroller's proposal limits the registration license to the issuer for one year.[133] If the issue is completely sold within the year and no more securities are to be offered, then the new provision is unnecessary. If the issuer continues to sell, the department would reevaluate that issue annually according to merit standards. This statute would result in additional administrative work to an already overworked department.[134] Even less time could be allocated to investigation of past fraud or evaluation of present applications,

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129. Uniformity may be undermined not only by modifications to the Act but through significantly different administrative rules in each state. See note 23 *supra*. *See also* 2 U.L.A., UNIFORM SECURITIES ACT §306(a)(E) and the official comment.

130. Fla. S. 1415 (Reg. Sess. 1976, introduced by S. Dunn). The bill died in the Committee on Commerce before coming to the senate floor. One author argued: "To contend that merit tests, such as those under consideration here, are unnecessary regulation or unduly hamper the marketing process is to underestimate the factor of overriding self interest which often motivates promoters and insiders, and to overestimate the ability of most investors to understand what they are doing." Hueni, *Application of Merit Requirements in State Securities Regulation*, 15 WAYNE L. REV. 1417, 1444 (1969).

131. FLA. STAT. §517.02(3) (1975) states: "'Sale' or 'sell' includes every disposition or attempt to dispose of a security or interest in a security for value."

132. *See* Fla. S. 1415, §§3-4 (Reg. Sess. 1976, introduced by S. Dunn) (amending FLA. STAT. §§517.05-.06 (1975)).

133. Fla. S. 1415, §5 (Reg. Sess. 1976, introduced by S. Dunn) (amending FLA. STAT. §517.07 (1975)).

134. With an average of over 1100 applications per year, see note 121 *supra*, and only ten investigators presently employed by the Florida Division of Securities, Letter from Donald A. Rett, Director of the Division of Securities, to author (Nov. 2, 1976), the commission is constantly kept busy. Robert Prince, Chief Investigator of the Bureau of Enforcement of the Division of Securities, in 1973 estimated that there were then probably three hundred valid complaints, of which only 25 went to prosecutors. Unfortunately, limitations on staff size will probably preclude any improvement on this effort in the immediate future. *Stock Swindles in Florida*, FLA. TREND MAGAZINE, May 1974, at 80. One writer commented: "For one thing, . . . the budgets are meager, resulting in staffs that are much too small and pay scales too low to be attractive. The work load is staggering in periods of heavy offerings . . . ." Gray, *supra* note 60, at 1523. The salary issue was acute in Florida, according to Prince: "[P]resently beginning salary for an appropriately trained investigator is only $7000. The same man can start with the Department of Law Enforcement for $11,500." *Stock Swindles in Florida*, *supra* at 80.

predictably on the increase.[135] This could serve to eliminate the effectiveness of the department and undermine the statute's enforcement. Moreover, because the proposal retains preexisting statutory[136] and common law remedies[137] for misleading or fraudulent statements, it thereby removes any need for the proposed annual reevaluations. The investor is left with many channels of recourse in subsequent years. If, in the long run, the yearly renewal only involved paper work, the additional marginal protection offered to the investor would be outweighed by the administrative burden and cost. The investor should be expected to rely on the corporate code for periodic statements from the issuer.[138] That statute is better suited for that purpose, having been designed to insure and protect the shareholder's access to this data.

Because of preconceptions about the need for heavy regulation of securities, the Comptroller's revisions basically enlarge the scope of the agency, adding new provisions which require more supervision of registered issuers and brokers.[139] The department under this proposal may apply to the court to require the issuer to return to the purchaser all sums obtained in violation of the chapter even if the purchaser is not a party to the department's suit.[140] The laudable motive behind adopting this additional responsibility for the department may have been to have all claims settled in one court action, yet the department's time might be better spent enforcing its other provisions rather than litigating individual claims. Moreover, special defenses may be available against the investor, not a party to the action, who may be barred from bringing the suit for some reason such as the statute of limitations. The civil damage remedy, on the other hand, might be a much more effective weapon than an injunction against the issuer. The immediate threat of reimbursement to investors coupled with the threat of an injunction, could give the department enough additional clout to force the issuer to settle.

Under this alternative, the department is also empowered to make investigations "within or outside of this state,"[141] thereby inviting the department to investigate interstate frauds that are more efficiently and capably handled by the federal agency. This may be an unfounded assumption if the interstate impact is insignificant and the federal agency directs its efforts in directions inconsistent with the interests of Florida residents. This proposal,

135. "In fact Florida has more new business incorporations than any of the big-gainer states, including California. Florida showed 2492 new incorporations compared with 1717 in May, 1975. Only New York has more business incorporations than Florida . . . ." FLA. TREND MAGAZINE, Oct. 1976, at 51. It may be debated if this increase in incorporations actually will be reflected in increased registrations for securities sales.

136. *See* FLA. STAT. §517.19, .21 (1975).

137. *See id.* §517.22.

138. FLA. STAT. §607.157 (1975) requires the corporation to publish annual financial reports which are to be made available to all shareholders.

139. This seems at odds with the Regulatory Reform Act of 1976, 1976 Fla. Laws, ch. 168, §2, which urges a restrictive approach in adopting any new regulations that might restrain the free market. Furthermore, the legislature inquires: "Is there a reasonable relationship between the exercise of the state's police power and the protection of the public health, safety or welfare?" *Id.* §5(2).

140. FLA. STAT. §§517.21, .23 (1975).

141. Fla. S. 1415, §14(1)(a) (Reg. Sess. 1976, introduced by S. Dunn).

however, rather than correcting present inconsistencies, adopts an expansive view of the department's role in regulating securities. A better approach to the problems accompanying the increased market activity in Florida might be to tighten and clarify the registration standards. Even if one acknowledges merit regulation as a valid means of discrimination among issuers, the enactment of more provisions may result in less enforcement and more statutory violation.

The Disclosure Proposal

The Florida Law Revision Council has drafted legislation that would replace merit regulation with disclosure standards.[142] The proposed legislation simplifies the statute[143] by adopting a singular anti-fraud provision modeled after the federal statute[144] and requiring only full and fair disclosure. This new approach implements the policies of the Regulatory Reform Act of 1976.[146]

Under the Council's scheme, the operation of the registration provisions will depend upon the court's interpretation of "disclosure."[147] Florida courts will need to formulate their own definition but may be guided by federal decisions interpreting similar statutory language.[148] Full disclosure might be

142. Fla. H.R. 2304 (Reg. Sess. 1976, introduced by the Committee on Commerce) passed by a unanimous vote. The bill, however, died in messages and never reached the senate floor.

143. It is difficult not to sympathize with the criminal defendant who argued that he did not realize he had violated the statute because it was beyond his comprehension. *See, e.g.*, State v. Smith, 151 So. 2d 889 (Fla. 1st D.C.A. 1963). But when the Florida supreme court ruled that scienter was not an element necessary to prove a violation of chapter 517, the issue lost significance. *See* State v. Houghtaling, 181 So. 2d 636, 638 (Fla. 1965).

144. See note 77 *supra*.

145. Fla. H.R. 2304, §1 (Reg. Sess. 1976, introduced by the Committee on Commerce) requires that a "prospectus sufficient for the purposes of this section must contain information providing full disclosure of financial and other information about the company and its securities which would enable a prudent individual to make an informed and realistic evaluation of the worth of the company and of the securities offered."

146. 1976 Fla. Laws, ch. 168. See text accompanying notes 168-174 *infra*.

147. "[T]here is the recurrent theme throughout these statutes of disclosure, again disclosure, and still more disclosure." 1 L. Loss, *supra* note 4, at 21. *Compare* Heller, *Disclosure Requirements Under Federal Securities Regulation*, 16 Bus. Law. 300, 300 (1961) ("[t]he Securities Act is essentially a legislative device to obtain certain basic information essential to an investment analysis") *and* Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 Am. Econ. Rev. 132, 134 (1973) (disclosure is required for fair and efficient operation of the market) *with* Knauss, *Disclosure Requirements — Changing Concepts of Liability*, 24 Bus. Law. 43, 43 (1968) ("The initial justification for the Federal Securities Acts was to protect the investor from fraud. . . . Investor protection is still 'number one' in the hierarchy of reasons for government regulation of disclosure. . . .") *and* Ferber, *The Case Against Insider Trading: A Response to Professor Manne*, 23 Vand. L. Rev. 621, 622 (1970) ("[s]ince I believe Congress was attempting to improve the morality of the marketplace, I think that the economic effect is largely irrelevant"). *See generally* Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 Hastings L.J. 311 (1974).

148. In one case a Florida court rejected a federal interpretation of a securities statute. *See* Merrill Lynch, Pierce, Fenner & Smith v. Byrne, 320 So. 2d 436, 440 (Fla. 3d D.C.A.

defined as proper dissemination of a statement which conveys the true state of affairs to a reasonable investor.[149] The courts have never restricted themselves by applying narrow labels to the key words in the securities statutes. Accordingly, they are able to assure a continued broad and remedial application of the law to protect the investor and serve the legislative intent.[150] The courts have required all "material" facts to be disclosed.[151] In proxies, this encompasses any fact that would "have a significant . . . propensity to affect the voting process."[152] The determination of materiality rests on a case-by-case analysis. It may depend on the clarity of the prospectus,[153] the sufficiency of the emphasis on certain matters,[154] the experience of the buyer and the

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1975). New York state's blue sky law also incorporates the same language as the disclosure proposal, but again, New York interpretations may have limited influence in Florida. In Schein v. Chasen, 478 F.2d 817 (2d Cir. 1973), *vacated and remanded sub. nom.* Lehman Bros. v. Schein, 416 U.S. 386 (1974), a federal circuit court applied Florida corporate law in accordance with New York precedent because no Florida case law existed and found a corporate fiduciary liable for the release of insider information. On remand for clarification of state law, the state high court refused to follow the New York precedent and unanimously reversed the verdict against the corporate fiduciary. Schein v. Chasen, 313 So. 2d 739 (Fla. 1975).

149. *See* Stier v. Smith, 473 F.2d 1205, 1208 (5th Cir. 1973).

150. See note 38 *supra.*

151. As early as 1895, the Lord Davey Report on English Company Law reform declared that "every contract or fact is material which would influence the judgment of a prudent investor in determining whether he would subscribe for the shares or debentures offered by the prospectus." CMD. 7779 (1895), §14(5). 17 C.F.R. §210.1-02(n) (1976) (Regulation S-X) defines materiality as "information required to those matters about which an average prudent investor ought reasonably to be informed."

152. Mills v. Electric Autolite Co., 396 U.S. 375, 384 (1970).

153. "[I]f application of accounting principles alone will not adequately inform investors, accountants, as well as insiders, must take pains to lay bare all the facts needed by investors to interpret the financial statements accurately." Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F. Supp. 112, 122 (S.D.N.Y. 1974), *modified,* 540 F.2d 27 (2d Cir. 1976). In Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 549, 566 (E.D.N.Y. 1971), the court condemned the obfuscatory tactics of some corporations and accountants, ruling: "Using a statement to obscure, rather than reveal, in plain English, the critical elements of a proposed business deal cannot be countenanced under the securities regulation acts . . . . [T]he prospectus must not slight the less experienced. They are entitled to have within the four corners of the document an intelligible description of the transaction." *See also* A. BRILOFF, UNACCOUNTABLE ACCOUNTING (1972).

154. Material facts must be completely, clearly, and prominently disclosed and cannot be buried or consigned to some irrelevant section of a long document. *See* Mills v. Electric Autolite Co., 403 F.2d 429, 433 (7th Cir. 1968), *vacated on other grounds,* 396 U.S. 375 (1970). *See also* Jacobs, *What is a Misleading Statement or Omission Under Rule 10b-5?,* 42 FORDHAM L. REV. 243 (1973).

An inventory adjustment was done to give the appearance of quarter-by-quarter growth. "Concededly, the profits for the year were . . . unaffected by the overstatement of December earnings, but the prospective purchaser was entitled to a full disclosure of all the facts that were known." Kaiser-Frazer Corp. v. Otis & Co., 195 F.2d 838, 843 (2d Cir.), *cert. denied,* 344 U.S. 856 (1952). *See also* Kohn v. American Metal Climax, Inc., 322 F. Supp. 1331 (E.D. Pa. 1970), *modified,* 458 F.2d 255 (3d Cir.), *cert. denied,* 409 U.S. 874 (1972); Beatty v. Bright, 318 F. Supp. 169 (S.D. Iowa 1970).

nature of the transaction,[155] or whatever special circumstances are involved. The Supreme Court has decided:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.[156]

The proposal states clearly that no action of the department is to reflect upon the merits of the issue or to suggest any approval of the security. The bill would permit a prospectus to be used even if it is not amended in accordance with a deficiency notification from the department.[157] While the SEC has been charged with enforcing its own brand of merit regulations,[158] the Council's proposal would prevent any enforced restrictions on the issuer without a court adjudication. The only limitation prohibits use of the prospectus until forty-five days after filing.[159] This is meant to allow the department time to issue a cease and desist order if an action "would be in the interest of the public."[160] The department allows investors to judge the security, and even if the department has not had time to investigate the possibility of misleading statements, the purchaser may act as the enforcer.

While this free market approach to securities registration and regulation allows the issuer substantial leeway in deciding what he must disclose and what he may properly conceal, several disadvantages result to the issuer and the investor. The issuer, more uncertain as to the adequacy of his disclosure, may fear greater liability because of the indefinite nature of his registration. The lack of any administrative action on prospectuses may invite more litigation, forcing the courts to evaluate the fairness of the disclosure. This evaluation may be more efficiently and effectively handled by the agency. The statute discourages the purchaser from trading in the market either because of a lack of an administrative ruling or from fear of possible legal expenses. It also forces the purchaser to rely solely on the issuer's nonregulated prospectus. Although the prospectus may be understood by the sophisticated in-

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155. "[T]he defendants devised a plan and induced the [Indian] holders of [the securities] to dispose of their shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972).

156. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

157. Fla. H.R. 2304, §1 (Reg. Sess. 1976, introduced by the Committee on Commerce). This would preclude enforcement of any kind of merit evaluation operating under the guise of disclosure principles, if the burden of proof was placed on the department to justify its action rather than giving judicial deference to the administrative agency.

158. See note 88 *supra*.

159. Fla. H.R. 2304, §1 (Reg. Sess. 1976, introduced by the Committee on Commerce).

160. *Id.* After the 45 days have passed, the prospectus may be used, but the department is never precluded from pressing charges for inadequate disclosure.

vestor,[161] it may be deficient, deceptive, or incomprehensible to the inexperienced, again inviting more litigation that might be settled better in an administrative proceeding. While the statute's purpose may be fulfilled if it encourages questionable issuers to register and disclose material facts, it may be counterproductive if it directs more investors into questionable securities.

Unlike the ambiguities in the present statute, the purpose of the proposed legislation is clear; the prevention of fraud has taken priority, relegating the evaluation of the financial risk to the investor.[162] Open market disclosure, however, may result in promoting fraud rather than preventing it. The issuer may suspect that few potential investors will want to go to the expense of litigating the adequacy of his disclosure and may be encouraged to be less than candid in the prospectus. It may arise in practice that the depart-

161. Many commentators have argued the pros and cons of prospectuses as well as how much they should disclose and how they should disclose it. Justice Douglas once wrote: "The truth about securities having been told, the matter is left to the investor. The [Securities Act of 1933] presupposes that the glaring light of publicity will give the investors protection. But those needing investment guidance will receive small comfort from the balance sheets, contracts, or compilation of other data revealed in the registration statement. They either lack the training or intelligence to assimilate them and find them useful, or are so concerned with a speculative profit as to consider them irrelevant." Douglas, *Protecting the Investor*, 23 YALE REV. (N.S.) 521, 523-24 (1934). His 1934 insight is even more penetrating in the face of the more complex contemporary prosepectuses. One writer noted: "[E]ven when an investor [is] presented with an accurate prospectus prior to his purchase, the presentation in most instances [tends] to discourage reading by all but the most knowledgeable and tenacious." Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607, 618-19 (1964). And another observed: "In the face of such obfuscatory tactics the common or even the moderately well informed investor is almost as much at the mercy of the issuer as was his pre-SEC parent. He cannot by reading the prospectus discern the merit of the offering." Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340, 1351-52 (1966). See note 11 *supra*. This discussion supports the contention that even full disclosure is of little benefit to the investor. This assumes, however, that professional securities dealers, through whom most investors transact their business and who are required to be licensed by both federal and state law, are also incapable of deciphering these prospectuses for their clients. Because these dealers may be more interested in selling securities than in educating the purchaser, it is doubtful whether the brokers fulfill this function.

162. "In practice, . . . it becomes extremely difficult to evaluate securities in these broad terms. . . . [T]here are at least two variables in any speculative investment: the degree of risk involved and the price of the stock. Inasmuch as neither of those is an independent variable, it is impossible to determine the degree of risk that an investor should be allowed to assume without, at some time, determining the price at which securities could be sold. . . . In truth, there is no way to establish an objective rule that quantifies such relationships with respect to newly promoted firms. It is the precise function of the market to make these determinations." Mofsky, *supra* note 31, at 29-30. "[T]here is some available evidence that blue sky commissioners may often fail in excluding the right people since from time to time the SEC has brought actions based on 'fraud' against offerings that have been registered in one or more of the regulatory states." Bloomenthal, *supra* note 13, at 1482. This argument may miss the point because blue sky regulation was only meant to weed out the worst issuers and never claimed perfection in its application. Supporters of merit regulation also respond that these standards deter the riskiest issuers, illustrating how this regulation is better than having absolutely no regulation or screening.

ment would formulate general standards of its own to determine adequate disclosure. While this might be a natural result in the face of a large number of applicants, there might develop a brand of regulation subject to the same criticisms as were aimed at merit regulation. Issuers would seldom challenge the department's findings due to legal costs and judicial deference to administrative agencies, and therefore administration of the statute would be the key to limiting discretionary actions.

The legislation should achieve its aim of unleashing a host of new securities by removing the restrictive merit regulations and exempting securities registered under the federal statute, thereby avoiding duplication and waste of administrative action. The supporters of the bill urge that small, innovative, or young businesses, locked out of the battle for public dollars by the merit standards, should have their deserved and rightful opportunity.[163] They will be able to present their issues to the public investors in a framework more closely resembling the truly free marketplace envisioned by our economic system.[164] If the market is flooded with new securities, it will simply provide the investor with a broader spectrum of potential purchases, thus encouraging market growth, competition, and diversification. It is conceded that a tremendous increase in the number of applicants for registration would leave the department understaffed to investigate even the prospectuses of these issuers.[165] If the agency is unable to act, however, the anti-fraud provisions of the statute are designed to allow all injured parties to litigate their own claims.[166]

Because the general anti-fraud provision adopts the federal approach, Florida courts may feel obliged to follow the Supreme Court's interpretations of the federal statute. This, however, would deny the state courts their proper role in the reading of the state law and subject the state to the variable federal interpretations.[167] While it may be advantageous to have federal rulings to

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163. "Aside from the desirability of merit standards at all, it seems clear that all firms—new or old, profitable or unprofitable—ought to have equal access to the same registration processes. . . ." Mofsky, *supra* note 31, at 13.

164. One federal investigation revealed: "The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price." SEC, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS, THE WHEAT REPORT 50 (CCH ed. 1969).

165. Although defendants charged with violations of blue sky laws have no less a right to speedy trials, preparation for these trials may be much more involved and time consuming. Robert Prince, Chief Investigator for the Division of Securities in Florida, in 1973 told reporters: "[District attorneys] can prosecute ten tradition[al] crimes in the time it takes to prosecut[e] one securities fraud." *Stock Swindles in Florida, supra* note 134, at 80. For example, a defendant, denied a speedy trial, was released and charges against him dismissed in Turner v. Olliff, 281 So. 2d 384 (Fla. 1st D.C.A. 1973). See note 134 *supra*.

166. Parties could rely on earlier case law to insure their rights: "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), *quoted in* Bond v. Koscot Interplanetary, Inc., 246 So. 2d 631, 635 (Fla. 4th D.C.A. 1971), and Florida Discount Center, Inc. v. Antinori, 226 So. 2d 693, 695 (Fla. 2d D.C.A. 1969).

167. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

aid in statutory inquiries, this could lead to conflicting interpretations of identical language between the federal and state courts. Federal courts in Florida would be particularly hard pressed to decide whether to apply Florida or federal rulings, especially if the complaint were based on violations of both statutes, a situation to be expected given the similarities of the statutes.

Economic Freedom Versus Merit Regulation

The Florida Regulatory Reform Act of 1976 repeals the present securities laws as of July 1, 1980.[168] The Act requires reevaluation of the state agencies that regulate certain services and products.[169] Only if significant harm develops in the absence of regulation may the legislature reinstitute some kind of statutory restriction;[170] that is, the restriction must pass a cost-benefit analysis.[171] The Florida Law Revision Council's proposal based on full disclosure most clearly comports with the goals of the Act[172] because it serves to educate the investor, not restrict the issuer. This proposal might minimize costs because theoretically it would reduce evaluations of offerings.[173] If more unreliable issuers register, however, this might result in increased costly investigations. Under this scheme, a regulatory body would intervene only in the event of some type of fraud, cleansing the market but not restraining it.[174]

In the wake of this proposed increase in economic freedom, the Supreme Court voiced its opinion concerning the scope of the consumer's constitutional right to be assured of an unrestrained flow of economic information. This approach could have a considerable effect on the status of merit regulations. In *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*,[175] the Court declared unconstitutional a Virginia statute which forbade a licensed pharmacist from advertising prices of prescription drugs.[176] The Court extended the first amendment's protection to certain commercial

168. 1976 Fla. Laws, ch. 168, §3(2).

169. 1976 Fla. Laws, ch. 168, §2(3). Moreover, 1976 Fla. Laws, ch. 168, §2(1), dictates: "That no profession, occupation, business, industry, or other endeavor shall be subject to the state's regulatory power unless the exercise of such power is necessary to protect the public health, safety, or welfare from significant and discernible harm or damage. The exercise of the state's police power shall be done only to the extent necessary for that purpose."

170. 1976 Fla. Laws, ch. 168, §5(1).

171. 1976 Fla. Laws, ch. 168, §5(5) inquires: "Is the increase in cost more harmful to the public than the harm which could result from the absence of regulation?"

172. 1976 Fla. Laws, ch. 168, §2(2) orders: "That the state shall not regulate a profession, occupation, industry, business or other endeavor in a manner which will unreasonably adversely affect the competitive market."

173. 1976 Fla. Laws, ch. 168, §5(4) questions: "Does the regulation have the effect of directly or indirectly increasing the costs of any goods or services involved, and if so, to what degree?"

174. 1976 Fla. Laws, ch. 168, §5(6): "Are all facets of the regulatory process designed solely for the purpose of, and have as their primary effect, the protection of the public?"

175. 425 U.S. 748 (1976).

176. *Id.* at 772. The Florida supreme court in Board of Pharmacy v. Webbs City, Inc., 219 So. 2d 681 (Fla. 1969), struck down the same statute because it violated the state constitution.

speech that educates the consumer.[177] A free enterprise economy can best serve the public when the public is well informed.[178] "To this end," wrote Justice Blackmun, "the free flow of commercial information is indispensable."[179] Investors in the state securities market might advocate the same policies to institute a challenge against the restrictions imposed on the flow of commercial information by merit regulations.[180]

Pharmacists unsuccessfully challenged the law,[181] which should deter dealers in securities from litigating the matter, but investors, as did the consumers, might succeed. "While freedom of speech presupposes a willing speaker,"[182] one will be found in the issuer promoting his investment. The first amendment, the Court has declared, protects the right to "receive information and ideas."[183] The Court announced: "Speech likewise is protected even though it . . . may involve a solicitation to purchase or otherwise pay or contribute money."[184] The consumer's interest in the free flow of commercial information might be "keener by far, than his interest in the day's most urgent political debate."[185] Merit regulations construct barriers between sellers and investors, blocking the flow of information to which the public may be constitutionally entitled. The first amendment, these investors might argue, does not permit this tampering with the flow of commercial speech:

> It is precisely this kind of choice, between the dangers of suppressing information, and the dangers of its misuse if it is freely available, the First Amendment makes for us. . . . What is at issue is whether a State may completely suppress the dissemination of concededly truthful information about entirely lawful activity, fearful of that information's effect upon its disseminators and its recipients. Reserving other questions, we conclude that the answer to this one is in the negative.[186]

An analogy between prescription drugs and securities has its weaknesses,

177. 425 U.S. at 759. In Bigelow v. Virginia, 421 U.S. 809 (1975), the United States Supreme Court noted: "[T]he notion of unprotected 'commercial speech' [has] all but passed from the scene."

178. 425 U.S. at 765. "And if it is indispensible to the proper allocation of resources in a free enterprise system, it is also indispensible to the formation of intelligent opinions as to how that system ought to be regulated or altered." *Id.*

179. *Id.*

180. When blue sky laws were last challenged as unconstitutional, the petitioners argued that these statutes denied equal protection and unduly burdened interstate commerce. *See* Hall v. Geiger-Jones Co., 242 U.S. 539 (1917). They have yet to be challenged on first amendment grounds.

181. In Patterson Drug Co. v. Kingery, 305 F. Supp. 821 (W.D. Va. 1969), the federal district court ruled that the pharmacists' challenge was premised on claims of commercial free speech and the court refused to strike down the law. The pharmacists did not appeal the decision.

182. 425 U.S. at 758.

183. *Id.* at 756 (quoting Martin v. City of Struthers, 319 U.S. 141, 143 (1943)). In Lamont v. Postmaster General, 381 U.S. 301 (1965), the Court established a first amendment right to receive political publications from abroad.

184. 425 U.S. at 761.

185. *Id.* at 763.

186. *Id.* at 773.

not the least of which concerns the public's physical dependence on some of the drugs.[187] The economic information that is passed to the consumer, however, may not be completely suppressed, according to the Court, if "concededly truthful."[188] Merit regulations permit the state agency to completely suppress concededly truthful information if the agency determines that the offering is not fair, just, and equitable,[189] or might tend to work a fraud,[190] regardless of truthfulness. The Court in *Virginia Pharmacy* made specific reference to the fact that the state may still bar deceptive or misleading statements;[191] nonetheless, that might not allow the agency to suppress a prospectus because of the risky nature of the venture or because of operations based on unsound business principles.[192] The anti-fraud provisions are clearly capable of "insuring that the stream of commercial information flows cleanly as well as freely,"[193] relieving the fear that the market would not be sufficiently policed in the absence of merit regulations. Merit regulation, in the long run, might not be struck down as an unconstitutional restriction on free speech, but the *Virginia Pharmacy* decision supports a disclosure oriented regulation of securities, while casting doubts on the propriety and effectiveness of merit regulation.

CONCLUSION

Despite merit regulations, south Florida has been labeled the "Con Man's Capital."[194] Underlying the disclosure statute is a recognition of the failure of merit regulation to protect against fraud and financial loss. This note has focused on problems created by the Florida brand of merit regulation. Securities laws administrators argue that more enforcement of present provisions, not more legislation, is needed.[195] Disclosure laws, repealing the labyrinth of

187. "Therefore, even if the First Amendment were thought to be primarily an instrument to enlighten public decisionmaking in a democracy, we could not say that the free flow of information does not serve that goal." *Id.* at 765. It could be argued that the economy is equally dependent on capital investment and would benefit from increased market offerings.

188. *Id.* at 773.

189. *See* FLA. STAT. §517.09(7) (1975); UNIFORM SECURITIES ACT §306(a)(E).

190. *Id.*

191. "Obviously, much commercial speech is not provably false, or even wholly false, but only deceptive or misleading. We foresee no obstacle to a state's dealing effectively with this problem." 425 U.S. at 771.

192. *See* FLA. STAT. §517.11(1) (1975), which allows revocation of registration for a variety of subjective reasons, including the fact that the issuer has not based the enterprise on sound business principles.

193. 425 U.S. at 772.

194. J. KWITNY, *supra* note 2, at 286. "The swindlers . . . have established something of a capital at Fort Lauderdale, Florida." *Id.* at 17. "Almost certainly the figure [of the securities defrauders' income in Florida] would be in the tens of millions of dollars and conceivably in the hundreds of millions. . . ." *Id.* at 304.

195. "New legislation, however, is not the real answer to the swindling problem. 'It takes the securities attorney a year to read the regulations we have right now,'" complains Stuart Goldberg, a former lawyer for the SEC. *Id.* at 317. "We do not need any more. What we need is enforcement of what we have." *Id.* The basic problem has been stated as follows: "[B]lue sky enforcement seldom reaches the really flagrant types of fraud. This

merit regulation, may help to simplify the agency's work, though providing no guarantee of additional fraud prevention. The disclosure proposal's straightforward approach to securities regulation is a reasonable response to the contemporary complex market.[196] It evidences concern for the high costs of administration from which the benefits to the public are difficult to discern. The proposal integrates a careful apportionment of administrative time with policies consistent with the theories behind our economic system.

Securities law administrators are incapable of insuring the financial success or forecasting the financial failure of securities, and therefore the statutes should not require evaluations of offerings for the purpose of protecting the public's financial stake. Securities statutes should aim to prevent fraud through disclosure requirements that emphasize those factors the agencies in the past have found most helpful in predicting financial futures. The investor and the marketplace in this way evaluate the risk, while the department is relegated the job of enforcing the anti-fraud provisions. Registered and unregistered fraud threatens the public with the greatest financial hazards. They must command the greatest time of the investigators and the focus of the agency's work.

The priority of economic freedom, based on disclosure and fraud prevention, supersedes the fear of loss from speculative ventures, which merit regulation attempts to prevent. The relaxation of economic regulation, evident in Supreme Court decisions and recent Florida law, suggests disfavor with merit regulation while encouraging disclosure statutes. Whether disclosure lessens fraud or not, this new kind of regulation will allow a radically different allocation of resources, better structured to deal with modern securities problems.

RONALD N. SCHWARTZMAN

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is true because the perpetrators of such fraud make no attempt to comply with state or federal securities laws. The only answer in this area is effective enforcement of the fraud provisions, something the typical blue sky commissioner does very little of." Bloomenthal, *supra* note 13, at 1481.

Responding to a change in securities regulation in West Virginia, one law professor wrote: "It is hoped that [the commissioner] will depend more on full and fair disclosure methods and less on 'merit' regulation. . . . If careful review is given to the information contained in a registration statement, and this in turn is fully disclosed to the public, there would be no need to wield a slow and heavy handed bureaucracy since criminal sanctions and civil liability are lurking behind every public offering in this state. There is a point where people, fully informed, can and should be permitted to decide for themselves." Tompkins, *The Uniform Securities Act—A Step Forward in State Regulation*, 77 W. VA. L. REV. 15, 18 (1974).

196. The New York statute provides the best example of this approach: "It is unlawful for any person, directly or indirectly, to offer or sell any security which is part of an issue offered and sold only to persons resident within this state unless an offering prospectus which makes full and fair disclosure of all material facts is first filed by the issuer of such security with the department of law." N.Y. GEN. BUS. LAW §359ff(1) (McKinney Supp. 1976).