The
California Corporate Securities Act*
(CONCLUDED)
SECTION 4. ADMINISTRATION OF THE SALE OF SECURITIES IN AN OPEN MARKET

The majority of corporations filing applications for the issuance of stock, about 70 per cent, request that the stock be sold to a limited number of persons — that is, in a closed market. The remaining 30 per cent request a permit allowing their securities to be sold to the general public. They apply for a so-called "open permit." These open permits are issued by a special division of the Corporation Department, the Promotional Division. This Division has been established in order that special consideration might be given to "projects which have for their purpose a method of financing by public contribution to their capital assets." It is through the work of this Division that the Department comes most frequently into contact with the investing public. One open permit commonly brings a sale to stockholders fifty or a hundred times larger than the limited number in a closed permit.

A corporation desiring to sell its securities publicly may be a newly organized entity or a going business with a corporate and financial record requesting a further sale of its securities. The first part of this section considers the regulation of the issuance of stock to the public by newly organized ventures, the second, the issuance of stock by going concerns, and the next section is devoted to bond issues. Each type of transaction has called for a different regulative approach by the Department.

The Department classifies the different types of applications and refers to a "promotional division" applications of a promotional type where companies propose to finance by an appeal for capital contribution to the public, to which most serious consideration must be given as to the personnel connected with the corporation, the feasibility of the enterprise, the corporate and stock structure, and the financing program. To the "regulatory division" are referred applications of "closed corporations" where the applicant does not propose to sell any stock to the public and where the entire amount of the price received will go to the company. There is also the "secured issues" division to

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54 This distinction is difficult to make because many corporations which have previously held a permit have a financial record showing losses not profits. When they apply for a supplementary permit for a new sale, such a permit is considered by the Department as a new promotion in that the initial start has been a failure.
deal with applications for the sale and disposal of bonds, collateral trust notes, and other evidences of indebtedness.

(1) Regulation of Stock Issued by Newly Organized Corporations

A. Characteristics of This Type of Issue.

The greatest number of applications filed in the Department asking for a permit allowing a public sale are submitted by newly organized corporations. Of the 130 applications examined for the month of March, 1928, 84 were of this type. A detailed examination was made of the outstanding features of these corporations and their securities. They are considered under the following headings: kind of business, method of raising capital, and the type of purchaser of the securities.

(1) Kind of Business:

Retail or wholesale trade. 18 cases. In most of these cases the promoter or organizer owned or had an option to buy a going concern.

Real estate development, including junior financing of hotels. 18 cases. A large number of public sales of stock in real estate developments is characteristic of this state. These cases include the subdivisions and resale of agricultural and urban properties.

Miscellaneous kinds of manufacturing. 17 cases. Some of these included the manufacturing of a product under a patented process, a few were small plants manufacturing products for a local market, e.g., local foundries.

Mining and oils. 10 cases. These cases were newly formed companies to mine unimproved claims held outright or under options, by the promoters. The frequency of their applications before the Department has called for the creation of a special department to consider them.

Finance companies. 8 cases. These include mortgage companies as well as stock and bond businesses. Special rules have been promulgated by the Department to cover this class of enterprise.

Exploitation of patents. 4 cases. The principal asset around which these companies were incorporated was a patent. This patent was to be commercialized by manufacture, but in no case had the commercial value of the article been assured.

Aeroplane industry. 3 cases. Three corporations applied for a permit to sell stock in a business to enter this new industry.

Miscellaneous. 6 cases.

Most of the ventures outlined above were to become profitable if promised events materialized in the future. The development was to be the discovery of minerals, the exploitation of a patented article, or the enjoyment of a profitable real estate market for subdivided property. The income for the corporation, with the few exceptions in which going retail organizations were incorporated, was to be derived from the realization of future prospects and, in this sense, an investment in the ventures can be characterized as having greater than ordinary chances for possible loss.
(2) **Method of Raising Capital:** An individual desiring to exploit a patent, mining claim, secret process, or going business has the option of raising the capital through friends, associates or private bankers, or through a sale to the public. The former method is the most economical and certain, and involves less trouble and delay. Granting that the promoter is honest, he will resort to a public sale only when the capital cannot be raised through private channels. Before going to the public directly, however, he may place his plan before an investment banker asking that specialist to purchase the securities for resale to the open market. In the cases involved, the majority of the securities were too small to be sold in this manner. In those cases in which large sums were to be raised, the absence of earning power ruled out the possibility of raising the capital through this channel.

The necessity of raising capital through the sale of stock to the public requires the organization by the promoter of a selling force to which a commission of 20 per cent is paid (generally) upon the sales of stock.\(^55\) This selling force becomes the third party in the promotion and has, as its motive, the selling of the maximum amount of stock to the public for a commission.

(3) **Purchasers of the Securities:** The purchasers of the securities issued under an open permit obtain indirectly their information about the newly organized corporation. They reside often in a different locality from the place of business of the corporation and have not inspected its properties. Their knowledge of its assets, and their acquaintance with its management are derived from representations made by selling agents. These representations are made through personal interviews, direct mail correspondence, circulars and, in case of sizable corporations, through newspaper advertisements. The purchasers, unlike the buyers of the shares of closed corporations, are numerous and scattered and become owners of small lots of stock.

The typical set-up of a corporation applying for an open permit is as follows: The leading spirit is an organizer or promoter desiring to raise capital from the public for the exploitation of some idea, property, patent or process which he owns.\(^56\) The success of the business lies in the occurrence in the future of some predicted development and involves greater than ordinary risk. The purchasers of the securities

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\(^55\) Sixty-three out of the 84 corporations were allowed to sell their stock at a commission.

\(^56\) It should be made clear that this description is that of the normal set-up presented by the 84 applicants examined. All were newly organized and about 67 per cent issued blocks of promotional stock of intangible value. A larger percentage, about 77 per cent, paid a commission, as a rule 20 per cent, for the sale of its stock.
supply the cash capital, the promoter assets of intangible value. Such purchasers occupy a position far different from that of the stockholders in a going corporation.

B. Administrative Standards for Promotional Corporations.

The matter of initial interest to the Department in examining an application for an open permit is the nature and value of the assets which are to be contributed by the promoter and the reward expected by the promoter for his services. These valuations and awards for the services and property of the promoter must be satisfactory to the Department before a permit will be issued.

(1) Valuation of promoter's assets and services. — The assets presented by the promoter to the corporation for its stock may be for property, e.g., an oil rig, real estate, patent, a going business, or for personal services in incorporating the venture.

The valuation of the property submitted by the promoter can be verified by the Department with different degrees of certainty. The valuation of real estate, called for in the numerous real estate subdivision ventures, is done by means of independent appraisers satisfactory to the Department. The appraising of the value of a going business which is to be sold to the public is done by the auditing department either through capitalization of earnings or the valuation of the net book worth, less intangible items.

There are several kinds of property submitted by the promoter which the Department does not attempt to evaluate, e.g., patents, goodwill and secret formulas. In the case of mining and oil property, the Department requires that a report of a mining engineer be filed with the application describing the location and extent of the property, its geological structure and formation, ore reserves and probable costs of production. In the case of unimproved mining claims, such a report would indicate something of the physical nature of the property, but little of its value. In the greater number of cases, the stock issued to promoters for unimproved claims is considered in the same light as stock issued for intangibles.

It is common practice for the promoter to request an issue of stock as remuneration of his service in incorporating the venture. This promotion stock is requested to be issued as a reward and also places control and management of the corporation in the hands of the organizer. In California, it is not permitted to issue classes of stock with different voting rights; consequently promoters are anxious to obtain a block of stock large enough to assure voting control.

The Department allows the full issuance of stock to a promoter for those assets which can be evaluated with ordinary certainty. It does
not allow, however, the free issue of stock to the promoter for assets of an intangible value, whether patents, mining claims or goodwill. The value of the services of a promoter can not be determined until after the corporation has shown an earning record. Stock for this consideration will not be issued free of conditions until that time.

Stock issued to promoters for assets of intangible value is issued only upon the condition, written as part of the permit, that none of the shares shall be issued unless a depository satisfactory to the Commissioner has been selected and such shares shall be deposited upon issuance with such depository. The owner or persons entitled to such shares shall not sell, or offer them for sale, until "the written consent of the Commissioner shall have been obtained so to do or said shares shall have been released from escrow." The Department will release the stock from escrow upon application of the owner showing that the intangibles have proved to have a definite value; until this time, the stock carries voting power and other corporate privileges, but it can not be sold in competition with the stock which is being bought and sold currently for cash.

In some instances, escrowed promotion stock is further conditioned by the provision that the promoter shall waive the rights to receive dividends (if paid) at a certain rate, generally 7 per cent, for a given number of years, commonly three, or the other stockholders shall have received dividends equal to the amount of the total cash contribution, at the discretion of the Commissioner. By the same token, the Commissioner requires that the promoter waive his rights to receive, on the escrowed stock, any liquidating dividends, voluntary or involuntary, until the cash stock purchasers have been paid in full.

The extent of the use of the escrow for stock issued to promoters for intangibles is indicated by the following schedule:

- Open permits examined: 84
- Promotion stock issued: 57
- Promotion stock equal to sale to public: 27
- Promotion stock larger than sale to public: 13
- Promotion stock smaller than sale to public: 17
- Waiver of assets and dividends in promotion stock: 46

Two facts of interest are disclosed by these figures: first, the large number of corporations issuing stock for intangibles, about 70 per cent; and secondly, the large proportion of cases in which promoters of corporations have the controlling interest in the corporation. In the 57 cases involving the issue of promotion stock there were 40 in which that stock was equal to or greater than that sold for cash to scattered stockholders. This gave absolute control over the corporation to the

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57 Generally a trust department of a bank.
promoter. The Department required that the promoter waive the right to receive dividends and distributed assets in 46, or nearly 85 per cent of the cases.

The Department, through its regulation of the plan of corporate setup, evaluates the contribution made by the promoter to a newly organized corporation. In cases in which this contribution can be appraised as to value, the stock is issued free and without conditions. In the great majority of cases, the contribution of the promoter, either property or services, can not be evaluated and in these cases the reward must be forgone until the value is proved. Although, in most cases, the promoter receives half or more than half the stock for promotion, nevertheless the Department has given a preferred position to the cash stockholders by requiring a waiver of dividends. Common stock purchased by the public under the conditions imposed by the Department is given the characteristics of a preferred stock.

(2) Examination of feasibility of project. — The Department does inquire into the economic feasibility of the project before a permit is issued. It is rarely, however, that a promoter is refused a permit to float a corporation upon these grounds. If the promoter has a clean business record and if he is willing to make a substantial property or cash contribution the permit will be issued. The requirement of a contribution by the promoter, in conjunction with preferences given to the cash stockholders, makes it difficult or at least unprofitable to obtain money fraudulently by the issuance of promotion stock for intangible values.

(3) Administrative examination and regulation at time of sale of securities. — After the plan of the promoter's business is examined, the value of the assets ascertained and the terms of the promoter's remuneration worked out, the permit can be issued. There are certain provisions which must be met by the corporation, however, just before and immediately after the stock is sold. The rules of the Department in regard to the policy to be followed by the corporation at this juncture are written as provisions or conditions in the permit.

(a) Transfer of assets. — The most common of these conditions is that the stock to be issued to the public for cash shall be issued after the assets to be absorbed shall be acquired by the corporation. For example, the promoter holding a patent when it is to be the core of the business venture, is required to file with the Department an assignment of this patent to the applicant corporation before the stock may be sold to the public. In a newly organized promotion the permit provides that shares shall be exchanged for the property or business to be acquired, the sine qua non of the corporation; then shares are allowed
to be sold to the public, and finally the promotional stock for services is to be issued to a depository under an escrow agreement when, as and if, the cash shares are issued. The transfer of the essential assets to the corporation before the sale to the public gives some assurance that the cash acquired will be used for the purposes professed at the time of sale.

(b) **Control over disposition of cash.** — The second, and by far the most important of the conditions written in permits to regulate the early life of the corporation, is that affecting the disposition of the cash obtained from the sale to the public. This control over the use of the funds raised is exercised in three ways: limitation of commissions, limitation of salaries, and impounding of cash.

The limitation of the selling commissions upon stock is invariably made in public sales. These limits are 20 per cent in industrial stock issues, 10 per cent in the case of bonds or notes, and 10 per cent in the sale of stock in finance companies or investment trusts. A further condition requires that the commissions be paid only on the amount of cash received from the purchaser and not on the sales price of the stock. The commissions are paid as, if and when, the corporation receives the balance of the payments. The limitation of commissions is demanded for two reasons: (1) It makes less attractive the old scheme of promoting a company for the commissions earned (often 50 per cent) on the sale of its stock; and (2) It allows the corporation to start with not less than 80 per cent of its capital fully paid. This lessens the chances that the company will fail for lack of funds.

The condition imposing a limitation on salaries is commonly used in those cases in which the newly initiated company can not stand the financial burden of excessive salaries. In 21 cases out of 84 there were such limitations, generally to $250 or $300 a month. By this provision, the limitation is to stand unless the net profits of the company are sufficient to pay dividends of generally 7 per cent.

The third, and by far the most important, regulation effected over promotional corporations in the early state of their development is that requiring an impounding of cash. This calls for the appointment of a depository, a bank or trust company, who shall impound or set aside

68 The wording of permits to corporations which are to acquire assets is, "That none of the shares shall be issued unless and until the business and assets, as described in the application for this permit and papers filed in connection therewith, shall have been first transferred to applicant in the manner described in said application."

69 In these cases the permit for the sale of stock is issued subject to the provision that an amendment is made in the by-laws of the corporation limiting the salary of all officers to the amount set by the Commissioner unless by two-thirds vote of the stockholders such salary is raised.
the cash received from the sale of stock. The amount to be impounded will depend upon the character and nature of the business, but it will equal, generally, the amount stated in the application as necessary to start the operation of the business. By this provision, the cash paid in to the corporation is set aside until the fund is large enough to warrant starting operations in the particular business. For example, a permit may allow the issuance of $100,000 of stock to a promoter for his oil lease and rig and $100,000 to the public for cash. The application states that $50,000 is necessary for current expenses before drilling operations may start. In this case, the proceeds of the sale of stock would be placed with a depository to be released, by order of the Commissioner, when the fund equalled $50,000. If that sum was not realized in a given period, the company may ask for an extension of time in which to raise the money. Otherwise, the impounded cash would be returned by the depository to the purchasers of stock.

The impounding of cash, to assure adequate capital for a satisfactory launching of a promotional venture, was required in about 50 per cent of the open permits written during March, 1928. The following data compiled for the period August 31, 1926, to September 1, 1928, throw some light upon the result of the impounding conditions:

| Report made of subsequent history of impounds | 726 |
| Amount raised and released | 85 |
| Amount raised and partially released | 80 |
| Amount not raised | 311 |
| Companies requesting extension of impounding period | 250 |
| **Total** | **726** |

The outstanding fact disclosed from the above is the large percentage of the corporations which fail to raise the funds needed for the launching of their business. Only 165 out of 726, 22 per cent, were successful in raising an amount sufficient to begin operations. The remaining 78 per cent could not sell their stock in sufficient amounts to start the operation of their enterprise and asked for an extension of time or a voluntary revocation of their permit. This indicates that three out of four promotional ventures are doomed to failure, in not being able to raise the fund of cash which the promoter has stated, and not the Department, as necessary for a successful beginning of the business.

A great number of the promotional corporations, then, are not stopped in their inception, following a rigorous investigation of their

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60 Biennial Report of the State Corporation Department (September, 1928) 65.
business plan, corporate set-up or management, but are stopped by their inability to raise a cash fund considered by them to be the minimum for a successful start.

(c) Conditions as to the method of sale of securities. — In addition to conditions imposed upon the corporation as to the transfer of assets before sale of stock and the disposition of the funds raised by such sale, the Department requires that the manner of making the sale be conditioned in two ways: first, as to the information to be given the prospective stock purchaser, and secondly, as to the contract of sale for the security.

The knowledge about a security sold to the public under an open permit is obtained indirectly through a selling agent. The provisions of the Act empower the Department to examine and check the advertising material used in forwarding such sale. The material is examined at the time of the filing of the application. A full description of the promoted corporation is contained in the permit and the Department requires that this permit be printed on the back of the subscription blank in order that the purchaser may read it before the purchase of the stock. The law provides that “every permit shall recite in bold type that the issuance is permissive only and does not constitute a recommendation or endorsement of the securities permitted to be sold.” (Section 4.) The permit, as placed before the purchaser, now averages two or three pages, often carrying two to four conditions qualifying the issue of the stock.

The Department has taken the position that the stockholder may not understand the financial set-up of the corporation and the conditions it must meet before (or after) the stock may be sold. During the administration of Commissioner Friedlander, it was decided that special emphasis should be placed upon the fact that a security was speculative in those cases in which the Department decided there were extraordinary risks involved. The standards upon which a stock is found to be speculative have not been elucidated by the Department, each case being considered upon its merits. During March, 1928, there were 11 securities (about 13 per cent) which were characterized as speculative, this being accomplished by writing across the subscription blank (in colored ink), “This is a highly speculative security.”

There is a difference, as between states, whether there should be any reference made to the state examination of a security. The Massachusetts act, section 11b of the Sales of Securities Act, provides that, “no person shall on issuing or publishing any circular or advertisement make any reference whatsoever to the fact that the provisions of the act have been complied with.”

The reason stated in the permit for designating as speculative the securities of a company incorporated to commercialize a patented article was: “The appli-
these cases the state has assumed the responsibility of designating what are speculative securities, and by the same token, what are not speculative securities.

(d) Contract for purchase of security. — In the public sale of the stock of corporations the Department requires often that the subscription blank be submitted with the application. This blank outlines the terms and conditions upon which the purchaser buys the stock, the initial payment, the interest rate on the unpaid balance and the condition of the delivery of the stock. The Department requires that all stock purchased on the installment plan shall not be delivered until the subscription price has been fully paid in cash. Until paid, the stock is required to be retained by the company to be held as collateral security for the payment of the balance due. By this condition, the stock issued for notes can not be sold in competition with that issued for cash. This amounts to an escrowing of shares issued for intangibles, the unsecured notes of a purchaser being considered as of that value.

(4) Administrative examination and regulation after sale of securities. — There are several conditions written in permits which have, as their primary purpose, the placing of corporate information before the Department after the issuance of a permit and the launching of the business. For foreign corporations, selling their stock within the state, there was formerly the requirement that they keep their books and records within this state. This is done in order that the Department "may determine the question either of over-issue of stock or solvency."\(^3\) This has been abandoned by the Department as not being practicable and as working an unnecessary hardship on foreign corporations desiring to qualify securities. Secondly, the Department requires that all corporations selling stock to the public appoint a transfer agent for its stock, and, in sizeable corporations, a registrar of the outstanding stock. The appointment of these corporate agents as well as the requirements for foreign corporations, followed after the over-issue of stock by the Julian Oil Company.

The permits issued to open corporations are conditioned further upon the submission of financial reports, both as to assets and liabilities, and profit and loss statements. These reports are to be submitted quarterly by those newly organized corporations without a permanent

\(^3\) There were 18 corporations, of the 84 examined for March, 1928, which incorporated outside of California—Nevada and Delaware being the states in which they were incorporated. In only one case, however, did the corporation have its assets and place of business outside the state.
record, every six and twelve months by going concerns. These reports are required of closed as well as open permit corporations and their examination and filing calls for a substantial amount of clerical and auditing work. Commissioner Friedlander reported in the Biennial Report of the State Corporation Department, 1928 (page 17), "Probably, one of the most formidable tasks performed by the Department during the past twenty months was an investigation to determine the financial status of the thousands of companies which had received permits. Our efforts concerned chiefly those companies receiving permits for the sale of their securities to the public."

The corporations showing a poor financial condition are halted by revocation of their permits from making further sale of securities. The reports submitted at the end of the year cover the financial transactions of the previous year. These reports, due to their great number, can not be analyzed at the time of their receipt. A delay is unavoidable. A revocation of a permit written on the ground of unsatisfactory financial condition would stop the sale of stock at least a year or six months after the company became involved financially. Such a revocation would appear after the stock had been sold in its original issue.

The conditions imposed upon a company affecting it after the sale of stock and the establishment of its business are of indirect value in protecting the investing public. Appointment of registrars, transfer agents, keeping of records within the state and the submission of financial statements aid the Department in ascertaining fraud and corporate mismanagement after the stock has been sold under the conditions of the permit. When discovered, the permit of the company is revoked, but by that time the dishonest promoter has sold the stock and stands outside the jurisdiction of the Department. It has recently been stated by the Corporate Securities Department that, "The use of conditions subsequent has been almost entirely abandoned as they may be likened to locking the stable door after the horse has been stolen. The Department now uses only conditions precedent."

C. Conclusion on Regulation of Newly Organized Corporations Selling Stock to Public.

The greatest number of corporations applying for permits to sell stock to the public are newly organized corporations of the promotion type. It is principally in the regulation of these corporations, having a great number of stockholders, that the administration of the Securities

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64 Twenty-two full-time auditors are engaged in this and other auditing work.
65 There is some doubt as to the present effect of a revocation on outstanding subscriptions, it being generally considered that the revocation stops any further action on stock other than that already issued at the time of the revocation.
Act touches the interest of the general public. The major characteristic of this type of corporation is that the organizer or promoter uses the corporation as a means by which he may exchange his assets, whether tangible or intangible, for stock and exploit these assets by the capital raised from numerous scattered stockholders. The business enterprises to be organized by the promoter entail more than ordinary risks. The regulation by the Department of these promotional corporations has centered about effecting an equitable distribution of rewards and control between the promoter and the cash paying stockholders. The most potent regulation appears in limiting the rewards of the promoter until the venture is a success and demanding the raising of a cash capital large enough to give a fair chance of launching the business. The last condition is particularly effective in stopping unwise and precarious ventures before they are started. Regulation of the capital set-up and the disposition of funds, minimizes the opportunity for unfair treatment of the public at the hands of promoters.

(2) Regulation of Stock Issues of Going Corporations

The nature of the financial plans submitted for approval by going concerns varies widely. In March, 1928, there were 134 open permits issued and 46 of these permits were granted to corporations which had a financial and business history. The securities which they requested to sell were as follows: bonds, 21; stock, 19; notes, 4; and 2 of miscellaneous nature. The policy of the Department toward the issue of securities by a going concern may be analyzed by a consideration of the two major types of securities, i.e., stocks and bonds.

The issue of stocks may be made by a going corporation with a favorable earning power and strong asset wealth or by one without earnings and in a weak, insolvent financial position. The applications received for the sale of stock by going concerns falls roughly within one or the other of these groups.

A. Corporation with Earning History and Solvent Position.

Strongly intrenched going concerns applying to issue to the public receive a permit with the minimum of delay. The price asked by the company is considered in the light of the net worth of its stock and its capitalized earnings. Since it has an earning history, the investing public has grounds upon which to check the price asked by the corporation. As explained in the action on "closed corporations," the Department requires that the new stock be offered to the existing stockholders of record before it is offered to the general public. Many instances occur where the book value of the stock is in excess of the par value or proposed selling price, or the stock may have bright prospects due to some factor within the knowledge of a small circle of officers or
stockholders. To guard against discrimination a proportional offer to stockholders is required first.

B. Corporations without Earning History or Solvent Position.

The great number of the going corporations applying for a permit to issue stock to the public have no earning power. The application filed indicates that these companies desire to issue more stock in order to rehabilitate their financial position. This issue to the public is accompanied often by an exchange of stock for assets or the cancellation of indebtedness. The reorganization is headed by the majority stockholders or more often by some person holding a working control of the corporation; in the latter case, the person assumes the rôle of the promoter as seen in case of the flotation of a new company. The promoter has now an interest in a defunct company which he wishes to rehabilitate by the contribution of cash from the public.

The policy of the Department toward the issuance of new stock by a weak going concern does not differ greatly from that in newly promoted schemes. The regulation centers about the valuation of new assets and the establishment of a fair price for the new stock. A company in poor financial condition proposing to raise additional working capital by the sale of stock to the public may, at the discretion of the Commissioner, be required to impound an amount which will, in his opinion, prevent the company’s failure for lack of funds. The Department usually requires that the existing shareholders salvage their company, and it is only where an exceptional showing is made, that further contributions from the public may be solicited.

SECTION 5. REGULATION OF BONDS ISSUED BY GOING CONCERNS

The application received by the Department requesting a permit for the issuance of bonds may be classified into two groups: first, those corporations desiring to issue their bonds to specified individuals and not to the public; second, those desiring to sell their securities to the general public. The second group is by far the more common. Closed permits for the sale of bonds are issued rarely. The open sale of bonds may be effected in one of two ways: either through direct sale to the public through the issuing corporation’s selling force, or through the sale of the issue to investment bankers or bond and mortgage houses.

It is not customary for a corporation to sell its bond issue through its paid agents. In the 17 straight permits for the sale of bonds examined during the month of March, 1928, there were three which proposed

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66 Individuals, as well as corporations, must qualify their mortgages sold by them to mortgage companies if the latter resell them to the public. These instances rarely occur.
this method of sale. In these three cases the issuing corporations sold the bonds through a sales force which had been organized previously for some other purpose. In one case the sales force sold concurrently, subdivision real estate and the bonds.

(1) THE ORIGINATION OF THE TYPICAL BOND ISSUE

The usual method of selling bond issues is through an investment banking or mortgage house. In the former case the bonds are resold directly to the public in $1,000 lots, and in the latter the bonds purchased are often combined with other real estate collateral as the basis of an issue by the mortgage house of its mortgage collateral certificates. Economy dictates that these financial middlemen be employed by the issuing corporation. These specialists relieve the corporation of the burden of organizing a retail selling force as well as of the numerous and intricate legal details entailed in the flotation of a bond issue.

In over 80 per cent of the cases of open permits for bond issues, the sale by the issuing corporation was made to a financial corporation or investment house. In these cases the permit states the name of the purchasing house and the terms upon which the bonds are to be sold. The Department, in these cases, issues a permit to the issuing corporation, but the application, with the supporting documents, description of title, appraisals, indenture of trust, etc., is submitted by the purchasing financial house, and in most cases, the counsels of that investment institution take full responsibility for the legality of the issue, including the obtaining of a permit for sale.

The steps through which the typical bond issue originates are as follows:

1. The issuing corporation and the investment bankers arrange for the terms of sale.

2. The counsel of the investment house, after submitting the financial plan, applies for a preliminary permit allowing that house to negotiate for and receive subscriptions pending the preparation of the trust indenture. The wording of the application is, "pending the preparation of the trust indenture, applicant desires and requests the Commissioner of Corporations to issue his permit whereby said A. B. C. Investment House will be authorized to negotiate for and receive subscription of said bonds, with the understanding and upon the condition that said bonds shall not be issued or payment made by any subscribres thereof until an appropriate final permit thereof has been duly issued by said Commissioner."

3. If the plan is acceptable, the Commissioner issues a preliminary permit to the issuing corporation allowing it to "offer for sale and negotiate for the sale of" the bonds. This is conditioned by the clause
that "no subscription shall be taken, cash or other considerations received, unless and until the Commissioner of Corporations shall have issued an additional permit authorizing the sale of the bonds."

4. The bonds are then offered for sale by the investment house and this offering, as advertised in the newspapers, is conditioned by the clause, "We offer these bonds for delivery when, as and if issued and received by us, subject to the approval of all legal details by counsel and subject to the approval of the Commissioner of Corporations and such changes as he may require."

5. A final permit is given to the issuing corporation to sell its bonds to the banking house which in turn delivers them to the subscribers under the preliminary permit.67

(2) ADMINISTRATIVE REGULATION OF BOND ISSUES

The plan of procedure as outlined above indicates that the Department, through the issuance of a preliminary permit, exercises its regulative function over the issuance of bonds without costly delays and interruptions. This does not mean, however, that the Department necessarily permits the sale of bonds upon the conditions and according to the plan acceptable to the issuing corporation and the purchasing bankers. The Department's examination and regulation centers first about the valuation of the mortgaged property, and secondly, upon the terms of the indenture of trust. This examination and regulation is made of every issue, regardless of the financial prestige of the issuing corporation or the strength of the purchasing bond house. The final permit for the issuance of bonds, unlike the permit for stock sales, has few conditions or provisions as the indenture of trust protects the interest of the bondholders after purchase.

A. Valuation of the property.—The Department has not issued regulations in regard to the manner or method to be followed in the valuation of the property to be mortgaged. It does demand, however, that an independent appraisal be made, independent of those employed by the issuing corporation or the purchasing house. If the bonds are to be issued by a going concern, a profit and loss statement of the business must be submitted in addition to an appraisal of the real property. The Department may require that the profit and loss statement be submitted by public accountants, independent of the accountants employed by the issuing corporation and the purchasing house.

B. Terms of indenture of trust.—Every indenture of trust submitted by the lawyers of the purchasing banking house is analyzed by a deputy-commissioner regarding default, covenants, expenditure of

67 Of course the procedure as outlined is incorrect insofar as it omits the rôle of the trustee.
funds and appraisal and description of the property. The Department examines, critically, the indenture which has previously been checked by the counsel of the issuing corporation and the bankers.

(3) **Possible Benefits of Regulation of Bond Issues in California**

Most states outside California give exemption in their Blue-Sky laws to first mortgage bonds issued in a conservative amount against real property.68 This is done because the opportunity for a purchaser to be defrauded is limited in these cases; the investment is secured by tangible assets which can be evaluated. California has not exempted the issuance of bonds and in the administration of the provisions of the Act affecting this type of security, the Department has played an active rôle.

The great majority of bond issues issued in California are purchased by investment houses for resale to the public. The most valuable asset of these institutions is the goodwill they enjoy from the public and this can not be obtained or maintained if its offerings bring a financial loss to clients. The regulation effected by the Department over appraisals and the form and content of the trust indenture has been criticised as offering no great amount of protection against possible losses to investors. The Department believes, however, that there is a concerted effort on the part of some toward over-valuations and the stuffing of appraisals in connection with bond applications. If it were not for the careful supervision of appraisals and the rigid requirements of the Department with reference to values, California investors might have sustained many more losses than they already have through so-called bond investments. Bond issues of corporations of financial prestige, underwritten by established investment brokers and bankers of good reputation, and whose legal proceedings are conducted by able attorneys, cause a minimum delay in being handled by the Corporation Department. On the other hand the frequent bond issues with improper security, by corporations which have little or no prospect of future success, indentures poorly and inadequately drafted to protect bondholders, underwritings by questionable or weak financial investment brokers or houses, need careful supervision by the Corporation Commissioner to give the public the protection that it deserves and the Corporate Securities Act contemplates.

**SECTION 6. ADMINISTRATION OF THE SALE OF SYNDICATED SECURITIES**

It is the purpose of this section to consider the administrative control of securities which enter the state through the process of syndica-

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68 The provisions are found either in the form of exemption or preference as to manner of qualification.
tion. By syndication is meant the customary process of resale of an issue of securities, previously purchased from a corporation by an originating syndicate (composed of one or more investment bankers) to a distributing or retail group of bankers who dispose of that issue to the public. It is through this process that a wide and extensive disposition is made of securities of a corporation which otherwise would be restricted to a local market in which to raise its capital funds.

In the case of those issues syndicated into California from other states, the original sale of the securities takes place outside the state and hence outside the jurisdiction of the Corporation Department. It is outside that jurisdiction only in the important sense that the corporation does not need to obtain a permit for the subsequent resale of its securities. The Department's control over interstate syndicated issues is exercised indirectly through the licensing of brokers. Before examining this indirect control, however, it is necessary to outline the kinds of dealers in California entering into the syndicating process.

(1) Types of Investment Dealers in the Syndicating Process

The nature and function of four types of investment bankers must be analyzed before further examination of syndicated issues is possible; namely, foreign brokers with or without branches in California, and California brokers with or without branches in other states.

A. Foreign Banking Houses Without Branches in California.

There are about 18 foreign bankers who have obtained licenses from the Department but who do not maintain a branch office in the state and consequently do not actively solicit accounts from the investing public. Their motive in obtaining a license is that they may advertise their issues in California. This advertisement is to acquaint dealers and the public with the investment house and its securities and is done primarily to assure a wide market for the security.

B. Foreign Banking Houses with Branches in California.

This important group comprises about 53 dealers, some of them small and inactive, but the great majority with branches in California which sell large blocks of stock of outside corporations to the public. These branches not only resell securities syndicated to them by their parent organization, but they may purchase securities for their own account and for resale. Some of these branches represent a parent

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69 In this sections the terms "investment banker" and "dealer" are used interchangeably.
70 The law provides that no company shall sell (meaning original sale) its securities without a permit being received from the Department.
71 Section 7 of the Act forbids the advertising of an issue by an unlicensed broker or dealer.
organization which has specialized upon the issuance of certain types of securities, others dealing in a general list.\textsuperscript{72}

The securities sold by these branch offices are obtained from the eastern parent organization. These securities have been sold by the corporation to the latter outside the state and consequently are not sold under a formal permit. The parent organization may syndicate its issue to other than its own branches, and in cases in which the issue is large this is the customary procedure. In this case, the securities are distributed to local (California) investment houses.

C. \textit{California Investment Dealers}.

The local dealers within California of strength and prestige are placed upon the syndicating list of eastern investment bankers. These local dealers generally purchase the securities of local corporations for their own risk, and in these cases they are investment bankers of the originating type as well as retail dealers. There were 58 dealers in California who were credited with originating their own issues during 1928.\textsuperscript{73} These total originations were securities purchased from California corporations in which the sale took place within this state.

D. \textit{California Investment Dealers with Branches Outside the State}.

There are a few California investment banking firms which have expanded into other states.\textsuperscript{74} This expansion takes place generally upon the Pacific Coast, but in some instances it has been into the capital market of the United States, New York. These out-of-state branch offices are primarily distributing points, but often they purchase securities from issuing corporations. These securities are syndicated in part through the main office in California and by this process California investors purchase securities the original issuance of which has not been under the administration of the Corporation Department. In a few cases California investment bankers have branches which are a source of foreign securities appearing before the investing public in this state.\textsuperscript{75}

\textsuperscript{72} For example, S. W. Straus and Greenebaum & Sons, in real estate mortgages, and Bonbright in utilities. For the most part, however, the branches sell a general list, such as the branch of the National City Company of New York.

\textsuperscript{73} This is from data compiled in the securities manual—\textit{AMERICAN UNDERWriters AND THEIR Issues} (1928).

\textsuperscript{74} Blyth and Company, for example, is a national investment house with branches, for purposes of buying as well as distribution, in the important eastern and western states.

\textsuperscript{75} A rough estimate of numbers: 71 outside bankers with permits to advertise and syndicate issues in California; 53 outside bankers (above) have branches in this state; 53 local bankers or dealers entering actively in syndicates of foreign securities; 6 local bankers (in the above) who originate foreign issues through their branches.
(2) **Analysis of the Securities of Foreign Corporations Sold Through Syndication**

In the case of foreign securities, syndicated into this state through investment bankers, it is difficult to obtain information as to the securities sold. The main source of information is through an examination of the advertising of the offering by the syndicate as it appears in the daily press. The financial sheets of the press were examined for the period March, 1928, to April, 1929, and a classification was made of the current offering of securities to the public by ascertaining: (1) the place of origin of the sale; (2) the type of security; and (3) the nature of the distribution within the state.

There were 527 original offerings of securities made in the California press during the year under review. Three hundred and twenty of these were offerings of securities, the original sale of which took place outside the bounds of this state. The type of transaction involved includes:

- 115 Stock (preferred and common) issues in industrial companies.
- 74 Bond issues — primarily real estate bond issues.
- 60 Issues — bond, stocks or notes in public utility group.
- 40 Foreign issues — outside the United States.
- 31 Issues of investment companies.

The bond issues include those issued by industrial companies, but the great majority are those issued by corporations as "real estate bonds." The national real estate mortgage houses supplied most of these issues. The securities issued under the public utility group were stock, bonds and notes of operating and holding companies. In the foreign group, there are included the securities of governments and their political subdivisions and also the issues of corporations residing in foreign countries, primarily public utilities and financial institutions. The last group included the securities of corporations organized to do a financial or investment business. The great majority of these were securities of so-called investment trusts.

Local dealers' names appeared in the syndicating list on 117 issues; that is, in about one-third of the cases of syndications of securities into California the local banker participates in their distribution. In the

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70 The San Francisco Chronicle and the Los Angeles Times were used for this purpose. This would cover practically all the original issues by reputable bankers and dealers within the state.
remaining two-thirds of the cases, the security is distributed in this state by local branches of national investment houses.\textsuperscript{77}

To recapitulate, about 60 per cent of the number of securities offered to the public by investment bankers are those of foreign corporations syndicated into California. In over one-third of these cases California investment bankers or dealers participate in the distribution of these securities to the ultimate purchasers; in the remaining cases this distribution is done through local branches of national houses.

(3) Analysis of Securities of Local Corporations Sold through Syndication

California investment bankers, besides distributing securities of foreign corporations in the syndicating process, purchase the securities of local corporations for resale. During the period under review there were 207 such originations made by them in this state, while they appeared 129 times as managers or syndicate members of the sale of foreign corporations.

The character of the 207 local offerings is as follows:

- 74 Stock issues in industrial companies.
- 72 Bond issues primarily real estate not industrial issues.
- 27 Municipals.
- 21 Issues of investment companies.
- 13 Issues of public utilities.

This schedule shows three outstanding differences in the type of securities of local origination as contrasted with those of non-California origination. In the first place, about 10 per cent of the local offerings are securities issued by municipalities within the state, primarily school districts. Eastern municipals are not commonly syndicated into California. Secondly, California bankers purchase for resale a large number of bond issues of local corporations issued against real estate. This is due to the rapid growth of the population and the great building and real estate activity within the state. Lastly, it is noticed that California, not being an international capital market, does not originate issues of foreign governments, their municipalities or private corporations within their jurisdiction.

The nature of the local offerings is such that few find exemptions under the California Securities Act. The municipals, of course, have this exemption and also some of the public utility issues.\textsuperscript{78} If the

\textsuperscript{77} It is to be understood that some of "remaining \%" are securities which do not enter California for distribution. The advertisement of issue appears for "purposes of record only and not as offer of sale."

\textsuperscript{78} The issues of the operating companies which have been authorized by the Railroad Commission. Holding companies are not exempt under this provision.
municipals alone were not included, there were 180 non-exempt original offerings made by local bankers and dealers; during the same period there were about 300\textsuperscript{79} non-exempt original offerings made by foreign corporations through the syndication process. In other words, for every eight issues currently offered to the investing public through the channels of high class investment bankers, only three are of local corporations under the immediate scrutiny of the Commissioner of Corporations.

(4) Administrative Regulations of Securities of Foreign and Local Corporations Sold by Syndicating Dealers

The administrative regulation over the issuance of the securities issued by foreign corporations is carried out indirectly, through control over the broker. The control over securities which are issued originally in this state is exercised by means of the permit system. If the securities are not an original issue, but are now issued and outstanding, the same may be disposed of through a broker holding a license then in effect from the Department. In such a case, the Commissioner is given notice of the impending resale by the broker through the provisions of section 7 of the Act which requires the submission of advertising copy used in the sale. This advertising copy is not to contain “any statement that is false or misleading or otherwise likely to deceive a reader thereof.”

The Commissioner, informed of the type and kind of security to be sold, has the power, under section 9, to require the broker to file a statement giving detailed information about the security together “with such other information as the Commissioner may require.” From this information the Commissioner may forbid the sale if, in his opinion, it would be “unfair, unjust and inequitable.” It is compulsory upon a broker to file advertising copy. The Commissioner must be notified of the sale. It is optional, however, upon the Commissioner to require any further information than that given in the offering advertisement.

In actual practice, the qualifying of advertisement material by a syndicate manager offers little difficulty. The syndicate or issuing house, upon completion of the details of distribution in an eastern city, wires the Department informing it that the security is to be sold in California. As soon as the advertising copy is drawn up and printed it is sent by air mail to the Department. If the copy or the security is not acceptable, this information is wired to the syndicate, otherwise a form letter of acceptance is sent via registered mail. A slightly different procedure is followed in case the syndicate employs a specialist to

\textsuperscript{79} Granting that 20 out of the 300 would be exempt under the provision of the Act.
handle its financial advertising. In this case, the eastern office of the advertising agency, in most cases the home office in New York City, sends the advertising copy to its branch office in San Francisco or Los Angeles. In these cities the branch office arranges to place the copy in the local newspapers and, as part of its duties, it submits the copy to the Department for its approval.

A hypothetical case is offered to indicate the difference of procedure involved in qualifying a security of a local corporation sold through investment bankers and that of a foreign corporation sold through the process of interstate syndication:

A local corporation, owning a plot of urban property, desires to construct a 10-story apartment building upon it. The plan is placed before a local California investment banker who agrees to finance the construction by purchasing the mortgage upon the land and building. The investment banker appears before the Department and outlines its plans, praying for an initial permit to take subscriptions for the issue. The permit is given, followed by a permanent permit when the trust indenture is filed and found acceptable by the Department. Before this, however, the bankers will submit an appraisal of the property by an independent appraiser. In cases where the Commissioner deems it advisable, he may ask for an independent appraisal by engineers or appraisers employed by him at the expense of the applicant, without disclosure of the contents to the applicant.\(^8\) The indenture of trust is submitted by the banker's counsel and checked by a deputy of the Department, and changes may be suggested. After the statutory fee is paid the permit is issued.\(^8\) Subsequently, the Department may address the trustee, under the indenture, to ascertain the condition of his account, including the status of the interest and amortization payments.

A foreign corporation organized to construct a building borrows the funds from an eastern mortgage house with a national distributing organization. This house wires the California Commissioner of Corporations that the bonds are to be sold in this state and the next day the advertising material is sent. The Department discovers from this material that the property has been appraised by a person unknown to it and that the indenture of trust is described in the broadest outlines. The Department finds that the advertising material fully describes the plan under which the bonds are issued and allows the sale within the state. This ends the concern of the Department in the issue.

It is not to be inferred from the above that the Department is not

\(^8\) Corporate Securities Act, section 20a; Rules of Practice, rule No. 28.

\(^8\) Fees are paid for filing an application for a permit and not advertising material.
fulfilling its statutory duties in its method of regulating the syndication of foreign issues within this state or that fraudulent issues enter the state by this means.\textsuperscript{82} It is doubtful if the Department could examine the securities of foreign corporations in the same manner as those of local concerns. It would be a task far beyond the physical capacities of the present organization. Even if it were possible, it would be unwise, in that the securities offered in national syndication, although the speculative element is often great,\textsuperscript{83} are sold and resold by bankers who have an expensive organization and a priceless goodwill to be maintained by the performance of their task to invest other people's money with a minimum of loss.

(5) \textbf{Summary}

The number of securities syndicated into the state has grown with the development of California as an important center of consumption of capital issues. At the time of the passing of the Blue Sky legislation (1913) few securities were offered to the public through that process. The law, therefore, gave its major attention to the issue of securities by local companies. At the present time, more than one-half of the securities purchased through investment bankers and dealers are qualified for sale by the simplified method of presentation of advertising material. Although this offers adequate protection, it places local corporations and bankers under a greater burden in qualifying securities of the same type which are sold through identical channels. In this regard, the California law is an anomaly. Other states, which provide a method whereby high-grade syndicated securities may be qualified, with a minimum of time and expense, grant this privilege to local as well as foreign corporations and bankers.

\textbf{SECTION 7. THE CALIFORNIA LEGISLATIVE SITUATION OF 1929 AND CONCLUSIONS}

The California Investment Companies Act of 1913 was enacted in a year which produced similar legislation in thirteen western, middle-western and southern states,\textsuperscript{84} the Kansas act of 1911 being the model upon which this legislation was drawn. The Kansas act proved to be experimental and tentative and was rewritten in 1913, 1915 and 1929. These changes, fundamental and basic, were made in an attempt to

\textsuperscript{82}The Department forces a foreign corporation, whose low grade securities are offered for sale in this state by newly established small dealers, to qualify its securities after a vigorous examination. (Under provisions of section 9.)

\textsuperscript{83}The issue of the Aviation Corporation of Delaware, syndicated by the leading bankers in the east and west, was described in the offering advertisement as being highly speculative.

\textsuperscript{84}Arizona, Arkansas, Florida, Georgia, Idaho, Montana, Nebraska, North Carolina, North Dakota, Ohio, Oregon, Tennessee, Wisconsin.
formulate an effective and satisfactory Blue Sky measure. Kansas has not been singular in this respect, as other states have admitted the weaknesses of their early Blue Sky laws.

The history of the legislative development of the California Blue Sky Law has not been different from that in other states; each biennial meeting of the Legislature has been the occasion for amendment and change. None of these amendments has changed the basic principle upon which the original Act was passed; that is, the traffic in securities was to be regulated by requiring the issuing corporation to obtain a specific permit after a formal investigation of its affairs by an administrative body. The amendments, with the exception of the revision of the law in 1917, have been made to strengthen the provisions of the original act rather than to change its substance. In this respect, California has differed from most states where a fundamental change has been made, to-wit, securities are classified as those having an established income or asset value, and those having a potential income. Established income securities are made to qualify, but the procedure is simplified and shortened, making qualification possible in less time. (See section on the types of Blue Sky laws.) Sixteen states, most of them pioneers in the adoption of Blue Sky legislation, have rewritten their laws, giving preference in this way to income securities. They have drafted their acts after the so-called Uniform Act drafted by the Investment Bankers' Association. In most cases this legislation has been formulated by committees of the State Legislatures working in conjunction with local State Bar Associations and local groups of the Investment Bankers' Association of America.

Before the meeting of the 48th Legislature of 1929, proposals were made for amendments to the California Securities Act, which, if accepted, would have changed its basic character. Such were the proposals for injunctive relief and criminal prosecution made by Commissioner

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<th>Year</th>
<th>Amendments</th>
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<td>1915</td>
<td>Section 3</td>
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<td>1917</td>
<td>&quot;Corporate Securities Act&quot; passed.</td>
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<td>1919</td>
<td>Section 2</td>
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<td>1921</td>
<td>Section 2, 20, 21, 25</td>
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<td>1923</td>
<td>Section 2, 5, 16, 17, 24A (added)</td>
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<td>1925</td>
<td>Section 2, 4, 5, 6, 7, 9, 11, 13, 14, 17, 18, 25</td>
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<td>1927</td>
<td>Section 15</td>
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<tr>
<td>1929</td>
<td>Section 2, 15, 20, 20A (added).</td>
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<tr>
<th>Original Act</th>
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<tr>
<td>Indiana</td>
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Friedlander\textsuperscript{87} and the substitution of a publicity measure advocated by Assemblyman Keaton.\textsuperscript{88} Neither of these proposals received the favor of the Legislature and their acceptance was not advised by the California State Bar Association, which, through its San Francisco subsection on the Corporate Securities Act, stated, "After surveying completely all Blue Sky legislation, your committee is of the opinion that it would be a mistake to recommend the repeal of the present Act and to adopt in its stead a Fraud Act or an act only partially regulating securities. The Committee feels that with certain amendments, the existing act would afford the best possible protection against the fraudulent sale and issuance of securities, although it is true that legitimate business enterprises frequently chafe at the delay and expense of submitting to the jurisdiction of the State Corporation Department."

By the provisions of Assembly Concurrent Resolution No. 34 (1929) a joint legislative committee has been appointed to "study, inquire into and survey, the corporation laws of, and the sale of securities within, this state and other states." The Legislature, for the first time, is to have an objective study of all "matters, laws and conditions pertaining to security legislation in this and foreign states." The study is to be made for the purpose of "recommending legislation" and the committee is not authorized to investigate or interfere with the conduct of the Corporation Commissioner's office.

This paper is concluded with a listing of some of the most important facts which will face the Joint Legislative Committee in its study of the experience of California and other states in Blue Sky legislation.

1. The California Investment Companies Act, although passed by an overwhelming vote in the Legislature of 1913, met vigorous oppo-

\begin{center}
\begin{tabular}{ll}
North Carolina & 1913 1927 \\
Ohio & 1913 1929 \\
South Dakota & 1915 1927 \\
Utah & 1919 1925 \\
Virginia & 1918 1928 \\
West Virginia & 1915 1925 \\
\end{tabular}
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The following have adopted other methods by which income securities are given preference in qualification:

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Alabama & 1919 1923 \\
Georgia & 1913 1920 \\
Illinois & 1917 1925 \\
Missouri & 1913 1925 \\
Wisconsin & 1913 1925 \\
\end{tabular}
\end{center}

\textsuperscript{87} In a letter to James S. Bennett, Chairman of the Special Committee on the Corporate Securities Act, California Bar Association, under date of August 17, 1927, February 9, 1928, and June 8, 1928.

\textsuperscript{88} Assembly Bill No. 665.
sition in referendum the following year. There has been since that time a formidable opposition to a security act giving such wide discretionary power to its administrative officer, the Commissioner of Corporations.

2. A study of other Blue Sky laws and their administration discloses a wide difference of opinion as to how far the state should go in the regulation of the traffic in securities. The question of the limits of the state's activity in regulation of this private business has not been settled, the difference in opinion on this fundamental question being very diverse as between the states. (Section 2 of this article.)

3. The most important investment states, Illinois, Pennsylvania, Massachusetts and Ohio, for example, have either amended their original Blue Sky acts, or adopted measures for the first time, which allow preferences, either in the matter of qualification or exemptions, to high-grade income securities sold by established investment bankers or dealers. (Section 2.)

4. California has not provided for exemptions of high-grade securities issued by reputable dealers or issued by sound corporations to a limited market and for this reason the cost of administration of the Act has been considerably higher than any other state. Relative to the size of Pennsylvania or Illinois, the cost has been strikingly large. (Section 2.)

5. A large part of the expense and labor expended in California is in the examination and subsequent regulation of the securities of small corporations sold privately in a closed market without a selling expense (about 70 per cent of all applications). All important states exempt this class of securities on the grounds that the opportunity for the perpetration of fraud and deception is infrequently present. To these states the occasional formation of corporations of this type for fraudulent purposes does not warrant the delay and expense involved in their examination. (Section 3.)

6. As the California law is administered, the Corporation Department comes into contact with the investing public most often through the exercise of the regulation over newly organized promotional schemes entailing a direct public sale, without the use of investment bankers. It is here that the Department brings to bear greatest control over the issuing corporation's financial and business plan, this control taking the form of conditions to be met by the corporation rather than the denial of the right to sell stock in a speculative venture. Outright denials are extremely rare and these are based usually upon the past dishonesty of the promoters. (Section 4.)

7. The control exercised over the issue of bonds by California corporations is much greater than similar control in other large states in which bonds are exempt because of the nature of the security or the fact that they are generally sold through bona fide investment bankers who are able to evaluate more accurately than state officials the investment quality of senior issues. (Section 5.)

80 The Investment Companies Act was adopted on November 4, 1914, by a vote of 343,805 for and 288,084 against. The net favorable vote of Los Angeles County of about 60,000 saved the measure from defeat. In the northern counties the vote was about 7 to 6 against the measure.
8. The present California Blue Sky law is an anomaly and differs from other important investment states, in that the securities of local corporations sold through investment bankers must pass a rigorous examination and post-permit regulation whereas securities of foreign corporations sold in this state through investment dealers, local or foreign, who have purchased these securities through a syndicating agreement, are examined primarily as regards the truthfulness of their advertising material. Control over these foreign, syndicated issues is exercised through the regulation of investment dealers, by a system of broker licenses and not through the regulation of their securities. (Section 6.)

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