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## Administrative Powers Under Blue Sky Laws

Jerome A. Gross

*Washington University School of Law*

Richard W. Brown

*Washington University School of Law*

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TYRRELL WILLIAMS, whose annotations to the *Restatement of the Law of Contracts* of the American Law Institute are continued in this issue, is Professor of Law at Washington University. An Introductory Note explaining the authorship of the restatement itself and the assumption of responsibility by the Missouri Bar Association for the preparation of annotations was included in the preceding instalment.

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### SAMUEL BRECKENRIDGE NOTE PRIZE AWARDS

The Samuel Breckenridge prize of fifteen dollars for the best note in the issue of June, 1930, of THE LAW REVIEW has been awarded to Robert J. Harding for his note on *Franchise Taxes of Corporations Having Stock Without Par Value*. The ten-dollar prize for the best note of 1929-30, has been awarded to Wallace V. Wilson for his note entitled *Recent Developments in State Taxation of Intangibles*, which previously received a prize as the best note in the issue of April, 1930. The committee of members of the bar which awarded the prizes for volume 15 consisted of Messrs. Adolph M. Hoenny, Maurice L. Stewart, and Monroe Oppenheimer.

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## Notes

### ADMINISTRATIVE POWERS UNDER BLUE SKY LAWS

Since the first Blue Sky Law was passed in Kansas in 1911<sup>1</sup> almost every state in the union has passed laws of a similar nature.<sup>2</sup> There are, however, several distinct types of statutes, which may be classified as (1) fraud acts, under which the attorney-general is given power to investigate the securities sold by dealers; (2) regulatory acts without control of dealers, under which the administrative board has surveillance of all securities registered for sale in the state; (3) dealer licensing acts, which operate on the theory that the regulation of the sellers of securities is the best mode of protecting the public; (4) acts requiring

<sup>1</sup> Wham, *Rights Under Blue Sky Laws* (1929) 15 A. B. A. J. 310.

<sup>2</sup> "All of the states have acts regulating the sale of securities but there are wide variations between the statutes in different states. In three states the acts provide only for the enjoining of the sale of fraudulent securities, and in two states only for the licensing of brokers and salesmen. In other states the principle of licensing security issues is adopted." Commissioners' Prefatory Note, Uniform Sale of Securities Act (1929). See also Mo. Laws (1929) p. 387; Ill. Laws (1929) p. 684; Okla. Comp. Stat. (Bunn, 1921) sec. 2270; Ark. Stat. (Castle's Supp., 1927) sec. 8418d.

specific approval of securities issues, with preferential position to non-speculative securities, accompanied by dealer control; and (5) similar acts without preferences to non-speculative issues.<sup>3</sup> All except the first type are preventive in character, either licensing dealers, or registering and approving securities issues, or both. It is to be noted that in all cases herein considered except a Pennsylvania case the statutes under which the actions were brought provided for the regulation of both dealers and securities issues. But it has been stated that under similar statutes there are wide variances in actual administration of state securities departments.<sup>4</sup>

It is the purpose of this article to examine the powers of the administrative officials under the Blue Sky Laws in the licensing of securities and dealers. Despite the fact that there has been much litigation in the short time since these laws have been passed, there has been very little in regard to the methods of administration. It is only in some half dozen states that the mode of exercise of the administrative officers' power has been questioned directly. No doubt in suits between private parties courts have at other times, as dicta, casually referred to the scope of such power. However, this article will be limited to cases in which the extent of administrative authority under the Blue Sky Laws has been the point in issue. Approximately half of the litigation on this matter has occurred in California, which apparently indicates great diligence on the part of the California officials in the performance of their duties.

The first question to be considered is the discretion of the commissioner in granting licenses to sell securities. Justice McKenna, in delivering the opinion of the Supreme Court of the United States interpreting an Ohio statute, said that the commissioner was "to be satisfied of the good repute in business of such applicants and named agents. . . . It is especially objected that as to these requirements no standard is given to guide or determine the decision of the commissioner. Discretion thus vested in commissioner leaves room for the play of arbitrary power. . . . It is certainly apparent that if the conditions are within the power of the state to impose, they can only be ascertained by an executive officer. Reputation and character are quite tangible attributes, but there can be no legislative definition of them that can automatically attach to or identify individuals possessing them, and necessarily the aid of some executive agency must be invoked."<sup>5</sup> Thus at a comparatively early date

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<sup>3</sup> Dalton, *The California Corporate Securities Act* (1930) 18 CAL. L. REV. 115.

<sup>4</sup> *Ibid.*

<sup>5</sup> Hall v. Geiger-Jones Co. (1917) 242 U. S. 539.

the United States Supreme Court adopted a liberal attitude in approving a very wide discretion in the commissioner.

In an early California case, *Doble Steam Motors Corp. v. Daugherty*,<sup>6</sup> where the agent of a corporation had taken part payment for subscriptions for more than the authorized issue of stock and had become bankrupt, and the corporation sought a permit to issue additional securities to the purchasers despite the fact that the full amount would not be realized from their sale, it was held within the discretion of the commissioner to determine whether the illegal subscriptions should be ratified and hence whether the loss should fall upon the subscribers or upon the corporation. This is one of the first of a series of cases involving the California securities commissioner in which the courts have almost uniformly upheld his decisions. In this case his powers are defined as follows: "Discretion is reposed in the commissioner to grant or to deny a permit to a corporation to issue and sell any particular portion of its capital stock whenever . . . there is room for a reasonable difference of opinion as to whether the proposed plan of the applicant for the issuance of securities and the proposed methods to be used by it in issuing or disposing of them will be fair or unfair, just or unjust, equitable or inequitable; and as to whether their issuance and disposition upon the proposed plan of business of the applicant will or will not work a fraud upon the purchasers of such securities."<sup>7</sup> Here, also, the commissioner was held to have the discretion to require the corporation to put itself on a substantial production basis before allowing the registration of a new issue of securities. The court added that he might also require a corporation to purchase patent rights which he deemed essential to the business, and to pay royalties out of net profits only.<sup>8</sup>

In a later case a petition for certiorari to review the action of the securities commissioner in refusing to register a second issue of securities was denied. "It will not do to say in such a proceeding as this that the commissioner may not refuse later permits, after granting the first one made, unless conditions affecting the disposition of the first application have later changed. It is for the commissioner to determine whether the conditions have changed. If he reaches an incorrect conclusion on that matter, it is obvious to us that his determination is merely error, and not in excess of his jurisdiction."<sup>9</sup> This illustrates the California stand that the only check on the commissioner will be in the event of the abuse of his discretion by going outside of his

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<sup>6</sup> (1924) 195 Cal. 158, 232 Pac. 140.

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

<sup>9</sup> *Pacific Home Bldg. Co. v. Daugherty* (1926) 75 Cal. App. 623, 243 Pac. 473.

jurisdiction. A similar result was reached where the commissioner issued an order permitting the sale of stock of a corporation only on return of certificates illegally sold. The court held that this was not clearly an abuse of discretion because of the possible liability to holders of the illegally issued stock.<sup>10</sup>

A review of the cases just cited shows that the California securities commissioner, before registering security issues of both domestic and foreign corporations, may make a thorough investigation of the business structure of the companies. He may decide whether a proposed plan of business is fair or unfair and may order the corporation to perform certain acts which he deems necessary to the proper conduct of its affairs before issuing the permit.

In considering the powers of commissions in other jurisdictions, we find almost the same rule obtains as to the investigation of the corporate plan of business. Thus the Kansas court said: ". . . it devolves upon the board to inquire as to the solvency and responsibility of the plaintiff, the sufficiency of its assets, the trustworthiness of those representing and managing it, the fairness, honesty, and equity of its plan, the security afforded investors that its funds will not be dissipated or misappropriated . . ." <sup>11</sup> In a Michigan case promoters were denied permission to sell bonds for which the public was to pay in installments. There was no security except the amounts paid in. The statute provided for the refusal of licenses "where it appears to the commission that the sale of such securities would work a fraud, deception or imposition on the purchasers or the public, or that the proposed disposal of securities is on unfair terms." The court said it did not understand that it was imperative for the commission to find the promoters of the project guilty of intentional dishonesty or active fraud; all that was necessary was a potential fraud or imposition on the public.<sup>12</sup>

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<sup>10</sup> *Basalt Rock Co. v. McMillan* (1926) 80 Cal. App. 147, 251 Pac. 322. A similar case was *Hayden Plan Co. v. Friedlander* (1929) 97 Cal. App. 12, 275 Pac. 253, where it was held that the corporation commissioner had discretion to deny a permit to a foreign corporation to sell an issue of certificates where the application therefor showed that the certificates were not negotiable or transferable without the corporation's consent, that funds obtained by the corporation could be invested in any state in the union and its assets thus removed from the control of local authority, and that the investor had no means of surrendering his certificate and securing the return of his principal or any portion thereof.

<sup>11</sup> *Home Lumber Co. v. State Charter Board* (1920) 107 Kan. 153, 190 Pac. 601.

<sup>12</sup> *Investment Reserve Corp. v. Mich. Securities Com.* (1927) 238 Mich. 606, 214 N. W. 311; *State v. Dept. of Commerce* (1928) 174 Minn. 200, 219 N. W. 81.

The Uniform Sale of Securities Act (1929) sec. 8, provides: "If upon

A recent Pennsylvania case, which is to be distinguished from the others because the statute provided only for the regulation of dealers, imposed a serious restriction upon the power of the commission to investigate the plan of business of a firm before allowing it to sell securities. An investment trust sought to sell its own certificates issued under a plan which, although not actually fraudulent, was deceptive to the public. The commission refused the license; but the court held that the statute was intended to regulate dealers in securities rather than to license the securities themselves, and therefore the commission had no power to review the plan of business of the firm, and was limited to a consideration of whether the securities were offered "honestly and in good faith."<sup>13</sup>

An opposite view of the extent of the commissioner's power to investigate the corporate structure was taken in *Dominguez Land Corp. v. Daugherty*.<sup>14</sup> It is to be noted that this was not a question of the granting of a permit to issue securities, but a proceeding in mandamus to compel the commissioner to consider and act upon the petitioner's application to distribute surplus to its stockholders. The court said: "The leading idea which seems to run through the Corporate Securities Act is that in all cases the commissioner is to consider whether the act which he is asked to sanction—the making of dividends from other than surplus profits, for example—will leave the corporation in a safe financial condition. . . . We believe it to be a sufficient standard for an adequate guard against arbitrary action." The court goes on to say that the commissioner is to determine by an examination of witnesses and the books and records of the corporation whether if the dividends be paid the corporation will remain in a safe financial condition. It declares this to be a ministerial or administrative, rather than a judicial function. This decision is in marked contrast to the Pennsylvania holding in showing the extreme scope of powers and duties of the commissioner in examining the corporate structure under the California act.

A commission is not limited to jury trial rules of evidence.<sup>15</sup> Its findings of fact are generally conclusive; and its decision will be disturbed only if it is oppressive and arbitrary,<sup>16</sup> or where it

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examination of any application the [Commissioner] [Commission] shall find that the sale of the security referred to therein would not be fraudulent and would not work or tend to work a fraud upon the purchaser, and that the enterprise or business of the issuer is not based upon unsound business principles, he shall record the registration of such security. . ."

<sup>13</sup> *Insuranshares Corp. v. Pa. Securities Com.* (1925) 282 Pa. 84, 127 Atl. 311.

<sup>14</sup> (1925) 196 Cal. 453, 238 Pac. 697.

<sup>15</sup> *Investment Reserve Corp. v. Mich. Securities Com.*, *supra* n. 12.

<sup>16</sup> *State v. Dept. of Commerce*, *supra* n. 12.

exceeds its jurisdiction or makes a finding completely unsupported by the evidence.<sup>17</sup> One case held that the commissioner was not liable to purchasers for his negligence in permitting the issuance of unsound securities. The statute, which was complied with, required the following words on securities: "The commissioner does not recommend the purchase of this security," printed in type two sizes larger than any other part of the certificates. On this ground the majority of the court held the commissioner not liable. In a terse dissent, Cothran, J., said: "While the license by the commissioner does not amount to a recommendation of the stock, it certainly is an assurance that the commissioner has at least exercised ordinary care in performing the duties imposed on him by the statute . . . the complaint presented issues for a jury."<sup>18</sup> The majority opinion indicates that the commissioner should have great latitude in making his decisions; the minority view is based upon the feeling that his duties will be more thoroughly performed if a penalty is placed upon his failure to perform them reasonably well.

Besides regulating the issuance of securities through requirements for their registration, the commission under most Blue Sky Laws takes charge of the licensing of brokers to deal in securities and the revocation of permits already granted. Where a broker was refused a renewal of license, an allegation that the commissioner was without jurisdiction to determine the question of the petitioner's good reputation, since the citation contained no direct charge or complaint against him, was without merit, since his right to engage in business as a broker for the succeeding year was not vested, but was wholly contingent on the quasi-judicial determination of the commissioner. The court said: "Not only the question of whether or not any further investigation or examination shall be had, but as well, in the event that such investigation or examination should be instituted, its nature and extent are apparently left to the corporation commissioner." Further, "his finding of fact based upon evidence, is conclusive" on the courts.<sup>19</sup>

The procedure in revocation of brokers' licenses is fairly well settled. ". . . even in the absence of any provision in the statute, a broker is entitled to a notice and hearing before the commissioner can revoke his license. . . . A 'finding' of the existence of certain facts presupposes some hearing of evidence tending to prove such facts."<sup>20</sup> The type of notice required depends largely upon the statute. Where three grounds of revocation were pro-

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<sup>17</sup> See cases cited in n. 12, *supra*.

<sup>18</sup> *Minter v. McSwain* (1923) 126 S. C. 37, 119 S. E. 901.

<sup>19</sup> *Leach v. Daugherty* (1925) 73 Cal. App. 83, 238 Pac. 160.

<sup>20</sup> *Abrams v. Daugherty* (1922) 60 Cal. App. 297, 212 Pac. 942.

vided—bad repute, violation of the act, and having committed or intended to commit a fraudulent transaction—it was held that the notice to the dealer must state the particular ground so that he may know the facts upon which to base his defense.<sup>21</sup> But where the statute provided for revocation for “good cause” the Michigan court held that the term “relates so clearly to the conduct of the licensed business, within the limits fixed by law, as to negative any arbitrary official action, and is so comprehensive of irregular, fraudulent, unauthorized and forbidden business management and transactions conducted as to demand no more particular specification of its meaning and application.”<sup>22</sup>

The findings of the commission in proceedings for revocation of brokers’ licenses are final, and even where a statutory review is provided they will not be disturbed unless clearly contrary to the overwhelming weight of the evidence.<sup>23</sup>

It will be seen that the procedure in revoking licenses already granted to brokers is somewhat more strict than that in issuing licenses, demonstrating the habitual reluctance of the courts to take away already acquired rights.

The power of the commission to suspend the licenses of dealers pending proceedings for revocation is not clearly established.<sup>24</sup> It seems apparent that this power should not be exercised arbitrarily or where there is no public need which demands more prompt action than can be had under a revocation proceeding. In *Abrams v. Daugherty*<sup>25</sup> the court, in speaking of the power of suspension, declared: “If we may assume that it is to be implied from the grant of the power of revocation, it nevertheless may be exercised only when the commissioner has obtained jurisdiction to proceed with a hearing and determination of that question. If this were not so, the commissioner could . . . order a temporary suspension and continue the order indefinitely, thus depriving the broker of his right to do business without any legal process whatever.”

Permits of registration of securities may theoretically be revoked upon the same considerations which would have justified a refusal by the commission to grant them.<sup>26</sup> As a practical mat-

<sup>21</sup> *Ibid*

<sup>22</sup> *Redmond & Co. v. Securities Com.* (1923) 222 Mich. 1, 192 N. W. 688.

<sup>23</sup> *Ibid.*

<sup>24</sup> The Uniform Sale of Securities Act (1929) sec. 12, provides: “Pending the hearing the [Commissioner] [Commission] shall have the power to order the suspension of such dealer’s or salesman’s registration; *provided*, such order shall state the cause of such suspension.”

<sup>25</sup> N. 20, *supra*.

<sup>26</sup> The Uniform Sale of Securities Act (1929) sec. 10, provides: “The [Commissioner] [Commission] may revoke the registration of any security by entering an order to that effect, with [his] [its] finding in respect there-

ter, however, it is probable that the commission would be more hesitant to exercise a broad discretion in revoking a permit previously issued, and the courts more inclined to interfere with such exercise of discretion, than in the case of an original denial of a permit. A syndicate in Minnesota had issued ten-year installment certificates with a surrender value, from the second to the sixth year, less than the principal amounts paid. Large numbers of purchasers, having failed to meet their payments during this period, suffered losses. The securities commission, empowered to withhold or suspend licenses where plans of business were fraudulent or would work a fraud on purchasers, suspended the syndicate's license. On certiorari the court held that the fact an investment often proves imprudent is no ground for revocation of the permit in the absence of fraud.<sup>27</sup>

In view of the fact that there has been so little litigation on the extent of the administrative authorities' power under Blue Sky Laws, it is futile to attempt to predict the applicable future rules of judicial decision. It must be remembered that the powers will necessarily vary somewhat under the different types of statutes. Nevertheless, the cases cited do show a marked attitude on the part of the courts to leave the commissions a broad discretion, in keeping with a growing policy in this country of turning over the determination of rights to administrative bodies.

JEROME A. GROSS, '31, and RICHARD W. BROWN, '31.

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## SOME RECENT METHODS OF HARASSING THE HABITUAL CRIMINAL

### INTRODUCTION

The prevalence of organized crime in the larger cities of this country, to a degree unheard of even a decade ago and undreamed of even today in the cities of other civilized nations throughout the world, is familiar to every reader of a metropolitan newspaper. Particularly shocking is the condition which

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to, if upon examination into the affairs of the issuer of such security it shall appear that the issuer: (1) is insolvent; or (2) has violated any of the provisions of this act or any order of the [Commissioner] [Commission] of which such issuer has notice; or (3) has been or is engaged or is about to engage in fraudulent transactions; or (4) is in any other way dishonest or has made fraudulent representations in any prospectus or in any circular or other literature that has been distributed concerning the issuer or its securities; or (5) is of bad business repute; or (6) does not conduct its business in accordance with law; or (7) that its affairs are in an unsound condition; or (8) that the enterprise or business of the issuer or the security is not based upon sound business principles."

<sup>27</sup>In *re Investors' Syndicate* (1920) 147 Minn. 217, 174 N. W. 1001.