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425 - 2nd Street N.W.

Washington 25, D.C.

OCT 19 1949

Mr. Earl F. Hastings, Director
Securities Division
Arizona Corporation Commission
Phoenix, Arizona

Dear Mr. Hastings:

Your letter of October 7, 1949, addressed to Mr. Anton H. Lund, and a copy of your letter to Mr. Charles H. Burrows, of September 26, 1949, have been forwarded to me. You refer to certain inadequacies of the existing statute of the State of Arizona with respect to the sale of securities and request our views as to the most effective state laws now in effect.

As you know, beginning with the Rhode Island Act of 1910, three major types of blue-sky legislation have been adopted by the various States, with the exception, I believe, of Nevada. Although there is much variation among the States and some overlapping between the types of legislation adopted, essentially the various enactments fall within three types: (1) laws providing for registration or qualification of securities, (2) those providing for licensing of dealers, and (3) fraud laws.

Merely by way of illustration, the Massachusetts statute may be referred to as the registration type of statute which provides generally for the filing prior to any offering of a notice or intention to sell securities. A variant of this type requires a formal order of qualification of the securities proposed to be offered. These statutes also generally provide for exemption of certain types of securities and transactions and for refusal of registration if it is believed that the enterprise is fraudulent. It is also quite customary to provide specifically that qualification or registration does not mean that the State has approved the issue as sound.

The second group of statutes provide generally for the licensing of dealers. In some respects the most interesting of the various state blue-sky laws is that of California which combines features of all three types. Thus, registration of securities required as a preliminary to the issuance of a permit. The securities administrator has rather wide powers to safeguard the public investor such as the right to prevent excessive issuance of promotion stock for services and other intangibles and to guard against dilution of public security-holders by providing for escrow arrangements, restrictions on dividends and similar provisions. The third category of statutes in effect in a minor number of States may for our purposes be exemplified by the blue-sky law of New York. These statutes are intended to prevent fraud in the sale of securities by means of investigations and injunctions issued by the courts.

Commerce Clearing House, Incorporated of New York City, N.Y., publishes a loose-leaf service known as "The Blue Sky Reporter" which contains an excellent summary history of blue-sky regulation and the current provisions of the various laws in effect in the several States, together with the rules adopted thereunder. In addition, the Council of State Governments, of 1313 East 60th Street, Chicago, Illinois, has published a pamphlet entitled "Securities Regulation in the 48 States." The pamphlet includes a rather good summary and analysis of securities regulation in effect at the time of publication of the pamphlet. Volume 14 of Fletcher, Cyclopaedia Corporations (Perm. Ed.), published by Callaghan & Company, Chicago, Illinois, contains a rather detailed study of the various blue-sky laws. In addition to the foregoing, analyses of specific statutes have been published from time to time in various journals. Thus, for example, the 1942 volume of the Wisconsin Law Review contains a symposium on the Wisconsin securities law; the Arkansas Law Review for Spring, 1944, contains an article which discusses the 1947 revision of the Arkansas statute; Volumes 33 and 34 of the California Law Review (1945-6) contain a rather comprehensive and detailed study of the California statute. This article is summarized in Ballantine & Sterling, California Corporation Laws (1949 ed.), together with a discussion of the act by one of its administrators. The following articles are helpful in a consideration of problems relating to the inter-relationship between Federal and State securities laws:

- Smith, State Blue Sky Laws and the Federal Securities Act, 34 Michigan Law Review, 1135 (1936);
- Smith, The Relation of Federal and State Securities Laws, 4 Law and Contemporary Problems 241 (1937);
- Wright, Correlation of State Blue Sky Laws and the Federal Securities Acts, 26 Cornell Law Quarterly 258 (1941).

In part due to the lack of uniformity of State laws, the National Conference of Commissioners on Uniform State Laws, in 1930, urged the adoption of a uniform blue-sky law. This proposal entitled "Uniform Sale of Securities Act" may be found in Volume 9 of Uniform Laws Annotated, published by Edward Thompson Company of Brooklyn, New York. It appears, however, that only six States have adopted this Act and that in 1943 the proposal was withdrawn by the Conference, apparently for further study and redrafting. In a report of the State Legislation Committee of the Investment Bankers Association of America dated December 8, 1948, it is stated that a new Uniform States Securities Act is in progress in the hands of special committees of the American Bar Association and the National Conference of Commissioners. I understand that Mr. Murray Hanson, General Counsel for the I.B.A., whose office is 1625 K Street, N.W., Washington, D.C., is very much interested in this matter. You may wish to communicate with him for such suggestions as he may have. I also note from this report which is contained in the 1948 yearbook of the Association that the Chicago Bar Association has been working on a draft of a new securities act for the State of Illinois.

Finally, as you know, experience under the several State acts has demonstrated the inability of State securities administrators to deal with transactions involving the use of the mails and other facilities and instruments of inter-state commerce. As a result of the feeling that effective action could not be obtained except by an appropriate Federal statute, some pressure was exerted beginning after the end of the first World War for the enactment of Federal legislation and led to the introduction in Congress of several bills intended to deal with the problem. The collapse of the securities market in 1929 sharpened the need for legislation and led to the Securities Act of 1933 and the Securities Exchange Act of 1934. While you are undoubtedly familiar with these two statutes and the later legislation known as the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act and Investment Advisers Act of 1940, I am enclosing for your ready reference pamphlet copies of these Acts and of the rules promulgated by the Commission thereunder. I am also enclosing a copy of Regulation S-X which pertains to financial statements filed with this Commission.

Some of the State registration laws are patterned in part after the Securities Act of 1933, which seeks to protect the interests of investors and the public through the disclosure of information necessary to apprise investors of the salient facts concerning securities and by prohibiting misrepresentation and other fraudulent acts and practices. The Securities Exchange Act of 1934 extended the disclosure doctrine of investor protection to securities listed on national security exchanges. It also deals specifically with trading activities on or off exchanges and, among other things, supplements disclosure requirements by providing a curb to the improper use of inside information. The Trust Indenture Act of 1939 is intended to supplement the requirements of the Securities Act of 1933 and deals specifically with securities issued under indentures by requiring, among other things, the insertion in such indentures of various protective provisions, including provisions designed to eliminate certain conflicts of interest in the indenture trustee. The Investment Company Act and the Investment Advisers Act of 1940 relate primarily to the activities of companies engaged in the business of investing, reinvesting and trading in securities and of persons engaged in the business of advising others with respect to their securities transactions. The Public Utility Holding Company Act relates primarily to public utility holding companies and has for its underlying objective the freeing of operating electric and gas utility companies from the control of absentee and uneconomic holding companies, thus permitting them to be regulated more effectively by the States in which they operate.

In the foregoing I have not attempted any detailed analyses of either the existing blue-sky laws or the statutes administered by this Commission. In view of the sometimes sharply opposing philosophies underlying the varying types of State securities laws and the difficulties inherent in assessing the relative effectiveness of the different types of statutes, it would be inappropriate to suggest any particular type of statute. I trust, however, that the enclosed material and references will serve to assist you in considering an appropriate type of regulation in the light of your particular problems and needs. Please be assured that this Commission is

desirous of being as helpful as it can in the premises. Please feel free to call upon me in connection with any of the foregoing matters.

Very truly yours,

Edward T. McCormick
Assistant Director
Division of Corporation Finance

Enclosures

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