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PROBLEMS OF JURISDICTION AND VENUE
AND OF THE RIGHT OF TRIAL BY JURY UNDER THE
FEDERAL RULES OF CIVIL PROCEDURE*

GUSTAVUS OHLINGER

In considering the Federal Rules of Civil Procedure we cannot be unmindful of the fact that the largest original contribution to the new practice in the federal courts came from England. Hardly a page of the Notes of the Advisory Committee but contains references to the Orders and Rules under the English Judicature Act of 1873 and subsequent acts, and many of the rules follow closely the language of the English models.

This may be the last gift of the Mother Country to her children; the last of a great heritage which includes Magna Carta, the Common Law, the Principles of Equity, the Bill of Rights, the Petition of Right, the Writ of Habeas Corpus, Representative Government; such treasures of the spirit and of the soul as the Canterbury Tales, the poetry of Shakespeare, the eloquence of the English Bible; such memories as are enshrined in the inspiring architecture of Westminster Abbey. Today that great country is being devastated and threatened with utter destruction. Not only in England, but in France, and Belgium, and in every other land we see

"... beauty and anguish going hand in hand
The downward slope to death . . ."

before the unspeakable beast of the Revelation that has set out to place its mark, the mark of the beast, upon the foreheads and in the hands of all mankind.

The heritage of English liberty under the law made possible the vast development of our material and human resources, and what we possess and what we have achieved we, today, in turn hold in trust for the preservation of that heritage. Overwhelming as the industrial and mechanical forces of totalitarianism may appear, we know that after all the instruments of modern total war fit most readily into our own hands; we invented the airplane and the submarine; American genius developed the automobile and the radio; we perfected the processes of machine manufacture; we first organized mass production; all these resources of the machine age we today are privileged to use for the preservation of our liberty and the freedom of mankind.

The Federal Rules of Civil Procedure point the contrast between two opposing and incompatible philosophies: the philosophy of force and brigandage

*Address before Lawyers Institute, held at Ithaca, N. Y., on August 15, 1940. [Ed.]
and of hatred so assiduously propagated by Germany and Japan, and the
deal of justice between man and man which has engaged Anglo-American
jurisprudence from the earliest times and of which the Rules represent the
latest development.

Before considering the Rules in detail, let us remind ourselves briefly
that the Constitution, in Article III, Section 2, conferred on our national
government just the minimum of judicial power that would enable a federal
system, founded upon the concept of divided sovereignty, to function. But
even the minimum of judicial power assigned to the nation was not utilized
for many years. With the exception of the short-lived Judiciary Act of
1801,1 passed by the dying Federalist party, and which the followers of
Jefferson promptly repealed the following year,2 federal trial courts were
not given general jurisdiction of cases arising under the Constitution, laws
and treaties of the United States until 1875. Until then the lower courts
were principally occupied with admiralty and diversity cases. By successive
process acts in 1789,3 1792,4 18285 and 1842,6 and finally by the General
Conformity Act of 1872,7 procedure, in law cases, was made to conform to
the procedure of the respective states in which the federal courts were held.
The principle of conformity to state practice continued until September 16,
1938, when the Federal Rules of Civil Procedure took effect. Now, instead
of federal conformity to state procedures, we have uniformity in federal
procedure, accompanied by an increasing pressure to conform state practice
to the federal rules. For this reason the federal rules are of vital interest
to the lawyer whose practice is chiefly in the state courts. Eventually many
of the federal rules will be adopted in state practice.

This is a development of major importance—a development in the pro-
cedural field which parallels the more obvious actions of the legislative
and executive departments by which state policies have been brought into
line with federal policies in the fields of social security, education and public
welfare.

An equally important consideration is the effect which the rules will have
upon the jurisdiction and power of the federal courts. Will the application
of the rules tend toward the expansion of jurisdiction and power through
judicial decision?

1Act of February 13, 1801, c. 4. 2 Stat. 89.
2Act of March 8, 1802, c. 8. 2 Stat. 132.
3Act of Sept. 29, 1789, c. 21. 1 Stat. 93.
4Act of May 8, 1792, c. 36. 1 Stat. 275.
5Act of May 19, 1828, c. 68. 4 Stat. 278.
7Act of June 1, 1872, c. 255. 17 Stat. 196.
History never repeats itself, but it does cast an illuminating beam ahead, and we may, therefore, look to the effect of judicial decisions in the past.

The Act of 1816 incorporating the Second Bank of the United States conferred upon the bank capacity “to sue and be sued in all state courts having competent jurisdiction, and in any circuit court of the United States.” Two branches of the bank were located in Ohio, and the Ohio legislature, being jealous of the intrusion of this monster of banking power in the peaceful financial affairs of the state, imposed a tax of $50,000 on each branch. Osborn, the auditor of state, sought to carry out the mandate of the legislature, and the bank brought suit in the United States Circuit Court to enjoin him. The case finally came before the Supreme Court, presenting there the question whether a suit by a corporation created by act of Congress was one “arising under the laws of the United States,” and, therefore, within the judicial power conferred in Article III, Section 2, of the Constitution and within the jurisdiction of a federal circuit court. Chief Justice Marshall laid down the principle that a case arises under a law of the United States when “the title or right set up by the party may be defeated by one construction of the Constitution or law of the United States, and sustained by the opposite construction,” and then applied the principle to the case before him merely because the bank had been created by an act of Congress, though the construction of that act was in no way involved and had nothing whatever to do with the controversy before the court.

The doctrine of Osborn v. Bank became important when the Judiciary Act of 1875 first conferred upon the federal courts general jurisdiction of cases arising under the Constitution, laws and treaties of the United States. When Congress incorporated the Pacific railroads the Court followed Osborn v. Bank and held that every action by or against such a railroad, whether involving a condemnation of property, a personal injury or an engine running over livestock was one “arising under a law of the United States.”

But against this extension of jurisdiction by judicial decision Congress took action. By successive acts it cut down the jurisdiction as to cases involving federal corporations until today Section 42 of Title 28 of the United States Code declares that “no district court shall have jurisdiction of any action or suit by or against any corporation upon the ground that it was incorporated by or under an Act of Congress.” The only exception provided in the section is in those cases wherein “the Government of the United States is the owner of more than one-half of its capital stock.”

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9 Act of March 3, 1875, c. 137, 18 STAT. 470.
10 Pacific Removal Cases, 115 U. S. 2, 5 Sup. Ct. 1113 (1884).
Finally the Supreme Court itself repudiated the doctrine of *Osborn v. Bank* by declaring that "the nature of the federal right to be established is decisive—not the source of the authority to establish it."\(^{11}\)

The same process of judicial extension appears in the development of jurisdiction in diversity cases. In *Bank of the United States v. Deveaux*,\(^ {12}\) decided in 1809, Chief Justice Marshall looked to the citizenship of the president and directors and company of the bank on the one side, and finding that they were citizens of Pennsylvania, while the defendants were citizens of Georgia, upheld jurisdiction on the basis of diversity. Following this decision, in 1840, in *Commercial & Railroad Bank of Vicksburg v. Slocomb, Richards & Co.*,\(^ {13}\) the Court denied jurisdiction because two of the stockholders of plaintiff bank were citizens of the same state as parties on the other side of the controversy. But four years later the Court reversed itself, and in *Louisville, Cincinnati & Charleston R.R. v. Letson*,\(^ {14}\) held flatly that a corporation created by a state was, for the purposes of diversity jurisdiction, "a citizen of that state, as much as a natural person." This simple declaration extended enormously the jurisdiction of the federal courts; it made them the favorite forum for corporate controversies, and the dockets of the federal courts have been crowded with corporate diversity cases ever since.

The same extension is seen in the field of admiralty. In *The Steamboat Thomas Jefferson*\(^ {15}\) the Supreme Court, following English precedents, limited the admiralty jurisdiction to the sea and waters within the ebb and flow of the tide; but beginning with *The Genessee Chief v. Fitzhugh*,\(^ {16}\) the jurisdiction was expanded by court decision until now the federal jurisdiction in admiralty covers the entire navigable waters of the United States where commerce may be carried on between different states or with foreign nations.\(^ {16a}\)

As we have seen, the extension of judicial power and jurisdiction under the doctrine of *Osborn v. Bank* was finally vetoed by Congress, and Chief

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12 5 Cranch 61, 3 L. ed. 38 (U. S. 1809).
13 14 Pet. 60, 10 L. ed. 354 (U. S. 1840).
16 10 Wheat. 428, 6 L. ed. 358 (U. S. 1828).
16a 12 How. 443, 13 L. ed. 1058 (U. S. 1852).
16a The recent Supreme Court case, *United States v. Appalachian Electric Power Company*, 9 U. S. L. Week. 4069 (Dec. 16, 1940), further extends this jurisdiction by holding that "navigable" includes "available for navigation with reasonable improvements"; and that the power of the United States over its waters is not limited to control of the operation of boats and improvement of the waterways, but includes flood protection, watershed development, and recovery of the cost of improvements through utilization of power. [Ed.]
Justice Marshall's construction of the phrase "arising under the Constitution, laws and treaties of the United States" has now been repudiated by the Supreme Court itself. On the other hand, the extension of jurisdiction under the diversity and admiralty clauses still stands, and there seems little likelihood that either Congress or the Supreme Court will ever limit the doctrines of the Letson and The Genessee Chief cases, and of succeeding cases.\textsuperscript{17} The development of corporate organizations and the expanding commerce on inland waterways have placed the approving stamp of realism upon those decisions.

But does the application of the new rules require a similar extension, by judicial decision, of the jurisdiction and power of the federal courts?

First of all, the Rules have abandoned the term "cause of action," familiar to lawyers under the Equity Rules\textsuperscript{18} and under most of the Codes.\textsuperscript{19} Professor Pomeroy years ago analyzed the term "cause of action" as follows:\textsuperscript{20}

"Every action is based upon some primary right held by the plaintiff, and upon a duty resting upon the defendant corresponding to such right."

He then goes on:

"By means of a wrongful act or omission of the defendant, this primary right and this duty are invaded and broken; and there immediately arises from the breach a new remedial right of the plaintiff, and a new remedial duty of the defendant."

He concludes:

"It is very clear from this analysis that the 'cause of action' mentioned in the codes includes and consists of these two branches or elements in combination,—the primary right and duty of the respective parties, and the wrongful act or omission by which they are violated or broken."

But long before the adoption of the Rules, the Supreme Court had announced its departure from this abstract concept of the content of a law

\textsuperscript{17}See S. B. 937 [75 Cong. Rec. 196 (1931)], introduced by Senator George W. Norris, for the purpose of limiting diversity jurisdiction in so far as it affected foreign corporations doing business in a state. President Hoover recommended such limitation, but the bill failed of passage. As against this effort to limit the jurisdiction in corporate diversity cases it should be noted that the decision in Neirbo Co. v. Bethlehem Shipbuilding Corp. 308 U. S. 165, 60 Sup. Ct. 153 (1939), by depriving foreign corporations doing business in a state of objections to venue on account of non-residence, has greatly enlarged the opportunity of recourse to the district courts.

\textsuperscript{18}Equity Rule 26: "The plaintiff may join in one bill as many causes of action, cognizable in equity, as he may have against the defendant." (Italics supplied.)


\textsuperscript{20}Pomeroy, Code Remedies (5th ed. 1929) § 413.
suit. Thus in United States v. Memphis Cotton Oil Co.,\textsuperscript{21} decided in 1933, it said:

"A 'cause of action' may mean one thing for one purpose and something different for another. It may mean one thing when the question is whether it is good upon demurrer, and something different when there is a question of the amendment of a pleading or of the application of the principle of res judicata. Cf. Chicago, R. I. & P. Ry. Co. v. Schendel, 270 U. S. 611, 617; Baltimore S. S. Co. v. Phillips, 274 U. S. 316, 321. At times and in certain contexts, it is identified with the infringement of a right or the violation of a duty. At other times and in other contexts, it is a concept of the law of remedies, the identity of the cause being then dependent on that of the form of action or the writ. Another aspect reveals it as something separate from writs and remedies, the group of operative facts out of which a grievance has developed. This court has not committed itself to the view that the phrase is susceptible of any single definition that will be independent of the context or of the relation to be governed. None the less, it has fixed the limits of amendment with increasing liberality. A change of the legal theory of the action, 'a departure from law to law,' has at times been offered as a test. Union Pacific Ry. Co. v. Wyler, 158 U. S. 285, 295. Later decisions have made it clear that this test is no longer accepted as one of general validity. Thus, in Missouri, Kansas & Texas Ry. Co. v. Wulf, 226 U. S. 570, plaintiff suing in her individual capacity under a Kansas statute for her son's death was allowed to amend to sue as administratrix under the Federal Employers' Liability Act after the statute of limitations would have barred another action. In New York Central & H. R.R. Co. v. Kinney, 260 U. S. 340, there was in substance the same ruling. In Friederichsen v. Renard, 247 U. S. 207, a cause of action by a defrauded buyer to set aside a contract was turned into a cause of action to recover damages for deceit. 'Of course an argument can be made on the other side, but where a defendant has had notice from the beginning that the plaintiff sets up and is trying to enforce a claim against it because of specified conduct, the reasons for the statute of limitations do not exist, and we are of opinion that a liberal rule should be applied.' New York Central & H. R.R. Co. v. Kinney, supra, p. 346."

Finally, in Gully v. First National Bank\textsuperscript{22} the Court recalled, passim, that it had had "occasion to point out how futile is the attempt to define a 'cause of action' without reference to the context."

For the familiar term of the Codes, the Rules have substituted "claim for relief"—a term sufficiently flexible to accommodate a narrower concept when the question involves the application of a state statute of limitation, framed on the abstract concept of cause of action, when a party seeks to

\textsuperscript{21}288 U. S. 62, 67, 53 Sup. Ct. 278 (1933). The italics in this, and other quotations, are supplied.
\textsuperscript{22}299 U. S. 109, 57 Sup. Ct. 96 (1936).
amend by bringing in allegations which under the state concept constitute a
new cause of action against which the statute has run;23 a narrower concept
when a judgment as to a cause of action under a state statute is pleaded as
against an action under federal statute arising out of the same transaction
or occurrence,24 or when a judgment in an action for personal injuries under
the Federal Employers' Liability Act is pleaded as a bar to an action for
death by reason of the same injuries;25 a narrower concept where under
state law different acts, though causing one injury, give rise to different.
causes of action, and a judgment of a state court is pleaded as res judicata
to an action upon the other acts in a federal court;26 a different concept
where, as in Hurn v. Oursler,27 it is necessary to define "cause of action"
for the purpose of determining the bounds between the jurisdiction of state
and federal courts.

But so far as actions commenced in the district courts are concerned, the
term "claim for relief" has a wide scope. It is not limited by any abstract
concept of a primary right in one party and a wrongful act or omission on
the part of some other party, but looks to "the group of operative facts out
of which a grievance has developed." In the liberal provisions which the
Rules make for different statements of a claim or defense, either alternatively
or hypothetically, for the statement of separate claims and defenses, regard-
less of consistency and whether based on legal or equitable grounds or on
both,28 for the joinder of claims and remedies,29 for the joinder of parties,30
for counterclaims,31 for third-party claims,32 for class actions33 and inter-
vention,34 they look to the presentation of numerous claims and for the
participation of multiple parties in a single civil action "on the theory that it
is a sound and a desirable thing that all spots of irritation between the parties
should be brought out into the open and should be fought over and disposed
of at one time."35

But however sound and desirable this may be, we, in our federal system,

28Rule 8 (e) (2).
29Rule 18.
30Rule 19.
31Rule 13.
32Rule 14.
33Rule 23.
34Rule 24.
35Judge Charles E. Clark, in PROCEEDINGS OF WASHINGTON INSTITUTE (1938) 58;
PROCEEDINGS OF CLEVELAND INSTITUTE (1938) 247; Warren v. Indian Refining Co.,
30 F. Supp. 281 (D. Ind. 1939).
are confronted immediately by limitations of jurisdiction and venue, and Rule 82 expressly provides that the Rules "shall not be construed to extend or limit the jurisdiction of the district courts of the United States or the venue of actions therein."

In the famous case of *Hurn v. Oursler* there were three very aggravated and inflamed spots of irritation between the parties. The plaintiffs claimed that they owned a copyrighted play called "The Evil Hour"; that they had subsequently revised the play, but the revision was uncopyrighted; that a feature of their play was the representation of a spiritualistic seance on the stage, with the audience taking part therein; that defendants were the owners of a copyrighted play called "The Spider," which, as originally produced, contained no representation of a spiritualistic seance; that plaintiffs had submitted their play, both in its copyrighted and in its uncopyrighted revision, to defendants for their consideration as to its production; that instead of producing plaintiff's play, "The Evil Hour," defendants incorporated the idea of a seance in their play "The Spider," and produced that play. Plaintiffs had, therefore, three inflamed spots of irritation, all arising out of the same factual situation: (1) the infringement by defendants of the copyrighted version of "The Evil Hour"; (2) unfair business practices and unfair competition on the part of defendants with reference to the copyrighted version; and (3) unfair business practices and unfair competition with reference to the uncopyrighted revision of the play. The Supreme Court held that spot of irritation (1) arose under the copyright laws, and the district court had jurisdiction; spot (2) was a complication furnishing merely additional grounds for the inflamed condition of spot (1), that it called for the same poultice and was, therefore, also within the cognizance of the district court; but as to spot (3), the court held that that spot did not rest on any federal ground, was wholly independent of the claim of copyright infringement, and that the district court was without jurisdiction.

There can be no question but that all three spots should have been poulticed at the same time; the Court poulticed two and left the third to further irritation.

We have, therefore, on the one hand the theory "that it is a sound and desirable thing that all spots of irritation between the parties should be brought out into the open and should be fought over and disposed of at one time" reenforced by the experience of courts of general jurisdiction in England and in the states for which the Rules were first formulated, and on the

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[37]Judge Charles E. Clark, in *PROCEEDINGS OF WASHINGTON INSTITUTE* (1938) 60, speaking of counterclaims: "The general philosophy I think is clear. Where it is all essentially a part of the same factual situation, then it can be tried out without new grounds of jurisdiction."
other hand our federal system with its hitherto limited judicial power in the national government and its corollary of federal courts of limited jurisdiction.

Whether in these momentous times we can limit ourselves to any abstract theories of divided sovereignty may be open to question; this much is certain: we must take account of the processes of centralization which have taken place under the clause of the Constitution which gives Congress power "to regulate commerce with foreign nations, and among the several States, and with the Indian Tribes"; of the fact that today it is becoming increasingly difficult to find anyone in industrial pursuits whose activities cannot be said to be subject to regulation under that clause; we must take account of the processes of taxation and benefits which the national government is using for the purpose of bringing state policies into line with federal policies; of the fact that in the early days litigation was relatively simple and local in character, whereas today parties in widely separated communities may be involved in a factual situation and may have an interest in the subject matter of a law-suit and in its outcome; and finally, of the fact that if we are to survive at all as against the enemies of our country, the processes of centralization may have to continue and even be accelerated in the years ahead of us.

Another important influence is the fact that many of the Rules, particularly those relating to counterclaims, to class actions and to intervention have long been applied in the equity practice in the federal courts and unavoidably equitable doctrines of completeness will follow the application of the Rules to what were formerly known as actions at law.

Lawyers must of necessity take into account these facts and these tendencies when they are called upon to define the scope of the flexible term "claim for relief" which the Rules have adopted; when they seek to define "subject matter" and "subject of the action"—the latter a term which the New York Court of Appeals has said is "so obscure and general as to justify the interpretation which shall be found most convenient and best calculated to promote the ends of justice"; when they attempt to define "transaction or occurrence" within the meaning of Rule 13 (a) relating to compulsory counterclaims; and when they are required to determine what is "ancillary" to the "subject matter" of the action and within the jurisdiction invoked in the principal action, in the case of third-party claims under Rule 14, and in interventions under Rule 24.

The influence of the equitable doctrine of completeness is seen in recent expressions of the courts regarding the scope of jurisdiction as to claims growing out of a single transaction. The Circuit Court of Appeals for the Fifth Circuit says of the Rules:

"The new rules seek to require in a civil action what has always been aimed at in an equity suit, that all claims growing out of a single trans-
action be brought in and settled in the one case. Rules 13, 15 (c), 18
(a). That one of them alone may involve less than $3,000 is not an
obstacle if the controversy as a whole involves that much; and jurisdic-
tion once acquired lasts till the court finishes with all parts of the con-
troversy." 39

A district court has said:

"Equity jurisprudence in the United States has always recognized the
propriety of cross bills, following the rule that a court of equity has
jurisdiction of all cross or counterclaims growing out of and germane
and ancillary to the plaintiff’s cause of action, even though they could
not be pleaded as independent suits within federal jurisdiction. To justi-
fy adjudication of a counterclaim, it was only essential that it be of a
character making it necessary to realization of complete justice as to the
subject matter of the original cause of action.

*   *   *

“It was once the rule apparently that new parties could not be brought
in on cross bill, but the equity rules and those now in force did away
with such limitation and expressly provide that new parties may be
brought in.” 40

Another district court has said, very generally:

“Whether a case at law be civil or criminal, it is well known that more
truth reaches the surface and better justice is attained, if all related
matters be considered and all involved persons be heard in one and the
same trial.” 41

Still another district court has said:

“... the tendency of the courts throughout is that in the aid of justice
and equity once the matter has come before the federal courts and the
question of venue is not one of paramount importance or is not affected,
the jurisdictional requirements are not looked upon as insurmountable
when no great hardship or inequity is inflicted upon those third parties.” 42

We cannot, of course, consider these expressions critically without looking
at the precise factual situations before the court in each case; at the same
time it is significant that these courts of limited jurisdiction seemed to ex-
perience no difficulty in employing language appropriate to courts of general
jurisdiction intent upon working out complete justice to all parties who might
be involved in a given set of circumstances.

41 Gray v. Hartford Accident & Indemnity Co. v. Robinson, 31 F. Supp. 299, 304 (W.
D. La. 1940).
The tendency is more marked when we come to Rule 14, Third-Party Practice. In the early cases in which the federal courts, under favor of the Conformity Act, applied state third-party practice acts, they looked rather closely to questions of jurisdiction. In *Paner v. Lyons Cafeterias, Inc.*, plaintiffs sued in a New York court, alleging breach of representation that food sold in defendant's restaurant was fit for human consumption. Defendant in turn impleaded as a third-party defendant *A*, a New York corporation which had sold defendant the food, and *A* in turn impleaded *B*, a New Jersey corporation which had furnished the food to *A*. *B* removed the entire suit to the district court, whereupon the plaintiff moved to remand on the ground that there was no separable controversy. The court agreed with plaintiff and remanded the action. It said, in effect, that there was no existing cause of action on the part of the original defendant, Lyons Cafeterias, Inc., against *A*, or on the part of *A* against *B*. "At most," so the court said, "there is a possibility that, as a result of the outcome of the primary suit, a cause of action may arise. . . . If the plaintiff should fail against Lyons, there would be nothing further to litigate."

In *Sperry v. Keeler Transportation Co.*, a suit instituted in a district court, the court refused to permit the defendant to implead a party, of the same citizenship as defendant, as a third-party defendant, on the ground that it lacked jurisdiction of the third-party controversy, that controversy being between citizens of the same state.

In *Lowry & Co. v. National City Bank*, plaintiff, a Delaware corporation, sued defendant, a New York corporation, for alleged refusal to pay drafts drawn pursuant to a letter of credit which defendant had issued. Defendant moved for leave to implead *D*, a Delaware corporation, which had agreed to indemnify defendant for all payments which it might make pursuant to the letter, and also *M*, a Louisiana corporation, which had agreed to pay the debts of *D*. The district court granted the motion and permitted defendant to implead both *D* and *M* on the ground that diversity existed between defendant and *D*, and between defendant and *M*, and that this controversy was entirely independent of that between the original plaintiff and the original defendant.

These cases illustrate the early attitude of the courts on questions of jurisdiction involved in third-party practice.

Then Rule 14 adapted to federal procedure the practice as it had been developed in admiralty, under the English orders and under the New York Civil Practice Act.

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4428 F. (2d) 897 (S. D. N. Y. 1928).
4528 F. (2d) 895 (S. D. N. Y. 1928).
Some courts have made the general statement that all third-party proceedings are ancillary in character, and that for that reason they present no questions of jurisdiction; others have added that they present no questions of venue; other courts, while considering questions of jurisdiction foreclosed by the ancillary character of the proceedings, say that third-party defendants may still assert the privilege of venue given by statute; others have considered the questions as debatable and calling for final determination by the Supreme Court.

Three primary situations are possible under Rule 14: (1) the defendant, third-party plaintiff, claims that the proposed third-party defendant is, or may be (depending upon plaintiff recovering a judgment against defendant) liable to defendant for all or part of plaintiff's claim against defendant; (2) the defendant, third-party plaintiff, claims that the proposed third-party defendant is liable to plaintiff for all, or for a part of plaintiff's claim, and that defendant is not liable at all, or not liable for such part; (3) the defendant, third-party plaintiff, claims that if defendant is liable at all to plaintiff, then the proposed third-party defendant is liable jointly with defendant for all, or for a part of plaintiff's claim against defendant.

In the first situation, that is, where the defendant, third-party plaintiff, claims that the proposed third-party defendant is, or may be (depending upon plaintiff recovering a judgment against defendant) liable to defendant for all or part of plaintiff's claim against defendant, unless the defendant admits that he is liable to plaintiff (an admission which will seldom be made), then defendant's claim against the proposed third-party defendant is contingent upon the plaintiff recovering a judgment against defendant. It has been said that in this situation, as between the defendant and the proposed third-party defendant, there is no existing "case" or "controversy" in the constitutional sense. This view is definitely against the weight of authority.

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Can the third-party claim be considered "ancillary" to the main action so that jurisdiction of the main action supports jurisdiction as to the "ancillary" third-party claim? It is to be noted that plaintiff's action is directed against the defendant; he asserts no claim against the third-party defendant; the controversy between the defendant and the third-party defendant is solely between them, whether defendant makes his claim upon a contract of indemnity insurance, upon some other indemnity contract, upon a right of contribution or upon an implied warranty. That it will be convenient to dispose of the third-party claim in the action in which the plaintiff's claim is litigated is beyond question; that consideration, however, does not dispose of jurisdictional limitations. A definite extension of the concept of what is ancillary seems necessary to support jurisdiction as to the third-party claim; otherwise an independent ground of jurisdiction, such as federal right or diversity is necessary.  

With reference to venue, it is to be noted that the situation is very different from that presented by a counterclaim against a party who is already "in a court of his own choosing." The third-party defendant, unlike a plaintiff against whom a counterclaim is asserted, is not in court at all until he is brought in by proper service of summons and complaint; original process being necessary as to him, he should have the benefit of the privileges which the venue statutes accord.

The second situation is presented when the defendant, third-party plaintiff, claims that the proposed third-party defendant is liable to plaintiff for all, or for a part of plaintiff's claim, and that defendant is not liable at all, or not liable for such part. Strictly under this heading come those cases in which defendant, as third-party plaintiff, tenders to the original plaintiff another party who, defendant declares, is solely liable to plaintiff; if plaintiff declines to amend so as to state a claim against the third-party defendant, some courts have dismissed the third-party complaint, remarking that where the defendant alleges that the sole responsibility is upon the

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third-party defendant, that defense can be made by the original defendant just as well without the presence of the other party.\footnote{Satink v. Holland Township, 31 F. Supp. 229 (D. N. J. 1940). It is within the discretion of the court to refuse leave to make such a party a third-party defendant. General Taxicab Ass'n v. O'Shea, 109 F. (2d) 671 (App. D. C. 1940).}

If plaintiff accepts the tender of the third-party defendant as the one solely liable, then jurisdiction and venue should be determined solely with reference to that party. If, as is more likely to happen, plaintiff accepts the tender of the third-party defendant as a joint defendant, or as an alternative defendant, then the same questions of jurisdiction with reference to the third-party defendant arise.

The third situation is presented when the defendant, third-party plaintiff, claims that if defendant is liable at all to the plaintiff, then the proposed third-party defendant is liable jointly with defendant for all, or for a part of plaintiff's claim against defendant. More often the defendant, third-party plaintiff, pleads this as an alternative to what is stated in the second situation. Some courts have said that the plaintiff may not object that he has no cause of action against the proposed third-party defendant;\footnote{Burris v. American Chicle Co., 29 F. Supp. 773 (E. D. N. Y. 1939).} others that plaintiff has no uncontrolled right of election where, under state law, a judgment against joint tortfeasors is solidary;\footnote{Gray v. Hartford Accident & Indemnity Co., 31 F. Supp. 299 (W. D. La. 1939); motion to dismiss overruled, 32 F. Supp. 335 (W. D. La. 1940).} and that if the defendant pleads a right of contribution as between the defendant and the third-party defendant the joinder should be allowed.\footnote{Kravas v. Great Atlantic & Pacific Tea Co., 28 F. Supp. 66, 67 (W. D. Pa. 1939); Crum v. Appalachian Electric Power Co. v. Winisle Coal Co., 29 F. Supp. 90, 91 (S. D. W. Va. 1939).} But has the defendant a right to say that an action shall be joint which plaintiff elects to make several?\footnote{This is the reverse of the question which the Supreme Court answered in the negative in Pirie v. Tvedt, 115 U. S. 41, 5 Sup. Ct. 1034 (1885). See Thompson v. Moore, 109 F. (2d) 372, 374 (C. C. A. 8th 1940).} Furthermore, may one defendant be thus brought in by another when, if plaintiff had impleaded him originally, identity of citizenship would have prevented jurisdiction? Rule 19 (b), in the careful provision it makes for non-joinder where the presence of a party would oust the jurisdiction of the court, seems to require a negative answer. If under the state law the proposed third-party defendant is an indispensable party to the plaintiff's action, then he must be joined, and it is for the plaintiff to join him as a defendant or suffer a dismissal of his action.\footnote{For dismissal for want of an indispensable party where such party, though allowed to intervene, files no pleading, see Paasche v. Atlas Powder Co., 31 F. Supp. 31 (N. D. Ill. 1940).}

If plaintiff refuses to amend, and the defendant's claim against the third-party defendant is solely for contribution, then, unless this contest is con-
sidered broadly as ancillary, it should be supported by an independent jurisdic-
tional ground.

What has been said of venue in the first situation applies to the situation
now under consideration.

The new problems of jurisdiction and venue have brought divergent an-
swers. One district court has said:61

“There have developed two schools of thought among the courts in
the application of the Rules of Civil Procedure with reference to the
joinder of third party defendants. The cases F. & M. Skirt Company,
Inc. v. A. Wimpfheimer & Bro., Inc., D. C., 27 F. Supp. 239, and
King v. Shepherd et al., D. C., 26 F. Supp. 357, hold that third-party
complaint practice does not extend venue or affect the jurisdictional
requirement of diversity of citizenship. These cases rely upon Rule 82
which provides as follows: ‘These rules shall not be construed to extend
or limit the jurisdiction of the district courts of the United States or
the venue of actions therein.’ To conform with these cases it would be
necessary to conclude that the proposed third-party defendants (the
owner and driver of the automobile) cannot be joined because they are
residents within the same state as plaintiff.

Supp. 412, and Kravas et al. v. Great Atlantic & Pacific Tea Co., D. C.,
28 F. Supp. 66, are cases adopting a rule contrary to the principles set
forth in the above cases. These cases hold that the third-party claim
does not need independent jurisdictional grounds for support, as the claim
is only ancillary to the primary claim. This reasoning is based upon
the fact, inter alia, that Form 22, accompanying the Rules of Civil
Procedure, which relates to third-party complaints, unlike the forms for
original complaints, omits any allegation of jurisdiction.”

Another district court says:62

“There is no denying the enthusiasm of those primarily responsible
for Rule 14 in their desire for a bold attitude on the part of courts
towards diminishing multiplicity of suits. With this general proposition
this court is in full sympathy and all decisions of other district courts
up to the present time, tend to substantiate claims of third-party plaintiffs
as we will note herein later. On the other hand, not having the benefit
of any court of appeals’ precedent, your district court must satisfy itself
that in being ‘bold’ it has not transgressed rules of law and direct pro-
visions of the constitution or acts of congress.

* * *

“We admit that the question is a close one but it is apparent that the
rule has a tendency to eliminate to some extent multiplicity of suits and
that until this court is bound by precedent of the court of appeals, which

decision may come before this case is actually tried, we will deny the motion to dismiss."

It will not do to assert jurisdiction merely on the ground that the third-party proceeding is "ancillary"; that is merely begging the question; what is meant by "subject-matter of the principal action"? How broad is the term? How is "ancillary" to be defined? No one questions the desirability of summoning into court all parties who may be involved in a certain factual situation and bringing out all spots of irritation and taking care of them in one action—but if this requires an extension of jurisdiction and a change in the rules of venue, let us say so frankly, and not by rationalization make a dead letter of Rule 82.63

Rule 2 says that "There shall be one form of action to be known as 'civil action'." The temple of federal justice was originally constructed with a partition extending from the foundation to the roof. On one side was a chamber labelled "law" and on the other side a chamber marked "equity." There was no opening in the partition and not even the most astute lawyer could penetrate it. If he found himself in the wrong chamber his case was dismissed, he was compelled to make his exit, and then from the outside enter the proper chamber.

After this awkward arrangement had continued for more than a hundred years the Act of March 3, 1915, c. 90 [38 STAT. 956] made an opening in this partition; then on September 16, 1938, the Rules removed the partition altogether, so that there is now only one chamber in which are accommodated all causes and issues which were formerly designated as being at law or in equity, respectively.

What effect has this alteration in the building upon the right of trial by jury?

Plainly it cannot restrict the right; Amendment VII, the Enabling Act, and Rule 38 prevent such a result. But is the right of trial by jury the same as it was before, or has it been enlarged?

The logic of the situation answers that it has been enlarged. In the first place, Rule 38 (b) allows a party to demand a trial by jury of any issue triable of right by a jury.

But more important than this, remedies and procedures which were formerly available only in equity are now available in all civil actions, making recourse to the special remedies and procedures of equity unnecessary. Formerly equity took cognizance of an action on behalf of a single complainant against a number of defendants, although there was no common

title nor community of right or interest in the subject matter among such
defendants, provided there was a community of interest among them in
the questions of law and fact involved in the general controversy. Rule 20
now permits such joinder in all civil actions. Formerly a stockholder suing
on behalf of his corporation could have relief only in a court of equity; Rule 23 now makes the device of the class action available generally.

In *Thompson v. Central Ohio R.R.*, two railroad companies sued in an
Ohio court to recover upon drafts drawn by a shipper, Thompson, in favor
of Robinson, cashier, in payment for charges for transportation. Robinson
had no interest in the drafts, the real party in interest being the railroad
companies which had performed the transportation service. The Ohio Code
of Civil Procedure, in force at that time, had abolished the distinction between
actions at law and suits in equity, and required that every action be prose-
cuted “in the name of the real party in interest.” Defendant Thompson
removed the action to the United States Circuit Court, and there the plain-
tiff railroad companies amended their petition to a bill in equity on the
ground that as the nominal legal title in the drafts was in the payee, Robin-
son, the companies could not proceed at law and continue plaintiffs on the
record, and were, therefore, obliged to change the case from an action at
law to a suit in equity. The Circuit Court rendered a decree in favor of
plaintiffs, and from this decree defendant appealed. The court pointed out
that the “real party in interest” provision of the Ohio Code constituted
“a title to sue”; that the sole test of equity jurisdiction was the absence of
a plain and adequate remedy at law; that the “real party in interest” pro-
vision of the Ohio Code gave an adequate remedy at law, and that by enter-
taining the action as a suit in equity the court had deprived the defendant
of his constitutional right of trial by jury.

The same may be said of the procedural devices which the Rules now make
available in all actions; there is no longer need of recourse to equity in the
case of multiple parties or class actions; and the issues in a suit which
could formerly be entertained only in equity are now, as of right, triable
by a jury, and the remedy of trial by jury is correspondingly enlarged.

In the leading case of *American Mills Company v. American Surety Com-
pany*, the Mills Company had sued the Surety Company in a state court
upon a contract of guaranty. The Surety Company then brought suit in a
court of another state for the cancellation of the contract for fraud. This
latter action was removed to a federal court, and in that court the defendant

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64 Hale v. Allinson, 188 U. S. 56, 23 Sup. Ct. 244 (1903).
65 United Copper Securities Co. v. Amalgamated Copper Co., 244 U. S. 261, 37 Sup. Ct. 509 (1917).
Mills Company pleaded as a defense that the Surety Company had an adequate remedy for its alleged claim of fraud by defending the suit which it had brought to collect upon the contract; the Mills Company further pleaded the contract of guaranty and prayed judgment thereon. The Supreme Court held that Equity Rule 30, which provided that "the answer must state in short and simple form any counterclaim arising out of the transaction which is the subject matter of the suit," related only to an equitable counterclaim, and that the Mills Company, by pleading its legal counterclaim, which it was not required to do under the Rule, and by offering evidence in support of it, waived (1) its objection that the Surety Company had an adequate remedy at law, and (2) its right of trial by jury.

Since Rule 13 (a), Compulsory Counterclaims, requires a party, under certain conditions, to state as a counterclaim "any claim, not the subject of a pending action, which at the time of filing the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim," it is clear, under the authority of the American Mills Company case, that he does not waive his right of trial by jury by pleading a legal counterclaim to a claim of equitable cognizance.

But does a party waive his right of trial by jury when to an equitable claim he pleads, as a permissive counterclaim, a claim at law? The decision in the American Mills Company case would require an affirmative answer; and so would the weight of state authorities. There are, however, strong arguments against this conclusion, the most cogent being that it cannot be the purpose of the Rules to permit unlimited joinder of claims and to encourage parties "to bring out in the open all points of difference and spots of irritation between them," only at the price of surrendering a valuable right. In any event, the opposing party may not, because a legal counterclaim has been pleaded to his equitable action, be deprived of his right of trial by jury as to the legal counterclaim.

The reconciliation of the theory of our federal system with the practical ideal of complete justice, in one action, between all parties who may be involved in any factual situation, rests ultimately with the Supreme Court.

In the meantime it is for us, in the face of totalitarian aggression, so to mobilize our resources, human as well as material, that the decision may be freely made in the tradition of English and American institutions.
CORRELATION OF STATE BLUE SKY LAWS AND THE FEDERAL SECURITIES ACTS*

THOMAS Z. WRIGHT†

Since the enactment of the federal Securities Act¹ in 1933 over seven years have passed, during which time the eyes of the nation and of those interested in so called “Blue Sky” legislation have been on that act and its administration by the Federal Trade Commission and the Securities and Exchange Commission. The Blue Sky or securities acts of the various states² practically have been forgotten by the legal writers, the bar associations and the Commissioners on Uniform Laws.³ This was unfortunate because the states,

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†The writer gratefully acknowledges his indebtedness to Professor A. E. Throop, Yale Law School, who read the manuscript and offered suggestions thereon.
²All states except Nevada have some form of Blue Sky legislation.
³The Blue Sky laws of the states have been described and classified many times, but to do so again may not be excessive repetition. These state acts generally can be briefly described and classified as follows:

a. "Fraud" type—providing penalties and injunctive action for fraud. The acts of Delaware, New Jersey and New York may be said to be examples of this type.

b. LAWS CONTROLLING DEALERS ONLY—providing for registration or licensing of dealers, revocation of such licenses for stated reasons, and other means of enforcement. The acts of Connecticut, Maine, Pennsylvania, and Rhode Island are fundamentally of this type.

c. LAWS CONTROLLING SECURITIES ONLY—providing that securities shall be qualified or registered before being sold but not providing that dealers shall be licensed. The acts of Wyoming and New Mexico are perhaps the only remaining examples of this type.

d. LAWS CONTROLLING BOTH SECURITIES AND DEALERS:

1. Those requiring registration by notification before sale of securities and the licensing or registration of dealers. The securities act of Massachusetts is an example of this type.

2. Those requiring registration by qualification before sale of securities and the licensing or registration of dealers. The acts of Illinois and Indiana are examples of this type.

3. Those requiring registration by notification or qualification before sale of securities and the licensing or registration of dealers. The Minnesota, Wisconsin, and Kentucky acts are of this type.

State acts controlling both securities and dealers are now the most prevalent type. For other classifications of the state Blue Sky acts, see Osgood, The Trend of Blue Sky Laws (1932) 3 INVESTMENT BANKING 144, 147; Smith, State Blue Sky Laws and the Federal Securities Act (1936) 34 MICH. L. REV. 1135, 1137-38; PROCEEDINGS, 21ST ANNUAL CONVENTION NATIONAL ASSOCIATION SECURITIES COMMISSIONERS (1938) 89-90.

See the remarks of S. M. Heilbron, Securities Commissioner of Pennsylvania, PROCEEDINGS, 19TH ANNUAL CONVENTION NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS (1936) 69, 84-85, charging that the American Bar Association did not make the enactment of the Uniform Sale of Securities Act by the states the interest or purpose of any committee after the act had been adopted in 1929 by the National Conference of Commissioners on Uniform Laws. The Uniform Sale of Securities Act has been adopted with minor modifications in only three states, Florida (1931), Oklahoma (1931), and Louisiana (1940). Little consideration has been given the suggested uniform statute.
finding that the federal act did not supersede or derogate from the powers and activities of their commissions, but instead had for its purpose the securing of full disclosure of all material facts for the guidance of investors, did not voluntarily abandon Blue Sky activities or even withdraw from the interstate field. There were numerous problems under the state acts which needed solution when the federal act was passed, many of which still remain with us. The enactment of the Securities Act of 1933, and the amendments thereto contained in the Exchange Act of 1934, meant that so far as its terms provided there was an additional regulation governing the distribution of securities in interstate commerce or through the mails, an additional law superimposed upon the laws of the various states, to which issuers and underwriters were already subjected. This naturally raised new problems, chief of which was the correlation of these various Blue Sky acts of the forty-seven states and the federal Securities Acts so as not to burden unduly legitimate business, yet provide maximum protection to the investors and maximum efficiency to the taxpayers of the nation.

I. SUGGESTIONS FOR CORRELATION

Soon after the enactment of the Securities Act the state commissioners through their national association began efforts to cooperate with the federal administration. Though their efforts went more to cooperation than correlation, their activities in this behalf resulted in some noteworthy accomplishments, such as the creation of the securities violation records of the Securities and Exchange Commission and an attempt to spread the use of uniform registration forms among the states.

In addition to the National Association of Securities Commissioners, a few legal writers during the intervening years have seen the need for correlation of the various state Blue Sky acts and the federal Securities Acts and have developed concrete ideas thereon. One writer in 1936 made a detailed

since amendments thereto were effected by the Conference in its 1930 meeting. The act is no longer adequate in many respects since it contains no specific provisions on problems raised by investment counsel and the issuance of whiskey certificates and oil royalties.

6Mr. A. G. Davis, Field Secretary of the Investment Bankers Association of America, in a communication to the writer under date of April 22, 1940, stated:
"... There is no more important project now in the field of security regulation than that concerning the correlation of the state Blue Sky laws and the Federal Securities Acts. . . ."
7Proceedings, 19th Annual Convention National Association of Securities Commissioners (1936) 103-104.
8See note 99 infra.
9See note 109 infra.
analysis of the jurisdiction of the states, the purposes of the state acts, and reasons for correlation. He came to the conclusion that "Issuers and underwriters must, . . . in order to gain relief from the burden of state requirements, address themselves to the task of inducing Congress to remove section 18 from the Securities Act and section 28(a) from the Securities Exchange Act, and substituting therefor declarations that the federal laws are to be deemed complete and exclusive, and to the task of inducing the various state legislatures to revise their securities laws to mitigate excessive and unnecessary burdens."\(^{10}\)

In 1937, Professor Allen E. Throop, then General Counsel for the Securities and Exchange Commission, addressed the National Association of Securities Commissioners on this problem.\(^{11}\) Professor Throop raised new problems of substantive law for correlation but did not suggest that the states' jurisdiction in interstate transactions should be withdrawn. He suggested that a common program be developed which would most "effectively and most simply integrate state and federal regulation in the achievement of the policy of investor-protection which each state has heretofore expressed."\(^{12}\)

It is the purpose of this article to consider the so called Blue Sky acts of the various states, reasons and suggestions which have been advanced for effecting their correlation with the federal acts, the progress already made in the field\(^{13}\) and finally what now should be done toward further carrying out such a program.

II. SHOULD THE FEDERAL GOVERNMENT EXCLUSIVELY OCCUPY THE INTERSTATE FIELD?

Under the federal jurisdiction over interstate commerce and the mails Congress has fully occupied the field of public offerings of securities through those mediums. Also, Congress has to a considerable extent entered the field of security qualification where there is no public offering of a new issue involved by providing for registration of national securities exchanges\(^{14}\).

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\(^{10}\) Smith, \textit{supra} note 2, at 1135. In a subsequent article this same writer also stated, "... duplicative requirements of state laws might appropriately be eliminated, and this could most easily be accomplished by Congressional action to the effect that, so far as transactions comprehended by the Federal Act are concerned, the state laws should be inapplicable." Smith, \textit{The Relation of Federal and State Securities Laws} (1937) 4 LAW & CONTEMP. PROB. 241, 254.


\(^{12}\) Id. at 100.

\(^{13}\) Research on the provisions of the state and federal acts and the rules, regulations and forms adopted thereunder has been carried up to Sept. 1, 1940.

the securities listed and sold thereon, and the registration of brokers and dealers who make use of the mails or instrumentalities of interstate commerce to effect transactions in or to induce the purchase or sale of securities other than on a national securities exchange.

A. Benefits of the State Acts

The suggestion for correlation of the state and federal regulations by eliminating state Blue Sky jurisdiction on interstate issues raises the all important question of whether there is any continued need for the state laws, or any real purpose to be served by their continuance. It is recognized that laws which are intended to stop bad practices also regulate legitimate business and constitute a burden on that business. To the extent these laws impose a burden without a contributing benefit they are a handicap rather than a boon to business. The extent to which state Blue Sky laws constitute a burden on legitimate business will be considered shortly, but first let us determine to what extent they constitute a benefit to the investing public. Their present value should not be weighed before determining this factor.

1. Determination of Quality Function.—Most of the argument of those desiring to eliminate state jurisdiction over interstate issues seems to be predicated upon the theory that the policies of the state acts are not to determine for investors the "soundness" of the securities offered for registration, refusing to permit the sale of those not meeting the standards set by the local acts, but rather that their policies are to require adequate disclosure of facts to the investing public to the end that fraud may be prevented. If this be true the state acts are merely duplicating the work of the Securities Act of 1933 and the Exchange Act of 1934 in so far as issue registration requirements are concerned, and if we desire to eliminate that duplication it will be necessary to choose between the two systems. This theory is not borne out, however, by the provisions of the state acts regulating registration of securities or the decisions arising thereunder. In fact, there is no doubt,
in view of the many express provisions in these acts and the cases which have arisen thereunder, that their fundamental purpose is to require that the "soundness" and quality of the securities be passed upon.

This being true, it follows that the state Blue Sky acts have a very definite place in the field of security regulation. The Securities and Exchange Commission does not purport to pass upon the quality of the securities being offered, its only duties being to see that a full disclosure of all facts has been made in the registration statement and that the prospectus meets the requirements of Section 10 of the Act. Thus, the federal commission forces a full disclosure of all material facts and the state commissions, on the basis of this disclosure, pass upon the quality of the securities, the two organizations forming a complete plan of security sales regulation on interstate distributions.

Acts 1923, Act No. 220, as amended by Pub. Acts 1929, Act No. 136, Pub. Acts 1931, Act No. 255 and Pub. Acts 1935, Act No. 37. In sustaining the decision of the commission the court said, "This commission is composed of members appointed for their experience in financial affairs, ... some weight is to be given to the special qualifications and experience of the commission in passing on testimony relating to the feasibility and fairness of such untried financial enterprises as proposed here ... [The] theoretical mathematical solution of the scheme does not relieve the proposed contract bonds of their unfair features, or the elements of uncertainty, potential constructive fraud and imposition on the public found by the commission." It seems certain in this case that the decision of the state commission was based, not upon any failure to disclose facts, but upon the uncertainty of the issuer's future and the small likelihood of its success.

In a similar case, Hayden Plan v. Friedlander, 97 Cal. App. 12, 275 Pac. 253 (1929), arising under the California act, the court said, "... the plan was untried and purely experimental; it was an innovation in modern financing. That fact alone would warrant a close scrutiny, and could be and doubtless was considered by the Commissioner in determining his action. The Corporate Securities Act was enacted for the purpose of protecting the general public, not only against fraudulent or unlawful stock schemes or enterprises, but likewise to give to the state authority to regulate and control the class and character of securities or investments that might be offered to the public for purchase. ..." It seems evident that in California the purposes of its act are more than requiring a disclosure of facts. (Italics are the author's.)

Notice also Section 8 (cc) of the Indiana Securities Law [H. B. 374, Ind. Laws 1937], denying registration if it be found that the business of the issuer is based upon "unsound business principles."


This statement assumes a correlation of registration requirements hereafter to be suggested.

It is the writer's belief that such paternalism on the part of the states is necessary to protect many investors. The federal prospectus, containing a mass of material information, is quite sufficient for the protection of the skilled investor who can and will read it, understand it, and act thereon for his own protection. But much of the technical and accounting information contained in the federal prospectus cannot be fully appreciated by lay individuals and the very size of the document often discourages the prospective investor until he makes no attempt to comprehend the "full disclosure" tendered him. Unless we are ready to say such investors either should not be given protection or that they should not be permitted to make investments in securities offered the public, it is necessary to recognize that to protect such purchasers the states must continue to eliminate, so far as possible, the unfair and fraudulent issues.
2. Regulation of Purchases of Intangible Properties and Expenses of Securities Sales.—It is common for state Blue Sky acts to provide for placing in escrow any of the securities proposed to be registered, or securities senior thereto, which have been or which are to be issued for intangible assets by the issuer.\(^{22}\) The statutes vary with respect to the requirements to be met before the escrowed securities may be released. The Florida Securities Act requires that the escrow agreement provide that the owner of such securities shall not be entitled to withdraw them from escrow until all other stockholders who paid for their stock in cash shall have been paid an actual earned dividend or dividends aggregating not less than six per cent, and in case of dissolution or insolvency during the escrow period that the owners of such escrowed securities shall not participate in the assets until after the owners of all other securities shall have been paid in full.\(^{23}\) Furthermore, it is common for the state acts to limit sales expense when the distribution is to be made through agents and there is no binding firm commitment to purchase the issue by an underwriter. The Illinois act provides that if the issue is to be sold through agents the issuer must receive not less than 80% of the proceeds of each sale,\(^{24}\) while the California act simply provides that the State Commissioner may impose 'conditions limiting the expense in connection with the sale but puts no express limits upon his discretion.'\(^{25}\) The federal registration statement requires the issuer to show the amount of such selling expense\(^{26}\) and reveal the purchase of any intangible properties within two years preceding the filing of the registration statement from any promoter, director, principal executive officer, stockholder (holding more than 10% of any class or in the aggregate of the stock of the issuer) or parties to a material contract made outside the ordinary course of business of the issuer.\(^{27}\) Here again the purposes of the federal and state acts tie together. The Securities and Exchange Commission can force a full disclosure of all the material facts and the state commissions, on the basis of this disclosure, may require securities issued for intangible properties to be placed in escrow and may refuse to register the securities for sale if the selling expenses thereon are too high.

3. Impounding Proceeds of Issue Pending Its Successful Completion.—

\(^{22}\)Heilbron, supra note 3, at 70-72.
\(^{26}\)Items 25, 28, 33, 34, 35, 36, 37, Registration Statement A-1, Securities and Exchange Commission.
\(^{27}\)Items 25, 28, 29, 30, 33, 34, 35, 38, 39, 40, 41, 42, 43, 44, 45, 46, Registration Statement A-1, Securities and Exchange Commission.
In a few states provisions are made either by statute or rule that the commission may in its discretion require funds raised by a sale of stock to be impounded until the minimum capital required for incorporation, or the amount deemed necessary to successfully finance the proposed corporation, or the amount needed to provide adequate working capital or finance proposed expansions has been secured. This seems to be an excellent way to handle certain doubtful issues when they are not underwritten, whether they arise in interstate or intrastate transactions. Furthermore, when the investor purchases stock in a corporation thinking it is to carry on business in a certain manner, or make certain expansions, and insufficient funds are raised to permit that contemplated action, a situation is created where the protection provided under the Securities Act of 1933 is hardly adequate. The most that the Securities and Exchange Commission can do in this case is require the issuer to state in detail the specific purposes for which the total proceeds were or are to be used, the use to which the actual net proceeds from the securities registered will be put if insufficient funds are raised to accomplish those purposes and if at any time it is found undesirable to proceed with the program. Thus the investor will be informed of proposed alternative action, but in most instances he will have invested to promote the primary purposes, giving little or no thought to any other course of action. It is believed that in this instance such state provisions, providing for a return of the purchaser's funds if the capital raising program miscarries or if it is found undesirable to proceed with the stated purposes, provide better protection for investors than do the requirements of the Securities Act alone.

4. State Exemptions of “Listed” Securities.—It has been argued that inasmuch as the states, by their provisions exempting from registration securities listed upon certain exchanges and, in some states, securities prior to

29Alabama, Rule 3, Sec. 1 [131 C. C. H. 153-54 (1940)], and Ohio Regulation R63 [131 C. C. H. 3356 (1940)].
30Alabama, Rule 3, Sec. 2 [131 C. C. H. 154 (1940)], and Ohio Regulation Q-1 [131 C. C. H. 3358 (1940)].
31Alabama, Rule 3, Sec. 3 [131 C. C. H. 154 (1940)].
32Items 42 and 43 of Registration Statement A-0-1 and Item 27 of Registration Statement A-1, Securities and Exchange Commission. Each of these items is carried over into the federal prospectus.

In the Matter of the Winnebago Distilling Co., Securities Act Release No. 2188, Feb. 26, 1940, the Securities and Exchange Commission entered a stop order because the answer to Item 27 of the registrant's registration statement was materially defective. In that case the Commission said, "... In our opinion, regard for the interests of investors required full and clear disclosure of the specific purposes for which registrant intended to employ its funds in the event only $150,000 were received, and of the use that would be made of the funds contributed by stockholders in the event that a minimum of $150,000 were not obtained."

33For a survey of the extent of such exemption in the state acts see 132 C. C. H. 6507-6516 (1940).
have recognized that adequate investor protection is secured when information as to the financial affairs of the issuer is made available, the states can with equal propriety extend an exemption to securities registered under the Securities Act of 1933. Since the passage of the Exchange Act in 1934 it has been suggested that the states might very well extend their exemption of securities listed on certain stated exchanges, and securities senior thereto, to include all securities listed upon registered national securities exchanges and unlisted securities senior thereto. It is true that many of the evils of this exemption have been eliminated by requiring in effect the same financial information listing requirements on all registered exchanges, but there are good arguments for narrowing this exemption rather than expanding it.

For a list of states granting an exemption to securities prior to listed securities see Smith, supra note 10, at 247 n.; 132 C. C. H. 6507-6516 (1940).

Smith, supra note 10, at 255. This argument, however, fails to recognize that the states in granting the exchange exemption have not recognized exactly that adequate investor protection is secured when information as to the financial affairs of the issuer is made available. In truth the listing of a stock for trading upon an exchange generally requires a finding by the committee on listing as to the quality of the security, and the sufficiency of its distribution. Under the listing requirements of the New York Stock Exchange [135 C. C. H. 8216 (1940)], the applicant must show that it is a going concern, or the successor to a going concern, and must have substantial assets or demonstrated earning power, or both. The committee considers the applicant's standing in its particular field, the character of the market for its products, its relative stability and position in its industry, and whether or not it is engaged in an expanding industry with prospects of maintaining its position. Generally, however, the listing requirements of some of the smaller exchanges have not been so rigid as those of the New York Stock Exchange. See note 43 infra, for a consideration of the distribution requirements for listing.

The exchange exemption has been used many times in the past to escape state Blue Sky laws. The exemption was not always limited to the New York Stock Exchange where fairly adequate listing requirements were maintained but often included smaller exchanges over the country, particularly any located in the state in question, where often inadequate listing requirements were maintained. See The Security Markets (Twentieth Century Fund 1935) 236-37, 257-59; Sibal, The Securities Act of 1933, as amended (Unpublished thesis Yale Law School 1935). Thus, in many instances it was easier to list the securities with some small exchange than to qualify them for sale under a complicated state act. Steig, What Can the Regulatory Securities Act Accomplish? (1933) 31 Minn. L. Rev. 775, 779-80. Furthermore, the market price on such exchanges offered no investor protection for it was generally maintained by the underwriters or selling group until the distribution was completed. Proceedings, 19th Annual Convention National Association Securities Commissioners (1936) 173. See Securities Exchange Act of 1934 Release No. 2446, by the Securities and Exchange Commission, however, for a recent discussion of this stabilizing problem and rules promulgated by the Commission under Section 9(a)(6) of the Securities Exchange Act of 1934. 48 Stat. 889 (1934), 15 U. S. C. A. § 78i (1935).


It also has been suggested that the exchange exemption should be extended to include securities which have been recommended for listing upon their issuance, by the listing committee of a designated exchange even before they are actually issued. See Smith, supra note 2, at 1165, for a development of this argument.

On the other hand, if the exchange exemption is consistent with the principles of
An analysis of the value of the exchange exemption requires separate considerations of its use in primary and in secondary distributions of securities. There are many arguments and reasons why the exchange exemption should not be available for use on an original primary distribution of securities. As has been previously pointed out, the listing requirements of the exchanges generally require findings by their committees on listing concerning the quality of the securities, although these requirements have not been uniform and those of the smaller exchanges have not been so rigid as those of the New York Stock Exchange. In view of this laxity on the part of some of the exchanges it is doubtful if listings generally give investor protection equivalent to that given by the state Blue Sky commissions from the standpoint of a determination of the quality and “soundness” of the securities. Furthermore, there is the danger that listing committees of small exchanges needing business will not exercise the same degree of care and prudence in passing upon the quality of securities as do the securities commissioners of the various states whose primary purpose is the protection of investors. Also, the previously considered state provisions limiting sales expense, requiring the placing in escrow of all shares, or securities prior thereto, given or to be given for intangible properties, and those provisions impounding the proceeds of security issues pending the success of their distributions, have no counterparts in the Securities Act of 1933 or the Exchange Act of 1934. These provisions serve useful and desirable functions, and their value must be weighed against the value of the exchange listing exemption when it is used to escape state registrations on original primary distributions of securities. The final argument against the use of the exchange exemption in such an instance does not concern any loss of protection under the Blue Sky acts but rather the impropriety of permitting securities to be listed and dealt in upon any exchange until there is a sufficient distribution of the issue to make a market. The Exchange Act of 1934 authorized the Securities and Exchange Commission to request any national securities exchange to limit or prohibit the registration of, or trading in, any security within a specified period after the issuance or primary distribution thereof. If the exchange did not comply with the request, the Commission was authorized to effect the change by its own regulations. In 1937 the

"qualification" of securities involved in most state Blue Sky laws because the exchanges, on the whole, have purported to pass upon the quality of the securities before listing, then it may be questioned if the exemption is a proper delegation of authority to a non-governmental agency. In most instances it constitutes a delegation of authority to exchanges operating entirely outside the states in question and owing not the slightest allegiance or duties to those states. Throop, supra note 11, at 96; Steig, loc. cit. supra note 37.

40 See supra note 35.

Commission reported that it was making a study of this problem, but a review of the listing requirements of the registered national securities exchanges shows few express rules on the problem, most of which are more or less inadequate. In view of the superior investor protection afforded by the state Blue Sky laws and the impropriety of permitting securities to be listed and dealt in upon any exchange until there is a sufficient distribution of the issue to make an adequate market, the advisability of permitting the exchange exemption to be used any time during an original primary distribution of an issue is very doubtful.

Slightly different considerations are involved if the problem concerns a primary distribution of an unissued portion of an issue previously distributed to the public and listed and dealt in upon a registered national securities exchange. In this instance there should be a sufficient distribution of the securities originally issued to make an adequate market; but the superior investor protection afforded by the state Blue Sky laws in passing upon the quality of the securities, regulating sales expense and the purchase of intangible properties, and impounding the proceeds of the newly issued securities pending the success of their distribution, still makes it doubtful that the exchange exemption should be permitted to operate at all during the primary distribution of an issue.

The state acts generally do not exempt secondary distributions of securities, whether interstate or intrastate. The securities in such instances likewise generally may become exempt by being listed upon an exchange.

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43The stock listing requirements of the registered national securities exchanges can be found in 135 C. C. H. 8001-8353 (1940). The rules of most of the exchanges including those of Cincinnati, Philadelphia, St. Louis, San Francisco, and the Chicago Board of Trade require only a showing of the distribution of an issue, leaving it to the judgment of the listing committee whether that distribution is sufficient to justify the granting of trading privileges. The Baltimore Stock Exchange requires this information only "on request." 135 C. C. H. 8005 (1940). The Boston Stock Exchange does not require a complete distribution but will grant listed trading privileges when "the security has been sufficiently distributed to the public to afford reasonable assurance of a free market for it." 135 C. C. H. 8011 (1940). The rules of the Chicago Stock Exchange contain a similar provision. The San Francisco Mining Exchange requires only that 15% of the capital stock be distributed to the public, exclusive of officers, directors, syndicate managers and agents. 135 C. C. H. 8312 (1940). The Washington Stock Exchange requires a statement of the number of authorized shares issued and outstanding and a statement of the number of shareholders, "which must in no case be less than twenty-five (25)." 135 C. C. H. 8345 (1940). The New York Stock Exchange, however, requires that the security be actually issued, outstanding and be sufficiently widely distributed to offer reasonable assurance that an adequate auction market will exist. 135 C. C. H. 8216-8256 (1940).

registration provisions of the Securities Act of 1933, on the other hand, do not apply to a secondary distribution of securities unless it is by an affiliate of the issuer or a person in a control relationship with the issuer within the terms of the last sentence of Section 2(11) of the Act. It is quite evident in this instance that the framers of the act recognized that a party making a secondary distribution, unless in the specified control relationship with the issuer, would be unable generally to secure the issuer's cooperation in the preparation and filing of a registration statement and prospectus. Therefore to prevent the freezing of large blocks of securities in the hands of individuals and corporations the act was drafted to exempt secondary distributions in such instances.

The opponents of the state Blue Sky laws can make a good argument that the state acts likewise should exempt secondary distributions when made for or on behalf of a party not an affiliate of the issuer or a person in a control relationship with the issuer, because of the practical difficulties inherent in effecting a registration by such person, the probable inadequacy of any registration thus effected, and the public interest in not hampering the free interchange of outstanding securities in bona fide transactions. Furthermore, in these cases there is less public interest in regulating sales expense and no necessity to impound the proceeds of the distribution pending its successful completion, both of which are important functions of the state acts. Also, it is to be noted that in most cases considerable investor protection will be given by the operation of the federal acts. Unless the security is one exempt by the provisions of Section 3 of the Securities Act of 1933 or issued in a transaction not involving any public offering there will be on file the original registration statement and prospectus, and all amendments thereto, used during the primary distribution of the issue.

Of course, the civil liability provisions of Section 12(2) of the Act apply to

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46 A secondary distribution is not exempt from the provisions of Section 5 of the Act, however, until one year after the date the securities are bona fide offered to the public, assuming the secondary distribution does not consist of the dealer's original allotment, and provided it is by a person who did not purchase from the issuer "with a view to the distribution" of the securities. Furthermore, this is assuming that the secondary distribution is not effected by or for the issuer. See Section 4 (1) and Section 2 (11) of the Securities Act of 1933. 48 Stat. 77 (1933), as amended by 48 Stat. 906 (1934), 15 U. S. C. A. § 77d (1935); 48 Stat. 74 (1933), 15 U. S. C. A. § 77b (1935). For a discussion of secondary distributions under the Securities Act of 1933 see Throop and Lane, Some Problems of Exemption under the Securities Act of 1933 in (1937) 4 Law & Contemp. Prob. 116-119.


48 If the occasion arose the purchasers could take advantage of the civil liability provisions of Section 11 of the Securities Act. In most such secondary distributions, however, the limitations of actions provisions of Section 13 would prevent recovery. 48 Stat. 82 (1933), as amended by 48 Stat. 907 (1934), 15 U. S. C. A. § 77k (1935); and 48 Stat. 84 (1933), as amended by 48 Stat. 908 (1934), 15 U. S. C. A. § 77n (1935).
either primary or secondary distributions. In many instances the securities being offered in a secondary distribution may be listed for trading upon some national securities exchange and registered under the provisions of the Exchange Act of 1934. Thus, considerable investor protection will be afforded by the federal acts in most secondary distributions. It would facilitate the free interchange of outstanding securities if the states would recognize the practical difficulties inherent in a registration of the securities in a secondary distribution for or on behalf of a party not affiliated with the issuer or in a control relationship with the issuer, and grant an exemption for those transactions. The exchange exemption is not an advantage to the unaffiliated party in such a case if the securities have not been listed previously, as he is in no position to secure their listing upon an exchange. If the states granted absolute exemption to such secondary distributions it would result in a loss of some investor protection; but in view of the registration difficulties faced by such unaffiliated parties and the investor protection afforded by the federal acts, the change is probably justified.

If the offering is a secondary distribution for or on behalf of an affiliate of the issuer or a person in a control relationship with the issuer then that party has the means of securing a state registration by the issuer and likewise the means of securing an application for listing of the securities upon a national securities exchange. In this type of situation there is little public interest in regulating sales expense and no necessity to impound the proceeds of the distribution pending its successful completion, both of which are normally important functions of the state Blue Sky acts. Some of the issuer's outstanding securities, however, may have been given for intangible properties, and investor protection may require that these securities be placed in escrow pending the success of the venture. The secondary distribution here being for or on behalf of an affiliate or controlling person, the public interest requires of such person the same protection as if the distribution were by the issuer itself. Furthermore, the primary function of the state acts in passing upon the quality or "soundness" of the securities still remains, as do other functions hereafter to be mentioned. All the investor protection offered by the state acts may be lost, however, by the use of the exchange exemption. The affiliated or controlling party, whose securities are being distributed, has the means to use such procedure to escape state registration of the securities. When the public interest in these secondary distributions and the investor protection provided by the Blue Sky acts are balanced against the protection afforded by listing it seems again that the basis of the exchange exemption is very doubtful.

To summarize, it seems apparent that in both primary and secondary distributions better investor protection would be secured if the states eliminated
their exchange exemptions, and that the free interchange of outstanding securities would be facilitated if the states granted an exemption for securities sold in secondary distributions for or on behalf of persons not affiliated with or under common control with the issuer. The simplest and most effective means of immediately eliminating the use of the exchange exemption to escape the provisions of state Blue Sky laws on original primary distributions is for the Securities and Exchange Commission to vitalize Section 19 (b) (2) of the Securities Exchange Act so as to prevent the listing of securities upon exchanges before the completion of their primary distributions. This would not prevent the use of the exemption on the primary distribution of an unissued portion of a previously issued security, or on a secondary distribution, but such action by the federal commission would point the way for broader action by the states.

5. Regulation of Section 3 (b) Exemptions.—Section 3 (b) of the Securities Act of 1933 empowered the Commission by its rules and regulations to add any class of securities to those exempt by Section 3 thereof, subject to such terms and conditions as it might prescribe, if it found that the enforcement of the Securities Act with respect to such securities was not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering. The exemption was limited to issues where the aggregate offering price did not exceed $100,000. By virtue of this grant of authority the Commission has adopted regulations A, B and B-T exempting various types of small issues of securities upon conditions adapted to the character of the particular issues and to the technique generally employed in their distributions. Brief prospectus requirements are imposed as a condition for obtaining exemption for certain types of issues, but there are no requirements that the prospectus or offering sheet shall be filed with the Commission except on issues of shares of stock in a corporation or similar interests in a trust or unincorporated association, first mortgage real estate notes or bonds of less than $500 denomination, oil and gas interests, and certificates of interest in oil royalty trusts or similar types of trust or unincorporated associations. No formal approval or action by the Commission is required to validate the

48If this were done it would be necessary for the states to grant an exemption for true broker transactions in order not to interfere with the operations of exchanges and over the counter markets when no solicitations of purchase are involved. Compare North Carolina's interpretation of its statute [132 C. C. H. 6516, § 27 (1940)], and Section 4 (h) Virginia Securities Law [Va. Acts 1928, c. 529, as amended by Acts 1934, c. 341].
49Throop and Lane, supra note 45, at 93-95, discuss these exemptions.
50Regulation A, Rule 202, Securities & Exchange Commission
51Regulation A, Rule 203, Securities & Exchange Commission.
52Regulation B, Rule 320, Securities & Exchange Commission.
53Regulation B-T, Rule 370, Securities & Exchange Commission.
use of the prospectus, a copy of which must be delivered prior to the conclusion of any contract of sale to every person solicited to buy the security in question. The regulations do provide that the offering sheets on oil and gas interests and the prospectuses on certificates of interests in oil royalty trusts are subject to a modified form of stop order proceeding.\(^5\) Also, after notice to the Commission, any securities offered to the public for cash, other than oil and gas interests covered by regulation B and certificates of interest in oil royalty trusts or similar types of trusts or unincorporated associations covered by regulation B-T, are exempt if they are sold in compliance with all applicable state provisions relating to the registration of securities and dealers.\(^6\) It is not the purpose of this article to give detailed discussion to the exemptions provided by regulations under Section 3(b) of the Act. Instead, it is sufficient to point out that with the elimination of the civil liabilities of Section 11,\(^7\) and the prospectus requirements in certain instances, and the stop order proceedings in other instances, there arises here a group of securities in the regulation of which the state commissions must continue to be vigilant if adequate investor protection is to be rendered in the interstate distributions of such issues.

6. The Use of False or Misleading Communications on Interstate Issues After Meeting Federal Prospectus Requirements.—Notices, circulars, advertisements, letters or communications, written, or by radio, which offer any security for sale are within the definition of “prospectus” in the Securities Act of 1933.\(^8\) If these notices, circulars, advertisements, letters or communications do not meet the requirements of Section 10 of the Act their transportation or communication in interstate commerce or in the mails is a violation of Section 5 (b) (1) even though a registration statement is in effect as to the security offered for sale. These communications are not deemed to be prospectuses, however, if prior to or at the same time with such com-

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\(^6\)Regulation A, Rule 210, Securities & Exchange Commission.

\(^7\)Civil liability under Section 11 of the Securities Act [48 Stat. 82 (1933), as amended by 48 Stat. 907 (1934), 15 U. S. C. A. § 77k (1935)] would not arise since there is no registration required on exempt securities. However, as a condition of securing the exemption the prospectus or offering sheet requirements are imposed in certain cases. If these requirements are not met absolute civil liability under Section 12 (1) of the Securities Act [48 Stat. 84 (1933), 15 U. S. C. A. § 771 (1935)] would be imposed upon the interstate seller. If the prospectus or offering sheet requirements are met civil liability for misleading statements therein would arise only under Section 12 (2) of the Act, except as effected by Regulation B, Rule 332, concerning representations in offering sheets on oil and gas interests and Regulation B-T, Rule 376, concerning representations in prospectuses on certificates of interests in oil royalty trusts or similar types of trusts or unincorporated associations.

munications a written prospectus meeting the requirements of Section 10 is sent or given to the person to whom the communication is made by the person making such communication or his principal. Thus the provisions of the Securities Act preclude the use of false or misleading notices, circulars, advertisements, letters or written communications prior to sending or giving to the prospective purchaser a prospectus meeting the requirements of Section 10. There is apparently nothing in the Act, other than perhaps injunctive relief\(^5\) and criminal penalties\(^6\) for violation of Section 17(a), to prevent the use of false or misleading printed, typed or written communications after the prospectus requirements have once been met.\(^6\) Fortunately, however, the state acts in many instances offer some relief in this situation. State Blue Sky laws generally prohibit the use of any advertising matter in connection with the sale of any security unless a copy thereof shall have been submitted to, and approved by, the state commission.\(^6\) A correlation of


\(^{6}\)Civil liability would not arise under Section 12 (1) of the Securities Act [48 Stat. 84 (1933), 15 U. S. C. A. § 771 (1935)] as there is no violation of Section 5 in such a case [48 Stat. 77 (1933), as amended by 48 Stat. 906 (1934), 15 U. S. C. A. § 77e (1935)]. It is conceivable that a purchaser in such a case, failing to read the prospectus or to understand it if he did read it, might purchase a security relying on the false or misleading statements in these later notices, circulars, advertisements, letters or written communications. However, it is still doubtful if such a purchaser has any relief under Section 12 (2) of the Act where the untrue statement must have been contained in "a prospectus or oral communication" to create liability thereunder. The extra notices, circulars, advertisements, letters or written communications are not "oral" and within the statute, and by Section 2 (10) [48 Stat. 74 (1933), as amended by 48 Stat. 905 (1934), 15 U. S. C. A. § 77b (1935)] they are not a "prospectus." If, under any theory, the purchaser were permitted to sue he might have difficulty refuting a contention that he knew of such untruth or omission when he purchased since the prospectus originally delivered to him presumably would show the falsity of the later misleading supplemental material. This is apparently an instance when the common law remedy of deceit would offer more protection to the purchaser than would the civil liability provisions of the Security Act. As stated above the only other protection afforded by the federal act would be perhaps action by the Commission to enjoin the use of such communications or the invoking of the criminal penalties of the Act under the theory there is involved a violation of Section 17 (a) [48 Stat. 84 (1933), 15 U. S. C. A. § 77q (1935)]. See Securities and Exchange Commission v. Macon, 28 F. Supp. 127 (D. Colo. 1939); accord, Coplin v. United States, 88 F. (2d) 652 (C. C. A. 9th 1937). In most instances, however, such action would come only after completion of the unlawful use of the extra communications and would not constitute an exercise of the administrative process to prevent injury to investors.

\(^{6}\)For a few of the state provisions thereon see:


Ohio: Rule A-1, Ohio Rules and Regulations [131 C. C. H. 3352 (1940)].
the registration requirements of the state acts with those of the federal act, as is suggested hereafter, will give the state commissions a copy of the federal registration statement which they can use in considering and approving the submitted advertising matter. The state commissions are thus in a position to be an invaluable administrative aid in seeing that there shall be no violations of the spirit, if not the letter, of the federal Securities Act in such cases.

7. Prospectus Requirements on Issues Registered with the Federal Commission.—Even after an issuer has registered a security with the Securities and Exchange Commission and fully met the registration requirements of the federal act, it or the underwriter may avoid the delivery of the federal prospectus to prospective purchasers by skillfully avoiding the use of any means of transportation or communication in interstate commerce or of the mails to carry or transmit any communication which would be deemed a "prospectus" under the terms of the act, and by avoiding the carrying of the securities in the mails or in interstate commerce for the purpose of sale or delivery after sale. Here is an instance where it would be well for

63See Sections 2 (10), 5 (b) and 12 of the Securities Act of 1933 [48 STAT. 74 (1933), as amended by 48 STAT. 905 (1934), 15 U. S. C. A. § 77b (1935); 48 STAT. 77 (1933), 15 U. S. C. A. § 77e (1935); 48 STAT. 84 (1933), 15 U. S. C. A. § 77l (1935)]. To be a prospectus the communication must offer a security for sale. Inter-office communications of the issuer or underwriter concerning a distribution in another state would not be "prospectuses" nor violate Section 5 (b) (1). The sales literature could be prepared in the state in question and there distributed without the use of any of the means of communication or transportation in interstate commerce or the mails necessary to violate Section 5 (b) (1) or to create civil liability under Section 12 (2). The securities themselves could be transferred between offices in different states without violating Section 5 (b) (2) by enclosing therewith a prospectus meeting the federal requirements even though Section 5 (b) (2) probably has no application to such inter-office shipments. The use of the federal prospectus by the sales office might then be avoided by distributing the securities without the use of any of the means of communication or transportation in interstate commerce or the mails necessary to bring the transaction under Section 5 (b) (2) of the Act. It is thought, therefore, that an interstate distribution of a registered security may be carried on without the use of the federal prospectus. The nearest approach to this problem which has arisen thus far in an actual case is Farrell v. Reynolds, 11 N. Y. S. (2d) 117 (Sup. Ct. 1939), although it cannot be said to be exactly in point. In that case the court sustained the defendant's motion to dismiss the plaintiff's second cause of action based on an alleged violation of Section 12 (1) in not furnishing plaintiff a copy of the federal prospectus prior to the offering or delivery of the stock. Plaintiff had alleged that "in carrying out the sales" of the stock "the mails and other means and instrumentalities were used and the said underwriting is within the purview of the Securities Act," and that the issuer was a Michigan corporation. The court's decision was based on the proposition, as it phrased it, that "It is not clear from such allegations that the plaintiff's stock was sold to the plaintiff through the mail or in interstate commerce." The case can be said to stand for the proposition that civil liability under Section 12 (1) for not furnishing the required prospectus, will not be imposed upon a vendor of shares where the allegation against him does not show that the shares purchased by the complaining party traveled (at all) through the channels of interstate commerce or the mails. See note (1939) 34 ILL. L. Rev. 368. The opinion does not make it clear, however, that the allegation showed a delivery of the stock in some state other than Michigan so the case cannot be said definitely to advance
the states to integrate their acts with the provisions of the federal act by requiring that all sales material within the federal definition of "prospectus" meet the requirements of Section 10 of the Securities Act when used to solicit sales of securities registered thereunder. This provision could be appropriately incorporated in even the state acts of strict "fraud" type. It has been suggested that the application of such a state enactment need not be limited to cases where written soliciting material is given to the purchaser but could cover oral and telephone solicitations as well. This application, however, would prove quite expensive and there is no apparent need to deliver a copy of the prospectus to every person solicited orally or by telephone. The preferable solution would be for the states to impose the same time requirements upon delivering the federal prospectus in such cases as

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Throop, supra note 11, at 95.
CORRELATION OF BLUE SKY LAWS

are imposed by the federal act so that the prospectus requirements may be kept as uniform as possible. 65

B. Burdens of the State Acts and Their Elimination by Correlation

1. Issue Registration Requirements.—The greatest objections to the continued existence of local state securities laws concern their registration requirements on securities to be distributed. This is not true, of course, when the state act is of the “fraud” type, or “dealer license” type, because they raise no problem of registration whether the distribution is local or interstate in character. Furthermore, sales by issuers to underwriters, even under the “notification” or “qualification” acts, are exempt and raise no problems of meeting Blue Sky requirements. Sales by underwriters to dealers are expressly exempt in some of the states having “notification” or “qualification” statutes and the registration may be made by the local dealer before a public offering of the securities. 66 In other states the registration is to be made by the issuer, and sales to dealers of the security being distributed would come within the prohibition that “no securities . . . shall be sold within this state unless such securities shall have been registered” as provided in the act. If the underwriter itself is to make a public offering of the issue within the state the registration requirements will first have to be met. The result is that it has become the usual practice to include in the underwriting agreement a proviso that the issuer will take whatever action the underwriters may reasonably request to qualify the issue under the Blue Sky laws of the various states.

Thus, after the preparation of the registration statement required by the federal act it becomes necessary to meet the diverse registration requirements of the various states. This is no small matter. If the issue is a large one a ready market probably cannot be found in a single state. Furthermore, the issuer may desire to secure the benefits from a widespread market covering most of the country. If the issue is an especially desirable security the investors of one state should have an opportunity to acquire their portion of the distribution. These factors will require the registration of the securities under the laws of a number of states. The magnitude of this undertaking is illustrated by the experiences of those who have attempted to follow a registration through the Securities and Exchange Commission and securi-

65 It appears that by Florida Laws 1933, c. 16,174, § 4, the Florida Legislature has attempted to confer on the state securities commission authority to require that all sales material within the federal definition of prospectus meet the requirements of Section 10 of the Act [48 Stat. 81 (1933), as amended by 48 Stat. 906 (1934), 15 U. S. C. A. § 77j (1935)], when used to solicit the sale of securities registered thereunder. The Florida Commission has apparently not seen fit to exercise this authority. 131 C. C. H. 851 (1940).

66 Local dealers, however, usually are not anxious to assume responsibility for detailed statements of fact concerning issuers.
ties commissions of the various states. Their studies show an unorganized, expensive and wasteful procedure.67 Sometimes the issuer does not have time after meeting the federal requirements to meet the requirements in all the states in which it is desired to make offers before the expiration of the twenty-day, or less, "cooling" or waiting period required under the federal act,68 the result being that a simultaneous offering of the securities in all states cannot be had.

If state registration requirements should not be barriers to the proper flow of investments for industry, especially at a time when the country is trying

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67 In one instance in 1937 when it was desired to offer the securities in twenty states it was found that after preparing the federal registration statement these states required the information to again be set up in twenty different forms. Proceedings, 20th Annual Convention National Association of Securities Commissioners (1937) 29-30. A study made by Halsey-Stuart & Company, Inc., in about 1936, revealed that to secure the registration of a nonexempt issue under the federal Securities Act and the Blue Sky laws of twelve states required the furnishing of 733 items of information, including schedules, exhibits, etc. Of these items, 184 were required by the federal form A-2, while the remaining 549 items were required by the combined application forms of the twelve states. Of the 549 items required in the twelve state forms, 314 items duplicated or were similar to the 184 items required by the federal form. This left a total of 235 items of information requested in the twelve state forms concerning which the same or similar information was not requested in the A-2 federal form. Proceedings, 19th Annual Convention National Association of Securities Commissioners (1936) 112-113. These experiences probably could not be duplicated exactly today as there has been some correlation of registration requirements since these surveys were taken, but the progress along this line has been so limited that the obligation to register securities in a number of states is still a major undertaking.

In addition, under most state acts and the rules and regulations thereunder, where there has been no attempt to correlate the state and federal registration requirements, the operation of the state and federal systems results in those states requiring double submission of much of the required information. In addition to the required state registration statements, generally, the state acts and the rules and regulations thereunder require the submission to the state commission of all sales literature to be used in the distribution. Ala. Code Ann. (Michie, 1928) c. 35, art. 12, § 9883, and Alabama Rule 19 (131 C. C. H. 169 (1940)); Section 15, Minnesota Securities Act [Minn. Laws 1925, c. 192, as amended by Laws 1927, c. 66, § 10, Laws 1933, c. 408, § 11, and Laws 1937, c. 481, § 21]; and Sections 7 and 8, Oklahoma Securities Act [Okla. Sess. Laws 1931, c. 24, art. 11]. This would include the federal prospectus. So far as the same information is required in the state registration statement as in the federal prospectus, whether in the same form or otherwise, these provisions result in double submission of the same material. Thus the state registration and prospectus requirements show an unorganized, expensive and wasteful procedure.

68 As originally passed, Section 8 (a) of the Securities Act [48 Stat. 79 (1933), 15 U. S. C. A. § 77h (1935)] provided, in effect, that no registration statement filed thereunder, except for certain governmental issues, could become effective until twenty days after being filed with the Commission. Congress has recently amended this section of the act, however, to provide the Commission with discretionary authority to accelerate effective dates. Pub. Act No. 768, 76th Cong., 3d Sess. (Aug. 22, 1940) § 301. In exercising this discretionary authority the Commission is required to give due regard to the adequacy of the information respecting the issuer previously available to the public, to the ease with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof, can be understood, and to the public interest and the protection of investors. See Securities Act Release No. 2340 announcing the general policy which the Commission proposes to follow in exercising this discretionary authority.
to step up its production in many lines of national defense, there is reason
for seeking correlation of the state provisions with those of the federal
Securities Act. To do this it has been suggested that the issuer of interstate
issues be permitted to file copies of the federal registration statement or
prospectus with the states in satisfaction of their registration requirements. It
would seem that ordinarily this would be sufficient. It is the purpose of
the federal Securities Act to require that the registration statement shall
not contain an untrue statement of a material fact, or omit to state a material
fact required to be stated therein or necessary to keep the statements therein
from being misleading. The Securities and Exchange Commission has
defined the term "material" to include "such matters as to which an average
prudent investor ought reasonably to be informed before purchasing the
security registered." If such a disclosure is not made in the registration
statement a stop order may be issued under Section 8 (d) and civil liabilities
will arise under Section 11 (a) of the Securities Act. It is not easy to see
from a theoretical standpoint why this disclosure requirement under the
federal statute does not include everything generally needed by the state
authorities even where the Commission before permitting registration has to
"find that the sale of the security . . . would not be fraudulent and would
not work or tend to work a fraud upon the purchaser, and that the enter-
prise or business of the issuer is not based upon unsound business princi-


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68Smith, supra note 10, at 254-255, and Throop, supra note 11, at 94-95.
70Section 8 (d), Securities Act of 1933 [48 Stat. 79 (1933), 15 U. S. C. A. § 77h
(1935)], and Section 11 (a), Securities Act of 1933 [48 Stat. 82 (1933), as amended by
71Page 14, Instruction Book for A-2 Corporations, Securities and Exchange Com-
mission.
how the federal registration statement can be utilized under the forms of the various state acts.\textsuperscript{73}

2. \textit{Correlation of Issue Registration Requirements}.—If the state act is of the "fraud" type or "dealer license" type the filing of a registration statement would not be necessary. Where the local statute is of the "notification and qualification" type it is necessary to consider separately the two means of registration. Under these acts only nonexempt securities of issuers meeting stated earning requirements over specified periods, and obligations meeting stated security requirements, may be registered by notification.\textsuperscript{74} A satisfactory correlation of the federal and state registration requirements for such securities could be worked out by the states accepting the federal prospectus or registration statement, amendments thereto, copies of all notices and orders concerning the effectiveness thereof, and a separate statement showing that the securities meet the mathematical formula set out in the statute providing registration by notification. When appropriate information showing the ratio required under the statutory formula is contained in the federal prospectus or registration statement this separate statement could consist merely of references to that information, and could be very simple and brief.\textsuperscript{75} Of course, provision should be made for the issuer's

\textsuperscript{73}The writer by personal letter recently addressed the following question to the securities commissions of ten states where by statutes or regulations federal prospectuses or registration statements are accepted as state registration statements or as exhibits thereto:

"Do you find any need for more information than is contained in the federal registration statement or prospectus and amendments thereto to enable you to exercise your statutory duties?"

All of the state commissions answered the writer's question. The Commissions of Indiana and Missouri were firm in their beliefs that the federal forms do not contain sufficient information, while the Vermont commission stated simply, "We sometimes find need for different information than is contained in the federal registration prospectus. . . ."

The commissions of Illinois, Massachusetts, Michigan, Ohio, South Carolina, Texas and West Virginia stated that generally the federal registration statements provide ample information.

These answers show the existing division of opinion as to the completeness for state purposes of the information contained in the federal forms.

\textsuperscript{74}Section 6, Minnesota Securities Law. Minn. Laws 1925, c. 192, as amended by Minn. Laws 1927, c. 66. Compare the new Louisiana requirements. Section 7 (b), Louisiana Securities Act [La. Acts 1940, Act 262].

\textsuperscript{75}Another suggestion for correlation of registration by notification requirements is that the states enlarge this classification to include securities of issuers meeting the federal requirements for use of registration statement form A-2. This form is used for registration of securities (except such securities as to which a special form is specifically provided), by any corporation which files a profit and loss statement for three years and has either made annually available to its security holders for at least ten years financial reports including at least a balance sheet and profit and loss or income statement or had a net income for any two fiscal years of the five fiscal years preceding the date of the latest balance sheet filed with the registration statement. See Instruction Book for Form A-2, Securities and Exchange Commission. If securities registered on form A-2 were accepted by the states for registration by notification, the state requirements could be met by the filing of the federal registration statement, amendments thereto, and copies of all notices and orders concerning the effectiveness thereof. The
filing with the state commissions copies of all future amendments, notices and orders.  

Nonexempt securities of issuers unable to meet the state requirements for registration by notification would then be registered by "qualification." In this type of registration, correlation of the state acts with the federal act again could be accomplished by permitting the registrant to file with the state commission the federal registration statement, amendments thereto and copies of all notices and orders concerning the effectiveness thereof. On the basis of this information the state commissions could determine if the sale of securities would work a fraud upon purchasers or if the issuer's business were based upon sound business principles, and act accordingly to register or refuse to register the securities for sale. Again, provision should be made for the issuer's filing with the state commissions copies of all future amendments, notices, and orders.

If the state act is of the "notification" type alone, or of the "qualification" type alone, the same correlation as just outlined can be accomplished, except that under the former there will be no occasion to require a supplementary statement showing that the securities meet the ratio of the statutory formula for registration in a "notification and qualification" state.

This correlation of the registration requirements of the state and federal acts can begin at once under the form and rule making powers existing in many state commissions, if they can be brought to realize that there is no essential difference between the information they need and that already required in the federal registration statement under the Securities Act of 1933. Many state commissions have authority to prescribe the forms that shall be used for their local registration and to specify what information shall be

76 The Illinois Securities Act, Section 7 (c) [Ill. Laws 1919, p. 351, as amended by S. B. 225, Laws 1935 and H. B. 771, Laws 1939], provides for telegraphic advice of amendments to the federal registration statement to be followed by submission of duplicate copies of such amendments within 10 days thereafter. The Michigan Securities Commission, under a broad rule making power [Section 8, Michigan Blue Sky Law (Mich. Pub. Acts 1923, Act. No. 220, as amended by Pub. Acts 1931, Act No. 255, and Pub. Acts 1935, Act No. 37) 1 has provided wider coverage by requiring that the applicant covenant that within five days after filing any amendments or immediately upon receipt of any notices or orders affecting its registration the applicant will forward to the state commission two duplicate copies of amendments and two photostatic copies of the notices and orders. 131 C. C. H. 2086-2087 (1940). Most effective results probably would be secured under a combination of these provisions.
included therein. Under such statutes correlation with the federal registration requirements would be a simple matter.

A difficulty presents itself in some states which may require amendment of the local statutes before complete integration of registration requirements as herein suggested can be accomplished. This difficulty is that some state statutes set out in mandatory form just what shall be included in the registration statement to be filed thereunder. Of course, in individual instances this may not include any information not already required to be contained in the federal registration statement and the state commissions, under their express or inherent rule making powers, may still provide for correlation without amending the local laws. In other instances these mandatory provisions may require the inclusion of considerable material in addition to that contained in the federal registration statement. Complete correlation would necessitate the elimination of the mandatory provisions in such cases. In the meantime considerable relief from present registration requirements in these states can be secured by the local commissions' accepting the federal registration statement plus the supplementary mandatory data for the local registration, pending a better legislative correlation at the state's next legislative session. In any case the states should take steps immediately to

\[\text{Footnotes:}\]

77 Minnesota: Section 5, Minnesota Securities Law. Minn. Laws 1925, c. 192, as amended by Laws 1933, c. 408, § 7.
Alabama: ALA. CODE ANN. (Michie, 1928) c. 35, art. 12, § 9879, as amended by S. B. 415 (1931).
Indiana: Section 3, Indiana Securities Law [Ind. Laws 1937, H. B. 374].

Such mandatory provisions often raise further problems by requiring the balance sheet or financial statement of the issuer to be as of a period not more than sixty days, and sometimes thirty days, prior to the date of filing. See Section 9, Illinois Securities Act [III. Laws 1919, p. 351, as amended by Laws 1931, H. B. No. 971, Laws 1933, S. B. 628, Laws 1935, S. B. 225]; Section 13, Georgia Securities Law [Ga. Laws 1920, Act No. 754, as amended by Laws 1933, No. 281, Laws 1937, H. B. No. 160]. The financial statement under the federal act is required to be as of a date not more than ninety days prior to the date of filing of the registration statement. Item 54, Registration Statement A-1, and Instruction Book for Registration Statement Form A-2. In many cases the issuer in preparing the federal registration quite naturally depends upon the ninety day provision, only to find when he begins state registrations during the twenty day or less "cooling" period that he may have to bring the financial information up to a more recent date. This is expensive and also causes delay. It would simplify registration of securities if the states would eliminate such mandatory provisions.

It is not thought, however, that this whole burden of correlation of registration requirements should rest upon the states. It is not the purpose of this article to contend that the federal forms are perfect. The only contention advanced here is that the federal Securities Act requires the stating of the information needed by the state commissions to enable them to make their required findings before permitting local security distributions. The duty therefore rests upon the Securities and Exchange Commission to seek continually to design its registration forms so they may bring out fully the information
eliminate their registration barriers which are impeding the proper flow of investment funds to industry.81

3. Nonexempt Sales by Underwriters to Local Dealers.—Sales by underwriters to local dealers are not exempt in thirteen or fourteen states,82 and assuming that such a sale would constitute an “offer,” a “sale,” or “business transacted” within the states in question it becomes necessary for all underwriters to register as dealers in those states, or turn the allotment for a particular state to one or more underwriters who are registered as dealers therein, or make no sales in such states. It is, of course, expensive for all the underwriters to register as dealers in each of those states, and turning the allotment for a particular state to the underwriters who are registered therein is said to involve difficult practical problems.83 These difficulties arise because the states in question probably have felt that a local dealer might not have accurate information, or sufficient information, concerning the issuer to provide a satisfactory registration of out of state securities. Statutes failing to provide an exemption for sales by underwriters to local dealers probably can be said to represent indirect means of securing registrations by the issuers or underwriters. Regardless of the custom of underwriters to require of the issuer the qualification of securities under the state acts, the need for state provisions not exempting sales by underwriters to local dealers expires upon a correlation of registration requirements as heretofore suggested. When an interstate issue can be registered with the state commission only by filing therewith the federal registration statement, amendments there-

81Similar registration difficulties on broker, dealer and salesmen registrations arise out of the many divergent state requirements thereon. Space does not permit their full consideration and discussion in this article but the writer feels that much can and should be done in this field to establish some semblance of uniformity as to registration forms, financial statements, the dates thereof, and renewal dates on licenses once granted. It is expected that the National Association of Securities Commissioners soon may recommend a program meeting these problems as it now has a special committee on uniformity working thereon. See Address of Mr. John T. Jarecki of the Illinois Securities Department, before the Central States Group Forum, March 29, 1940, entitled The Uniform Licensing of Dealers and Brokers.

82For a listing of these states see Smith, supra note 10, at 250 n.

83Smith, supra note 10, at 250.
to, and copies of all notices and orders concerning the effectiveness thereof, each state commission will have a registration prepared by the issuer.\textsuperscript{84} It would seem therefore that after such correlation these states might very well exempt sales by underwriters to local dealers.

4. State Registration of Securities Required to be Made by a Registered Local Dealer.—An attempt to secure a widespread distribution of a small but sound security where there are only one or two underwriters may raise the possibility of their being unable to secure simultaneous offerings in all states, because certain states under “notification” or “qualification” types of statutes require the registration to be by a registered dealer doing business in the state in question. It is probable that the members of such a small underwriting group would not be licensed to do business in all the states in question; thus necessitating that some one of them first become a registered dealer in each of these states before it would be possible to register the securities therein, if it is desired to have the securities qualified with the states at the expiration of the twenty-day, or less, waiting or “cooling” period under the federal Securities Act.\textsuperscript{85} It would seem that there is need for the states, where registration of securities must be by a registered dealer licensed to do business therein, to provide that an out of state underwriter may at the same time file both an application for registration as a dealer and an application for registration of the securities to be sold, provided he appoints the state commissioner his agent to accept service of process on suits arising out of the later purchase of the securities and that the twenty-day, or less, federal waiting period has not expired.\textsuperscript{86} This change in state laws plus the correlation of the registration requirements on securities herein suggested should assure the underwriters that state registrations may all

\textsuperscript{84}Except in an interstate secondary distribution by a nonaffiliated person not in a control relationship with the issuer. It has been suggested previously that the states should follow the example set by the Securities Act of 1933 and also exempt such secondary distributions. See \textit{supra} pages 267 et seq.

\textsuperscript{85}This could not be solved by a sale to a registered dealer already doing business in the state in question since under the Securities Act, Section 2 (3), only “preliminary negotiations between an issuer and any underwriter” are exempt from the definition of “sale” and the prohibitions of the act until the registration statement becomes effective. \textit{48 Stat. 74} (1933), 15 U. S. C. A. § 77b (1935).

\textsuperscript{86}The problem here considered is not the same problem as the one just previously discussed where a number of states do not classify as an exempt transaction sales of securities to local dealers. In the prior case the sales could not be made because of state requirements. In the instant case sales to local dealers cannot be made until the federal registration statement becomes effective under the federal Securities Act. The solution offered in this case concerns the means of securing a state registration during the twenty day or less waiting or “cooling” period. When this period has expired and the federal registration has become effective, if the state registration has also been accomplished, underwriters, whether all are registered as dealers in the state or not, may then make sales to local dealers if such sales are exempt transactions.
be completed by the time the federal registration becomes effective.\(^8\)

5. *Publication of "Announcement" Advertisements or "Newspaper Prospectuses."*—The publication of an "announcement" or "tombstone" advertisement by the underwriting group which merely identifies the security, states the price thereof, names the persons by whom orders will be executed and from whom a prospectus meeting the requirements of the federal Securities Act may be obtained, does not constitute a violation of that act.\(^8\) In addition, the Securities and Exchange Commission sometimes permits the publication of a "newspaper prospectus" in longer form.\(^9\) The publication of such advertisements by the underwriting group is said to be a violation of some state acts by those members of the selling group who are not registered as dealers therein, even though the advertisements include appropriate "hedge" clauses making it clear that they are being published on behalf of only those who are registered dealers in securities in such states.\(^9\) If this is a criticism of the state acts it is not a particularly serious one, as it is no great burden on the underwriters to arrange the advertisements appearing in a particular state so they may include only the names of those underwriters who are registered dealers therein. A more serious objection to the state acts and their administration arises from the contention by some state commissions that such advertisements published in financial magazines or newspapers outside the state, but brought into the state in interstate commerce or the mails, constitute a violation of the state acts by those members of the selling group who are not registered as dealers therein.\(^9\) Such statutes, or the interpretations thereof, would require underwriters to register in each of these states if the newspaper or magazine in which the advertisement was to appear had a national circulation. This interpretation seriously limits the value of the exemption of this type of advertising by the Securities and Exchange Commission and seems to justify a revision of the state laws in question, so they may harmonize with the national practice in this instance.\(^9\)

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\(^8\)For another suggestion on how this problem may be solved see Throop, *supra* note 11, at 93-94.


\(^8\)Under the authority granted the Commission by Section 10 (b) (4) of the Securities Act of 1933 [48 Stat. 81 (1933), 15 U. S. C. A. § 77j (1935)], to classify prospectuses according to the nature and circumstances of their use.


\(^9\)Other problems of correlation are raised by Sections 3 (a) (9), 3 (a) (10) and the last sentence of Section 2 (3) of the Securities Act of 1933, and Section 264 (a), Chapter X, of the Bankruptcy Act, exempting from registration various securities. [48 Stat.
III. CORRELATION ON INTRASTATE DISTRIBUTIONS

A. Civil Liabilities

State Blue Sky acts commonly do not subject those who deal only in intrastate transactions to as severe civil responsibility to the purchaser as is imposed by the federal Securities Act. The Indiana Securities Law provides no civil remedies except rescission by the purchaser when the sale is


Section 3 (a) (9) of the Securities Act exempts securities exchanged by the issuer with its existing security holders exclusively, where no commission or other remuneration is paid or given for soliciting the exchange. Section 3 (a) (10) of the act exempts securities issued in exchange for outstanding securities, claims or property interests where the exchange is approved after hearing by any court or governmental authority authorized by law to grant such approval. Section 264 (a), Chapter X, of the Bankruptcy Act, provides an exemption for the securities issued by the receiver, trustee or debtor in possession pursuant to paragraph (2) of Section 116 of the Act or any transaction in any security issued pursuant to a plan in exchange for securities or debts of the debtor or partly for cash and/or property, or issued upon exercise of any right to subscribe or conversion privilege so issued.

State laws commonly exempt company offers exclusively to existing stockholders provided no commissions or fees are paid in connection with such offers and they likewise generally exempt the exchange of securities in bona fide reorganizations. Iowa Code (1935) § 8581-c5 (d). The same considerations prompt state exemptions of such transactions as prompt the federal exemptions, except the exemption provided by Chapter X of the Bankruptcy Act, where by Article VII the Securities and Exchange Commission is given notice of hearings, and may be deemed a party in interest and may render advisory reports upon proposed plans during the course of the reorganization. 52 Stat. 888-929 (1938), 11 U. S. C. A. § 556-580 (Supp. 1939). Such procedure, however, in reorganizations under Chapter X should afford sufficient investor protection for the states to grant the same exemption even though their commissions are not deemed parties in interest and may not render advisory reports. States which do not recognize the federal exemptions discussed above are imposing unnecessary burdens upon those transactions. (Note the provisions of the California Corporate Securities Act, Sections 2 (b) and 2 (c) [Cal. Gen. Laws (Deering, 1931) Act 3814], as amended by Laws 1931, c. 423, §§ 1, 2, Laws 1933, c. 898, § 1, and Laws 1937, c. 477). In order to eliminate confusion and conflicting interpretations the states should adopt uniform exemptions following the terms of Sections 3 (a) (9) and 3 (a) (10) of the Securities Act and Section 264 (a), Chapter X, of the Bankruptcy Act. See Throop and Lane, supra note 45, at 102, for a discussion of the above exemptions under the Securities Act.

By the definition of “sale,” “sell,” “offer to sell,” or “offer for sale” contained in Section 2 (3) of the Securities Act of 1933 a conversion privilege, issued or transferred with a security, which cannot be exercised until some future date is not deemed a sale of such other security until the issue or transfer of the other security. Thus the other security does not need to be registered under the act until the specified future time arrives. The statutes of some states, for example Iowa and Ohio, provide similar exemptions in such cases. Iowa Code (1935) § 8581-c3; Ohio Gen. Code Ann. (Page, Supp. 1935) § 8624-4 (6). The laws of some states, however, contain no express provisions concerning conversion privileges issued or transferred with a security but which cannot be exercised until some future date. Whether the other security needs to be registered in those states depends on the wording and possible construction of their definitions of “security” and of “sale.” This is an unsatisfactory situation and correlation of the state and federal acts would require that the states adopt a definition of “sell” or “sale” containing a provision similar to the last sentence of Section 2 (3) of the federal Securities Act which appears to be based upon sound principles. See Smith, supra note 10, at 245, for a criticism of the state acts in the above cases.
made in violation of the (security and dealer registration) provisions of the act.93 The Illinois Securities Act provides the same remedy94 but goes a bit further by providing that the offer or sale of securities, in any other manner or form than specifically set forth in the information required to be filed under the provisions of the act and the rules and regulations of the Secretary of State, shall be considered prima facie evidence of fraud.95 Neither of these provisions gives the purchaser a civil remedy comparable to that granted by Sections 11 and 12(2) of the Securities Act. State registration of securities generally requires the filing of a detailed registration statement but no civil liabilities are provided for untrue statements contained therein or the omission to state material facts required to be stated or necessary to keep the statements therein from being misleading. If the imposition of civil liability by Section 11 of the federal act, as a means of securing a full and accurate disclosure and as a relief for wronged investors, is sound when the distribution is an interstate one, then it likewise should be sound when the distribution is made entirely intrastate. So long as we find this difference in the state and federal standards of civil responsibility to purchasers, we may expect to find the poorer issues and fraudulent issues concentrated in intrastate distributions. The protection of investors who purchase securities distributed in intrastate transactions demands that the states establish civil liabilities for false statements contained in state registration statements. Furthermore, experience is showing the necessity for civil responsibility, in intrastate distributions, of the same standard as that set out in Section 12(2) of the Securities Act. Michigan has already established such responsibility, practically enacting word for word, so far as applicable, the civil liability provisions of Section 12(2), the limitation of actions provisions of Section 13, and the undertaking for costs provisions of the last sentence of Section 11(e) of the Securities Act.96

B. Information on Previous Registrations

It would be well also for the states, by appropriate statutes or rules and regulations, to require the registrant of an intrastate issue to give full and complete information regarding whether the applicant or issuer ever filed a registration statement with the Securities and Exchange Commission, on this or any other issue, and if so the action thereon.97 This requirement

95Id. § 36.
96Section 16, Michigan Blue Sky Law. See note 90 supra.
97See Item 5, Michigan Form S-2 [131 C. C. H. 2056 (1940)] for an example of how this suggestion may be used in a state registration statement on an intrastate distribution of securities.
might give the local commission considerable insight into the applicant’s or
the issuer’s business methods in the past and be an invaluable aid in passing
on the “quality” of the present issue tendered for registration. Furthermore,
we may expect to see some issuers withdrawing their federal registration
statements on current issues and turning to intrastate distributions when
refusal or stop order proceedings are begun under Sections 8(b) or 8(d)
of the act. In such cases the local commissions need to be informed of
the issuer’s action as such facts may indicate fraud in the securities sought to
be registered.

IV. SURVEY OF WHAT HAS BEEN DONE TO CORRELATE THE STATE AND
FEDERAL SECURITIES ACTS

A. Securities Violations Records of the Securities and Exchange Com-
nission

The most successful bit of correlation between the security jurisdictions
of the state and federal governments has been one of correlation of informa-
tion and activities rather than of laws. The violations records of the Securi-
ties and Exchange Commission, established in 1935 as a result of a conference
between a committee representing the National Association of Securities
Commissioners and federal officials, have become the central index and
clearing house for information relating to security frauds both past and
present in the United States and Canada. State commissions may secure in-
formation from the records at any time, while current information is published
in a monthly confidential bulletin distributed to official and unofficial agencies
engaged in the prevention and punishment of security frauds. This cor-
relation of information and activities has aided materially both the state
and federal commissions in the administration of their respective acts.98

98On the right to withdraw a registration statement, see Jones v. Securities and
Exchange Commission, 298 U. S. 1, 56 Sup. Ct. 654 (1936), and the discussion thereon
by Johnson and Jackson, The Securities and Exchange Commission: Its Organization
and Functions under the Securities Act of 1933 in (1937) 4 LAW & CONTEMP. PRON.
14-16. Compare Jones v. Securities and Exchange Commission, supra, with Oklahoma
Texas Trust v. Securities and Exchange Commission, 100 F. (2d) 288 (C. C. A. 10th
1939); Resources Corporation International v. Securities and Exchange Commission, 103

99The violations records now contain data upon thousands of individuals while new
information regarding convictions, indictments, injunctions, and stop, cease and desist
orders is continually added thereto. Contributions of information come from state com-
missions, state and federal prosecuting officials, the Post Office Department, the Federal
Bureau of Investigation, Better Business Bureaus, Investors Protective Committees,
Investment Bankers Associations, Chambers of Commerce, the Securities and Ex-
change Commission itself, and various associations and individuals. FIRST ANNUAL
REPORT OF THE SECURITIES AND EXCHANGE COMMISSION (1936) 58; SECOND ANNUAL
REPORT OF THE SECURITIES AND EXCHANGE COMMISSION (1936) 35; PROCEEDINGS, 19TH
ANNUAL CONVENTION NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS, (1936)
B. Correlation by State Statutes

As might be expected, without any uniform plan having been provided, the attempts of the states by statutes to correlate their registration requirements with those of the Securities and Exchange Commission have resulted in various provisions—some practical, but others vague and unhelpful. The Virginia statutes hint that the state wants nothing of the Securities and Exchange Commission. On the other hand, Louisiana, Ohio, Massa-

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103-104; PROCEEDINGS, 18TH ANNUAL CONVENTION NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS (1935) 123-124.


101 Louisiana adopted a new Blue Sky Act in 1940 (La. Acts 1940, Act 262). The new act provides for the registration of certain securities by notification in addition to registration by qualification. This type of registration is correlated with the federal requirements by providing that in lieu of the information otherwise required for registration by notification the issuer or dealer may file a copy of the federal registration statement, and all information in connection therewith, filed with the Securities and Exchange Commission, including the circular to be used on the public offering. This is to be deemed sufficient compliance with the state requirements.

Registration by qualification may be made under this new Louisiana Act by filing with the state commission a copy of the registration statement and all information in connection therewith filed with the Securities and Exchange Commission, in lieu of all other state requirements, if such filing is made before a stop order is issued under the federal act. The state commissioner is authorized to accept this as sufficient compliance with the requirements of the act for registration by qualification.

It must be recognized that, on the whole, this is a very satisfactory correlation of the registration requirements of a notification and qualification statute. In the interests of Louisiana investors, however, it must be observed that the act makes no provision for filing with the state subsequent amendments to the federal registration statement or notices or orders of the Securities and Exchange Commission concerning the effectiveness of the federal registration.

102 Ohio, by an act effective in 1938, has provided:

"In so far as any information required to be filed with the division under any section of this act is contained in a registration statement filed with the securities and exchange commission (of the United States) and such registration statement is in effect, such required information may with the consent of the division be furnished by filing with the division a copy of such registration statement together with an affidavit of an interested party that the same is in effect." OHIO GEN. CODE ANN. (Page, 1938) § 8624-23a, added by H. B. No. 794, § 2, 2d Spec. Sess. 1937-38 (effective Jan. 31, 1938).

The Ohio rules, however, adopted by the Commission under the authority thus granted, provide only that in cases where the application is for registration by qualification (as contrasted with registration by notification, where the requirements are simple and go only to showing that the issuer meets certain specified earnings and security ratios) and the applicant has filed a federal registration statement, that registration statement will be accepted by the Commission in lieu of exhibits required by the registration by qualification section of the Ohio act. Such an issuer files the regular application form and attaches thereto a copy of the federal registration statement noting the pages therein on which appear the pertinent required information. 131 C. C. H. 3360 (1940).

The most serious criticism of the Ohio correlation is that it does not require amendments to the federal registration statement, which are filed with the Securities and Exchange Commission after the registration statement has become effective, to be filed also with the state commission. The Ohio statutes and rules, furthermore, contain no provisions or procedure requiring the issuer to inform the state authorities when notices or orders of the Securities and Exchange Commission concerning the effectiveness of the federal registration have been issued.
Massachusetts has provided (1938) that in lieu of the information formerly required for its registration by description, after notice of intent to sell securities, the commission shall accept (subject to requiring additional information) a copy of the final prospectus or offering sheet, or original prospectus or offering sheet and subsequent amendments, used for registration under the federal Securities Act. Section 5, Massachusetts Securities Act, as amended by Mass. Acts 1938, c. 445, § 6.

On the whole, this seems to be an entirely adequate correlation of registration requirements for this type of state statute except that it contains no provisions or procedure requiring the issuer to inform the state authorities when notices or orders of the Securities and Exchange Commission, concerning the effectiveness of the federal registration, have been issued. See also 131 C. C. H. 1953 (1940) for the Massachusetts Rules and Regulations correlating financial statement requirements of brokers who are members of registered national securities exchanges.

West Virginia in 1935 attempted to correlate its registration by qualification statute with the federal acts by granting the state Securities Commissioner authority to make rules and regulations he deemed necessary “to cooperate effectively with the Securities and Exchange Commission.” No rules have been provided, however, under this grant of authority, except that the state registration form does inquire whether the security has been registered with the Securities and Exchange Commission and whether the registration of this or any other security of the applicant has ever been revoked by that commission. The instructions on the state registration form “recommend” that a copy of the “Federal form” be filed therewith and that the registrant may answer state items by specific reference to items on the federal registration statement if a copy thereof is filed with the state application. No provisions are included in this form for handling amendments to the federal registration statement or prospectus or notices or orders by the commission concerning the effectiveness thereof. The state forms for registration of oil and gas interests, investment companies and investment trusts contain no provisions for correlation with the federal requirements. It seems quite evident that this is not a well worked out plan of correlation under the broad grant of authority given the state commission. See West Virginia Laws 1935, S. B. 165, and 131 C. C. H. 4676-4676-2, 4677-3 (1940).

South Carolina in 1937 attempted to correlate its registration requirements with those of the Securities and Exchange Commission and was partially successful in its efforts. It extended to certain securities of foreign governments, registered under the Securities Act of 1933, an exemption [S. C. Acts 1937, Act No. 1, § 4 (b)], and by a vague provision attempted to make an exempt transaction of the issuance of securities in consolidations, mergers and adjustments of capital stock when the plan of distribution is contained in a registration statement filed for twenty days with the Securities and Exchange Commission. S. C. Acts 1937, Act No. 1, § 5(f). North Carolina in 1935 had adopted practically this same provision. N. C. Laws 1935, S. B. 436, § 4 (6).

Neither of these acts specify what effect a refusal order, stop order, amendment or withdrawal of such federal registration statement may have on the state exemption. South Carolina also provides that securities which are subject to registration by notification shall include securities of “seasoned” corporations as now defined for registration under form A-2 under the federal act, and as “the same may hereafter be defined or designated or classified.” The act also provides that these securities may be registered by giving notice of intent to sell and filing a statement of the amount to be sold within the state, a copy of the prospectus filed with the Securities and Exchange Commission, and payment of the required fees. S. C. Acts 1937, Act No. 1, § 7.

This statute contains no provisions or procedure, however, requiring the issuer to inform the state authorities of subsequent amendments to the federal prospectus or when notices or orders of the Securities and Exchange Commission concerning the effectiveness of the federal registration have been issued.

The South Carolina Commission also has recently adopted the uniform registration forms recommended by the National Association of Securities Commissioners (see page 291 infra, and notes 109, 110, and 111 infra) but the commission has not made it clear whether they are to be used for registration by notification or by qualification, or both. 131 C. C. H. 3875-3889 (1940). In view of the express statutory provisions in
have by express statutes and rules thereunder provided means for correlation

the state act, however, setting out in mandatory form the procedure for registration by notification (S. C. Acts 1937, Act No. 1, Pt. II, § 7) it seems likely that the uniform forms are intended for use only in cases of registration by qualification.

106Vermont in 1939, by statute, provided that in lieu of the information regularly required to register a security for sale by qualification its commission may accept a copy of the federal registration statement or prospectus. The act attempted no correlation of the requirements for registration of securities by notification or "description" and the commission has adopted no rules or forms attempting any additional integration. The act makes no provision for handling amendments to the federal registration statement or prospectus or notices or orders of the Securities and Exchange Commission affecting the issuer's registration. VT. PUB. LAWS (1934) § 6835, as amended by Laws 1939, S. B. 72, § 3.

107The Illinois Securities Act, which has been amended and built on to as the years have passed, contains a recent attempt to correlate partially its registration requirements with those of the federal act.

It provides that class "C" securities, which in general are those of issuers meeting specified earning requirements, may be registered for sale by the Secretary of State when he has been given certain required information; or if the securities are registered under the federal Securities Act he may register them if the application contains the amount of the issue, amount to be offered in Illinois, price, underwriting costs, and is accompanied by two duplicate copies of the federal registration statement, all amendments thereto, prospectus, fees and other additional data if required. Provision is also made for written or telegraphic advice of material changes in the federal registration statement, to be followed by submission of duplicate copies of such amendments within ten days. Section 7 (c), Illinois Securities Law. See Laws 1919, p. 351, as amended by an Act approved June 11, 1921, Laws 1935, S. B. No. 225, and Laws 1939, H. B. No. 771. The Illinois form 7 (c) has been adopted for registration under this provision and follows the statute closely. 131 C. C. H. 1140-41 (1940).

Illinois has made no statutory attempt to correlate its registration requirements with those of the federal act on its class "D," "investment contracts" and "investment trust" securities. The Secretary of State, under his rule and form making power, has helped the situation, however, on registration of class "D" or "speculative" securities by providing a short form for registration of such issues as are registered under the federal Securities Act. This form is simple, requiring little more than the federal registration statement and prospectus require, and both these instruments must be submitted as exhibits. IL. SECURITIES ACT 1151-56 (1940).

All other Illinois forms are elaborate and require that if the securities have been registered with the Securities and Exchange Commission the dates thereof and the action thereon should be shown, attaching the registration statement and amendments thereto, except that exhibits may be eliminated in certain instances. But these forms contain no provisions for answering the state questions by reference to items in the federal registration statement, or no provisions that the federal forms be a substitute for the state requirements. See Illinois forms, 131 C. C. H. 1139-7, 1141-7, 1142, 1145, 1145-5, 1155-7, 1157-4, 1159-3, 1159-4, 1161-3, 1161-4, 1163, 1163-2 (1940). These forms therefore often result in a duplication of answers. The Illinois forms also require that if the issuer has not complied with, and does not intend to comply with the federal act, it attach opinion of counsel setting forth why such compliance is not necessary.

The supplemental registration statements required by the Illinois act provide for the submission to the Secretary of State of copies of any amendments filed to the federal registration statement since the last such report. Again no provision is made to avoid duplication of information where it would be possible to do so. See Illinois forms, 131 C. C. H. 1147-5, 1148, 1163-7, 1165-4, 1166, 1167-4 (1940).

In a private communication to the writer the Illinois Secretary of State, who administers the state act, wrote: "In drafting the revised regulations, the thought of correlation with the forms required by the Securities and Exchange Commission was kept in mind. Many of the interrogatories will permit applicants to supply the same answers as would be used in preparing a registration statement for the Securities and Exchange Commission." The writer feels that the Illinois commissioner has made great progress but that he should have gone, at least, a step further and permitted the answering of state questions by reference to appropriate items in the federal form in these latter instances.
of their registration requirements with those of the Securities and Exchange Commission by using the federal registration statement or prospectus as an exhibit to the usual state registration statement, making references to the federal statement or prospectus for answers to state questions, or by using the federal statement or prospectus as the state registration statement, adding thereto only a few local requirements. The most serious defect of some of these statutes is that they make no provision for handling amendments to the federal registration statement or prospectus. The next most serious objection in certain instances is that the states have not agreed whether the federal registration statement or prospectus should be used in cases of registration by notification or registration by qualification, or both, where the state act contains both provisions. Texas, Maryland, Oregon, and North Carolina statutes contain miscellaneous provisions integrating the state and federal acts in particular instances.\(^{108}\) These states, with the exception of Maryland, however, have not attempted a complete statutory correlation of even their registration requirements with those of the Securities and Exchange Commission. The lack of space in this article prevents a detailed examination and evaluation of these recent additions to the state Blue Sky laws, but it is only fair to acknowledge that in some instances their contents have had a bearing on the writer's suggestions for future integration of the state and federal regulations.

C. Correlation by Rules and Regulations

A number of the state commissions, without specific statutory direction, have attempted to lower the registration barriers to facilitate a free flow of

\(^{108}\) Texas provides an exemption for certain securities of foreign governments if they are on "the list approved by the Securities and Exchange Commission of the United States." Section 23 (b), Texas Securities Act (Tex. Laws 1935, H. B. No. 521).

Maryland, in 1937, added dealer registration requirements to its fraud type statute and provided that the registration statement thereon contain the same information as is required of brokers and dealers in over the counter markets. The Maryland provision permits the filing of a certified copy of the broker dealer registration statement filed with the federal commission, when accompanied by the required letters of recommendation. Section 10a, Maryland Blue Sky Law, added by Md. Laws 1937, c. 348, § 1. See also forms in 131 C. C. H. 1875-1880 (1940).

The Oregon Securities Law, Section 20 (Ore. Laws 1939, c. 397), provides an exemption under Sections 3 (a) (10) of the Securities Act of 1933, as amended [48 Stat. 75 (1933), as amended by 48 Stat. 906 (1934), 15 U. S. C. A. § 77c (1935) ( Incorrectly described in the Oregon statute as the "Federal Securities and Exchange Act of 1934")], for the securities of a non-judicial reorganization of all corporations, other than utilities, by providing for a hearing as to the fairness of the plan and the proposed exchange of securities thereunder before the state securities commissioner. It is doubtful if this is the type of hearing and approval Congress had in mind when Section 3 (a) (10) was made a part of the Act. But the Oregon provision apparently is within the terms of the federal exemption. See Throop and Lane, supra note 45, at 106, and Comment, Effect of Section 3 (a) (10) of the Securities Act as a Source of Exemption for Securities Issued in Reorganizations (1936) 45 Yale L. J. 1050.

Another miscellaneous statute is the North Carolina provision discussed supra note 105.
investment funds through an exercise of their rule and form-making powers. The National Association of Securities Commissioners appointed a committee on Coordination and Uniformity in 1935, which reported two years later after working out a plan, together with specimen forms, designed to establish approximately uniform practices among the states for the handling of security issues. The committee was assisted by representatives of the Investment Bankers Association. The forms recommended by this committee, had they been adopted by the states, would have established not only practical uniformity of registration requirements throughout the country but also a fairly satisfactory type of correlation of state and federal registration procedures. The plan did not suggest that the states adopt a uniform inflexible form but suggested uniformity of procedure instead. It proposed the use of only one form supplemented by exhibit forms relating to the particular class of securities sought to be registered. This proposal was to accomplish an integration of the state and federal registration requirements on interstate issues by having a copy of the federal registration statement and all amendments thereto filed as an exhibit to the state form, in lieu of certain specified exhibits and in lieu of other exhibits where the information required therein was fully set forth in the federal form. This was, then, a workable proposal.

But the suggested forms have not broken down the registration barriers as was expected. Their adoption by state commissions has been rather limited. Six states, Indiana, Florida, Nebraska, New Mexico, South Carolina and Texas thus far have actually adopted all or part of them. Several other states, apparently not satisfied with the committee proposal, for one reason or another, have adopted ideas of their own for the solution of


110 For an example of a state form and exhibit forms designed as recommended by the Committee on Coordination and Uniformity of the National Association of Securities Commissioners see Florida form 8, 131 C. C. H. 882-866 (1940). Cf. Texas forms, 131 C. C. H. 4175-4189 (1940).

111 Florida, 131 C. C. H. 851, 882-86 (1940); Indiana, 131 C. C. H. 1256-1260 (1940); Nebraska, 131 C. C. H. 2575-2579 (1940); New Mexico, 131 C. C. H. 2978-2984 (1940); South Carolina, supra note 105; and Texas (First three divisions, I. General Issues, II. Investment Trusts, III. Oil and Gas Issues), 131 C. C. H. 4175-4189 (1940).

It is to be noted in each of these instances that the forms are being used for registration by qualification or similar applications. It is to be noted, also, that the forms provide that amendments to the federal registration statement must be filed with the state commission and that the applicant shall furnish full information relating to any proceedings of the Securities and Exchange Commission delaying, suspending or denying the effectiveness of the federal registration.
the problem. It can be said briefly that Michigan\footnote{The Michigan commission, administering a qualification type of statute, has provided, under its broad rule making powers [Section 8, Michigan Blue Sky Law (Mich. Pub. Acts 1923, Act No. 220, as amended by Pub. Acts 1931, Act No. 225 and Pub. Acts 1935, Act No. 37)] an excellent correlation of its forms. The Michigan rules provide for two forms, S-1 and S-2, the former to be used when a registration statement covering the proposed offering has been filed with the Securities and Exchange Commission. See 131 C. C. H. 2041 (1940). This form, among other things, provides for a statement of underwriting costs, organization papers, by-laws and two duplicate copies of the registration statement and prospectus, and amendments thereto, filed under the Securities Act of 1933, exhibits thereto, and photostatic copies of all orders and notices of the Securities and Exchange Commission pertaining thereto. The rules provide that applicant covenants to file two duplicate copies, within five days, of all amendments or supplemental information filed with the Securities and Exchange Commission and upon receipt thereof to file with the state commission photostatic copies of orders and notices of the federal commission, or state regulating bodies, relating to the registration therewith. 131 C. C. H. 2086-2087 (1940). Form S-2, used on securities not registered with the federal commission, requires applicant nevertheless to give detailed information concerning any experiences applicant or issuer may have had with that commission on other issues. 131 C. C. H. 2056 (1940). See also Form S-3, the Michigan exempt transaction securities application, requiring a legal opinion on the basis of the exemption if the security is not registered under the Securities Act of 1933. 131 C. C. H. 2056 (1940). Michigan Rule 18 provides that qualification for sale of shares in investment trusts, investment companies, or investment or installment contract issues shall be subject to the underlying securities all meeting certain requirements, or being fully listed and registered on a national securities exchange registered under the Securities Exchange Act of 1934. 131 C. C. H. 2044 (1940).} and Missouri\footnote{Missouri, with a statute providing for both registration by notification and qualification, has adopted no rules [131 C. C. H. 2351 (1940)] under its rule making powers, but under the provisions of Mo. Stat. Ann. (Vernon, 1932) § 7730, as amended by Laws 1939, S. B. 129, the commission has provided a fairly effective plan (Form Q) for correlating its registration by qualification with the Securities Act requirements by providing that the federal prospectus or registration statement shall be filed as an exhibit, references to be made thereto in answering questions on the state form. 131 C. C. H. 2375-77 (1940). No provisions are made for handling amendments to the federal registration statement or prospectus or notices or orders concerning the effectiveness thereof, nor has any correlation been attempted on securities to be registered by notification. Missouri has a separate form for the registration of investment trust shares (MT 42) but it is poorly correlated with the federal requirements, being subject to the criticism previously directed at the Illinois form for registration of such securities since both contain identical provisions concerning the federal registration. 131 C. C. H. 2395-99 (1940). See supra note 107. See also Form X, the Missouri exempt securities application, inquiring whether the securities in question have been registered with the Securities and Exchange Commission. 131 C. C. H. 2378 (1940).} have done the best job among these states, although the Missouri forms, since they make no attempt to correlate the state's registration by notification requirements with those of the federal act, leave much to be desired. The Michigan Commission, operating under a statute providing only for registration by qualification and granting broad rule making powers, has apparently covered the usual problems quite adequately and simplified its forms even more than was proposed in the suggested uniform forms. Also, Rhode Island has departed from its statutory theory of permitting sale of securities upon notice
of intent to sell and has imposed restrictions upon the sale of oil and gas interests in the state which do not meet the requirements of the Securities and Exchange Commission.\textsuperscript{114} The commissions of Iowa and Washington require the submission of copies of the federal registration statement when the security has been registered with the Securities and Exchange Commission, but the correlation of requirements is so incomplete that the Iowa and Washington result is merely to impose more burdens on the issuer.\textsuperscript{115} The California, Colorado, Kentucky, New Hampshire, Maine, Pennsylvania, Virginia, and Wisconsin forms do no more than recognize the existence of the

\textsuperscript{114} The Rhode Island Blue Sky act requires only that dealers and salesmen be licensed and notice of intent to sell securities be given before offering them for sale to the public. The state commissioner, apparently exercising authority given him by virtue of R. I. Gen. Laws 1923, c. 273, § 4 (d), has adopted, however, specific regulations covering the sales of oil and gas interests in the state. These regulations provide that "only offerings which have met all the requirements of the Securities and Exchange Commission" will be considered for qualification. 131 C. C. H. 3751 (1940). Form R, for state registration of these securities, requires the applicant to attach a certified copy of the offering sheet or registration statement filed with the federal commission and provides that "No [such] interests shall be offered unless they shall first have been qualified by the Securities and Exchange Commission at Washington, D. C." 131 C. C. H. 3782 (1940). It is conceivable that an intrastate distribution of Rhode Island oil and gas interests might be exempt from these regulations since they would be exempt from the "requirements" of the Securities Act if Section 3 (11) [48 STAT. 75 (1933), as amended by 48 STAT. 906 (1934), 15 U. S. C. A. § 77c (1935)] were satisfied. If the statement on Form R is to prevail, however, such securities would have to meet the offering sheet requirements of the Securities and Exchange Commission's Regulation B since Form R makes no distinction between interstate and intrastate distributions. Aside from this inconsistency between the regulations and Form R neither of them contain any provisions for handling amendments to the offering sheet or notices or orders of the federal commission concerning the effectiveness thereof.

\textsuperscript{115} The Iowa commission, operating under a statute permitting the sale of non-exempt securities only upon registration by qualification, but granting the commission broad form making authority [Iowa Code (1935) c. 393-Cl, as amended by Laws 1937, c. 209], has provided by its Form 8 the same registration requirements for all securities. Form 8 requires, as additional information, that the federal registration statement be attached thereto or the submission of a legal opinion that registration with the Securities and Exchange Commission is not necessary. The form makes no provision for the registration statement to be a substitute for other required information or for even the answering of required questions by reference to answers contained in the federal form. 131 C. C. H. 1377-1378 (1940).

The Iowa annual report form then requires a statement on whether the securities have been registered with the Securities and Exchange Commission and a statement of any stop orders or rulings by that Commission. 131 C. C. H. 1375-76 (1940). But this information is required only in this form and not necessarily upon the promulgation of such orders or rulings.

On the whole, the Washington forms provide no correlation with the federal registration requirements. The only recognition of the existence of the federal act by the Washington commission is contained in the instructions for preparation of the statutory statement required from metalliferous mining companies. Instruction 6 provides: "If filed with the Federal Securities Exchange Commission, enclose registration statement and prospectus." This is obviously no correlation of the registration requirements of the state and federal acts. This procedure only results in duplication of information before the state director. Wash. Laws 1933, c. 69, and Laws 1937, c. 178. 131 C. C. H. 4586-87 (1940).
Neither the statutes, rules or forms of the remaining states contain any provisions for their correlation with the federal acts, or even provisions recognizing the existence of such acts or the commission administering them.

V. CONCLUSION

The present value of the state Blue Sky acts on interstate distributions of securities can now be determined. This survey has revealed that the state acts by supplementing the federal acts are a decided benefit to the investing public in many instances. The quality of the securities is passed upon after the federal commission has forced a full disclosure of all the material facts. Needed investor protection is offered in several instances, and by means not included in the national legislation. In fact, state Blue Sky laws are a necessary part of any comprehensive national plan of security regulation. This survey also has revealed that these same laws are imposing needless burdens on interstate distributions of securities, burdens which have become barriers to the free flow of investment funds to industry. It is not necessary, however, to balance these benefits and burdens against each other. To do so might prove unfavorable to the cause the states espouse. The preferable solution is to eliminate the needless burdens, thus retaining only the benefits accruing from such regulations. This can be done by a careful correlation of the state and federal requirements. Furthermore, it has been found that the states may appropriately integrate in some instances their regulation of intrastate security distributions with the federal interstate requirements to the end that intrastate investors will receive more effective protection.

It has been the purpose of this article to suggest appropriate and apparently sufficient means of correlating certain requirements and provisions of the state and federal acts, where it seems necessary to do so either for the purpose of eliminating needless burdens or affording more adequate investor protection. A survey of what the states have done to accomplish these purposes, since the first exercise of the federal jurisdiction over seven years ago, clearly indicates that generally they have not seen or appreciated the many problems involved, or the need for such correlation. In the few instances where the states have acted, most of their new statutes, rules or forms are insufficient to eliminate all the needless burdens imposed by their acts or to give more adequate investor protection. Also, there has been little uniformity in these new provisions. It therefore seems evident that here

116 California Regulations, 131 C. C. H. 473 (1940); Colorado Regulations, 131 C. C. H. 553 (1940); Kentucky forms, 131 C. C. H. 1581-83, 1583-92 (1940); Maine forms, 131 C. C. H. 1781, 1785, 1786 (1940); New Hampshire forms, 131 C. C. H. 2776 (1940); Pennsylvania forms, 131 C. C. H. 3676 (1940); Virginia forms, 131 C. C. H. 4476-78; Wisconsin forms, 131 C. C. H. 4770-73 and 4778-82 (1940).
is a problem calling for the unified action of all who seek improvement in our laws and elimination of needless burdens on legitimate business. It seems that the National Conference of Commissioners on Uniform Laws should offer to the states for adoption at the earliest possible moment either a new uniform securities act or a group of uniform amendments designed to accomplish the correlation of the state and federal requirements and provisions. Then interested business and professional groups such as the Investment Bankers Association, The National Association of Securities Dealers, and the American Bar Association, along with interested individuals, should make a continuous and concentrated effort in each of the states to secure the acceptance and adoption of the uniform legislation. Such an approach to the solution of the problem is necessary. Otherwise, we cannot hope that the states, without direction and suggestions, will be able to accomplish all that is possible by such a correlation.

The writer believes such a project, especially as regards registration requirements, to be just as essential to the national defense program as the recent amendment of the Securities Act [Pub. Act No. 768, 76th Cong., 3d Sess. (Aug. 22, 1940) § 301] and other amendments to that act which have been proposed "in order to speed up the flow of capital into industry and make capital available to numerous industries which are vital to our defense program." See H. R. 9807, and H. R. 10013, 76th Cong., 3d Sess. (1940), and exchange of correspondence between Chairman Jerome N. Frank of the Securities and Exchange Commission and E. F. Connely, President of the Investment Bankers Association of America, released by the Commission June 21, 1940.

It can be said that the Investment Bankers Association now has something of this nature in mind. Mr. A. G. Davis, Field Secretary of the Association, in a communication to the writer under date of April 22, 1940, in discussing present practices for the correlation of state and federal registration requirements stated, "... Certain variations in the state laws interfere with the complete adoption of this practice, but we are hopeful of changing this situation in due course by asking for appropriate amendments to the respective state laws, with the active support of the state Securities Commissioners. ... Perhaps next year, when practically all of the state legislatures are in session, they will be able to clear up a number of these situations."