Securities Regulation

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Securities Regulation

Cases and Materials

Tenth Edition

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To Bonnie, Olympia, Joni, and Estelle

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Preface

This Tenth Edition keeps its content up-to-date with new cases, notes, and problems that reflect the changes that keep happening in Congress, the courts, and at the SEC. By far, the most dramatic developments—and the reason we wrote this new edition sooner than we had anticipated—was the abundance of rulemaking undertaken by the SEC in the second half of 2020 to alter the transactional exemptions under the Securities Act. This was the work product of a more conservative SEC, often with vigorous dissents from the Democratic commissioners. Now that political power has shifted, it will be interesting to see how these reforms are implemented going forward. And with that shift, new priorities emerge, especially on "ESG" disclosures. We have also made revisions in the book to take account of the SPAC phenomenon, the SEC's approval of a liberalized Direct Listing procedure, and scores of other significant changes. As always, we have tried to bring clarity to these teaching materials in the face of (and without hiding) the complexities and nuances that challenge all who enter the field of securities law.

Once again, we are grateful to those who teach from our book and help us out with suggestions for the things we could do better and matters that need correction. As with all editions of our casebook, occasional case and statute citations have been omitted from quoted material without indication. Most footnotes have been omitted from cases and other cited materials, also without indication, but those that remain retain original numbering.

James D. Cox
Robert W. Hillman
Donald C. Langevoort
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September 2021

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Chapter 1

The Framework of Securities Regulation

A. SECURITIES TRANSACTIONS

The securities laws exist because of the unique informational needs of investors. Unlike cars and other tangible products, securities are not inherently valuable. Their worth comes only from the claims they entitle their owner to make upon the assets and earnings of the issuer, or the voting power that accompanies such claims. Deciding whether to buy or sell a security thus requires reliable information about such matters as the issuer's financial condition, products and markets, management, and competitive and regulatory climate. With this data, investors can attempt a reasonable estimate of the present value of the bundle of rights that ownership confers.

Securities are bought and sold in two principal settings: issuer transactions and trading transactions. As we shall see, the federal securities laws are structured differently for each of these settings.

1. Issuer Transactions

Issuer transactions are those involving the sales of securities by the issuer to investors. They are the means by which businesses raise capital — to develop, to grow, or simply to survive. The successful business is one that grows. Growth in sales, assets, and earnings can occur without the issuance of additional securities that would add new claimants to the firm's assets and earnings beyond those of its founders, but, frequently, in order to grow a firm must expand its ownership base. The sole proprietorship may take on a partner, the partnership may add partners, the close corporation may become publicly owned, and the public corporation may issue more stock or bonds to become an even larger company or to acquire another company.

By far the most expedient form of issuer transaction is the private placement of securities. This entails the issuer selling securities to a select number of investors. On the small scale, a private placement includes a partnership or closely held corporation adding new owners. Large public corporations also engage in private placements when they raise large sums of capital through negotiated sales of securities to one or more financial institutions, such as an insurance company. In either case, special exemptions exist under the securities laws that enable private placements to escape the rigors of regulation.

On the other hand, the firm may not be able to raise all the capital it needs from a small number of investors. In this case, it must make a public offering of securities to a large number of diverse investors. We shall refer to such a public offering as a *primary distribution*. Whenever a large amount of securities is to be offered to the public, the selling effort usually occurs through a syndicate of broker-dealers, known as *underwriters*. An offering on behalf of a company going public for the first time is called an *initial public offering* (IPO).

2. *Trading Transactions*

a. Introduction to Trading

In contrast to primary distributions, *trading transactions* are the purchasing and selling of outstanding securities among investors. Resales of securities may either be privately negotiated or occur through public markets. Those who hold securities in a small firm for which no public market exists generally can only dispose of their shares by privately negotiating with an interested buyer. An exception to this statement occurs when the amount of securities to be resold is so great as to support a public offering. This is called a *secondary distribution* and most frequently occurs when individuals who control the securities' issuer wish to sell some of their shares.

Resales of outstanding securities are much more easily accomplished when there is a preexisting public market for those securities. The facilities through which outstanding securities are publicly traded are known as *securities markets*. Trading activity on U.S. markets is immense; in 2019 average daily trading volume on all U.S. public markets was 7 billion shares ($322 billion). By way of comparison, the total equity raised through all forms of public offerings in 2019 was $228 billion. SIFMA 2020 Capital Market Fact Book 29. It should be apparent that investors engaged in trading transactions are in need of information just as are those who purchase securities in a primary distribution. The considerations of whether and at what price to purchase IBM common shares on an exchange are identical to the considerations that investors ponder when offered IBM shares in a primary distribution. As will be seen, the mechanics, practices, and rules for disclosure, as well as other activities, differ significantly for primary distributions and trading transactions.

American securities markets can be roughly divided among bond, equity, and derivative/options markets. Traders in bond markets are primarily large financial institutions. Although trading in corporate debt instruments is in absolute amounts significant, all trading in such instruments is dwarfed by the magnitude of trading in U.S., state, and municipal bonds. Even though trading in government securities, as well as original issues of government securities, involves significantly larger amounts than trading in and offerings of business issuers, government securities are exempt from the disclosure regulations. Regulation of government securities focuses upon those who sell government securities. Corporate bond issuances dwarf the issuance of stocks: In 2019, offerings of corporate bonds were nearly $1.4 trillion, whereas public offerings of equity involved $228 billion (traditional IPOs represented only $49.8 billion). SIFMA 2020 Capital Market Fact Book 10, 11 & 13.

b. The Structure of Trading Markets

The trading of a security begins with a customer instructing her representative, a broker, to purchase or sell a security either at the best available market price ("market order") or at a stated price ("limit order"). With a limit order, the broker is not to execute the trade until the shares reach (or surpass) the price specified by the customer. Since 2007, all U.S. equity market transactions are executed at penny ($0.01) increments, more commonly referred to as decimalization of pricing. The broker first will seek to match the customer's order with that of another customer within the firm; if this is not possible, the broker may take the other side of the transaction so that the firm becomes a principal in the transaction—for example, buying from a selling customer. If the broker does not act as a principal and the order is not matched internally with another customer's order, the order is routed to the floor broker at the *exchange* or to a *market maker.*

Securities trade on one or more competitive markets in the United States. By far the largest U.S. equity market is the New York Stock Exchange; indeed, NYSE listed shares represent nearly 80 percent of the capitalization of all U.S. equity markets. The next largest market is Nasdaq. There are many other exchanges that are registered with the Securities and Exchange Commission (SEC). Because securities listed on one market, such as NYSE, can also be traded in another of these markets, such as the BATS Exchange, competition among the markets is keen. For example, only about 25 percent of the securities listed on NYSE or Nasdaq are traded on their respective exchange.

Shares not "listed" on an exchange can be traded in the over-the-counter market. At the core of the over-the-counter market is an electronically connected network of broker-dealers who publicly and regularly publish "bid" and "ask" prices for a security. They are therefore referred to as "market makers," as they attract investors' orders. The orders are handled either on a principal or agency basis. If the market maker purchases for its inventory, or sells the security from its inventory, it is deemed to be acting as a principal; in contrast, if a market maker simply matches the willing buyer with a willing seller, it is acting as an agent. In either case, the commission derived by the market maker is the "spread" between the bid and the asked price. Nasdaq, although technically today an exchange as defined in the Exchange Act, evolved from this over-the-counter structure; it is a computer network that links brokers and market makers (and, more importantly, their bid and ask quotes).

Of special note is how limit orders can pose a particular challenge since the requested price may depart materially from the present market price. For example, a customer limit order may call for the purchase of a security at $15 when the most recent transaction in that security occurred at $16. Since the market professional can be expected to avoid selling personal inventory shares at a price below the then market price, the broker can leave the order in the limit order book. Thus, an alternative function of the intermediary is to maintain a limit order book in which unfilled orders are recorded and later filled by the intermediary as market conditions permit. In the preceding example, if the price of the security in the limit order book declines to $15, the intermediary will execute the order for the customer—receiving, of course, a commission on the trade.

We should take a moment to reflect on the multiple social benefits provided by public securities markets:

> The modern regulated exchange has several roles. Its transparency provides a price discovery mechanism and liquidity so that investors, speculators, and hedgers can quickly create and liquidate positions at current market prices. . . . The exchange clearinghouses provide clearing and settlement functions that assure the smooth processing and confirmation of trades . . . within . . . [one day] on the securities exchanges. . . .
>
> The stock exchanges and Nasdaq impose minimum listing requirements as quality control mechanisms. . . .
>
> One service, and revenue source, for exchanges is fulfilling the demand for market data. . . . The exchanges' profitability from the dissemination of trade data is large; according to some researchers, market data fees accounted for 50% of the NYSE Group's total revenues in 2006 while those same fees represented about 80% of Nasdaq's total revenues. . . .
>
> [Exchanges] are uniquely qualified to act as gatekeeper for membership, resolve disputes, establish codes for acceptable trading practices, and implement other policies that are applicable to the industry and its trading requirements and standards. . . .

Markam, For Whom the Bell Tolls: The Demise of Exchange Trading Floors and the Growth of ECNs, 33 J. Corp. L. 865, 882-885 (2008).

B. THE LEGAL FRAMEWORK OF SECURITIES REGULATION

Before learning more about the various legislative and administrative initiatives that have produced the American securities laws, consider the following regarding the challenges policymakers face in formulating sound regulation:

> Investing is a choice; people can do many different things with their money. If people choose not to invest (or invest less), the capital markets—and the financial community—suffer. Given the inevitability and repeated salient examples of opportunism, the level of investment should vary based on how confident investors feel that they will not be exploited when parting with their hard-earned money. The standard economic justification for investor protection regulation is that some public commitment to fight marketplace abuses is necessary to offset fear of exploitation and instill investor confidence. Regulation at this base-line level can be cost-efficient and justifiable even to the most ardent free-marketeer, promoting the conservative trilogy (now baked into the law) of "efficiency, competition and capital formation." But where that sweet spot is, no one knows. Economists, by and large, think we have too much—or at least too much of the wrong kind—of securities regulation.
>
> As you read on, I want you to put yourself in the role of a securities regulator, perhaps the SEC chair. Here is the mental image with which

> to begin: There are more than a hundred million investor households in the United States, all making difficult financial choices. There are tens of thousands of businesses and entrepreneurs seeking capital from investors. There are competing stock exchanges and electronic trading platforms facilitating the secondary trading of hundreds of millions of shares every day, and thousands of large institutional investors like mutual funds, hedge funds, pension funds that now dominate these financial markets, with massive conflicts of interest. Legions of brokers and investment advisers engage in a never-ending effort to get deeply into their clients' wallets. Much of this takes place globally, often outside the reach of any one domestic regulator. Imagine that you were asked to make this wide-open territory "safe" for investors, many of whom seem habitually disinclined toward prudence, and also to promote robust capital formation. How would you do it? How much in the way of resources would you insist on as a condition for taking the job and doing it well? How would you know whether you are succeeding or failing, or being used?
>
> What does investor protection even mean?

D.C. Langevoort, Selling Hope, Selling Risk: Corporations, Wall Street, and the Dilemmas of Investor Protection 2-3 (2016).

1. *The Federal Securities Laws*

a. The Securities Act of 1933

Debate on the merits of a mandatory disclosure system began early in the twentieth century, but it was the Great Depression and the market collapse in October 1929 that provided the political momentum for congressional action that would over the course of a decade produce a collection of acts known as the federal securities laws. The first of the federal securities laws enacted was the Federal Securities Act of 1933 ('33 Act), which regulates the public offering and sale of securities in interstate commerce. The abuses prompting the legislation were legion:

> During the postwar decade some 50 billion of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise.
>
> Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High pressure salesmanship rather than careful counsel was the rule in this most dangerous enterprise.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

Disclosure is the remedy the Securities Act embraces for this malady. The '33 Act and much of the federal securities laws are influenced by the regulatory philosophy championed by Justice Brandeis: "Sunlight is said to be the best of disinfectants: electric light the most efficient policeman." L.D. Brandeis, Other People's Money 62 (1914). The Act's disclosure demands apply to public offerings of securities that occur through the process of "registering" such an offering with the SEC. The following is a broad overview of the Securities Act's registration process; a much closer examination of that process occurs in Chapter 4.

Through the preparation of a registration statement, the Securities Act seeks to assure full and fair disclosure in connection with the public distribution of securities. The information issuers are compelled to disclose in their registration statements is set forth in the SEC regulations and covers all significant aspects of the issuer's business. The precise disclosure requirements are somewhat industry sensitive. In general, the registration statement must provide a thorough description of the issuer's business, property, and management. Extensive financial information must be disclosed, including certified financial statements for the current and several previous years as well as revenues and earnings for each significant product line. Management must also provide its analysis and review of the issuer's capital needs, solvency, and financial performance, including analysis of any variances in revenues or profits from the preceding year. A detailed description of the rights, privileges, and preferences of the offered security, as well as the existing capital structure of the firm, must be set forth in the registration statement.

Paternalism toward investors is evident throughout the SEC's instructions and guides to its disclosure regulations as it seeks to paint a somber picture of the issuer's prospects. This dimension of the '33 Act disclosure process is underscored by information appearing in the first section of the registration statement, where any "risk factors" that make the offering speculative must be described. Examples of such special risks are that there is no preexisting market for the security (i.e., it is an IPO), that the issuer has recently experienced substantial losses, and that the nature of the business the issuer is engaged in or proposes to engage in poses unusual risks. The information filed by an "unseasoned" issuer with the SEC undergoes several drafts and reviews under the watchful and demanding eye of the SEC's Corporation Finance staff. Most of the registration statement's substantive information is also required to be disclosed in the *prospectus*. The need for care and honesty in the preparation of the registration statement is underscored by the exposure of the issuer's underwriters, officers, directors, and certain experts to civil liability for omissions and misstatements in the registration statement.

As can be seen from the above, the objective of the registration process is the production of a prospectus that includes most of the information disclosed in the registration statement. The prospectus is designed to provide all material information necessary for investors to fully assess the merits of their purchase of the security; the prospectus is the vehicle for stationing investors on as nearly an equal footing with the issuers and their underwriters as possible, with the hope their purchase is neither worthless nor overpriced.

The underwriters' selling efforts cannot commence until the registration statement has been filed with the SEC, and no sales or deliveries of securities may occur until the registration statement is effective. Nevertheless, extensive selling efforts commence after the registration statement is filed, at which time investor interest is orally solicited. Written offers during this period can be made through a preliminary prospectus that embodies all the substantive information then contained in the registration statement as well as through other materials if certain conditions, reviewed later in Chapter 4, are satisfied. Once the registration statement becomes effective, actual sales can be made, and the purchased securities can be delivered. The Securities Act's objective of full disclosure for public offerings of securities occurs through the registration process and the Act's compulsion for a prospectus to be available to investors.

As will be seen in later chapters, Section 3 exempts numerous categories of securities from the Act's registration requirements, the most significant being those issued by governmental bodies, banks, and insurance companies, and Section 4 exempts securities sold in certain types of transactions. Importantly, the Act provides both private and public remedies to assure compliance with its provisions. Thus, Section 11 provides a private right of action for materially false statements in the registration statement, and Section 12 imposes civil liability upon those who sell securities in violation of Section 5's registration requirement as well as upon anyone who sells any security in a public offering by means of a materially misleading statement. The SEC's enforcement powers include the power to issue administrative cease-and-desist orders under Section 8A as well as to prosecute violations civilly in the federal courts under Section 20.

b. The Securities Exchange Act of 1934

History and Philosophy. The disastrous market effects of the Great Depression were, of course, not borne solely by the purchasers of new issues. The decline in value of outstanding securities was dramatic and painful. For example, the total value of all New York Stock Exchange listed securities declined from a pre-crash 1929 high of $89 billion to $15 billion in 1932. Investor interest and confidence in markets evaporated overnight, and for many stocks, trading halted completely.

The causes of the crash were many, and most were unrelated to abusive practices. The pre-crash market was driven not by fundamentals, but by speculative frenzy. Speculating in stocks was something of a national pastime. For example, 55 percent of all personal savings were used to purchase securities. E.R. Willet, Fundamentals of Securities Markets 211 (1968). A significant amount of all investment was on margin, in which an investor borrowed most of the stock's purchase price. There was no limit on the amount of credit that could be extended to an investor for margin trading. Typically, the lender was the brokerage firm, which in turn borrowed the funds from a bank. So long as the stock price did not decline, substantial margin trading posed no harm to the investor or markets generally. However, once steam began to run out of the market in late 1929, lenders began making calls upon the investor to cover the amount that the securities' market value had declined below its purchase price. This produced a chain reaction as margin calls triggered sales of securities owned by overextended customers; sales made in response to margin calls further depressed stock prices, so that even more margin calls were made upon other investors, and so on.

A good deal of the content of the Depression Era securities laws, and particularly the collage of provisions that would become the Exchange Act, was shaped by the sensational hearings of the Senate Committee on Banking and Currency, whose chief investigator, Ferdinand Pecora, presented in riveting detail the abuses visited on public investors. *See* Michael Perino, The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance (2010). Much of the hearings leading up to Congress' enactment of the securities laws was devoted to accounts of trading practices by unscrupulous market manipulators. The hearings produced reports that the bull market of the 1920s was the heyday of the crooked stock pools. These were devices used by brokers and dealers to create a false appearance of trading activity by simultaneously buying the same security they were selling. Innocent investors were attracted to the manipulated stock by its price and volume changes. Eventually, unwitting investors' orders provided all the upward momentum to the stock's price. And, as the price rose, the brokers and dealers behind the scheme dumped their holdings at the higher price created by the unwitting investors' interest. More recent examination of market practices in the 1920s suggests that the congressional hearings greatly exaggerated the effect and existence of such abusive schemes, perhaps doing so for political purposes. *See* Mahoney, The Stock Pools and the Securities Exchange Act, 51 J. Fin. Econ. 343 (1999).

There also was plenty of evidence that stock prices were adversely affected by false and misleading information and that corporate insiders took advantage of their access to confidential inside information to further their own trading profits. Related to this was the absence of legal compulsion for publicly traded firms to make timely disclosures of material information or to publish even annual financial reports. A further problem was the belief that public corporations were not sufficiently responsive to their owners due to weaknesses in the proxy solicitation process.

An inventory of these market abuses is summarized in Section 2 of the Securities Exchange Act ('34 Act), which captures the popular and congressional view that stock prices reflected the actions of speculators, manipulators, and inside traders, as well as the gullible, but not the astute and the sophisticated. *See* Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 Stan. L. Rev. 385, 409 (1990). One of the great ironies of securities regulation is that, even though Congress when it enacted the '34 Act had a dim view of the overall sophistication of market participants, today many of the Commission's regulatory initiatives under the '34 Act are premised on the assumption that trading markets are dominated by sophisticated, resourceful investors. The irony of this underscores the breadth and flexibility of the '34 Act's provisions.

There is an important difference in style between the Securities Act and the Exchange Act. In the Securities Act, Congress empowered the Federal Trade Commission (FTC) to discharge a specific and well-defined task: the registration of public offerings of securities not otherwise exempt from the Act. The means, as well as the end result, are clearly and unequivocally defined in the Securities Act. In contrast, the Exchange Act is in large part a laundry list of problems for which Congress articulated neither the means nor the end objective. Instead, Congress, through Section 4 of the Act, created the Securities and Exchange Commission and delegated to it the task of grappling with the problem areas.

The contrast in style between the two acts bears witness to the fact that compromises were necessary to assure passage of the Exchange Act whereas that was not the case for the Securities Act. Recall that the Congress that enacted the

Securities Act also enacted in those heady first hundred days of Roosevelt's first term other legislative packages that greatly centralized the federal government's control over the economy, the most prominent piece being the National Recovery Act. Many of Roosevelt's advisers were urging upon him a similar approach to the regulation of securities practices. For example, then-Professor William O. Douglas, who would later become the third Chairman of the SEC before being appointed to the Supreme Court, was one who openly counseled Roosevelt that a disclosure-oriented approach was inadequate and that legislation was needed that directly involved the federal government in identifying the firms that should be permitted to approach investors with their public offerings and thus gave it an active role in channeling capital into industries the government preferred to nurture. *See, e.g.*, Douglas, Protecting the Investor, 23 Yale L.J. (N.S.) 521 (1934).

Despite the willingness of the New Dealers to embrace modes of direct government involvement in the economy's private sector, the Securities Act's exclusive orientation was disclosure, a clear victory for those who embraced a less intrusive federal role in capital markets. Landis, The Legislative History of The Securities Act of 1933, 28 Geo. Wash. L. Rev. 29 (1959). On the other hand, the Exchange Act as originally proposed envisioned strong federal control of the trading markets as well as important structural changes for the securities industry and its participants. The radicalism of these proposals energized the securities industry, and its representatives came to Washington with their own proposals. In the end, the '34 Act reflects the many compromises necessary to assure its passage. Indeed, the creation of the Securities and Exchange Commission itself was a concession to the industry, which felt it would fare better under an agency whose energies were focused exclusively on capital markets and the securities industry—the industry had found the leading regulators at the FTC to be formidable and devoted regulators.[1] In the end, many of the pressing regulatory issues were unresolved in the '34 Act and were instead dumped into the lap of the newly created Commission, where the debate and compromise would continue. *See generally* J. Seligman, The Transformation of Wall Street, chs. 2 & 3 (3d ed. 2003).

Continuous Disclosure and Other Disclosure Provisions. Whereas the Securities Act grapples with the protection of investors in primary distributions of securities, the Exchange Act's concern is trading markets and their participants. An important contribution to efficient trading markets is the '34 Act's system of continuous disclosure for companies required to register under its provisions. Three categories of companies are subject to the '34 Act's continuous disclosure requirements: companies that have a class of securities listed on a national securities exchange (Section 12(b)); companies that have assets in excess of $10 million and that have a class of equity securities held by at least 2,000 record holders (Section

1. The industry believed the creation of a separate commission would shield it from individuals such as James M. Landis, then an FTC commissioner and a strident proponent for regulation. With the creation of the SEC, the industry saw one of its own, Joseph Kennedy, appointed as its first chairman, but also found to its horror that Landis became one of its members and succeeded Kennedy as chair when Kennedy was appointment ambassador to Britain. When Landis left to become Dean of Harvard Law School, William O. Douglas, later Justice Douglas, became its third chairman.

12(g) and Rule 12g-1—prior to 2012, continuous reporting was required for firms with 500 or more record holders); and companies that have filed a '33 Act registration statement that has become effective (Section 15(d)). A company that meets any one of these requirements is called a *reporting company*.

Reporting companies are required to register with the SEC and thereafter make timely filings of reports required by Section 13 of the '34 Act. Unlike the '33 Act's disclosure requirements, there is no additional requirement that '34 Act filings be forwarded to investors or market professionals. All registrants (domestic and foreign) are required to file with the SEC their '33 Act registration statements and their periodic reports under the '34 Act in electronic format (i.e., submissions occur through e-mail or the physical delivery of diskettes or magnetic tapes). The present system is called EDGAR (Electronic Data Gathering, Analysis, and Retrieval System). In its quest for facilitating investor decisionmaking, since 2009 the SEC has required filings to be pursuant to its Interactive Data Electronic Applications (IDEA), which itself builds on a software program, XBRL (Extensible Business Reporting Language), by which information is "tagged" by reporting companies so that users can thereafter sort information according to the pretagged codes. The XBRL system allows investors to compare discrete reporting items (e.g., research and development expenditures) across a range of companies without the necessity of serially accessing the forms of individual companies. Information filed with the SEC is available to anyone through its web site (www.sec.gov). A further benefit is XBRL allows most issuers to reduce the time to file periodic reports with the SEC. *See* Zhou, Does One Size Fit All? Evidence on XBRL Adoption and 10-K Filing Lag, 60 Acctg. & Fin. 3183 (2020).

The most significant of the compelled reports is the annual report on Form 10-K, which is required to include an extensive description of the company's business, audited financial statements for the fiscal year, and management's discussion and analysis of the position and performance of the company. Quarterly reports on Form 10-Q are also required to be filed with the SEC. The disclosures on Form 10-Q include unaudited interim financial statements for the company as well as management's analysis of financial operations and conditions. A further report compelled by Section 13 is Form 8-K, which must be filed within a few days of the occurrence of a material development of the type specified in the form, for example, a change in control, credit downgrade, the acquisition or disposition of a significant amount of assets, the commencement of insolvency proceedings, a change in auditors, or the resignation of a director in a dispute over policy.

The SEC in the early 1980s adopted the process of "integrated disclosure," whereby certain companies registering securities under the Securities Act could fulfill many of the '33 Act's disclosure demands by incorporating into the Securities Act registration statement information from their Exchange Act (e.g., Form 10-K) filings. As we see in Chapter 4, following sweeping reforms adopted by the SEC in 2005, today integrated disclosure is available to seasoned issuers, which is defined as a company that has filed an annual report with the SEC and is current in its filings. Integrated disclosure was the first step toward melding the Securities Act and Exchange Act so that their disclosure demands are complementary and their registrants' burdens lightened. Under integrated disclosure, issuers are required to file a registration statement with the SEC in advance of their offering, and for most issuers there is a period of delay before the issuers can sell the registered securities. As will be seen, integrated disclosure reduces greatly the delay and costs that normally accompany registering securities.

The Act also requires those companies that are subject to the continuous reporting requirements because they fall within either Exchange Act Section 12(b) or Section 12(g), discussed above, to make full and fair disclosure whenever soliciting their stockholders' proxies and to otherwise comply with the numerous proxy rules the Commission has promulgated under Section 14(a). Through the Williams Act Amendments in 1968, disclosure by an outsider is required when more than 5 percent of a class of registered equity securities is or will be owned as a result of a tender offer or purchase. Other tender offer practices are also regulated as a consequence of the Williams Act Amendments.

Regulation of Exchanges, Broker-Dealers, and Market Abuses. Continuing its emphasis on regulating trading markets, the Exchange Act embraces a strong, active role for a variety of self-regulatory organizations (SROs). Two important types of SROs are each of the national securities exchanges and the Financial Industry Regulatory Authority (FINRA). As discussed in section B.3 below, the SROs' regulatory role is played under the Commission's watchful eye. Later, in Chapter 18, we examine the regulatory authority of FINRA and the SEC over brokers and dealers. The Exchange Act also seeks to protect the integrity of capital markets and investors by arming the SEC, as well as private litigants, with its antifraud and anti-manipulation provisions. Both the public and the private enforcement of the antifraud and anti-manipulation rules are closely examined later in this book.

c. Federal Regulation Beyond Disclosure: The Sarbanes-Oxley Act of 2002 and Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

In July 2002, the Sarbanes-Oxley Act was enacted and ushered in a new era of financial regulation for U.S. capital markets. As is seen throughout this book, many of the provisions Congress included in Sarbanes-Oxley depart radically from the securities laws' historical preoccupation of addressing investor protection via disclosure. Among other features, the Act sets forth broad prescriptions for corporate governance, authorizes the SEC to develop rules for professional conduct for lawyers, and regulates areas that have always been the province of the states, such as loans to officers and directors. The events that prompted Congress to act were many and are collectively referred to as the accounting and financial scandals of 2002. The scandals actually began in 2001 with the sudden collapse of Enron Corporation, the seventh largest American corporation.

Enron was a high-flying energy trading company whose aggressive management style consistently impressed Wall Street with ever-increasing profits and reports of an even brighter future. For five consecutive years before its collapse Fortune 500 executives had voted Enron as one of America's most innovative companies. But all that glitters is not gold. In early December 2001, Enron filed for bankruptcy protection, at that time the largest bankruptcy filing in American history. It was soon revealed that Enron's profits were fabricated by its executives, that its Big Five accounting firm, Arthur Andersen, had acquiesced in clear violations of accounting and reporting principles, that it appeared that two national law firms that advised it had not appropriately advised their clients of possible misconduct by senior management, and that financial analysts were co-opted by pressures from their investment banking colleagues to support Enron with "strong buy" recommendations as a means to garner lucrative investment banking business from Enron. *See generally* Report of the Staff to the Senate Committee on Governmental Affairs, Financial Oversight of Enron: The SEC and Private-Sector Watchdogs (Oct. 8, 2002). More information regarding the financial reporting frauds and other market abuses committed by Enron and others in the months leading up to Sarbanes-Oxley is presented in later chapters.

Sarbanes-Oxley would not have been enacted if Enron had been an isolated event. Enron's bankruptcy was soon followed by the financial collapse of approximately a dozen large public companies where there was also strong evidence of reporting violations and audit failures even more egregious than that which occurred in Enron. Moreover, over the course of the five preceding years the number of earnings restatements by public companies quadrupled. The final culminating event propelling the enactment of Sarbanes-Oxley was the revelation in late June 2002 that WorldCom's chief financial officer had overstated earnings over several quarters by several billions of dollars. Soon after making its own earnings restatements, WorldCom itself entered bankruptcy, supplanting Enron for the honor of the largest company ever to seek the protection of the bankruptcy laws. With the enactment of Sarbanes-Oxley the focus of the securities laws and the SEC is today significantly broader than disclosure. Sarbanes-Oxley does not alter the core features of the U.S. securities laws, but the Act introduces important procedural and substantive requirements for public companies as additional safeguards to protect investors. It is also apparent from this book's review of the regulatory initiatives ushered in by Sarbanes-Oxley that important areas of corporate governance are no longer solely a matter controlled by state law.

Just as the Great Depression ushered in various New Deal regulators such as the SEC, the financial crisis that began in 2008 led to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010. The seeds of this crisis can be traced to the housing bubble that had reached full bloom by mid-2005. As a result of extraordinarily low interest rates and questionable predatory lending practices, home mortgages were granted against what quickly became artificially heightened real estate values. Many of these mortgages were denoted "subprime" because their borrowers posed serious credit risks. Through the alchemy of asset-backed securitization, the mortgages were bundled together, given questionable "investment-grade" ratings, and then sold to financial institutions. When the bubble burst, which is a nasty tendency of bubbles, the financial institutions found that their investment-grade securities were hardly that, and many institutions failed or teetered at the edge of failure. Fear gripped all sectors of the financial markets. In fall 2008, the Dow Jones Industrial Average plunged dramatically, banks became unwilling or unable to lend to one another, and the once highly liquid and low-risk commercial paper market evaporated. This was followed by massive government bailouts of commercial banks, investment banks, and other financial institutions that on a worldwide basis exceeded $2 trillion.

There were many culprits behind the credit crisis. Most of Dodd-Frank is aimed at the regulation of depositary institutions, derivatives, and consumer finance. These areas are not covered in this book as they involve institutions and regulatory paradigms that are outside the realm of securities regulation. However, Dodd-Frank does contain numerous provisions that impact the scope and content of U.S. securities laws such as mandatory disclosure related to "conflict minerals," authorization for the SEC to adopt rules providing shareholders with a means to nominate directors of public companies, and clarification of the SEC enforcement authority with respect to foreign issuers. Each of these provisions, as well as many other Dodd-Frank securities-related provisions, are studied later. In broad overview, what is notable about Dodd-Frank's interface with the securities laws is that many of its securities-related provisions, like those of Sarbanes-Oxley, transcend disclosure. One question is whether the strong bipartisan support the SEC and securities regulation has historically enjoyed is weakened by the content of U.S. securities laws that no longer focuses exclusively on disclosure and fraud, but includes as well procedures by which public companies govern themselves and their need to disclose information that is politically and socially sensitive, e.g., trafficking in conflict minerals or CEO pay versus pay of the average employee. In this sense, Congress through Sarbanes-Oxley and Dodd-Frank has moved the SEC into new and unfamiliar terrain.

d. The Regulation of Investment Advisers and Investment Companies

The bulk of the securities regulation course materials focus on the provisions of the Securities Act and the Securities Exchange Act. As is seen in Chapter 19, the SEC has an important regulatory role with respect to investment advisers and investment companies.

The Investment Company Act of 1940 and the Investment Advisers Act of 1940 were the culmination of a comprehensive four-year SEC investigation of investment companies and their advisers. *Investment companies*, simply defined, are companies formed for the purpose of buying, selling, and holding a portfolio of securities for investment, rather than for control purposes. Common versions of investment companies are money market funds and mutual funds. The Investment Company Act regulates the independence of the company's board of directors; requires annual review of any management contract between the investment company and its investment adviser; conditions transactions between the company and its officers, directors, or affiliates upon approval by the SEC; and regulates the capital structure of investment companies. Even though investment companies are required to register under the Investment Company Act, they remain subject to the registration and prospectus requirements of the Securities Act when they engage in a public offering of their securities. They also are subject to the reporting requirements of the Exchange Act.

An *investment adviser* is one engaged in the business of rendering investment advice to others for compensation. The Investment Advisers Act of 1940 requires advisers to register with the SEC, establishes a few minimum requirements for fair dealings by investment advisers, and prohibits fraudulent and deceptive practices by investment advisers.

e. The Organizational Structure of the SEC

The SEC is an independent, nonpartisan agency created by the Securities Exchange Act of 1934; the '33 Act, until the creation of the Commission, was administered by the FTC. The Commission is composed of five commissioners appointed by the President to five-year terms. The terms are staggered so that one expires each June, and not more than three commissioners may be of the same party as the President. One of the commissioners is designated by the President to serve as the chairman of the Commission. The commissioners meet frequently as a deliberative body to resolve issues raised by the staff. The Commission's staff is organized into divisions and offices.

The SEC operates through four principal divisions. The Division of Corporation Finance has overall responsibility for administering the federal securities laws' disclosure requirements through its review of the registration statements for public offerings, quarterly and annual reports, proxy statements, tender offer statements, and other documents required to be filed with it. The Division of Trading and Markets has responsibility to oversee the operation of secondary trading markets, including the registration and behavior of exchanges and broker-dealers as well as rating agencies. Responsibility for administering the Investment Company Act and the Investment Advisers Act is with the Division of Investment Management. The Division of Enforcement is to the general public the most visible of all the divisions because of the publicity that frequently accompanies its investigations and prosecutions. Enforcement actions can occur via an administrative proceeding or in the courts. Criminal prosecutions, however, are within the exclusive authority of the Department of Justice attorneys, usually through the appropriate U.S. Attorney's Office, with assistance of the SEC enforcement staff. In 2009, the newest part of the SEC was established, the Division of Economic and Risk Analysis, which draws on a variety of disciplines to assist the SEC in policymaking, rulemaking, enforcement, and examinations.

f. The Mediums Through Which the SEC Speaks

The Commission and its staff's views on regulatory issues are communicated in a variety of mediums. Through the exercise of its broad rulemaking power, the Commission formally makes its position known on regulatory issues. In the releases that accompany its proposals and adoption of regulations, the SEC goes to great lengths to provide guidance regarding the content of the regulations it is considering. SEC releases are essentially press releases and invariably accompany the proposal, adoption, or modification of rules. The Commission, through its enforcement staff, plays an important role in expanding and refining the law through the enforcement actions it chooses to initiate and the theories under which the suits are maintained. The classic illustration of the Commission's impact in this regard was its success in proscribing insider trading through its early administrative proceedings, *see* Cady, Roberts & Co., 40 S.E.C. 907 (1961), and judicial proceedings, *see SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968). The Commission's positions are also presented in private litigation through amicus briefs the staff files on important issues.

Extensive guidance is provided through the SEC web site in its "Compliance and Disclosure Interpretations." These staff interpretations are focused on distinct regulatory topics or rules and provide a good deal of guidance into how the provisions are administered by the staff. An especially important source of guidance occurs through the staff's issuance of *no-action letters*. Since the SEC's creation, its staff has been willing to respond to individual inquiries regarding the staff's interpretation of the federal securities laws' application to a specific transaction. The staff's responses to such inquiries are known as no-action letters because the key expression in a favorable response to an inquiry states that the staff "will recommend *no action* to the Commission" if the transaction is carried out as stated in the letter. Because the no-action letters express the views only of the staff involved with the day-to-day responsibility of administering that provision of the law, they do not represent the official view of the Commission. 17 C.F.R. §202.1(d). No-action letters are compliance oriented and designed to provide some measure of certainty to those planning securities transactions. Even though the Commission will not challenge that transaction as a violation of the law if the transaction is completed as represented in the no-action letter request, Securities Act Release No. 4553 (Nov. 6, 1962), a no-action letter is not binding on private parties, who can challenge the transaction. Also, the predictive value of relying on a no-action letter obtained by another is seriously weakened by the power of the Commission or its staff to reconsider the position it took in the earlier no-action letter.[2] In any case, there is a somewhat lengthy list of items the staff refuses to offer an opinion on through the no-action letter process. Securities Act Release No. 6253 (Oct. 28, 1980). Among those areas so excluded is the availability of a statutory exemption from registration, whether novel real estate interests are a security, and hypothetical questions. *See* Nagy, Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and Proposed Framework, 83 Cornell L. Rev. 921 (1998) (examining the conditions when it is appropriate for courts to defer to SEC no-action letters).

The SEC's web site, *www.sec.gov*, also contains a good deal of guidance on regulatory issues. Found there are guides ("Compliance and Disclosure Interpretations") addressing commonly asked questions as well as recent speeches of commissioners and agency personnel, enforcement releases, and other helpful publications.

Further guidance through the uncharted waters of the securities laws and regulatory discretion occurs informally by individual commissioners, division and office heads, and their assistants expressing their views and describing prevailing practices within the SEC in their speeches and during participation in securities programs. This medium also nurtures a professional bond between the regulators and the securities bar.

g. The SEC: Some Critical Perspectives

The SEC has long held a reputation for quality and vigor that sets it apart from many of its regulatory peers. This reputation is of considerable importance: It aids in the recruitment of new personnel and serves as a form of psychic compensation

2. SEC no-action letters are not judicially reviewable because they are not *orders* of the Commission. *Board of Trade of the City of Chicago v. SEC*, 883 F.2d 525 (7th Cir. 1989).

to the staff to help offset some of the financial sacrifices of government service. It also gives to the Commission a considerable level of public support from which to draw when it takes action.

The Commission is not without its critics, however. Much of the criticism comes from the perspective of economic theory and charges that the SEC has substantially over-regulated areas such as disclosure policy, with excessive and paternalistic focus on "investor protection" to the exclusion of equally compelling notions of cost justification and allocative efficiency. To state this concern, however, does not help explain *why* it is that the Commission might behave in a way that, in substance, seems short of optimal.

One explanation that has achieved a good deal of currency draws from the body of literature of public choice theory, as articulated by such notable economists as George Stigler and Sam Peltzman. Public choice theory posits that far from seeking some independent conception of the "public good," regulators rationally seek simply to maximize their own level of political support and thus frequently allocate wealth (in the form of regulatory subsidies and/or restraints on competition) to those groups that offer the most in terms of such support. Often, this means regulation that actually favors some segment of the industry that the agency is supposed to control (sometimes referred to as the "capture" hypothesis), since that special interest is likely to be the best organized and most effective "rent-seeker." Here we may ask whether securities lawyers and financial accountants, among others, who earn their livelihood through providing the compliance efforts related to mandatory disclosure requirements have a significant stake in the status quo. For a public choice perspective on the SEC, *see* Coates, Private vs. Political Choice of Securities Regulation: A Political Cost Benefit Analysis, 41 Va. J. Int'l L. 531 (2001); Macey, Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty, 15 Cardozo L. Rev. 909 (1994).

There has long been concern with regulatory agencies regarding the "revolving door" whereby civil servants migrate from the regulator to the regulated. There indeed is a good deal of movement of staff of the SEC to the private sector, no doubt reflecting the valuable experience garnered by working with the Commission. But does it reflect more? Studies of SEC enforcement personnel who thereafter are retained by law firms reflect that the individuals moving to the private sector during their tenure at the SEC were associated with successful, even aggressive, enforcement efforts that involved more complex matters. *See* de Haan, Kedia, Koh & Rajgopa, The Revolving Door and the SEC's Enforcement Outcomes: Initial Evidence of Civil Litigation, 60 Acct. & Econ. 65 (2015); Choi, Gulati & Pritchard, Should I Stay or Should I Go?: The Gender Gap for Securities and Exchange Attorneys, 62 J.L. & Econ. 427 (2019). A very different dimension of the revolving door is examined in Cox & Thomas, Revolving Elites: The Unexplored Risk of Capturing the SEC, 107 Geo. L.J. 845 (2019), reporting that during the first 50 plus years of its existence SEC division heads were selected from the existing SEC staff; however, beginning in the mid-1990s, the prevalent practice shifted so that division heads were recruited from outside the agency, generally from law firms who represent clients before the Commission. Thus, over the past 20 years nearly three-fourths of all directors came from outside the SEC. What might be the regulatory benefits sought by wooing outsiders to become SEC division heads?

Separate from the industry capture concerns expressed above are complaints of the SEC's disinclination to adopt or endorse bright-line rules, notwithstanding the value of such an approach in promoting, planning, and reducing the incidence of litigation. Inevitably claiming that such an approach provides a "blueprint for fraud," the Commission jealously seems to preserve the largest degree of discretion to sanction conduct that it determines, after the fact, to have been improper. One sees this in the Commission's preference for making policy through no-action letters or enforcement, rather than through rulemaking, and in its cautious approach to the development of safe-harbor rules in areas of considerable statutory ambiguity (such as the non-public offering exemption under the '33 Act). *See* R. Karmel, Regulation by Prosecution (1981). A further concern is that the agency tends to be "siloed"—referring to complaints that there is not sufficient communication and collaboration among divisions.

A final source of criticism focuses on the dominance of lawyers in policymaking roles at the SEC. Indeed, an overwhelming number of SEC commissioners and high-level staff persons have been attorneys. It has frequently been said that regulators have a natural bias toward the presence (or enhancement) of complex regulation, rather than its absence (or reduction),[3] a function of institutional and personal self-esteem as well as economic self-interest. In many ways, this same bias is held by lawyers generally and is hence reinforced when lawyers assume the function of regulators. For a more detailed analysis of these issues, *see* Langevoort, The SEC as Lawmaker: Choices About Investor Protection in the Face of Uncertainty, 84 Wash. U. L. Rev. 1591 (2006).

h. Judging SEC Rulemaking

The rulemaking authority the SEC enjoys under each of the securities laws is subject to the statutory mandate that "the Commission shall . . . consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[4] In 2011, the SEC's modest rule authorizing stockholders to nominate a limited number of directors was struck down for failure to satisfy what the D.C. Circuit said was required in meeting this review standard:

> Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.

Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011). This defeat for the SEC comes on the heels of similar reversals the SEC has faced when its actions were

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3. A. Downs, Inside Bureaucracy (1967), referred to this as the "Law of Increasing Conservatism."

4. Each of the four major securities laws administered by the SEC now contains the same review standard. Securities Act of 1933 §2(b), 15 U.S.C. §77b(b); Securities Exchange Act of 1934 §3(f), 15 U.S.C. §78c(f); Investment Company Act of 1940 §2(c), 15 U.S.C. §80a-c(c); and Investment Advisers Act of 1940 §202(c), 15 U.S.C. §80b-2(c).

challenged for their failure to consider a rule's impact on "efficiency, competition and capital formation." *See American Equity Investment Life Insurance Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005). While neither the express statutory language nor the legislative history calls for rigorous cost-benefit analysis, until the Supreme Court speaks, SEC rulemaking proceeds with a healthy respect that there is now ample precedent before the court where challenges to its rules most likely will occur. *See* Cox & Baucom, The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority, 90 Tex. L. Rev. 1811 (2012). The SEC has therefore entered a most uncertain area in its history.

In *Business Roundtable*'s wake, the SEC has provided guidance to the staff calling for future rulemaking to include the following four elements: (1) a statement of the need for proposed action; (2) a definition of a baseline against which to measure the likelihood of economic consequences of the proposed regulation; (3) the identification of alternative approaches; and (4) an evaluation of the benefits and costs, both quantitative and qualitative, of the proposed action and the main alternatives identified in the analysis. SEC, Current Guidance on Economic Analysis in SEC Rulemaking (Mar. 16, 2012). In an important article, Professor John Coates characterizes cost-benefit analysis in the context of financial regulation as "guesstimating" due to the degree of complexity and interconnectedness of financial regulation being deeply integrated so that the result depends on casual inferences, problematic data, and contestable assumptions. Coates, Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications, 124 Yale L.J. 882 (2015); Coates & Srinivasan, SOX after Ten Years: A Multidisciplinary Review, 28 Acct. Horizon 627 (2014) (illustrating why it is easier to identify and measure the *direct* cost of a regulatory initiative than the measure's benefits and *indirect* costs).

In an earlier era, the SEC did not face the level of scrutiny in adopting rules that it faces today. Hence, as you progress through the course material and study specific rules consider the difficulty the SEC would have confronted if, when it adopted the rule, it was compelled to estimate the rule's likely compliance costs and expected benefits. Query, might this force the SEC to regulate via enforcement, since enforcement actions are not subject to the before mentioned review standard?

2. Blue Sky Laws

Sharp promoters and questionable investment opportunities have been a fixture of markets throughout their existence. State regulation of securities and their promoters began in the nineteenth century with requirements for registration of securities offerings by public utilities and companies engaged in the exploration and extraction of minerals, each being a fertile area of abusive practices. Kansas in 1911 enacted the first comprehensive system of registering securities brokers and offerings of securities of all types of enterprises. Similar reforms soon swept across America as part of the legislative agenda of the populist movement. At the time of the Great Crash, nearly all states embraced some form of regulation of brokers and securities. These laws reflected the prevalent view that hardworking common men and women were frequently the victims of not just confidence men, but also slick investment bankers from Wall Street. *See generally* M.E. Parrish, Securities Regulation and the New Deal 5-20 (1970). A recent reexamination of the history of the causes leading to the states' enactment of their securities laws found they were driven by the interests of "state banking regulators, interested in protecting and expanding their regulatory turf and in advancing the financial interests of banks under their supervision . . . [as well as] farmers and small business owners who saw the suppression of securities sales as a useful means for increasing their own access to bank credit." Macey & Miller, Origin of the Blue Sky Laws, 70 Tex. L. Rev. 347, 351 (1991). *See also* Mahoney, The Origins of the Blue Sky Laws: A Test of Competing Hypotheses, 46 J.L. & Econ. 229 (2003) (concluding that the impact of blue sky laws adopted by states in 1911-1930 was to increase the profits of small banks).

State securities laws are generally referred to as *blue sky laws*, an expression rooted in their initial objective of curbing promoters who would sell interests having no more substance than "so many feet of blue sky." *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917) (upholding the constitutionality of blue sky laws under the Fourteenth Amendment and finding no burden on interstate commerce). The original author of the Kansas legislation explained that the term referred to rainmakers who promised rain but produced nothing but blue sky. *See* Fleming, 100 Years of Securities Laws: Examining a Foundation Laid in the Kansas Blue Sky, 50 Washburn L.J. 583 (2011).

As is discussed in Chapter 4, an important difference between the federal and the state approaches to securities regulations is that the former is exclusively disclosure oriented, whereas many state jurisdictions include within their blue sky laws a so-called merit regulation standard whereby qualification depends on convincing the state blue sky administrator of the substantive merits of the offering. Most state laws embrace some form of merit review. *See* SEC Report on the Uniformity of State Regulatory Requirements for Offerings of Securities That Are Not "Covered Securities," 8 (1997).

The lack of uniformity among the states is a problem, if not a nightmare, for the attorney "blue skying" an offering that will be made in several states. The Uniform Securities Act was promulgated by the National Conference of Commissioners on Uniform State Law in 1956. The current version of the Act was adopted in 2002 (with some revisions in 2005). *See* Seligman, The New Uniform Securities Act, 81 Wash. U. L. Rev. 244 (2003). Most states have some version of the Uniform Securities Act. But there are two important caveats: Two notable non-adopting states are New York and California and in crafting their own blue sky laws, individual states vary widely in their deviations from the Uniform Securities Act.

The North American Securities Administrators Association (NASAA), a group composed of blue sky law administrators, has worked diligently to coordinate the approach and interpretations followed in each of the states. Nonetheless, the lack of uniformity remains a constant concern. A further blow to uniformity is that the budgets of blue sky regulators vary widely from state to state, with the individual state's population only partially explaining the different levels of funding and more of the resulting variance being accounted for by the importance a state's legislature places on the regulation of securities transactions. Some relief for the attorney facing multiple states in which an offering will occur is the 1996 enactment of the