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THE BLUE SKY LAW

The problem of winning the war has been accomplished, but that of reconstruction is still in its infancy. The problems which faced us during the war were complex, intricate ones, to which we had to lend our best efforts. Those of reconstruction appear insurmountable, for we must rise to a different level and plane than we were previous to the war. In order to finance the great projects, which lead ultimately to end the cataclysm into which we were plunged to save civilization, the Liberty Loans were introduced. Bonds were issued in sums ranging from fifty dollars and upwards. This made the American people investors, bond buyers, prospects. Virtually every adult with a fixed place of abode and a job became a purchaser of a Liberty Bond. Some had two and three buttons upon their coats to prove to the public that they were the owners of bonds. It is estimated that there were some odd twenty million purchasers of these bonds, men and women inexperienced in bond buying, nevertheless, within the short period of one year converted into investors.

Now that the war is over and one by one the restraints are taken from the various business enterprises, there looms before the American public a serious problem. There is the salesman whose specialty is the sale of worthless or dubious stock. It is his business to obtain a list of untrained and ignorant persons who can be separated from real money. This man has really found the opportunity of a lifetime, for he can get hold of a list of the purchasers of Liberty Bonds in every community of this country. His tales of turning the money over quick, doubling and trebling the same, take very well with the unsuspecting man, who previous to the war had not ventured into such investments as stocks and bonds. These purchasers are easy prey, falling into the snare set by the wiles of the stock salesman.

It has been estimated in responsible quarters that as much as \$400,000,000 of Liberty Bonds placed with investors, have already fallen into the hands of dishonest brokers in the exchange for wildcat oil or mining issues. This estimate is undoubtedly very large, but the lesson can not be too plain. Something should be done to protect these innocent, ignorant, and foolish persons from parting with their Liberty Bonds, which are as good as gold. It has been suggested that probably only a Federal Blue Sky Law, controlling the sale of securities the country over, will save these people from the loss of millions within the next two or three years.

There is much talk of the Blue Sky Law. Where did it originate, what is its purpose, and what has it achieved?

The Blue Sky Law had its origin or birth in the southwest, where many of those wildcat projects in oil and mining arise. It was in 1911 that an energetic campaign was waged by the State Banking Commissioner of Kansas, a Mr. Dolley, against "foreign" corporations who were selling worthless stock certificates. A law was passed aimed at the evil of the sale of spurious and dubious stock defrauding people. After the passage of this law, all foreign corporations desiring to do business in Kansas were obliged to file a petition to do so with the banking department of the state. It was required that such petition state in detail the assets, liabilities, the future prospects, and the past progress of the applying corporation. In the year following the passage of this law only one hundred out of fifteen hundred applicants for permission to sell stock within that state were granted. Mr. Dolley, in commenting on the law in 1913, said: "The Kansas law has saved the Kansas people more money during the time it has been in operation than it takes to run our entire government, and this money was largely saved to a class of citizens who can least afford to lose it; whose knowledge of business is limited, and who are more or less at the mercy of the dishonesty and shrewdness of this class of confidence men and thieves. I believe that any law which accomplishes such results should be upheld by our citizens."¹

It was in 1913 that the Blue Sky movement — "so christened in the picturesque, popular metaphor of the day, because designed to clear away the clouds and fogs from the simple investor's horizon" — took its impetus.

It is the general purpose of the Blue Sky Law to have some commission to pass judgment upon the securities offered to the purchasing public; to assure credit where it is deserved and confidence to investment and trading; to prevent deception and save the credulous and ignorant from deception as far as this can be done by the approved reputation of those selling the securities, and authoritative information.

This legislation received no little criticism by the writers in the financial section of the magazines throughout the country. Franklin Escher, writing on the "Overcast Blue Sky Legislation" in 1913, said in part: "Will the fact that an issue is approved

1. Literary Digest, 46 : 936-37.

by the state commission or by any other official prove anything as to its intrinsic value? Many an issue examined into with the greatest of care by the most scrupulous bankers has gone wrong. Besides that, what intelligent investor wants someone else to tell him in what proposition he may invest, and in what proposition he may not invest? To have some official act as a censor, with the right to keep him from investing his money in any particular security, such official may not happen to fancy—that is something for which the average American investor can not be expected to stand. When he comes to realize that that will be the result of a large part of the 'Blue Sky Legislation' now pending, he will be the first to rise up in protest. The weak and credulous have to be protected, of course, but that does not mean that every investor is willing to be classed in with them and have his thinking done for him."² Thus you can see in what light the financial men viewed this bit of legislation.

The constitutionality of this law was attacked in a number of cases in the United States Supreme Court.³ In the case of *Geiger-Jones Co. vs. Hall—Superintendent of Banks and Banking of Ohio*,⁴ the court in speaking of the Blue Sky Law said: "The prevention of deception is within the competency of government, and the consequences of the same are not open for the review of the court. Therefore, the purpose of this law is lawful." The judge, in speaking of the equal protection clause of the 14th amendment of the constitution, said: "The equal protection clause of the 14th amendment leaves the states at liberty to regulate those activities which they deem conspicuous sources of existing evils, without embracing others which, but for this distinction would fall in the same class. A state law designed to prevent fraud in the selling of securities, which affects securities coming from other states only, in requiring that persons dealing in them within the state shall be first licensed, shall file information concerning them, and be subject in such dealing to executive supervision, is not invalid as a direct burden upon interstate commerce.

"Upon their transportation into the state there is no impediment, no regulation of them or interference with them after they get there. There is the exaction only that he who disposes

2. Harper's Weekly, 57 : 24.

3. *Caldwell vs. Sioux Falls Stock Yards Co.*, 242 U. S. 559 (South Dakota); *Merrick vs. N. W. Halsey*, 242 U. S. 568 (Michigan).

4. 242 U. S. 539.

of them there shall be licensed to do so and this only that they may not appear in false character and impose an appearance of a value which they may not possess,— and this is certainly only an indirect burden upon them as objects of interstate commerce, if they be regarded as such.

“It is a police regulation strictly, not affecting them until there is an attempt to make disposition of them within the state. Therefore, after they reach the dealer their interstate character is only incidentally affected by the statute.”

The Blue Sky Law of Wisconsin was passed in 1913 and was amended in 1915. It comprises Sections 1753-48 to 1753-53 and applies first, to dealers in securities, and secondly, companies selling their own securities. This law exempts securities of the United States or any foreign government, state or territory thereof; commercial paper or other evidences of indebtedness maturing not more than three years from the date thereof; securities of public or quasi-public corporations regulated by the Railroad Commission; securities listed upon the New York, Boston, or Chicago stock exchange approved by the commission; securities of banks, state or national, trust companies, or building and loan associations of this state; securities of domestic corporations established for educational, benevolent, charitable or reformatory purposes, shall be declared or added to the members thereof; securities sold to banks, trust companies or other dealers.⁵

(1) SALE OF SECURITIES BY DEALERS.

A dealer shall make a statement under oath showing the name of his principal place of business, or if there is a company then the names, residences and business addresses of all persons interested as officers, trustees, members, or partners, and with such other information which the commission may require.⁶ If the dealer is a non-resident corporation, it shall file with the proper officer of the state its appointment of an attorney for service of process as required by law; if such dealer is not a corporation he shall file with the railroad commission an irrevocable appointment of the secretary of the railroad commission as attorney for service of process in all actions and proceedings which may be brought against such dealer arising out of transactions by residents of the state.⁷

5. Section 1753-49.

6. Section 1753-50-(a).

7. Section 1753-50-(b).

The commission reserves the right to examine the securities sold or offered for sale from time to time, and also the method of transacting the business.⁸

(2) *SALE OF SECURITIES BY THE ISSUING COMPANY.*

Every company in the state, organized or proposed to be organized, or which shall hereinafter be organized, which shall directly or indirectly, sell or negotiate for the sale of any stocks, bonds or other evidences of indebtedness, which are termed securities, the proceeds of which are to be used directly or indirectly, for the payment of any commission or other expenses in excess of twenty-five hundred dollars incidental to the organization or promotion of any such company, shall be subject to this section.⁹ Before offering or attempting to offer for sale any such securities, every such company, domestic or foreign, shall make a statement showing in full detail the plan upon which it proposes to do business; a copy of all contracts, or other instruments which it proposes to make with or sell to its subscribers; a statement showing the name and the location of the head office of such company. On the other hand, if the corporation is a foreign one, incorporated or unincorporated, it shall also file (a) a statement specifying particularly the laws of such state or territory or government under which it exists or is incorporated, (b) a certificate of the proper officers of its home state that it is authorized to do the business therein, and (c) a copy of its articles of incorporation, constitution and by-laws, and of all amendments thereto, and (d) it shall also file or have filed the power of attorney.¹⁰

The commission shall have the power to make such examinations of any such company at its expense, including actual expenses and the per diem of the examiners and to require such further information and reports as it may deem advisable, but the making of such an examination shall be wholly within the discretion of the commission.¹¹

8. Section 1753-50-2.

9. Section 1753-50 (b).

10. Section 1753-51-2.

11. Section 1753-51-6.

A change in the by-laws, or articles of organization, or plan of doing business, of such company shall be filed with the commission, before it shall transact or offer to transact the sale of securities within the state.¹²

After the securities have been approved that fact shall not be published in a statement or advertisement.¹³ A complete inspection may be had of the books of the commission, relating to Sections 1753-48 to 1753-53 at any time.¹⁴

A corporation violating this law with reference to the sale of securities shall be fined \$500, and a company, person, or dealer, shall be fined \$500 or be imprisoned six months or by both fine and imprisonment.¹⁵

The purpose of the passage of the Blue Sky Law was a high and ideal one, namely, to protect the innocent investors from being deceived and defrauded by the wily, crafty salesman of dubious or spurious stock. But even though the purpose of this law is laudable, it is nevertheless inadequate. It is difficult for the commission in the administration of this law to determine the value of the property of those corporations domiciled outside of the state. The people rely upon the state and thus when permits are given by the commission, the people are led to believe that the commission has made a thorough investigation of the company making the application. But this is not really the case, for the commission has no way of making an investigation of the standing of all of the companies who propose to dispose of stock in this state. The result is that the endorsement of some of these certificates, the value of which can not be determined, paves the way for the sale of valueless stock, or in other words, perpetrates a fraud upon the people.

It would seem that the only way to curb the wildcat schemes of the get-rich-quick stockbroker and prevent the sale of worthless stock would be a strict Federal Blue Sky Law, which, combined with the state laws, would give greater protection to the investing American public.

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12. Section 1753-51-7.

13. Section 1753-51-8.

14. Section 1753-51-9.

15. Section 1753-52, 1-2.

