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Recommended Citation
Donald A. Pearce, California Corporate Securities Law vs. Proposed Uniform Securities Law, 9 Hastings L.J. 1 (1957). Available at: https://repository.uchastings.edu/hastings_law_journal/vol9/iss1/1

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CALIFORNIA CORPORATE SECURITIES LAW
vs. PROPOSED UNIFORM SECURITIES LAW

By Donald A. Pearce†

Should the time-tested and value-proven California Corporate Securities Law be abandoned and in its place substituted the Proposed Uniform Securities Act as drafted by Professor Louis Loss of Harvard University and his associate, Edward M. Cowett? The possibility of such a substitution is currently being considered by the Los Angeles County Bar Association, and it is because this writer believes that the problem is one of primary importance to lawyers, legislators, securities dealers, business men, and the California public in general that this article has been written.

It is generally conceded that there are four principal systems or philosophies of securities regulations, namely: (1) the fraud system; (2) the licensing of brokers, agents and investment counselors; (3) the disclosure or registration system; and (4) the permit system.1 It is possible for a Proposed Uniform Securities Act to include any one, or any combination, or all, of the foregoing four systems or philosophies of regulation.

The strange fact is that the Proposed Model Uniform Securities Act, drafted by Professor Louis Loss, of Harvard University, and his associate, under the sponsorship of the Merrill Foundation for Advance of Financial Knowledge, Inc., does include the first three types of securities regulation, but omits the permit system.2 What is even stranger is the fact that it is expressly stated by Professor Loss that states may adopt any one, any combination, or all of the three types of regulation. This, of course, would accomplish just the opposite of uniformity in that State A might adopt only the fraud type of regulation, State B might adopt only the licensing of professional sellers type of regulation, State C might adopt only the disclosure type of regulation and State D might adopt the first and second, State E the first and third, etc., making it possible, therefore, for seven different States to have regulations different from each other because of having adopted a different portion or portions of the Proposed Model Uniform Securities Act. To be even more accurate, the proposed third type of regulation, namely, the disclosure or registration system is broken down by Professor Loss into three divisions: first, Registration by Notification;

† Assistant Commissioner of Corporations, State of California.
1 See BALLANTINE & STERLING, CALIFORNIA CORPORATION LAW, 575-76 (1949).
2 See Loss & Cowett, A Proposed Uniform Securities Act Final Draft and Commentary, Harvard University, June 1, 1956, p. 3: "... it is possible in very broad terms and with a good deal of over-simplification to categorize all of the acts as following one or more of three basic philosophies. These are fraud prevention, broker-dealer registration, and securities registration."
second, Registration by Coordination; and third, Registration by Qualification. This, therefore, makes it possible to increase the number of combinations of types of regulations to the point where there would be as many variations between the States as there are States in the Union. If we would add to this the permit system, there would be six types of regulation, which will allow far more combinations than there are states available to adopt them.

It appears to the writer that if a model act is advisable, it ought to be the best model act obtainable, and not a series of combinations of types of regulation which the states could adopt helter-skelter, resulting in mediocrity and non-uniformity.

A brief analysis of the principal systems or philosophies of securities regulations as well as a brief review of the history of the enactment of securities regulation statutes would be advisable before discussing the principal problem of the California Corporate Securities Law vs. The Proposed Model Uniform Securities Act.

Principal Systems of Regulation

_Fraud._—The first system or philosophy of securities regulation enumerated both by Professor Loss and the writer, is the fraud system. This is the type of regulation enacted by the State of New York and consists principally in broadening the term “fraud” somewhat beyond the common law definition, placing upon the shoulders of the Attorney General of the State of New York the responsibility of investigating frauds and incipient frauds, and seeking injunctions before the courts against the commission of fraud in the sale of securities. This system lies on the side of the pendulum where there is no regulation as contrasted with the permit system of California, which lies on the other side of the pendulum, where there is full and strict regulation.

_Licensing of Agents and Brokers._—The second system or philosophy of securities regulation is the so-called licensing of brokers and agents who are the professional sellers of securities. To this has been added the licensing of investment counsellors or advisers. Some states have deemed it suf-

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3 (a) Registration by notification is in reality qualifying securities for sale merely by showing that the corporation has operated profitably for the past five years and has not defaulted in interest and/or dividends on senior securities for the three years immediately preceding the proposed issue.
(b) Registration by coordination is merely qualifying securities for resale in the state by showing that the proposed security issue is currently registered with the SEC.
(c) Registration by qualification requires filing the registration data with the state securities administrator, enabling him to impose a few minor substantive restrictions. These restrictions and doubt as to their effectiveness are discussed in the concluding paragraphs of this article.
ficient to license the professional sellers only with the view that the bulk of securities for sale and resale will thus be controlled.

**Disclosure or Registration System.**—The disclosure or registration system of regulation of securities is probably best represented by the Federal Securities Act of 1933, wherein Congress established the policy that the issuer and/or underwriters should set forth in a registration statement to be filed with the Government and in the prospectus to be delivered to prospective securities buyers, the truth and the whole truth concerning the securities being offered. This calls for not only the truthful statement concerning securities, but the obligation to state all material facts, in other words, to make no omission of material facts. In this system there is no test of whether the issue of securities is fair, just and equitable; rather it is required that the seller beware except for fraudulent statements and omissions. The old doctrine that the buyer shall beware appears to be revived, leaving the burden on the prospective purchaser.

**Permit System.**—The fourth system of securities regulation is the permit system. This system or philosophy has existed in California since the Investment Company Act of 1913 and the Corporate Securities Act of 1917, which latter law has been amended at each session of the legislature thereafter. Basically the permit system involves the decision of an administrative officer, namely, the Commissioner of Corporations in the State of California, in judging upon a verified application, exhibits, and any further investigation, whether or not he should issue a permit authorizing the sale of securities or deny the application. In the event the Commissioner is satisfied, and finds upon the showing made in the application and in any further investigation, that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just, and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities that it proposes to issue and the method to be used in issuing or

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4 The Securities Act of 1933 is a typical disclosure or registration act wherein there is no power or duty in the SEC to pass on the proposed securities issue as being fair, just and equitable. Professor Loss, co-author of the model Uniform Securities Law, in his address of June 6, 1957, to the Mexico Stock Exchange in referring to the Federal Securities Act as being a mere disclosure act stated as follows:

“When Congress finally entered the scene in 1933, it decided that federal legislation was essential because the state statutes were inadequate for what had become very largely an interstate economy. The first major decision which Congress faced was whether to follow the disclosure philosophy of the English statute or the more stringent regulatory philosophy of the states, which was also the philosophy of the Canadian provinces. The latter choice would clearly have been more consistent with the idea of a planned economy which underlay the National Industrial Recovery Act, with its codes for various industries. But philosophical consistency is not an outstanding characteristic of legislation in a democracy. At any rate, Congress chose the milder disclosure philosophy of Great Britain rather than the substantive controls of the state blue sky laws.”
disposing of them is not of such a nature, as will in his opinion work a fraud upon the purchasers thereof, the commissioner shall issue to the applicant a permit authorizing it to issue and dispose of securities, as therein provided, in this State, in such amounts and for such considerations and upon such terms and conditions as the commissioner may provide in the permit.\(^5\)

This reference to Sections 25507, 25508 and 25512 of the Corporate Securities Law of the State of California goes far beyond mere disclosure or registration. It involves the preparation of the issuance authority in a document entitled a “Permit”, in which permit there are three basic provisions, namely: the recitals—disclosing a brief summary of what might be expected to be found in the prospectus or registration statement; secondly, the issuance authority fixing the fair selling price, the terms of payment, kind of consideration, and the maximum selling expense and commissions; and thirdly, the conditions precedent, concurrent and subsequent affecting the securities issue. These conditions include the requiring of the Commissioner’s approval of the stock subscription forms; requiring of a disclosure of the true copy of the Commissioner’s permit to subscribers prior to taking their subscriptions; the impounding of the proceeds of the security sale to meet the minimum budget; the escrowing of the promoter’s shares and the subordinating of said shares in relation to shares sold for cash until the cash investors have received preferred cumulative dividends; protecting such shares sold for cash against the promoter’s shares as to participation in assets on dissolution and requiring the transfer of the voting control from the promoter to the cash investors in the event the promoter is unable to operate the corporation profitably within a two-year period. It is obvious, therefore, that the permit of the Commissioner is an exercise of administrative determination and discretion far beyond the provisions the issuer may choose to make in a registration of disclosure system.

**History of Securities Regulation in the States**

Securities regulation was begun by the states as early as 1911, and by the federal government twenty-two years later in 1933. Kansas and Rhode Island are credited with having been the first states to enact a modern securities regulation statute known as Blue Sky Law.\(^6\) Today, nearly all the states except Delaware\(^7\) and Nevada\(^8\) have some form of Blue Sky Law.

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\(^6\) Kan. Stat. c. 133 (1911).

\(^7\) A single paragraph anti-fraud statute was enacted in Delaware in 1931, but this was omitted from the 1931 Delaware Code, so that at this date (1957) Delaware does not have any securities regulation statute.

\(^8\) Nevada had a statute regulating securities only, which was repealed 1915. Nev. Stat. c. 56 (1909) and c. 59 (1915).
In passing, it might be said that a far graver situation confronts the states and federal government than the problem of possible uniformity of securities regulation acts. That grave problem is the flow of securities from the two states, Nevada and Delaware, where no regulation exists, into the other 46 states, District of Columbia, and the Territories of Hawaii and Alaska and Puerto Rico.

During the period 1911 to 1920, all the 46 states except Delaware and Nevada enacted some one or more of the four basic features of securities regulations, namely: (1) fraud, (2) licensing of brokers, dealers and agents, (3) registration or disclosure, and (4) permit authority.9

The federal government commenced its securities regulation by enactment in 1933 of the Securities Act10 followed by enactment in the ensuing year of the Securities Exchange Act of 1934.11 Subsequently, Congress amended the Bankruptcy Acts in regard to corporate re-organizations by Sections 77A and 77B of the United States Bankruptcy Acts,12 the Trust Indenture Act of 1939,13 the Investment Companies Act of 1940,14 and the Maloney Act.15

The two basic acts of the federal government are the Securities Act of 1933, providing for the registration of securities offered inter-state in amounts over $300,000, (originally this minimum was $100,000), and the Securities Exchange Act of 1934, which regulates the stock exchanges. All of these acts are administered by the United States Securities and Exchange Commission in Washington, D.C., aided by the various regional offices of the SEC in nine geographic regions. It is important to note that Congress specifically left exclusive jurisdiction as to inter-state transactions in securities to the states where the amount of securities being issued is less than $300,000 and left concurrent jurisdiction with the states along with the federal government in issues in excess of $300,000. It is also important to note that the federal government's Securities Law is a mere disclosure system or type of securities regulation, not a permit type.16 Therefore, if any state is to have the privilege of maintaining or adopting a permit sys-

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9 It is presumed that the forthcoming book analyzing the Blue Sky laws of the various states, edited by Loss and Covett, will set the history of Blue Sky legislation in the states and will be as full and accurate a source of such legislation as to satisfy most persons interested in the subject.

16 See note 4, supra.
tem of securities regulation, it must necessarily go far beyond the mere disclosure system of the federal law.

**History of Blue Sky Law Regulations in California**

The first Blue Sky Law in California was the Investment Companies Act of 1913. This law applied to public sales of securities only, not to closed issues. Obviously, any promoter with any degree of imagination simply evaded that law by having the corporation issue securities to the promoter and/or to a closed group and immediately thereafter redistributed the securities to the public. The loophole in this law was effectively stopped by the enactment of the Corporate Securities Act of 1917. The California Corporate Securities Act, later entitled Corporate Securities Law and made a part of the Corporations Code, has been amended or revised at every general session of the legislature from 1917 to the present and it seems safe to predict that it will continue to be amended at each future general session of the legislature. The need for improvement of the law or plugging of loopholes created by imaginative promoters would appear to justify this prediction.

A careful study of the amendments of the past 40 years will illustrate the ingenuity of those who try to evade securities legislation and the readiness of the legislature to plug these loopholes as rapidly as they are created. Also, the continued efforts of the Commissioner of Corporations, the State Bar, and business men, to strengthen the act justifies these continuous amendments. It is generally admitted that California has the most thorough and effective securities regulation statute among all the 46 states which have some form of securities legislation. No one would argue that the California legislation is perfect or complete; however, with many hundreds of attorney general’s opinions and court decisions interpreting the Corporate Securities Law of California over a period of 40 years, and with the rules and regulations of the Commission adopted over 40 years of experience in administering the law, there is a strong foundation for the foregoing statement. It is obvious that such a law should not be lightly cast aside for some less effective type of securities legislation in the form of a mediocre disclosure type of securities legislation.

Perhaps the most important philosophy behind the Corporate Securities Law of California is that the “seller shall beware”—not the buyer. In disclosure systems, as contrasted with permit systems, the emphasis is “let the buyer beware”, even though the buyer may be incapable of intelligently

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17 CAL. STAT. c.353 (1913).
18 CAL. STAT. c. 532 (1917).
19 CAL. CORP. CODE §§ 25000-26104.
analyzing the voluminous registration statement or prospectus and exhibits. The underlying test in the permit system is that the applicant seeking authority from the Commissioner of Corporations of the State of California must convince the Commissioner that the proposed plan of business, issue of securities, and manner and method of sale thereof, are fair, just and equitable, honest, and will not work a fraud upon the purchasers of the securities. If the applicant does not so satisfy the Commissioner, the application for permit authority shall be denied. In a disclosure system, on the contrary, the proposed issue and/or underwriter of the securities need only tell the truth, omitting no material facts, no matter how unfair, unjust, and inequitable the proposed issue may be, and the public may be sold such securities. Quoting from an address by the Honorable Ralph Demmler, Chairman of the United States Securities and Exchange Commission, at the Thirty-seventh Annual Convention of the National Association of Securities Administrators in 1954,\textsuperscript{20} Mr. Demmler frankly stated as to the disclosure statute as follows:

"The Federal statute, of course, leaves an investor free to part with his money like the proverbial fool. It is based on a relatively non-paternalistic doctrine that the role of Government in policing the sale of securities is fulfilled when the investor is assured of a legal right to get the facts and a remedy in case of fraud. Is that an adequate protection of investors? No one contends that every investor reads the prospectus any more than the millions of people covered by life insurance read their policies. Nevertheless a disclosure statute accomplishes two things in addition to getting through, at least to some investors, the information set forth in the registration statement. First, the very fact that transactions of a suspect character must be disclosed probably prevents many such transactions from ever taking place. Second, while the prospectuses may not be read by individual purchasers generally, they are read by analysts, bankers, and other specialists through whom the information is disseminated and whose appraisal contributes to the fixing of a market price more nearly fair than could be fixed if the information were not available."

As Professor Loss has said from time to time, the mere disclosure act of the federal government allows the issuer and/or underwriter to sell anything, as long as the truth is told.

\textbf{Why a Uniform Securities Act for All the States}

Perhaps, before we even attempt to answer why a uniform act for all the states, shouldn't we admit that while it might be possible, it's almost certain that many of the states will not adopt the proposed model uniform securities regulation act even as Delaware and Nevada for 40 years have

refused to adopt any part of the four basic means of securities regulation. Since the probability of all states adopting a uniform act is most unlikely, we might drop the subject, there, except for the fact that there seems to be some pressure arising from various sources toward the states to adopt the proposed uniform securities regulation act. Why is there a hue and cry for such adoption of the Proposed Model Uniform Securities Regulation Act? According to the Los Angeles Bar Committee Report quoted in part below, we note the following comment by James E. Dunlap, one of the members of the Corporation Committee of the Los Angeles Bar Association, in an appendix to the formal report of the Committee dated June 25, 1957, wherein he states:

"In evaluating the act, the position has been taken that absolute uniformity among the states is impossible and not necessarily desirable and, further, that the need for uniformity differs in different parts of the legislation. Consideration has also been given to Section 415 of the proposed act, which declares a legislative intent of uniformity. This declaration of intent can be expected to influence judicial interpretation so that fundamental divisions of interpretation are not unlikely to arise.

"There is little doubt that uniformity among the states would be of great assistance in enabling a general practitioner to advise his clients as to the applicability and effect of foreign Blue Sky Laws on security transactions; however, it appears that most of the pressure for the uniform law has come from the large brokerage houses and their attorneys who are well acquainted with the laws of all 48 states. They are of the opinion that the discrepancies of the present laws are such that they needlessly complicate and burden the national distribution of generally acceptable securities. The purpose of this report is to determine how successfully the proposed uniform law has removed the complications and burdens now caused by the lack of uniformity among the states. The desirability of various provisions as such is not considered except where necessary to properly weigh the advantages of uniformity."

If the pressure for adoption of uniform legislation is from the large brokerage houses and their attorneys who are well acquainted with the law of all 48 states, then it would appear that there is little need of urging repeal of the effective California permit system law for a mediocre or mere disclosure statute. A partial analysis of the great bulk of the securities sold to the California public by the large brokerage houses indicates that approximately $2,000,000,000 of securities are sold each year to the California public by large brokerage houses, practically all of which is through underwritings in which California licensed brokers estimate that they sell from 10% to 20% of the total national underwriting registered with the United States Securities and Exchange Commission. Only rarely do the large brokerage houses distribute securities to California residents under
a "best efforts contract" and therefore under a permit. It is safe to say that the principal reason why the brokers rarely sell under a "best efforts contract" and under a permit is that the cream of the securities issued are underwritten while the skimmed milk type of securities issued does not justify or merit an underwriting. Therefore the weaker issues are covered by permits and should be carefully and thoroughly regulated under the permit system, rather than allowing such issues to reach our public under a mere disclosure act, where you merely tell all the facts without regard to the standards of fair, just and equitable, honesty, and the anti-fraud tests which could be applied through a permit system. In fact, on the "underwritten securities", registration statement and exhibits are practically the only material required to be filed with the Commissioner of Corporations of the State of California to qualify such issues for trading. Of course, the appointment of the Commissioner and the resident agent for receipt of service of process is required. While the great majority of the securities registered with the SEC submitted for qualification in California are acceptable to the Commissioner, there are a few issues, such as the Tucker Automobile promotion case, where the proposed security issue does not measure up to the California Corporation Commissioner's determination of what is fair, just and equitable, and as a result such securities registered with the SEC are denied qualification for trading in California, thus saving millions of dollars to our California residents.

**History of the Proposed Model Uniform Securities Regulation Act**

An early draft of a model uniform securities regulation act was approved by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association in 1929. As to the success of this early draft, Professor Loss stated at the 37th Annual Convention of Securities Administrators in New York, 1954, as follows:

"Its success was something less than phenomenal. It was adopted only by Louisiana and Hawaii and, with various modifications, in a handful of other states. Actually, it became outmoded only four years after its approval. When the adoption of the Securities Act of 1933 shifted the emphasis to Federal-State coordination, the conference finally struck it from the list of approved acts in 1944. . . . In 1947 a special committee of the American

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21 A best efforts contract is a mere agency undertaking by a broker, as contrasted with a true underwriting where the broker is legally bound by contract to purchase any share not resold to customers.

22 Qualification for trading in true underwritings and on resale of outstanding securities by licensed brokers is accomplished by filing the prospectus with the Commissioner of Corporations subject to his disapproval if not satisfactory. See Cal. Corp. Code §§ 25600–604.

23 See file number 85675 L.A. Division of Corporations, State of California.
Bar Association recommended that the conference be requested to consider a uniform or model act in cooperation with the National Conference of Commissioners on Uniform State Laws. Three successive drafts—which were largely the work of the very able chairman of the American Bar Association Committee on State Regulation, Robert M. Blair-Smith, of the Philadelphia Bar—were considered in 1949, 1951, and 1953, by the appropriate committee of the conference.

"The 1953 meeting of the conference was held in Boston and Commissioner Edward L. Schwartz of the Boston Bar, Chairman of the conference Sub-Committee on the Uniform Securities Act, invited me to attend the meeting of the parent section of the conference. That section disapproved the third draft and was about to recommend to the conference that the entire idea of a uniform or model securities statute be dropped, on the ground that the legislative philosophy of the states were too diverse. But the members reconsidered when it was suggested that a model statute might be drafted in several parts, each corresponding to one of the basic regulatory philosophies. Thus, Part I might deal with fraud, Part II with broker-dealer registration, and Part III with securities regulations."

It was here that the writer believes Professor Loss and whoever else entered the discussion made the error of overlooking the Part IV philosophy of regulation of securities, namely the permit system.

Professor Loss continued to state in the aforesaid address, as follows:

"Under the scheme of things a state like New Jersey, which wanted to continue with a pure 'fraud' philosophy, might adopt only Part I (and the general provisions); a state like Pennsylvania, which wanted to combine anti-fraud provisions with a system of broker-dealer registration, might adopt Parts I and II (and the general provisions); and most of the states might consider the entire statute. This basic approach,—I wish I could say it were my own, but it has a rather mixed paternity—was received with so much enthusiasm that the conference committee was instructed to prepare a fourth draft accordingly."

Professor Loss stated that, some months later, he was consulted by representatives of the conference with a view to preparing a suitable draft; that he spoke to Mr. Cavers, Associate Dean of Harvard Law School, where Professor Loss was then teaching; that Mr. Cavers was in charge of research and had some months previously voiced the possibility of a Blue Sky study. Professor Loss reported that the result was that they undertook to make such a study under a grant which the Harvard Law School obtained from the Merrill Foundation for Advancement of Financial Knowledge, Inc.

An advisory committee was set up, the composition of which is outlined on Pages 37 and 38 of the Proceedings of the 37th Annual Conference of the National Association of Securities Administrators.

It is interesting to note Professor Loss' earlier report in 1954 to the Securities Administrators Convention, in part as follows:
"For better or for worse, we are living under a Federal system. In my opinion it is for better, even with the cumbersome and dual regulation. If we had attempted a unitary government for this vast and variegated country, we might long since have fallen apart at the seams. As Justice Brandeis put it in one of his great decisions: 'It is one of the happy incidents of the Federal system that a single, courageous state, if its citizens choose, serve as a laboratory and try novel social and economic experiments without risk to the rest of the country.' Accordingly, we see no point in looking for ways to make New York yield to California's philosophy in this field or vice versa. Not only would this be an idle dream; we are not even sure that it would be desirable in principle."

Mr. Robert Blair-Smith, chairman of the American Bar Association Committee for State Regulation, whom Professor Loss referred to as the author of the three drafts of the uniform securities act turned down in 1949, 1951, and 1953, and disapproved by the Sub-Committee on a Uniform Securities Act, commented in a recent article on the use of these three parts of the proposed act:

"Although it is entitled a 'Uniform Securities Act', it is not intended for adoption as a whole by every state, but is constructed in four parts (the fourth being the general section) so that any one or more of the first three (the substantive parts) may be selected by any state, according to the regulatory philosophy prevailing at the time."2

Where did this leave California and the other states which have a permit philosophy of securities regulation? The answer is, of course, that California's philosophy is either apparently ignored or deemed too strict to be considered in a model uniform act.

Honorable Ralph Demmler, Chairman of the United States Securities and Exchange Commission, stated again to the National Convention of Securities Administrators in 1954 as follows:

"The Federal statute, however, is not a qualification statute. Section 23 makes it clear that the Securities and Exchange Commission does not approve and may not approve issues and that it is unlawful for anyone to represent that it has approved any issues. This does not seem to be realized by many members of the public, so I say it again in the hope that you and your staffs will help to disseminate a public appreciation of the fact."

"Yet the fact that we have had such statutes since the original Kansas Act of 1911 indicates that the qualification approach is still highly regarded in some areas. Justice Holmes repeatedly expounded the philosophy that the states are laboratories in which economic ideas can be tried and proved or tried and found wanting. I suggest that this trial process is just what has been going on in the states over the years in respect of the offering of securities and particularly in respect of the imposition of qualification standards."

In the report of Proceedings of the 38th Annual Convention of the National Association of Securities Administrators, held in Vancouver and Victoria, B.C. in 1955, Professor Loss went into a considerably detailed analysis and explanation of the progress of the draft of the Model Uniform Securities Regulation Act. This report, appearing at Page 43, quotes Mr. Lammy of the Oil Securities Committee reporting as follows:

"In order that the administrators of both the class of security laws known as 'Permit Method', or regulation, or the class known as 'Registration Method', may have the benefit of the Committee's study, the following policies are recommended to each Security Administrator for adoption as standard, in handling applications for permits or registrations in dealing with organizations engaged in purely exploratory ventures."

He then outlined policies recommended in States With Permit Systems. This insert is clearly to demonstrate that the Security Administrators at their national convention recognized and distinguished the permit system as contrasted with the registration or disclosure system of securities regulation.

Particular attention is called to Professor Loss' discussion of the basis for issuance of a stop order against issuers under Section 306(7) of his early draft of the model uniform securities act, as he discussed the same at the 38th Annual Convention of the National Association of Securities Administrators, wherein he states:

"If the offering would be made on terms which are unfair, unjust, and inequitable, by reason of the amount of commissions, options, promoters profits and number of similar things, it would not be enough for you to say simply 'I don't like the terms of the offering'. You will have to find that the terms of the offering are unfair, because there is too much promoter's profit, too many options or similar things; that ties your hands a little, but at the same time—I am talking to the administrators now—I think it gives you fairly broad powers—some of my friends in the industry have said too broad powers—to stop offerings where the options, promoters' profits, or commissions, are outrageous."

In the fourth and final draft of the model act, this Section 306(a)(2)(f) —has been redrafted to read that the ground for issuance of a stop order is that the administrator would find (1) that the issuance of the (stop) order is in the public interest, (2) that . . . (f) the offering has been or would be made with unreasonable amounts of options, underwriters' and sellers' discounts, commissions or other compensation, or promoters' profits, or participation.

Apparently, the words "not fair, just, and equitable" are dropped and the words "not in the public interest" are substituted, but the facts that make the administrator determine that it is either not just, fair and equita-
ble or that it is not in the public interest are practically the same; namely, unreasonable amounts of underwriters' commissions, options, promoters' profits, etc., so we end up finding, because of these unreasonable amounts of underwriters' commissions, options, and promoters' profits in finding it to be against the public interest instead of unfair, unjust, and inequitable. This appears to be like Tweedledum and Tweedledee, or double-talk.

Professor Loss explains that it was not thought to be desirable to fix an arbitrary percentage by statutory provision or rule because it would be either too low for some types of offering, or so high as to be largely meaningless. He states:

"On the other hand, some of the statutes in the group as well as many others, permit administrators to attack the problem of excessive selling costs under some such broad standard as 'fair, just, and equitable' (California), 'inequitable' (Illinois), 'more a scheme to profit at the expense of the purchasers' (Kansas), or 'grossly unfair terms' (Ohio)."

Professor Loss states that sub-section (f) above discussed solves the whole problem of unreasonable promoters' profits against which the Blue Sky Laws have been traditionally directed as well as the recently accelerated problem of unreasonable options whether issued to promoters or to underwriters, insiders or other persons.

An administrator still has either to adopt a rule or rules regarding maximum underwriters commissions, options, promoter's participations, or judge each case on its merits, in which case the administrator will undoubtedly fix different maximum commissions for different types of financing, and in the eyes of the law he will be fixing a figure beyond which it will be unreasonable, therefore unjust, unfair, and inequitable, and not in the public interest to go beyond such a fixed figure.

Professor Loss attempts to explain why he used the terminology "registration system". He says on Page 44 of the fourth and final draft of the Model Uniform Securities Regulation Act, dated June 1, 1956, as follows:

"It is, therefore, the draftsmen's view, which it is understood the California Commissioner of Corporations does not share, that there is no inherent difference between the so-called 'permit system' and the so-called 'registration system'. That is to say, this statute uses the word 'registration' in the generic sense—the sense in which it is most commonly used in the existing statutes—rather than in the Federal disclosure sense or the Massachusetts notice-to-sell sense. A uniform act should attempt to arrive at an optimum procedure and an optimum set of substantive standards. When that end has been achieved, no purpose would be served by recognizing a terminological difference between a 'registration statement' and a 'permit'. This is not to say that the permit tradition in California has not made for a somewhat different emphasis and flavor. But it is precisely the purpose of this uniform
statute to fix upon a single emphasis and flavor within each of the major regulatory philosophies represented by the first three parts of the act."

On the third appearance by Professor Loss before the Convention of National Securities Administrators, he stated:25

"Now I should say one thing before stopping on this point: We have left out a reference to 'fair, just, and equitable'. That is found today in about 15 statutes, and that is largely the reason that California voted against the act in the National Conference of Commissioners on Uniform State Law, as well as Nevada. I must confess that I find the point quite troublesome. If I were administrator in a state which had such a standard today, I do not know how happy I would be abandoning it. I would certainly have a little reluctance to abandon it. You have to make a choice in a uniform act. If we put the standard in, we would be following the minority view. Leaving the standard out, at least we are following the majority pattern today. And we took that view not because we always followed the majority pattern—we did not where we thought it was ill-advised—but because we think—and this is no question of basic morals, but a question on which reasonable men can differ—we think that in a well-ordered Blue Sky Law, with all of these other standards you don't need a standard of 'fair, just, and equitable' in order to function properly. We think that law ought to be as definite as it can be. I do not like to go around mouthing that this is 'a government of laws and not of men', because those are just words. We all believe in 'a government of laws' just as we all believe that sin is evil, but we all know that laws have to be administered by men. We all know that in an administrative statute, no matter how definite you are, you have to have some flexibility. But when all that is said, the fact is, to my mind, that law generally ought to be as specific as you can make it. You ought not to use vague language, such as 'fair, just, and equitable' unless you have to. We do not think you have to. If a particular state disagrees with us, it would be a fairly simple matter to put additional standards in the statute in that state. But we recommend the standards which are in here now."25a

In one breath, Professor Loss states that the California Securities Law is too vague and in another that this is too strict. In one breath he says the California law is unique and cannot be included in the three-part pattern of the model uniform securities regulation act, and in another breath

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25a The Thirty-Ninth Annual Convention of the National Association of Securities Administrators (now changed to North American Association of Securities Administrators) resolved in their convention September 9–12, 1956 as to the Model Uniform Securities Act as follows: "Resolved: that subject to the provisions of Paragraph 2, Chapter II, entitled: 'Objects: Constitution of NASA,' the Uniform Act be approved as presented."

On reconsideration at this current convention of the NASA, October 7–10, 1957 the following clarifying resolution was adopted by unanimous vote except for Ohio abstaining: "Now, therefore, it is hereby resolved, that Dr. Louis Loss is commended for the laborious task which he has undertaken and completed but that the Administrators did not intend to and did not approve or recommend the adoption of the proposed Uniform Act in any State."
he states that in his opinion the permit system and the registration system are inherently the same thing.

It appears quite clear that the mere disclosure system and the strict permit system are very distinct and different forms of security regulation. It would appear that we should study the model act not with an eye to its adoption in California in lieu of our strong effective California securities law, but with an eye to improving our permit system with any additional provisions that may be borrowed from the model uniform act. This article could not possibly cover the ground set forth in the report of the Los Angeles Bar Association Committee on Corporations which discussed in detail the proposed model act, but we may summarize by referring to that portion of the report by James E. Dunlap wherein he discusses the proposed Uniform Securities Regulation Act in contrast to the California Corporate Securities Act. Mr. Dunlap states that while the Part I, in regard to fraud does achieve a fair degree of uniformity, such uniformity is of little consequence to the securities industry. As to the registration of broker-dealers part of the model act, he says that while a relative degree of uniformity has been achieved, such uniformity would not seem to be of any real importance. As to the first subdivision of Part III, relating to registration by notification, he says that while it is, of course, of extreme importance to have relative uniformity in connection with the registration of securities to be sold nationally, on the other hand, it is of only minor importance for issues to be sold only in one or two different states. Registration by notification applies only to corporations who have been in continuous operation for five years and have not defaulted in interest or dividends on senior securities for the immediately preceding three years. As to registration by coordination, he states that, since most national distributions will be registered by coordination, the highest degree of uniformity is desirable. On the other hand, he states, since there is no guarantee that a security registered by coordination meets any minimum standards, the administrator will want the maximum discretion in determining whether an offering should be made in the state. As commented upon hereinabove, the great bulk of underwritten national issues will qualify by filing their registration statements and appointments of the Commissioner and resident agent for service of process with the Commissioner of Corporations. As to those issues which do not measure up, such as the Tucker Automobile promotion, as above stated, the California Commissioner should have discretion to turn down such issues, even though registered with SEC. Mr. Dunlap continues to comment that only very few states require a registrant to supply any material already furnished the SEC, and accordingly, it would appear that

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28 See note 23, supra.
the uniformity achieved by the model act is not substantially greater than that which now exists. He also states parenthetically that it should be noted that in states which now require only notification, typical filings, the filing burdens would be increased with the adoption of the uniform law. As to registration by qualification, Mr. Dunlap comments that this procedure will be used only by securities not qualifying for registration by notification and not being registered with the Securities and Exchange Commission. He states that since virtually all widely distributed securities involve offerings of over $300,000, and must be registered with the Securities and Exchange Commission, all issues will not be concerned with the procedure for registration by qualification. In this field the need for uniformity is not great. It is important to note that some 16,000 permits per annum are issued by the Commissioner of Corporations of the State of California, of an aggregate amount of approximately $2,000,000 which are covered purely by the permit system, rather than by the qualifying registration statements on national underwritings and it is in this field of 16,000 corporate permits per annum that the permit system is most vital to the protection of our California investing public.

Mr. Dunlap comments on the provision for escrow and impound provisions in Section 365g of the Model Uniform Act and says that no standards are set forth to guide the administrator in determining whether such requirements should be imposed and for that reason, there is not likely to be much uniformity in its application. He states that the escrow requirement can only be used in the case of issuers with securities outstanding which were sold substantially below the present public offering price or for a consideration other than cash, and that this is a narrow application of the escrow condition. He says, therefore, that little protection is to be gained by such an escrow provision, and that because of the ineffectiveness of this section and its tendency to reduce the uniformity which the proposed act is designed to achieve, it is difficult to justify the escrow provision in its present recommended form. He further states that as the escrow provision is now written, the right of the administrator to impose conditions of escrow probably cannot be construed as authorizing him to require a subordination of the promoters interests in dividends or liquidation rights and, I might add, the waiver of voting rights where the promoter may be either dishonest or unsuccessful in operating the company. Such waiver conditions are a vital appendage to the escrow condition to protect the California cash investors against promoters' interests. He further states that the lack of uniformity in applying the impound requirements made possible because

27 See appendix to Report of Committee on Corporations, Los Angeles Bar Association, April, 1957.
of the lack of a statutory standard for its application could cause considerable hardship with regard to an offering registered with the SEC.

**Need for Critical Study**

Time does not allow voluminous additional criticism that could be made of the model uniform securities regulation act but in view of the fact that the Los Angeles Bar Association Board of Trustees have been asked to authorize the Committee on Corporations to devote an additional year to the study of the model act, and in view of the fact that there is a possibility that some may urge the adoption of said act at the coming, or an early succeeding California legislative session, it is deemed of grave and vital importance that we make haste slowly; that the bar associations in northern California, particularly in San Francisco and the Bay Region, as well as other industrial centers in northern California, launch upon detailed studies of the proposed uniform securities regulation act, with an eye toward further strengthening our own Corporate Securities Law while adopting any advantageous provisions from the model uniform act, rather than casting aside our act and losing the 40 years benefit of experience, practice, interpretation by Attorney General and courts, and familiarity of Bar, security brokers, and business men with what we proudly believe to be the best securities regulatory act in the United States.