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REFORM OF THE FLORIDA SECURITIES LAW*

JAMES S. MOFSKY**

I. INTRODUCTION

"Consumerism" may be of relatively recent origin with respect to landlord-tenant law and other areas that are receiving current popular attention. This concept, however, is not new to securities regulation. In fact, it dates back to 1911 when the Kansas legislature enacted the first comprehensive "blue sky" law.¹ Within the following two years, 23 states,² including Florida, followed the Kansas lead, enacting laws which, in a majority of cases, were either identical to or based on the Kansas statute. The Eastern and a few Western states initially rejected such regulation, but eventually, after World War I, most of the remaining states succumbed to some form of securities regulation. After the "crash" of 1929, Congress, finding state regulation inadequate for investor protection, enacted the Securities Act of 1933³ (one of the first pieces of "New Deal" legislation) and the Securities Exchange Act of 1934.⁴ These laws did not preempt the area; rather, they provided for concurrent regulation by the states and the United States Securities and Exchange Commission (SEC).⁵ Later, Congress enacted additional statutes governing the securities markets.⁶ Those

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1. Kan. Laws 1911, ch. 133. The term "blue sky" was first used to describe the business practices of promoters and securities salesmen in Kansas at the turn of the century. The activities of these individuals, it was claimed, bordered on the "sale of building lots in the blue sky in fee simple." L. Loss & E. COWETT, BLUE SKY LAW 7 n.22 (1958). The legislation intended to prevent such frauds was called blue sky law. Id.


laws, as well as amendments to them, have been implemented by far-reaching rules and interpretations adopted by the SEC.

The blue sky laws, however, have not stood still as federal securities regulation has proliferated. Indeed, there has been a plethora of state statutes, amendments, recodifications based on two uniform acts, and a continuous flow of rules and regulations. As recently as July 1973, a version of the Uniform Securities Act became effective in Delaware, which for some time had been the last state to resist any form of blue sky regulation.

Thus securities regulation, unlike other varieties of consumer protection, has been with us for a long time—never diminishing in quantity or complexity, instead, spawning a web of greater controls. It is not difficult to perceive the reasons why this form of "consumer-ism" took hold so early. At the outset of the Civil War, the United States Treasury experienced great difficulty selling the bonds necessary to raise the capital for that enormous undertaking. The government engaged Jay Cooke, who introduced the "Fuller Brush Man" technique of door-to-door salesmanship to market the bonds throughout the country. Cooke's salesmen, from all accounts, solicited, and perhaps harassed, prospective purchasers in every conceivable manner. Following the war, the promoters of the transcontinental railroads adopted Cooke's techniques for retail securities distribution and financed the country's railroad network, to a large extent, through the stock and bond purchases of small investors. Many of the investors were farmers and tradesmen who purchased securities on the promise that the railroad would run through or near their farms. As industrial ventures were increasingly financed through public solicitation, Cooke's techniques were again followed, and securities salesmen were found traveling the countryside easily unloading stocks and bonds—sometimes


8. The Uniform Sale of Securities Act, approved by the National Conference of Commissioners on Uniform State Laws in 1929, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK AND PROCEEDINGS 171 (1929), and the Uniform Securities Act, approved by that organization in 1956, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK AND PROCEEDINGS 83 (1956).


10. For a more detailed description of these historical matters and for citations to historical references, see J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 5-14 (1971). See also L. LOSS & E. COWETT, supra note 1, at 3-10 (1958).

11. See J. MOFSKY, supra note 10, at 8.

12. Id. at 9.
worthless or heavily watered—during the speculation following the war.  

At that time there was no regulation, either state or federal, of the sale of securities, with the exception of futures trading. Although the amount of losses incurred by investors at that time has never been calculated, it would not be surprising to find that there were large losses incurred by many small investors. Similarly, it would not be surprising to find an amount of fraud commensurate with the wild times, a period when a national transportation system was built with incredible speed and when speculation in gold and oil was rampant, not only among persons who understood such matters, but also among unsophisticated investors. It has always been unfortunate for many investors, but nevertheless true, that economic conditions tend to be cyclical, and the aftermath of the speculation in the early 1900's resulted in the panic of 1907. Many persons who could ill afford to lose their hard earned savings suffered severe losses. That panic and its effects on individuals served as the catalyst to reformers who condemned promoters of speculative ventures and investment bankers as the prime causes of the country's financial reverses. Reformers advocated regulation of stock exchanges, reform of the federal banking system and legislation designed to protect investors from the promoters and salesmen of highly risky securities. The prevailing economic conditions gave rise to emotional responses among the people. That in turn generated the political climate for what came to be known as "Populism."

State securities regulation was generated in Kansas at a time when politicians seeking the favor of agrarian interests advocated the protection of the common man from American industry's robber barons. The philosophy underlying that early legislation was emotionally appealing to a large segment of the populace. The principle of this regulation—sometimes called "merit regulation"—is that state administrators should make official evaluations regarding the degree of riskiness inherent in a proposed offering, and deny business firms the opportunity of offering their securities publicly if the risks to investors are deemed too high. Merit regulation exists today in the vast majority of states, including Florida, and it has been codified in the Uniform Securities Act, which has been enacted, in some form, in a majority of states. That same philosophy was advocated by many persons prior

13. Id.
14. Id. at 10.
15. Alabama, Alaska, Arkansas, Colorado, Delaware, District of Columbia, Hawaii, Idaho, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mis-
to the enactment of the Securities Act of 1933, but was ultimately rejected on the federal level in favor of the “full” and “fair” disclosure standard.  

The securities laws—whether of the disclosure or merit variety—have always been advocated and enacted in the name of “investor protection.” 17 Anyone arguing against a policy that, on its face, seems so patently desirable might as well condemn motherhood. The securities laws, however, have been with us for a considerable period of time, and to continue blind acceptance of them necessarily results in the failure to consider important issues that require rigorous analysis. The fundamental question to be addressed is whether the presumed benefits of Florida’s securities laws are in fact being obtained, and, if some of the benefits do indeed accrue, whether the costs of such regulation exceed those benefits. In this connection, there are several rhetorical questions which superficially give rise to simple answers. For example, is more or less disclosure desirable? Are we in favor of more or less fraud? Would we rather have greater or fewer losses to investors? The usual responses to those questions are often given too lightly. Ordinarily, they are offered without consideration of the costs of regulation, and, if regulation has grown more costly than the benefits it produces, perhaps it is time to question seriously whether it should be reduced or, indeed, eliminated entirely. With respect to the question of full disclosure, it is important to recognize that information, like any other commodity, is not a costless good, and the current regulatory process may be generating disclosure in a highly inefficient manner. Further, much if not all of such disclosure, as now required, may be of little benefit to investors. Similarly, merit regulation under the blue sky laws is not a free good and indeed comes very dearly; its effects may be more detrimental than many persons realize.

One reason these thoughts are not suggested more often is that, in an age of increasing government paternalism, they are not always politically popular. Additionally, it is often easier to accept the pat “consumerism” argument than to subject a highly complex area to careful analysis.

Moreover, the point can be made with respect to all areas of government that regulation has the tendency to proliferate exponentially. In other words, regulation breeds more regulation, and the costs of regulation increase with the expansion of quantity and

souri, Montana, Nebraska, Nevada, New Jersey, New Mexico, Oklahoma, Oregon, Pennsylvania, South Carolina, Utah, Virginia, Washington, Wisconsin and Wyoming.

16. 1 L. Loss, Securities Regulation 122 (2d ed. 1961).

17. See Douglas, Protecting the Investor, 23 Yale Rev. 521 (1934).
complexity. This process continues endlessly. As the costs of regulation increase, the entry barriers to regulated industries or, in the case of securities regulation, to the capital markets become more formidable, and fewer firms are able or willing to pay the expenses to compete in such industries or markets. The anticompetitive effects of regulation initially adopted for perfectly desirable reasons become onerous as well as obvious.

Neither the identity nor the number of persons adversely affected by securities regulation is known with any degree of accuracy, although regulators and attorneys are aware of isolated situations that come before them. The fact that the scope of the adversely affected class is unknown even to its members precludes them from organizing with a view to announcing their complaints and attempting to remedy their plight through the political process. For the most part, the regulators and attorneys specializing in a complex area of regulation develop vested interests that they will quite naturally defend. For example, governmental regulators do not willingly give up power. Similarly, attorneys profit substantially by the myriad regulations through which they guide their clients. Furthermore, lawyers and most regulators are not trained to perceive the economic effects of regulation. Thus the persons who are usually at the forefront of policy formulation are often unlikely to observe the ramifications of the laws they administer or to advocate reforms that may be unprofitable to them.

The purpose of this article is to focus on the economic costs of Florida's securities laws, while at the same time to point out the benefits sought and those actually attained. The tone of this article is intended to differ from that associated with the more traditional literature in the securities regulation area. This course was chosen to avoid the arguments that are already well known to persons acquainted with this field, and because any contribution to reform must be based on a disciplined form of analysis rather than upon the leap of faith made regularly by so many market observers. Hopefully, in the light of such examination, illogical and empirically incorrect justifications for Florida's securities laws can be isolated. Only then can meaningful reform be undertaken. Even if the Legislature is unwilling to enact reform along the lines suggested in this article, at least the existing laws will be retained with a greater realization of their economic and social costs to Florida.

Before pursuing the more subtle ramifications alluded to above, it is important to understand how Florida's securities laws compare with blue sky regulation in general, not so much because comparison will assist in policy formulation (in fact, it will not), but rather be-
cause it will help to illustrate concepts relating to this type of regulation. Therefore, an overview of state securities regulation will be developed at the outset, and the varieties of such regulation that currently prevail throughout the states will be categorized. At that point, the philosophy underlying the varieties of regulation will be stated uncritically. Next, the Florida law will be introduced and compared with the statutes and rules of other jurisdictions. The full disclosure aspects of the Florida law will then be examined both from the point of view of economic theory and within the context of empirical findings distilled from recent economics literature. That will be followed by critical analysis of the merit aspects of the Florida law. Finally, the conclusions developed in the article will be applied to the alternative approaches that might be considered in reforming the laws, and the opinions and recommendations of the author will be advanced.

II. TYPES OF BLUE SKY REGULATION

At the present time, all states and the District of Columbia have some form of blue sky law. To some degree, the statutes vary in their regulatory approaches. They are generally categorized as (a) statutes regulating securities brokers, dealers, salesmen and investment advisers through licensing or registration; (b) statutes providing for the registration of securities; and (c) "fraud" statutes. The laws of several of the states, however, do not fall into any clear-cut category, but instead incorporate certain provisions common to each category. For example, New York commonly has been referred to as the foremost example of a jurisdiction with a "fraud" variety of blue sky law. Yet, New York also has a broker-dealer registration provision and a statute requiring the registration of securities issued by firms engaged in real estate operations. The latter area of regulation grants the New York Attorney General wide discretion to prevent public offerings of such issuers. Additionally, New York law provides for registration, on a full disclosure basis only, of all securities offered in that state but not registered under the federal securities laws. This registration requirement is, however, inapplicable to securities exempt from federal registration except those exempted by the intrastate offering exemption.

Finally, a brief and simple notification must be filed by dealers in connection with all securities offered publicly in that state.\textsuperscript{28}

Like New York, several other states require that securities be registered with the state government only if not registered federally.\textsuperscript{24} For example, the Pennsylvania statute exempts from registration securities that are registered under the Securities Act of 1933.\textsuperscript{26} Similarly, the New Jersey statute exempts from registration non-real estate securities that are registered under the Securities Act of 1933.\textsuperscript{26} The Nevada statute applies its registration provisions only to "public intrastate offerings" (defined to exclude those offerings registered under the Securities Act of 1933 or exempt from registration thereunder other than by virtue of the federal intrastate offering exemption).\textsuperscript{27}

The philosophy prompting these rules, peculiar to New York, New Jersey, Pennsylvania and Nevada, is that federal regulation is adequate for investor protection. All other jurisdictions, however, except Connecticut and the District of Columbia (where the laws do not require registration of securities),\textsuperscript{28} have laws that necessitate registration with state authorities even if the securities are also registered under federal law. Dual registration is intended not only to further ensure full disclosure and to prevent fraud but also to facilitate greater protection of investors by subjecting the securities being offered to state merit standards.

It is apparent that the standard categorization of blue sky laws does not hold true in all instances. There are other examples of this phenomenon, such as regulation of tender offers.\textsuperscript{29} However, the securities laws of the vast majority of states have certain common elements that are both structural and substantive. To some extent, that uniformity existed prior to the advent of the Uniform Securities Act in 1956. Nevertheless, the Uniform Securities Act has certainly been a


\textsuperscript{26} N.J. STAT. ANN. § 49:3-60 (1970); 2 BLUE SKY L. REP. ¶ 33,115 (Nov. 15, 1967).

\textsuperscript{27} NEV. REV. STAT. § 90.075 (1973); 2 BLUE SKY L. REP. ¶ 31,110 (Nov. 19, 1975).

\textsuperscript{28} Although securities as such need not be registered in those jurisdictions, the Connecticut and District of Columbia laws contain broker-dealer registration provisions and antifraud provisions. CONN. GEN. STAT. §§ 36-322, 36-338 (1958); 1 BLUE SKY L. REP. ¶¶ 10,103 (Nov. 19, 1973), 10,119 (April 24, 1973); D.C. CODE ANN. §§ 2-2402, 2-2403 (1967); 1 BLUE SKY L. REP. ¶¶ 12,102, 12,103 (Jan. 25, 1972).

\textsuperscript{29} See, e.g., VA. CODE ANN. § 13.1-528 (Supp. 1973); 3 BLUE SKY L. REP. ¶ 49,228 (March 8, 1971).
major factor in the increased uniformity of the securities laws in most of the states. Although the Act has been modified by many legislatures, certain common elements may be found in the statutes of those states where it has been enacted. First, with respect to the structural similarities, most state securities laws require registration of broker-dealers, agents and investment advisers. Provisions governing registration of securities, fraud, civil liabilities and criminal penalties are usually included, in addition to grants of rule-making, definitional and other powers to agencies that administer the securities laws. With respect to the question of substantive uniformity, the Uniform Securities Act, like the statutes in many jurisdictions that have not adopted the Uniform Act, grants broad rule-making authority to state administrators, so, while the statutes they administer may be uniform, the merit and other rules they adopt often vary from state to state. Additionally, the rules usually have more substantive significance in a real-life situation than does the language of a given statute. Thus, although the statutes of most states are structurally and substantively uniform, the rules often are not. This fact has long been a major complaint among businessmen and lawyers who plan public offerings of securities in several states.

As previously mentioned, the main difference between most blue sky laws and the federal securities laws is that, while the former have adopted the merit concept, the latter adhere to the full disclosure philosophy. It is in connection with these merit standards that the greatest diversity among the states occurs. Merit standards will be examined in greater detail later in this article. Now, however, the relationship between the Florida securities law and blue sky regulation generally will be explored.

III. THE FLORIDA SECURITIES LAW

Florida has not enacted the Uniform Securities Act. Until recently, the Florida statute was entitled the "Uniform Sale of Securities Law," inasmuch as certain provisions of the statute were modeled after the Uniform Sale of Securities Law. This uniform law was never widely adopted and eventually was stricken from the list of approved laws by the National Conference of Commissioners on Uniform State

30. For a list of those jurisdictions where the Act has been enacted, in whole or with modifications, see note 15 supra.
31. This is because the statutes generally contain broad standards and grant state administrators wide discretion to adopt rules that specify, usually in quantitative terms, the basis on which securities will qualify for registration.
Laws.\textsuperscript{33} Since its enactment in a form based on the first uniform law, the Florida statute has undergone periodic changes. Today, the Florida statute differs substantially in many respects from the Uniform Sale of Securities Act, the Uniform Securities Act and the statutes of most other states. Similarly, the rules adopted by the Florida Division of Securities differ in material respects from the rules of many other states. The basic structure of the Florida statute, however, in common with the laws of other states, includes anti-fraud provisions and provisions relating to registration of securities and registration of dealers, salesmen and investment advisers.\textsuperscript{34}

Although it might be an interesting academic exercise to itemize all the similarities and differences between the Florida law and the Uniform Securities Act, that process would be fruitless in assessing the desirability of retaining the present law or adopting some other statute, such as the Uniform Securities Act. To be sure, it would simplify this author's task to advocate uniformity for its own sake. Most other states\textsuperscript{35} seem to have done just that, as did the drafters of the Uniform Act.\textsuperscript{36} Uniformity does indeed have some virtues.\textsuperscript{37} For example, it simplifies many of the procedural aspects of meeting blue sky regulations for a particular issue and of registering dealers, salesmen and investment advisers.\textsuperscript{38} In that respect, uniformity has the desirable effect of lowering the transaction costs associated with such matters. But aside from those savings, which are probably small compared with the high costs related to full disclosure and merit regulation generally, uniformity in itself has few other virtues, especially since the administrative rules adopted by the Uniform Act jurisdictions are not themselves uniform.

If the kind of analysis suggested in the introduction to this paper were applied to the Uniform Act and if the benefits of that law were

\textsuperscript{33} The Act was adopted by Louisiana and Hawaii, and, with modifications, by Alabama, Florida, Michigan, Oregon and South Carolina. Subsequently, the Act was either repealed or substantially modified in those states. In several of those states, the Act was replaced by the Uniform Securities Act. The Uniform Sale of Securities Act was stricken by the Conference from its list of approved acts in 1944. \textit{National Conference of Commissioners on Uniform State Laws, Handbook and Proceedings} 233 (1944).


\textsuperscript{35} See note 15 supra.

\textsuperscript{36} The drafters of the Uniform Securities Act did not undertake a study of the desirability of mandatory disclosure, merit standards or for that matter any other policy considerations underlying state securities regulation. See L. Loss \& E. Cowett, \textit{supra} note 1, at 285-86.

\textsuperscript{37} \textit{Id. passim}.

\textsuperscript{38} \textit{Id.}
found to exceed the costs it produces, there would be no difficulty in recommending adoption in Florida of that act. However, no such analysis has been done, and, even if it were, the results would probably not differ very much from those derived from a similar analysis of the current Florida statute, since at the heart of both laws are the disclosure and merit requirements. Therefore, the next several portions of this article will focus primarily on the disclosure and merit aspects of the Florida law, although comparison of Florida law with statutes and rules of other states will be made whenever it is useful to illustrate particular concepts.

IV. REGISTRATION OF SECURITIES IN FLORIDA

A principal regulatory feature of the Florida Sale of Securities Law is that no securities, except those exempt or sold in exempt transactions, may be offered for sale in Florida unless they are registered. Registration entails the filing and processing of certain prescribed documents with the Division of Securities, the agency that examines those documents to ascertain whether the securities and the firms offering them meet the disclosure and merit standards created by the Florida statute and the Division’s rules. If the securities and the issuer meet those standards, the registration becomes effective or a license is issued, depending on the method by which the securities are registered. At that point, the securities may be sold publicly. If the securities or issuer fail to comply with those standards, however, the Division of Securities is empowered to deny or suspend effectiveness of registration statements or to revoke registrations.

There are three techniques by which securities may be registered in Florida: (a) coordination; (b) qualification; and (c) announcement. Before discussing those processes in greater detail, it is im-

40. FLA. STAT. § 517.07 (1971); 1 BLUE SKY L. REP. ¶ 13,107 (June 19, 1973).
41. FLA. STAT. §§ 517.08(2), 517.09(3) (1971); 1 BLUE SKY L. REP. ¶¶ 13,108-09 (June 19, 1973). See also FLA. ADMIN. CODE §§ 3B-1.02 to .03, 3B-2.01 to .02, 3B-2.07; 1 BLUE SKY L. REP. ¶¶ 13,602-03, 13,631-32 (Sept. 8, 1972), ¶ 13,637 (May 22, 1973).
42. The Division of Securities is a division of the Department of Banking and Finance, which has the statutory mandate of administering and enforcing Florida securities law. See FLA. STAT. § 517.03 (1971); 1 BLUE SKY L. REP. ¶ 13,103 (June 19, 1973).
43. FLA. STAT. § 517.09 (1971); 1 BLUE SKY L. REP. ¶ 13,109 (June 19, 1973); FLA. STAT. § 517.08 (Supp. 1972); 1 BLUE SKY L. REP. ¶ 13,108 (June 19, 1973).
44. FLA. STAT. §§ 517.08(4), 517.09(7), 517.11 (1971); 1 BLUE SKY L. REP. ¶¶ 13,108-09, 13,111 (June 19, 1973).
45. FLA. STAT. § 517.08 (Supp. 1972); 1 BLUE SKY L. REP. ¶ 13,108 (June 19, 1973).
46. FLA. STAT. § 517.09 (1971); 1 BLUE SKY L. REP. ¶ 13,109 (June 19, 1973).
47. FLA. STAT. § 517.091 (1971); 1 BLUE SKY L. REP. ¶ 13,109-1 (June 19, 1973).
portant to point out that registration, regardless of the technique used, is required only in the event that securities are offered for sale and there is no exemption from registration applicable either to the securities themselves or to the transaction in which they are offered. Thus questions involving the definitions of "security" and "sale," as well as the possible exemptions available, are threshold considerations that lawyers must resolve before considering the appropriate form of registration for a given offering. If a security is in fact being offered for sale and no exemption from registration is available, the differences among those three registration techniques become significant.

Registration by coordination, unlike its namesake under the Uniform Securities Act, is limited in Florida to firms that have established successful business records. To qualify for this form of registration in Florida, a firm must show that it has been in continuous business operation for a period of not less than three years. Additionally, a firm must demonstrate net earnings for each of its last two fiscal years of not less than $100,000, as well as no material change in its operations that would indicate net earnings less than $100,000 for its current fiscal year. If a firm has senior securities outstanding any default

48. The definition of "security" has been expanded recently to include many financing devices that were not in the past generally regarded as securities. This expansion has occurred in connection with the catchall terms "investment contract," "interests in or under a profit-sharing or participation agreement or scheme," and "any other instrument commonly known as a security." See Fla. Stat. § 517.02(1) (1971); 1 Blue Sky L. Rep. ¶ 13,102 (June 19, 1979). For a description of judicial and legislative expansion of those terms, see Mofsky, The Expanding Definition of "Security" Under the Blue Sky Laws, 1 Sec. Reg. L.J. 217 (1973). The judicial application of these terms to a wide variety of financing devices has not been done by means of any clear-cut definition of the terms. Accordingly, there is considerable uncertainty in many states, including Florida, with respect to the question of whether a particular plan of financing constitutes a security. Cases contributing to that uncertainty in Florida include Florida Discount Centers, Inc. v. Antinori, 232 So. 2d 17 (Fla. 1970); Bond v. Koscot Interplanetary, Inc., 276 So. 2d 198 (Fla. 4th Dist. Ct. App. 1973); Frye v. Taylor, 263 So. 2d 835 (Fla. 4th Dist. Ct. App. 1972); Bond v. Koscot Interplanetary, Inc., 246 So. 2d 631 (Fla. 4th Dist. Ct. App. 1971); Florida Discount Centers, Inc. v. Antinori, 226 So. 2d 693 (Fla. 2d Dist. Ct. App. 1969), aff'd, 232 So. 2d 17 (Fla. 1970).


interest, dividend or principal payments on such securities in the present or the two preceding years—will disqualify the issuer from use of this form of registration. Finally, offerings registered by coordination must be supported by firm commitments from underwriters registered under the Securities Exchange Act of 1934, unless the securities being registered are offered in exchange for the securities of another issuer. The only prerequisite for using the Florida coordination procedure that remotely resembles the requirements in the analogous Uniform Securities Act procedure is the requirement that a registration statement covering the securities, prepared in accordance with the provisions of the Securities Act of 1933, must be filed with the SEC.

The purpose behind the coordination procedure of the Uniform Act is to lower the transactions costs of registration by permitting filing with state administrators of essentially the same documents that are filed with the SEC and by permitting registration with the SEC and state agencies to become effective simultaneously. Although the Uniform Act jurisdictions may impose their respective merit standards on promotional or other speculative companies, those coordination benefits are available to all issuers that register securities with the SEC. The coordination procedure in Florida, however, precludes its use by start-up or promotional firms or even older businesses that have had earnings below the requisite amount during the two years prior to filing. The obvious economic ramification of the Florida coordination procedure is to create a competitive advantage for larger, older firms over newer, less profitable ones, since firms that do not qualify for the Florida coordination technique must use the more costly method made available by the statute—registration by qualification.

The registration by qualification procedure is more costly because, unlike the coordination method, the registration in Florida does not become effective concurrently with SEC effectiveness. Accordingly, lawyers must spend time and effort coordinating Florida and SEC

effectiveness; that work by lawyers raises costs. Such coordination takes place automatically under the provisions permitting registration by coordination. Similarly, more complex documents, completed at greater cost, must be filed when securities are registered by qualification. Yet those greater costs associated with registration by qualification do not yield commensurate benefits. Registration by coordination under the Uniform Securities Act can be used by any issuer that also registers securities with the SEC pursuant to the Securities Act of 1933, and the merit standards of those Uniform Act states nevertheless apply. But in Florida, merit standards (earnings history, etc.) are prerequisites for the use of registration by coordination. 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, especially since merit standards can be made applicable to securities regardless of the method by which they are registered.

The third technique for registering securities—registration by announcement—is unavailable to an issuer for purposes of raising capital. Its use is restricted solely to registering shares that are already outstanding and have been in the hands of the public for not less than one year. The securities statute of only one other state contains a registration by announcement provision. Since there are many exemptions for after-market trading in Florida and since registration by announcement is of no beneficial use for a firm in raising capital and only of very little consequence with respect to registering outstanding securities, further discussion of it is of little benefit. Suffice it to say that the provision continues as a vestige of earlier law. In any event, that exemption, even in theory, is at best anomalous, since the Florida Division of Securities does not have the financial capacity and manpower to police and enforce the registration of securities that are already in the hands of the public but neither registered nor exempt from registration in Florida. The costs of creating a mechanism to

60. See the requirements for forms prescribed by the Florida Division of Securities in FLA. ADMIN. CODE § 3B-2.01; 1 BLUE SKY L. REP. ¶ 13,631 (Sept. 8, 1972).
64. These conclusions are derived from the restrictions contained in the statutory provision and, additionally, are based on the registration requirements imposed by the statute. See FLA. STAT. § 517.091 (1971); 1 BLUE SKY L. REP. ¶ 13,109-1 (June 19, 1973).
65. An enforcement team of enormous proportions would be required to detect those securities that are already outstanding but not exempt. Constant surveillance of all aspects of the securities markets would be necessary to accomplish the result.
enforce registration in this context are extremely high—far higher than any benefits imaginable.66

Thus far, the three registration techniques included in the Florida statute have been described, and the more obvious technical aspects have been criticized. But no consideration has been given to the fundamental issues underlying the registration process: (a) the objectives that registration is intended to accomplish; (b) the extent to which those objectives are in fact accomplished; and (c) if some or all of those objectives are indeed achieved, the extent to which the benefits emanating from them exceed the costs of their production. The import of these issues has already been raised; it goes to the very policies that are at the core of the registration process.

Basically, there are three objectives underlying registration requirements: first, to provide disclosure to investors of certain specified information regarding the issuer and its securities;67 secondly, to limit the incidence of fraud, through governmental supervision of the disclosure process;68 and finally, to provide information from which the Florida Division of Securities or its counterpart in other jurisdictions may determine whether offerings meet the Florida or other state merit standards.69 The first and second objectives are identical to those underlying the disclosure requirements of the federal securities laws;70 the third, however, as previously indicated, was rejected on the federal level and is unique to the states.

Although the disclosure aspects of blue sky regulation have not been examined from the standpoint of their implicit and explicit costs and benefits, certain disclosure provisions of the federal securities laws have been subjected to analysis by professional economists. By analogy, that analysis is useful in assessing the degree to which the disclosure provisions of the blue sky laws—and Florida's in particular—have, on balance, proved beneficial. Indeed, since the disclosure requirements of the state laws and those adopted under the Securities Act of 1933 are very similar, it is probably correct to predict that an empirical economic study of the disclosure aspects of the state laws would yield results essentially symmetrical to those already obtained in connection with the Securities Act of 1933.

There have been no empirical economic studies of the merit provisions of blue sky laws, and since the federal securities laws, with a

66. See note 65 supra.
67. See J. MOfSKY, supra note 10, at 19.
68. Id.
69. Id.
few very specialized exceptions, were not enacted with the intention that they regulate the merits of securities offerings, the existing economic analysis of federal regulation will not help us with respect to assessing the effects of merit regulation. Accordingly, any economic analysis in this article of the merit aspects of the Florida securities law must, of necessity, be limited to theoretical inquiry. But that limitation does not render such analysis of the merit standards worthless. In fact, the theoretically derived ramifications of the merit standards seem to be very persuasive indicia of the adverse effects those regulations probably have in the securities markets, particularly in connection with the public promotion of new ventures and the public sale of small offerings.

V. THE DESIRABILITY OF MANDATORY DISCLOSURE STANDARDS

Everyone acquainted with securities regulation, at both the federal and state levels, is aware that the disclosure system requires the production of information that is processed by governmental authorities, distributed on various levels and ultimately disseminated to the public. But it is often forgotten or perhaps never really understood that information is not a free good and that the production of the information required by the disclosure rules involves substantial costs. These costs include direct expenses such as attorneys', accountants', printers' and filing fees as well as the salaries of corporate employees whose time is allocated to assisting in the preparation of disclosure documents rather than to other corporate affairs. Additionally, there are indirect costs such as delays in selling the securities. These costs are generated by the need to gather information, verify its accuracy, put it in the form required by the governing agency, wait for that agency to respond with its deficiency comments and amend the disclosure documents in response to those comments. In some cases this entire process might be repeated one or more times in connection with a single offering.

71. Examples of those few exceptions are the merit standards contained in the Investment Company Act of 1940, 11 U.S.C. §§ 72, 107; 15 U.S.C. §§ 80a-1 to -52 (1970). Although the federal securities laws were not generally enacted to regulate the merits of public offerings of securities, the manner in which the full disclosure laws have been administered has given rise to federal administrative procedures that are indeed merit-like in effect.

72. For a comprehensive discussion of the costs of a public offering, see Wheat & Blackstone, Guideposts for a First Public Offering, 15 Bus. Lawyer 539 (1960); Blackstone, Post-effective Amendment to "Guideposts for a First Public Offering," in Selected Articles on Federal Securities Law 27 (H. Wander & W. Grienenberger eds. 1968).
Other indirect costs include the expense to a firm of divulging information to competitors and the cost of misinformation that may occur if investors accept the disclosed information as accurately reflecting the financial condition of a business enterprise when in fact it may not. One example of an indirect cost is that resulting from the conservative accounting bias of the SEC and state rules that preclude disclosure in financial statements of appreciated assets at their fair market value.\(^7\) One could easily list many other direct and indirect costs associated with disclosure. To belabor that analysis is unnecessary, however, if it is recognized that the benefits of disclosure should not be viewed in a vacuum, separated from the costs associated with it.

If there were no legal requirements forcing disclosure according to specified standards, voluntary disclosure might nevertheless be undertaken by corporate executives, if one can assume that such persons would act in the best interests of shareholders. Given that assumption, corporate officials would provide information to investors if the marginal benefits of the information to investors equaled the cost of its production to the corporation. Such a result would be consistent with the general rule that the efficient allocation of resources in the economy is optimized when marginal costs are equated with marginal benefits.\(^7\)

Corporate managers may withhold some information if they believe that the benefits to shareholders would be lessened as a result of making such information available to competitors. Similarly, corporate officials may decide that certain disclosure would mislead investors, causing them to make unwarranted investment decisions. However, if information were not disclosed voluntarily, investors would be free to purchase it in the market place just as they might buy any other commodity. Experience in other areas\(^7\) shows that an open market for information services is feasible, and there is no reason to believe that it would fail to develop here. To some extent, that market exists today through the activities of securities dealers, mutual funds and the many investment services.

Additionally, although the enforcement costs would be high, shareholders—under common law principles and by state statutes—have some rights to inspect the books and records of corporations in which they own shares.\(^7\) It is also true that courts, in the past, have not grant-

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73. See Benston, The Value of the SEC’s Accounting Disclosure Requirements, 44 Accounting Rev. 515 (1969).
75. E.g., various periodicals describing, comparing and assessing consumer products have been published for years.
ed those rights liberally. Based upon the changing climate regarding corporate social responsibility and duties to shareholders, courts might now grant those rights more freely in the absence of mandatory disclosure administered by government agencies.

In the foregoing theoretical perspective, corporate officials would be assessing marginal costs and benefits in determining the amount and kind of disclosure to make. If such officials did not make voluntary disclosure, investors and others who wanted undisclosed information would be forced to bear the costs of obtaining it. That proposition should not seem unfair or unreasonable. In other areas, it has long been considered quite acceptable that persons who receive benefits should pay the accompanying costs. These conclusions are based on the assumption that corporate officials would adopt behavior designed to maximize the market value of their corporations' outstanding stock. Such behavior, in turn, would have the desirable effect of maximizing shareholder wealth. If that assumption and the above analysis are accurate, disclosure forced by a government agency would be more damaging than beneficial to shareholder wealth.

The conclusions derived from this analysis fail if the fundamental assumption regarding the behavior of corporate managers is wrong. For example, corporate officials might be deceitful. In fact, they might steal corporate assets and hide their larcenous behavior by refusing to disclose their corporations' true financial conditions. Furthermore, for a variety of selfish reasons, they might disclose misleading or untrue information that would cause losses to investors. Additionally, apart from any question of intentional dishonesty, corporate officers might simply miscalculate the marginal benefits of disclosure to the stockholders and the marginal costs of its production to the corporation. Although one could argue that these activities would be exposed by the information gathered and sold by private investment services, it is conceivable that management could undertake a variety of activities that might raise the costs of gathering information by private services. That behavior would result in increasing the costs of information to shareholders without the accompanying benefit of decreasing the costs to corporations. There is a final argument in favor of the current disclosure system that many advocate with great vigor: "investor confidence" in the information required by and processed with government agencies. This argument is based on the notion that, absent mandatory disclosure, members of the public would cease investing in American industry to the eventual damage of the entire economic system.77

Thus there are theoretical arguments that can be advanced for and against mandatory disclosure, depending on the assumptions one is willing to make. Fortunately, however, some empirical evidence has been carefully gathered from which inferences may be drawn regarding the costs and benefits of forced disclosure. In his recent article evaluating the accounting disclosure requirements of the Securities Exchange Act of 1934, Professor Benston analyzed all the arguments in favor of the accounting disclosure requirements of that law and, after detailed statistical testing, concluded that they have had "no measurable positive effect on the securities traded on the New York Stock Exchange. There appears to have been little basis for the legislation and no evidence that it was needed or desirable."  

Before describing those arguments and Benston's findings in greater detail, it is worthwhile to note the statistics regarding voluntary disclosure prior to the requirements of the federal law. Benston found that a large majority of the corporations listed on the New York Stock Exchange had previously made public much of the financial disclosure material that was ultimately required by the 1934 Act. For example, for the year ended December 1933, all Big Board listed corporations were audited by CPA firms, all reported current assets and liabilities in their balance sheets, 93 percent disclosed depreciation expenses, 62 percent reported sales and 54 percent disclosed the cost of goods sold. Furthermore, these percentages had been increasing steadily throughout most of the 1920's.

Thus there are empirical findings to support the theoretical argument for voluntary disclosure discussed above. But Benston went well beyond that proposition and amassed a large body of data that he used to test the correctness of the main reasons advocated in favor of mandatory disclosure. The first argument examined—that forced disclosure is necessary to prevent fraud and manipulation—was found to have little empirical basis. Examining the available literature, including hearings in both houses of Congress on the proposed legislation, Benston discovered very little evidence of fraud in financial statements. Furthermore, the recent BarChris, Yale Transport, Green Department Store, Continental Vending and Equity Funding debacles strongly indicate the fact that forced disclosure, even under the rules of the SEC and state securities commissions, has not eliminated the problem of fraud and manipulation. First of all, the current mandatory disclosure rules do not require independent accountants to audit

79. Id. at 133.
80. Id.
for fraud. But even if such a rule were adopted, it could not banish fraudulent disclosure. Nothing short of policemen—assuming they are incorruptible (an assumption few persons would be willing to make)—looking over the shoulders of businessmen and accountants could remedy the fraud problem, and few persons would be willing to pay the costs associated with that kind of system.

Although Benston's findings indicate little evidence that corporations issued fraudulent financial statements prior to the enactment of the federal securities laws, the SEC has asserted that failure to disclose reliable information facilitated fraudulent activity by providing the tools through which manipulators organized massive pool operations. These pool operations were, in turn, used to manipulate stock prices. To test that allegation, Benston examined the financial statements of over one hundred corporations (whose securities were subject to pools according to the Senate Banking and Currency Committee) for years before, during and after the pools. He found that the percentage of corporations involved in pool operations and making disclosure was practically the same as the percentage of corporations involved in pool operations and not making disclosure. Thus, regardless of any claim that pool operations were damaging to investors, their existence was not caused by the nondisclosure of financial information.

Another rationale offered by the SEC for mandatory disclosure is that it permits “investors [to] make realistic appraisal of the merits of securities and thus exercise an informed judgment in determining whether to purchase them.” This argument is based, first, on the belief that the disclosure required by the SEC provides information that affects investor expectations regarding the future prospects of a firm and, secondly, that the information is distributed to investors before it has been fully discounted in the market price. If the information required by the 1934 Act meets the foregoing two criteria, then it should have an effect on market prices during the period when the information is disclosed publicly according to the SEC rules. To test this hypothesis, Benston computed a lengthy series of regressions dealing with accounting data for the months when such data were filed with the SEC and for the months when earnings were actually announced publicly, usually a month before the earnings reports are

81. Id. at 135.
83. Benston, supra note 78, at 136.
84. Id.
86. Benston, supra note 78, at 137.
sent to the SEC. The findings are extremely damaging to the mandatory disclosure argument. To quote Benston's conclusion: "On the average, a one hundred percent unexpected increase (or decrease) in the rate of change of income is associated with a 2 percent increase (or decrease) in the rate of change of stock prices in the month of announcement." Using different techniques, other economists have established corroborative findings. In other words, mandatory disclosure processed with the SEC has minimal impact on investor behavior.

Two possible reasons have been advanced for this result: either the required disclosure is meaningless or stale, or insiders are not being prevented from trading on the information prior to its disclosure. Professor Manne has argued that there is a strong implication of the latter situation with respect to most price movements. His argument, for which there is indirect empirical support, is that much of the value of material information is being discounted in stock prices prior to public disclosure because of the trading of insiders who have access to that information. In any event, it seems clear that the mandatory disclosure provisions of the federal securities laws have not benefited outside investors.

The final argument analyzed by Professor Benston is that mandatory disclosure creates investor confidence in the information received and, therefore, in the securities market itself. To test this hypothesis, he equates investor confidence with the riskiness of returns from securities. If mandatory disclosure did indeed reduce risk to investors, there would then be tangible evidence of beneficial results emanating from that aspect of the securities laws. Although disclosure in itself does not eliminate all risk, it could reduce the risk of investors failing to know of material information; such a reduction would, in turn, cause them to behave in ways that would change market prices consistent with the nature of the particular information disclosed mandatorily. With respect to corporations disclosing accounting data prior to the 1934 Act and those not disclosing such data, Benston found the degree of risk to be about the same. Moreover, in connection with companies engaged in industries whose accounting policies were

87. *Id.* at 137-40.
88. *Id.* at 139.
90. *See Manne, supra note 77, at 7, col. 4.*
91. *Id. See also H. MANNE, INSIDER TRADING AND THE STOCK MARKET 77-105 (1966).*
93. *BENSTON, supra note 78, at 150.
94. *Id.* at 151.
severely affected by the conservative accounting principles forced on independent accountants by the SEC, less information was in fact disclosed to investors after enactment of the 1934 Act. Thus there is evidence that the disclosure requirements of the Act have had a dysfunctional effect on the market.

It is interesting to hear so many statements in 1974 that investor confidence has been lost and that its re-creation is necessary before investors (particularly small ones) will return to the stock market. These assertions are heard forty years after the mandatory disclosure laws were enacted. During those four decades, the disclosure requirements have become more complex, pervasive and detailed. If investor confidence is now at such a low ebb, how can one continue to maintain that it is promoted by mandatory disclosure? There has certainly been sufficient time to develop disclosure standards that would do the job, if in fact there were some correlation between mandatory disclosure and investor confidence. What the proponents of the investor confidence argument fail to realize is that stock losses alone diminished investor confidence. During bear market periods since 1933, the investor confidence argument was probably always raised, although it was probably seldom advanced when stock prices were rising.

Thus far only the empirical findings developed in connection with the 1934 Act disclosure requirements have been considered. However, data and conclusions have also been gathered and drawn with respect to the disclosure requirements of the Securities Act of 1933. Professor Stigler, in the first economic work testing the effectiveness of the disclosure aspects of the federal securities laws, measured the success of investors by comparing the five-year performance for all new issues of industrial stock of a certain value issued before the 1933 Act (1923-28) with the five-year performance of all new issues of industrial stocks of a certain value issued after the effectiveness of that act (1949-55). After correction by critics of Stigler's methodology, the data indicate practically no difference in the relative market values of the new issues studied in the pre- and post-1933 Act periods. Thus Stigler concluded that the disclosure requirements of the 1933 Act seem to be of only little significance to investors.

There is substantial evidence that the costs associated with the disclosure requirements of the 1933 Act have channeled debt issues from

95. Id.
98. See Stigler, supra note 97.
99. See Stigler, supra note 96; Stigler, supra note 97.
the public to the private market. Regardless of whether one views this as socially desirable, it clearly was not a consequence intended by the members of Congress whose objective was an increased public participation in securities ownership. But this result is highly undesirable aside from the expectations of legislators. The restrictions inherent in the private placement exemption severely limit, among other things, the identity of persons to whom securities may be offered, absent registration under the 1933 Act. Banks, insurance companies, other financial institutions, and other more affluent investors who meet the identity requirements of the exemption have, because of the disclosure costs connected with 1933 Act registration, been granted a competitive advantage over less affluent investors in purchasing securities in the private market.

Additionally, there are economic studies dealing with the performance of mutual funds. These studies warrant consideration since mutual funds have staffs of experts who spend their professional careers analyzing financial information. To the extent that mutual funds use information disclosed in 1934 Act reports or 1933 Act prospectuses, it is doubtful that such information is used economically, since none of the published studies indicates that mutual funds, on the average, have been able to outperform the market. Therefore, highly sophisticated users of information that is mandatorily disclosed do not seem to profit from such information, unless mutual fund managers exploit valuable information for their personal benefit rather than for the benefit of fund shareholders, or unless other skilled persons are able to analyze information and use it faster than fund managers. In either event, the nonprofessional investor would clearly get the mandatorily disclosed information too late for it to be of any value to him.

For purposes of this article, it is unnecessary to elaborate further the findings of economists concerning the costs and benefits of disclosure under the federal securities laws. While it is true that complicated statistical research is always prone to errors in methodology or
computation, the results mentioned should at least make one question whether the existing federal disclosure system is generating benefits commensurate with its costs. And if one is suspicious of the effects of that system, he ought to be doubly concerned with assertions that there are net benefits emanating from disclosure on the state level. The Florida Division of Securities does not have the financial resources or manpower to operate as efficiently as the SEC. Accordingly, if results of the SEC’s activities are open to serious question, one can hardly continue to presume that disclosure via the Florida Division of Securities is worth its price.

In any event, there appears to be little justification for mandatory disclosure to both the SEC and the Florida Division of Securities, especially since less information must be divulged under the Florida rules than under SEC regulations. Therefore, the elimination of the registration requirements in Florida for firms that either register securities under the Securities Act of 1933 or those that report periodically under the requirements of the Securities Exchange Act of 1934 is recommended. As indicated earlier in this article, there is precedent for that type of exemption in other states, and there is no evidence of greater losses to investors in those jurisdictions than there is to Florida investors. This recommendation should not be disconcerting in view of the economic data described in connection with the mandatory disclosure requirements of the federal securities laws. If Florida is to retain any system of mandatory disclosure (and for the reasons already advanced, it is questionable whether it should), such a system should apply only to those securities not registered federally and those not exempted because of the private nature of the offering or for some other policy reason. Specific recommendations regarding types of exemption are made at the conclusion of this article.

There is one final matter that must be dealt with at this juncture. Registration of securities in Florida has, it must be remembered, three purposes: (a) full disclosure; (b) prevention of fraud; and (c) application of the Florida merit standards. The applicability of registration to full disclosure and fraud has already been discussed. Before presenting final conclusions regarding the registration aspects of the Florida securities law, the ramifications of the Florida merit standards will be considered.

VI. THE FLORIDA MERIT STANDARDS

The concept of merit regulation is that state administrators should make official evaluations regarding the degree of risk inherent in a proposed offering, and deny business firms the opportunity to offer their securities publicly if the risk to prospective investors is deemed too high. Although such judgments are often made on the basis of ad hoc and informal rules, efforts to simplify the administrative task have led to the adoption of formal rules with respect to various aspects of a proposed securities issue.

Many of these explicit, published rules are directed exclusively at the public offerings of newly promoted ventures, since such businesses are often organized around an idea or invention of disputable value and are therefore, by nature, highly risky. Although other formal rules are by their terms applicable to all firms seeking to enter the capital market, some assume significance only in connection with specific types of ventures or offerings. For example, most states have generally applicable rules limiting the amount of underwriters' compensation and other expenses that may be paid by firms attempting to raise capital publicly. Such restrictions have little, if any, real effect on established businesses seeking substantial amounts of capital; the impact of the rules is felt almost entirely by small businesses or new ventures attempting to finance operations with relatively small amounts of capital.

The blue sky statutes of most states contain provisions granting administrators the authority to regulate the expenses of public offerings. Pursuant to those statutory provisions, administrators have adopted rules that quantify the maximum expenses that may be incurred in connection with public offerings of securities. In Florida, there are specific statutory provisions regarding the expenses that may be incurred in registered offerings. Both registration by coordination and registration by qualification provisions limit the discounts, commissions, expenses, remuneration and other compensation to an amount not in excess of 20 percent of the value of the securities offered in Florida. Rules in other states quantify expense limitations to amounts ranging from 15 to 20 percent of the aggregate value of securities offered.

The benefits sought from this form of regulation are clear. As

107. For a collection of those statutes and citations to them, see Mofsky, Adverse Consequences of Blue Sky Regulation of Public Offering Expenses, 1972 Wis. L. Rev. 1010.  
108. For a collection of those rules, see id.  
109. See notes 45 & 46 supra.  
110. Mofsky, supra note 107, at 1011-15.
previously noted, the concept underlying merit regulation is that administrators should make judgments regarding the degree of risk inherent in a proposed offering and stop issues from coming to market if the risks to investors are deemed too high. Restrictions on the expense of nonexempt offerings are designed to limit investors' risk by preventing dilution of the public's investment beyond some fixed point. To the extent that expenses of offerings might be higher in the absence of regulation, these limitations have had their desired effect. Before concluding that such regulation should be retained, it is important to consider some of the undesirable consequences. In that connection, the initial step is to determine how these regulations function in practice.

For the three periods 1945-49, 1951-55 and 1963-65, the SEC has published statistical reports on the costs of issuing new securities.\textsuperscript{111} These reports show that the total costs of public offerings in excess of $1 million were well below limitations imposed by all the states (Florida included).\textsuperscript{112} Thus expense limitations have not had, during those periods, a detrimental effect upon the larger public offerings. For the periods 1945-49, 1951-55 and 1963-65, however, the SEC studies show that the average total costs of issues between $500,000 and $1 million were 18.3 percent, 21.8 percent and 14.6 percent, respectively. For issues under $500,000, the studies indicate total costs of 24.1 percent, 27.2 percent and 18.5 percent for the respective periods.

The significance of these statistics, in relation to blue sky regulation generally and Florida law in particular, is clear. As the size of the issue diminishes, average costs more closely approach state limitations. For the smallest offerings ($500,000 or less), average total costs for the periods 1945-49 and 1951-55 exceeded the current Florida standards and the standards of all states in which there are published rules limiting expenses. With respect to those issues ranging from $500,000 to $1 million, the average expenses in the 1951-55 period exceeded the expense limitations in Florida as well as those in all other states in which there are published rules.

The impact of such regulation on the costs of public offerings is not fully illustrated by the statistics of the SEC study, since the SEC computations of total expenses and underwriters' compensation do not reflect an input for noncash compensation to underwriters in the form of options, warrants or "cheap" stock (stock issued at a price sub-


\textsuperscript{112} See note 111 \textit{supra}.
stantially below the public offering price). Noncash compensation was omitted from the SEC study because of the practical problems of valuation. Most blue sky administrators, however, require that such compensation be valued and included for purposes of determining whether total expenses or underwriters' compensation exceed the prescribed limits.\textsuperscript{113} For example, the Florida rule arbitrarily values options or warrants to underwriters at 20 percent of the public offering price of the securities to which they pertain.\textsuperscript{114} Although there is no published rule regarding "cheap" stock in Florida, some value must be given to it to determine whether the expenses of offering securities to the public in Florida exceed the 20 percent limitation.

Since the SEC study gives no information about the nature or amount of noncash compensation that was paid during the periods studied, it is impossible to determine with precision the specific instances when inclusion of the value of such compensation caused total expenses or underwriters' compensation to exceed the limits imposed by Florida or any other state. Such compensation seldom, if ever, appears in connection with large issues by established firms. It is an element of compensation associated with the distribution of small issues by relatively small companies in the promotional stage. In fact, the Florida rule limits the issuance of underwriters' options or warrants to relatively small firms that are in the promotional stage.\textsuperscript{115} Accordingly, inclusion of the value of noncash compensation would be of significance primarily in connection with issues of $1 million or less. For such issues, especially those under $500,000, there were periods when total expenses surpassed amounts that are currently permissible in Florida.

It could be argued that even if total costs were computed after including an appropriate amount for noncash compensation, such costs still would not exceed the Florida limits in many instances. The basis for that argument would be the evidence found in the SEC study that the costs, expressed as a percentage of gross proceeds from offerings, were less during 1963-65 than during 1951-55, and if that trend has continued, costs might be less now than the maximum amounts permitted in Florida. The SEC explained that trend in terms of fundamental changes that took place in the securities markets—for example, greater appeal of equity securities relative to fixed income securities, increased participation by institutions and proliferation of the number of individual shareholders.\textsuperscript{116} Expansion of the market for common

\textsuperscript{113} See Mofsky, supra note 107, at 1018-19.
\textsuperscript{114} See FLA. ADMIN. CODE § 3B-106; 1 BLUE SKY L. REP. § 13,606 (Sept. 8, 1972).
\textsuperscript{115} Id.
\textsuperscript{116} See note 111 supra.
stocks caused by those and other factors eased the marketing task, and the risks associated with underwriting activity were thereby lessened.

In light of recent market developments, it is unwise blithely to assume continuation of that trend and to conclude that there is probably little present impact emanating from restrictions limiting costs of offerings. The effects of current market conditions are extremely severe. The extent to which losses occasioned by the 1969-70 and 1973 markets have restrained individuals from returning to common stock investments in small companies is readily discernible by daily reading of the financial sections of newspapers and by noting, among other things, the small number of new issues, the low price-earnings ratio for blue chip securities as well as speculative stocks and continued net redemptions by mutual fund shareholders. Indeed, given market conditions for equity securities during the past few years, there are strong grounds for arguing that underwriting risks, especially those associated with small issues by relatively small firms, have increased substantially since 1968.

There are other arguments against assuming continuation of a downward trend in the costs of a public offering. For example, while it is true that for offerings exceeding $2 million the SEC studies show successively lower percentages of total costs and underwriters' compensation, it is also true that, with respect to smaller issues, both total costs and underwriters' compensation increased from 1945-49 to 1951-55, before decreasing during the 1963-65 period. The factors that caused the upturn in 1951 may well be contributing to higher total costs now than during 1963-65, especially with respect to smaller issues. Furthermore, the SEC study shows successive increases in costs other than underwriting compensation—4.5 percent for 1945-49, 6.2 percent for 1951-55 and 7.3 percent for 1963-65. This phenomenon is explained by continuous increases in costs such as attorneys' fees, accounting expenses, engineering fees and printing expenses. Everyone associated with the public marketing of securities knows that those costs have increased dramatically since 1963-65. Although increases in non-underwriting costs were offset by drops in rates of underwriters' compensation during the periods 1951-55 and 1963-65, one may seriously question whether underwriters' compensation—particularly in the case of small offerings—is now on the average less than it was in 1963-65 or, assuming it has declined, whether it has decreased at a rate sufficient to offset increases in other costs.

The SEC statistics show that percentage costs of offerings decline as the size of issues increases. Several factors probably contribute to this trend. First, there are certain minimal costs of an offering, for example,
attorneys', accountants' and printers' fees that do not increase proportionately with an enlargement of the issue size.\textsuperscript{117} Next, some underwriters' costs for marketing an issue are relatively fixed and can be spread over a larger dollar amount as the size of an issue increases.\textsuperscript{118} Most significant, however, is the fact that, as a general proposition, first public offerings are relatively small and offerings by established firms having an existing public market for their securities are generally larger.\textsuperscript{119} Thus, since there is usually greater underwriting risk in connection with initial public offerings than with seasoned issues, it is not surprising to find that the rate of underwriting compensation increases as the issue size declines. Moreover, the evidence also indicates a correlation between increased asset size of the issuer and decreased underwriting costs expressed as a percentage of the offering.\textsuperscript{120} This phenomenon can probably be attributed to the fact that larger firms have generally had a longer operating history than smaller ones, are more likely to have an existing market for their securities and are usually better known. The combination of these factors results in less marketing risk for underwriters and lower rates of compensation.\textsuperscript{121}

Consequently, the impact of expense limitation on the cost of public offerings is most severe for small issuers, newly promoted companies and other firms seeking to raise relatively small amounts of capital. The costs of flotation for these firms are higher than the expenses generally incurred by larger, more established enterprises. This impact is entirely consistent with the concept of merit regulation—to protect public investors when risks increase. But to view regulation of the costs of offerings solely from the standpoint of presumed benefits is to ignore resulting social costs that may be far greater than the benefits attained.

Other merit standards in Florida are also geared to affect only those newly promoted firms that attempt to raise capital publicly. The sources of these standards are the statutory provisions that empower the Division of Securities to deny or revoke registrations for a variety of highly discretionary reasons. For example, the statute provides that registration may be denied if the securities are offered on terms that are unfair, unjust or inequitable.\textsuperscript{122} Additionally, registration may be refused if the issuer's business is not based upon sound business principles or if the issuer is of bad business repute.\textsuperscript{123}

\textsuperscript{117} Id.  
\textsuperscript{118} Id.  
\textsuperscript{119} Id.  
\textsuperscript{120} Id.  
\textsuperscript{121} Id.  
In practice, however, it becomes extremely difficult to evaluate securities in these broad terms. Assuming the percentage of equity to be sold is held constant, there 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 the same time, determining the price at which the securities could be sold. Accordingly, administrators invariably adopt devices that, in effect, set the prices at which issues may be sold.

In Florida, these devices are found in the form of rules that set specific quantitative limits to the dimensions indicated by the broad statutory language. For example, in offerings where the issuer is in the promotional or development phase, the offering will not be considered "fair, just, and equitable" unless the equity investment by promoters or insiders is at least 15 percent of the "total equity investment resulting from the sale of the entire offering." An exception to the 15 percent rule is permitted where the net worth of the issuer is in excess of $100,000 and the offering is supported by the firm commitment of an underwriter registered under the Securities Exchange Act of 1934. That exception is of little benefit to firms in the promotional stage, since reliable underwriters seldom give them firm commitments. Moreover, the exception still requires a substantial investment by the promoters ($100,000). That investment by insiders, like the one required to meet the 15 percent standard, must be in cash or tangible assets.

The equity contribution requirement imposed on promoters directly limits the amount that can be raised publicly according to the prescribed ratio. That limitation, in turn, effectively sets the price at which securities are sold publicly. For example, assume that the promoter is able to raise only $150,000 from private sources and that he is unable to obtain a firm-commitment underwriting. He is thus limited to a public offering of approximately $1,000,000. For his investment ($150,000 plus time, effort, ideas, know-how, etc.), he will attempt to retain the largest equity position possible and still sell the offering. He may, in fact, insist on absolute control. Assuming he does, he will retain slightly more than 200,000 shares of common stock, if, for example, 200,000 shares are sold to the public. Accordingly, the public offering price per share is set at $5. The price per share

125. Id.
126. Id.
is thus a function of the Florida Division's equity contribution rule combined with the percentage equity requirements of the promoter.

Although the policy for the 15 percent rule is not explained, it may be assumed that one objective is to prevent the interests of outside investors from being diluted beyond a stated point. Another objective is to preclude promoters from raising public capital, unless they either contribute substantial personal capital to the venture or raise a large amount from private sources. Both theories imply that there is some relationship between the amount of capital contributed by outside investors and the value of the promoter's or other insiders' investment. Such an assumption is unwarranted. A promoter's nontangible innovation may be worth far more to a firm than a tangible contribution in cash. For example, one innovation ultimately may be worth one thousand times the initial capital required to promote it, but another innovation may be worth only ten percent of such capital.

Thus, in an attempt to quantify an objective standard of fairness, the Division of Securities has only created an arbitrary rule that has no relationship to the real values inherent in an innovation. 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. The costs of substituting market determination with arbitrary rules are, therefore, more apparent.

Another question with respect to the promoter equity investment rule quickly comes to mind. Why 15 percent? Experience with regulators far more sophisticated than those who administer state securities laws indicates that the 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. To permit state administrators to create rules that have no basis in logic or experience has the additional effect of causing members of the public to be misled into believing that they are receiving protection that may not exist.

For many years, the predecessor of the Division of Securities administered an unpublished rule that limited the ratio between public offering price and the amount paid per share by insiders for their stock. Thus the public offering price could not exceed, for example, three or four times the amount paid per share by promoters. This ratio was never quantified in any rule. But combined with the promoter equity investment (15 percent) rule, it had the clear effect of restricting the amount of equity participation that promoters could take. A promoter
might attempt to circumvent this informal rule by taking all the common voting stock for himself and selling only preferred or nonvoting common stock, or debt securities to the public. However, the Division of Securities divined that possibility and adopted rules precluding the public sale of nonvoting common stock, preferred stock or debt securities to finance a newly promoted venture.127

The effect of these restrictions is to limit severely promoters' participation and, in some instances, promoters' ability to raise capital publicly and still retain control. If one assumes that promoters treat control of their companies as an economic good and that the demand for control is responsive to costs, then it must be true that some promoters who would otherwise anticipate total revenues greater than total costs now foresee a different picture. In other words, some businesses may never be formed because of these restrictions, unless there is another way to raise the requisite capital and still satisfy the needs of promoters. The loss to society of those promotions may be far greater than the benefits derived from this form of regulation. Indeed, economic theory leads to this conclusion.

There are additional merit standards that also have severe effects on new firms attempting to raise capital publicly. The escrow requirement for promoters' stock (if there is a substantial disparity between the proposed offering price and the consideration paid by the promoter128 or if securities are to be issued for intangible forms of consideration129) is another example. This latter restriction as well as the remaining merit standards have already been discussed fully by this writer.130 Furthermore, a detailed scenario illustrating the ramifications of merit regulation in a case history setting has been prepared by this writer and published elsewhere.131

The total net effect of this type of regulation is perhaps not consciously recognized by participants in the industry. But large underwriting firms are aware that the effect of regulation has been to eliminate some competition in providing underwriting services. It is not underwriters alone who benefit by protection from competition. Another group benefited by such regulation is comprised of the more affluent members of the total business community. In certain instances, promoters must necessarily shift control to those individuals in transactions that would not take place in the absence of the described merit

127. FLA. ADMIN. CODE §§ 3B-1.05-09; 1 BLUE SKY L. REP. ¶¶ 13,605-09 (Sept. 8, 1972).
128. FLA. ADMIN. CODE § 3B-1.15; 1 BLUE SKY L. REP. ¶ 13,615 (Sept. 8, 1972).
129. FLA. STAT. § 517.18 (Supp. 1972); 1 BLUE SKY L. REP. ¶ 13,118 (Sept. 18, 1972).
130. See J. Mofsky, supra note 10.
131. See id. at 41-57.
standards applicable to public offerings. Control may be shifted to such persons by outright sale of an innovation or idea or, indirectly, by sale to them of a very large or absolute majority interest in a privately financed firm. The Florida private placement exemption contains severe restrictions on the number of persons to whom securities may be sold absent registration.\textsuperscript{132} As the number of private placees diminishes, the amount that each contributes will increase, and that increase will normally be accompanied by greater demands for control, since each investor will have a larger interest to protect.

The cost to promoters of that shift in control in the private placement situation may be greater than the benefits they would derive, just as the costs occasioned by the promoter equity investment rule in connection with public offerings may exceed the contemplated benefits. If that is so, the firm will not come into existence, since other sources for capital are generally not feasible for new promotions.\textsuperscript{133} The anticompetitive effects of the blue sky laws are again confirmed, and it is unnecessary to discuss other merit restrictions, such as those relating to real estate investment trusts and limited partnerships, which generate similar consequences. For these reasons, it is recommended that merit standards be eliminated from the Florida securities law.

\textbf{VII. Regulation of Securities Dealers}

Florida securities law requires registration of broker-dealers, securities salesmen and investment advisers.\textsuperscript{134} It also establishes financial responsibility, examination and other standards designed to protect customers of those persons.\textsuperscript{135} The standards of the SEC, the National Association of Securities Dealers, and the Securities Investors Protection Corporation, in many instances, overlap with those of Florida.\textsuperscript{136} Furthermore, the standards of and surveillance by those organizations are generally more stringent and comprehensive than those of Florida.\textsuperscript{137} Accordingly, it seems highly inefficient for Florida to impose its rules in an area already being heavily regulated. Therefore,

\footnotesize{132. FLA. STAT. § 517.06(10) (1971); Fla. Laws 1973, ch. 73-68, § 2 (§ 517.06(11)); 1 BLUE SKY L. REP. § 13,106 (June 19, 1973).
133. See J. MOFSKY, supra note 10, at 19.
137. Id.}
the elimination of broker-dealer, securities salesmen and investment adviser regulation (when those persons are already regulated by another agency) is recommended. If the number of Florida dealers, salesmen and investment advisers not regulated by a non-state agency is relatively small, their regulation by the state should be eliminated as well, since the cost of enforcement for a small number of persons would probably be far greater than the benefits created.\textsuperscript{138}

Elimination of regulation in this area would have the desirable effect of lowering costs of operation for securities dealers. That, in turn, would make the securities business more profitable. To the extent that elimination of controls in Florida would have that effect, perhaps more new brokerage firms would be formed and fewer firms driven out of business. There is a paucity of small securities dealers in Florida. They have traditionally made an extremely important contribution to the economy by servicing small investors and assisting small and new ventures in raising capital.\textsuperscript{139} These considerations far outweigh any benefits accruing from regulation, especially when a firm is already regulated by some other agency.\textsuperscript{140}

**VIII. Conclusions**

There are several possible approaches that may be taken to reform the Florida securities laws. It would, for example, be possible to analyze each provision of the existing statute and rules with a view to resolving ambiguities and revising areas of technical deficiency. If that would achieve the best possible result, the tedium of the task would warrant its undertaking. However, such law reform does not focus on the policy issues underlying the laws, and, it is submitted, policy analysis and formulation should be the key to reform of the securities laws. Similarly, a strict comparative approach designed to create uniformity would detract from analysis of the fundamental issues. Accordingly, a technical examination of the statutory and rule provisions has not been pursued. Instead, an attempt has been made to present the theoretical arguments and empirical evidence against the laws as they are presently constituted. Moreover, an effort has been made to demonstrate that such arguments and evidence strongly suggest the need for fundamental reform of the philosophy underlying securities regulation in Florida.

\textsuperscript{138} This writer does not know the number of such dealers, salesmen and investment advisers, since there is no published list in Florida. It is presumed that the information can be readily supplied by the Florida Division of Securities.

\textsuperscript{139} See Hearings, supra note 136, at 1550-78.

\textsuperscript{140} Id.
The main recommendations made in this article are the total elimination of merit standards, elimination of registration of those securities that are registered federally (under either the 1933 or 1934 Act) and the partial elimination of broker-dealer regulation. There should also be retention of a strong antifraud law with a staff to enforce it. Additionally, private placement exemptions should be liberalized. Implementation of these recommendations could be accomplished readily. If Florida is to generate more business and is to encourage firms to raise capital more efficiently, the state must be willing to take some pioneering steps. If the legislature should enact new laws based on these recommendations, empirical study can be done after a sufficient period of time to determine whether the changes have been beneficial. If not, the law can be changed again. In the meantime, analysis supports the arguments for basic reform. This analysis does not indicate that important safeguards would be sacrificed.