Blue Sky Law in Wisconsin

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THE judicial interpretations of the Securities Act in Wisconsin have been few in number and are not of such nature as to be of much aid to attorneys or investment bankers in actual practice before the Securities Division of the Railroad Commission. The decisions have determined certain constitutional questions involved but have not passed upon the more specific problems of whether particular sets of facts satisfy the statutory standards so as to require the issuance of a permit by the Commission as a matter of right. The case of Klein vs. Barry, 182 Wis. 255, restated the rule that the attempt to confer legislative and judicial power upon an administrative body is in violation of the constitution and held the particular section of the statute there under consideration as void since it "furnishes no guide, establishes no standard, makes no limitations, but by its terms vests in the Commission an unlimited and uncontrollable discretion". Attention is called, however, to Kreutzer vs. Westphal, 187 Wis. 463, in which the provisions of the act are examined quite exhaustively and their constitutionality sustained. But whether specific conditions imposed in the granting of a particular permit are within the statutory powers of the Commission or whether a denial of an application because in the judgment of the Commission the particular plan of business is inequitable is on the facts, an abuse of its powers, are questions unanswered by our Supreme Court.

It is unfortunate that the time element involved in the issuance and sale of securities makes impractical attempts to obtain rulings from the Supreme Court on individual cases. Specific guides have been furnished by decisions of the court in the administration of the Real Estate Board, the Industrial Commission and similar bodies. The applicant for a permit from the Railroad Commission, of course, may appeal from the order of the Commission to the circuit court of Dane County or may mandamus the Commission under proper conditions. The aggrieved person may have his day in court, if he so desires, but it is regrettable that the right is theoretical only and of little practical benefit to the litigant. An applicant for a real estate broker's license gains a valuable privilege if he prevails on an appeal from a denial of his license application; it is true that he has lost whatever real estate commissions he might have earned pending the appeal, but thereafter he can make use of the license. The issued of securities to whom a permit has been denied, however, acquires what is an empty right if

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he prevails in his appeal, since an issue must be sold at or about the
time it is underwritten or offered; a permit for a particular issue
granted a year or two later, after an adjudication by the courts, under
ordinary circumstances, is worthless. It is too late then to sell the
securities. The Commission, it is assumed, would welcome such rulings
if and when they are obtained through proper proceedings as much
as would attorneys and investment bankers.

It is but natural that specific standards promulgated by the legis-
lature cannot cover every possible type of security which may be
issued in the future. Changes in fashions in securities have necessi-
tated changes in the administration of the law as well as in the stat-
utes. The original classification of all securities, not exempt, as class
A, based upon established values or income, and class B, being secur-
ities without established values or income, has been found inadequate
to meet, for example, the recent offerings of fixed investment trust
shares. This type of security represents a proportionate interest in a
trust fund which consists largely of common stocks, hence to some
extent speculative, but the particular common stocks, generally, have
established values or income. To meet this peculiar type of security
there has been presented for consideration by the present legislature
a bill to create a new classification to be known as "unclassified secur-
ities". The present exemption accorded fixed investment trust shares
will be removed under the proposed bill and a set of rigid standards
established, which if satisfied will require the issuance of an unclassi-
ified security permit.

In Wisconsin the method of satisfying the Commission that a par-
ticular issue has met the statutory requirements is through qualifica-
tion upon application for a permit to sell. In a number of states the
method of registration followed is through notification, under which
procedure the issuer or dealer first satisfies himself that the proposed
issue meets the statutory requirements and then notifies the Commis-
sion that he is about to sell the same, furnishing complete information
thereon. If the Commission is satisfied that the representations made
by the issuer are true and that the security does in fact satisfy statu-
tory requirements, nothing further need be done; if not so satisfied,
the issuer is notified that he must furnish additional information or
that in the opinion of the Commission the proposed issue does not
meet the statutory requirements and further sales must cease. In
some instances there is a provision requiring the issuer to repurchase
the particular securities sold prior to the stop sale order, upon demand
by the purchaser. A surety bond insuring the observance of the stat-
utes is required of the dealer under certain acts.

Although the Wisconsin act has not adopted the notification
method, it nevertheless recognizes the principle thereof and under sec-
tion 189.08 permits the sale of Class A securities prior to the issuance
of a permit, upon condition that an application for permit will be made
within thirty days; and upon the furnishing of a surety bond provid-
ing that in the event a Class A permit is not issued, the broker will
repurchase, upon the demand of the purchaser, the security thus sold
prior to the denial of the permit application. There is pending too,
in the present session of the legislature a bill affecting section 189.03
(3) with respect to the sale of certain exempt utility securities and
which will continue as exempt if the issue meets certain requirements.
It is proposed that the dealer be required to notify the Commission
that he intends to sell such securities and unless the Commission
notifies the dealer within a limited time that in its opinion the issue
does not meet the statutory requirements, the exemption shall continue
in force.

With respect to many types of securities it is contended that the
notification method is more reasonable and satisfactory. It is the
dealer who assumes the risk of sale and possible disqualification by the
Commission; and through the furnishing of a surety bond insures the
purchaser to the extent of the effectiveness of the bond that he will
be repaid the amount of his investment if he so desires. National
offerings of many issues are handled in such manner as to make im-
possible the obtaining of a permit through qualification. These issues
are usually the highest grade investments and the most desirable to
the investor. The syndicate originating the issue, open their subscrip-
tion books at a given hour and the same may be oversubscribed several
times within a few hours thereafter. The time is too limited to attempt
to qualify the issue. To some extent section 189.08 gives relief there-
from and permits Wisconsin investors to acquire through their own
dealers high grade securities which they might otherwise be prevented
from purchasing. It is hoped that the experience of the Commission
during the next two years with reference to the proposed notification
method under section 189.03 (3) will be sufficiently satisfactory to
warrant the further extension of the use of the method.

It is perhaps an unfortunate designation of the classifications of
securities into Class A and Class B that many persons, including at-
torneys and dealers, draw an inference therefrom that the use of A
and B is in the nature of a rating of the desirability of the investment.
This was certainly not the intention of the legislature. As the Supreme
Court said in the Kreutzer case,

"The statute is not to be construed as classifying any of the securi-
ties enumerated as safe or any others as unsafe. It was doubtless,
however, the legislative thought that there were differences in degree
as to their safety and that as a rule some were, from their nature or the conditions of their issue, more hazardous than others."

One class is based upon established values or earnings while the other on prospective profits. It is but natural that the latter class could lend itself more readily as an instrument of fraud and misrepresentation, not so much in the original qualification of the security as in its subsequent sale. To minimize this opportunity for fraud the legislature imposed certain additional conditions upon the sale of this class of securities. These additional conditions lie in the control of advertising matter and in the requirement that stock purchase contracts be executed by the purchaser. It is hoped that some other designations may be found which will take away the present inferences therefrom that the Securities Division is in competition with stock and bond advisory services in rating investments. It is true that the present act seeks to prevent the use of the fact of issuance of a permit as any recommendation of the security by requiring under section 189.15 (5) that if any reference to the permit is made by the seller in its advertisements of class A securities, it shall be accompanied by the statement that it is without recommendation from the Commission as to value; but this has not accomplished the desired result.

The particular problem of avoiding designations of classification in a manner which, though not so intended, does have the effect of placing something of a stigma upon one classification has been solved in the Uniform Sale of Securities Act as approved by the National Conference of Commissions on Uniform State Laws (also by the American Bar Association in 1929) and in the Sale of Securities Bill as approved by the Investment Bankers Association. Both avoid any designation, merely classifying securities which are entitled to registration by notification from those required to register through qualification. Unfortunately the attempt to secure uniformity of this class of legislation throughout the nation has not met with complete success. The proposed act, however, has been adopted in substance in no less than ten states, including Indiana, Minnesota, Missouri, and Iowa in the middle west. The motive of most security acts of the various states is identical with the Wisconsin Act, that is, to prevent fraud so far as possible before the securities are offered for sale, as distinguished from the theory of such states as New York where, under the so called Martin Act, the business of dealing in securities is uncontrolled unless fraud appears after the issuance, when an injunction may be obtained and criminal penalties imposed. Nevertheless, most of those states which are generally in accord as to purposes and methods seem unable or unwilling to adopt a uniform act with uniform forms. Attempts to enact federal legislation have been futile to date and the
desirability thereof appears somewhat doubtful. The present control of the Federal Government with respect to misuse of the mails would seem sufficient to limit a great deal of fraudulent practices: extension of this control to long distance telephones would result in a fairly complete control without the necessity of any national blue sky legislation.

There is the theory, too, that the prevention of fraud in the sale of securities should be effected through greater control of the dealers and salesmen rather than through control of security issues. The Wisconsin Act, as well as the uniform acts referred to, includes control of both the issues and the dealers. It is certain, however, that neither one or both methods of control will prevent losses by Wisconsin investors.

The Commission is accused of laxity on the one hand by the purchaser whose investment has been a total loss (although the issue and the methods of sale fully satisfied the statutes) and on the other hand is charged with preventing the raising of capital for legitimate business development by those to whom a permit application has been denied. It is believed that such complaints are founded upon a misinterpretation of the purposes of the act. The Commission's duty extends to finding the facts of absence of fraud and inequities in the conduct of the issuer's business; it does not and should not include an attempt to foresee the success or failure of any contemplated business venture. If the state desires to educate its citizens in the proper kind of investments, it should do so through some educational program, but such is not the function of the Railroad Commission under our present Securities Act. Whether such paternalistic legislation is wise is for the legislature to determine. To be efficacious the state would have to set up an investment advisory service open to all citizens and at least a moral obligation would rest upon the state to hold harmless investors who followed the suggestions of such a service. This is one of the complaints against the sale of various federal land bank securities. It is doubtful if Wisconsin cares to assume such an obligation. On the whole the statute has been exceedingly effective in accomplishing its objects, the objections that exist being in the procedure required rather than in substance.
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